

Discussion: Computer Tech

Ethics: Manipulating Percentage of Completion Estimates

Computer Tech Corporation produces computer keyboards, and its fiscal year ends on December 31. The weighted average method is used for the company's process costing system. As the controller of Computer Tech, you present December's production cost report for the Assembly department to the president of the company. The Assembly department is the last processing department before goods are transferred to finished goods inventory. All 160,000 units completed and transferred out during the month were sold by December 31.

The board of directors at Computer Tech established a compensation incentive plan that includes a substantial bonus for the president of the company if annual net income before taxes exceeds \$2,000,000. Preliminary figures show current year net income before taxes totaling \$1,970,000, which is short of the target by \$30,000.

The president approaches you and asks you to increase the percentage of completion for the 40,000 units in ending WIP inventory to 90 percent for direct materials and to 95 percent for direct labor and overhead. Even though you are confident in the percentages used to prepare the production cost report, which appears as follows, the president insists that his change is minor and will have little impact on how investors and creditors view the company.

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	A	B	C	D	E	F
1	Assumptions/Data		Percent Complete			
2	Unit information		Direct Materials	Direct Labor	Overhead	
3	Units in beginning WIP	50,000	100%	100%	100%	
4	Units started and completed	110,000	100%	100%	100%	
5	Units started but not yet complete	40,000	60%	40%	40%	
6	Cost Information		Direct Materials	Direct Labor	Overhead	
7	Costs in beginning WIP		\$ 80,000	\$ 30,000	\$ 28,000	
8	Costs incurred during period		\$ 210,000	\$ 85,000	\$ 72,000	
9						
10	Computer Tech Company					
11	Assembly Department Production Cost Report					
12	Month Ending December 31					
13	Units to be accounted for					
14	Beginning WIP	50,000				
15	Started during the period	150,000				
16	Total	200,000				
17			Equivalent Units			
18	Units accounted for	Physical Units	Direct Materials	Direct Labor	Overhead	
19	Completed and transferred out	160,000	160,000	160,000	160,000	
20	Ending WIP	40,000	24,000	16,000	16,000	
21	Total	200,000	184,000	176,000	176,000	
22						
23	Costs to be accounted for		Direct Materials	Direct Labor	Overhead	Total
24	Costs in beginning WIP		\$ 80,000	\$ 30,000	\$ 28,000	\$ 138,000
25	Costs incurred during the period		210,000	85,000	72,000	367,000
26	Total		\$ 290,000	\$ 115,000	\$ 100,000	\$ 505,000
27						
28			Direct Materials	Direct Labor	Overhead	Total
29	Total costs to be accounted for		\$ 290,000	\$ 115,000	\$ 100,000	
30	Total equivalent units accounted for		184,000	176,000	176,000	
31	Cost per equivalent unit		\$ 1.5761	\$ 0.6534	\$ 0.5682	\$ 2.7977
32						
33			Direct Materials	Direct Labor	Overhead	Total
34	Costs assigned to units transferred out		\$ 252,176	\$ 104,544	\$ 90,912	\$ 447,632
35	Costs assigned to ending WIP		\$ 37,826	\$ 10,454	\$ 9,091	\$ 57,372
36	rounding adjustment					(4)
37						\$ 505,000

Discuss the following questions with your classmates:

1. Why is the president asking you to increase the percentage of completion estimates?
2. [Using the attached spreadsheet](#), prepare another production cost report for Computer Tech Company that includes the president's revisions. Indicate what impact the president's request will have on cost of goods sold and on net income (ignore income taxes in your calculations).
3. As the controller of the company, how would you handle the president's request?

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