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Query : In part (i) of the question, calculation of Maximum Transfer Price per unit that division 'Y' will offer is not understood.

OR

How this price can be calculated using the formula given in the notes?

Solution :

Dear Student Friend,

This is a logical topic and not restricted to remembering formula only.

Division 'Y' can purchase the imported component at 640 i.e. outside purchase price

However, if it purchases the component from division 'X' and division 'Y' has to spend additional Rs. 64 to make it useful.

Hence, it will be ready to pay maximum Rs. $(640 - 64) = \text{Rs. } 576$ to division 'X'

Cross check : If division 'Y' purchases it from 'X' at Rs. 576, it will have to spend Rs. 64 to make it fit for 'Wheels'.

The effective cost to division 'Y' shall be $= 576 + 64 = \text{Rs. } 640$ i.e. equal to purchase price of imported component.

Div. 'Y' won't be ready to pay more than Rs. 576, else the cost will go beyond Rs. 640.

Let's go by the formula :

(a) Outside purchase price = Rs. 640 (But it should be adjusted for additional cost Rs. 64)
Hence, effective purchase price $= 640 - 64 = \text{Rs. } 576$

(b) The incremental net revenue shall be :
 $= \text{External Sales Price} - \text{Incremental Variable Cost}$
 $= 1,160 - 96 (\text{DM}) - 320 (\text{VC}) - 64 (\text{modification cost}) = \text{Rs. } 680$

Maximum Price Payable = Lower of Rs. 576 or 680 = Rs. 576.

Note : If still there is a difficulty, then you may watch the same video lecture again for better understanding.

