

PROBLEM 6-16 Second-Stage Allocations and Product Margins [LO 6-4, LO 6-5]

AnimPix, Inc., is a small company that creates computer-generated animations for films and television. Much of the company's work consists of short commercials for television, but the company also does realistic computer animations for special effects in movies.

The young founders of the company have become increasingly concerned with the economics of the business—particularly because many competitors have sprung up recently in the local area. To help understand the company's cost structure, an activity-based costing system has been designed. Three major activities are carried out in the company: animation concept, animation production, and contract administration. The animation concept activity is carried out at the contract proposal stage when the company bids on projects. This is an intensive activity that involves individuals from all parts of the company in creating storyboards and prototype stills to be shown to the prospective client. After the client has accepted a project, the animation goes into production and contract administration begins. Technical staff do almost all of the work involved in animation production, whereas the administrative staff is largely responsible for contract administration. The activity cost pools and their activity measures and rates are listed below:

Activity Cost Pool	Activity Measure	Activity Rate
Animation concept	Number of proposals	\$6,000 per proposal
Animation production	Minutes of animation	\$7,700 per minute of animation
Contract administration	Number of contracts	\$6,600 per contract

These activity rates include all of the costs of the company, except for the costs of idle capacity and organization-sustaining costs. There are no direct labor or direct materials costs.

Preliminary analysis using these activity rates has indicated that the local commercials segment of the market may be unprofitable. This segment is highly competitive. Producers of local commercials may ask several companies like AnimPix to bid, which results in an unusually low ratio of accepted contracts to bids. Furthermore, the animation sequences tend to be much shorter for local commercials than for other work. Because animation work is billed at standard rates according to the running time of the completed animation, the revenues from these short projects tend to be below average. Data concerning activity in the local commercials market appear below:

Activity Measure	Local Commercials
Number of proposals	20
Minutes of animation	12
Number of contracts	8

The total sales for local commercials amounted to \$240,000.

Required:

1. Determine the cost of serving the local commercials market.

Activity-Based Costing: A Tool to Aid Decision Making

2. Prepare a report showing the margin earned serving the local commercials market. (Remember, this company has no direct materials or direct labor costs.)
3. What would you recommend to management concerning the local commercials market?