



## Finance 1

### Relevant Loads Exercise

[Relevant Loads Directions.pdf]

In the *Finance 1 Workbook.xlsx*, go to the worksheet tab “RelevantLoads”, at the bottom of the Spreadsheet.

#### Background

Conclackinflacker Meds, Inc. (CMI) develops, manufactures, and markets various pharmaceutical products. They have a world-wide list of clients, both retailers and wholesalers of their own one dozen pharmaceutical products and more than 100 off-brand products produced for a variety of labels.

CMI has an image problem with their clients. They are unable to answer questions when issues arise. The call center of 120 people has been functioning for ten years, but is using old technology. A vendor of a new call center information system promises savings through reduced staffing of the call center and, of course, improved client satisfaction from easier online access to information.

Is this new information system justified financially? The intangible, while crucial, will not be considered. Only the reduced staff will be considered.

#### The Learnings

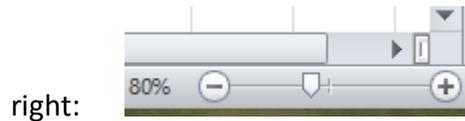
This exercise helps you:

1. Recall the needs of accounting for depreciation purposes.
2. Know the difference between accounting’s needs and the needs of finance to make a financial recommendation.
3. Determine the appropriate use of loads for accounting.
4. Determine the appropriate use of loads for a financial decision.

# Relevant Loads Exercise Directions

## General Instructions

The worksheet can best be seen without a lot of navigating using about 80% size in the lower



For this exercise, disregard PTAT and DTS.

Study the table below from the spreadsheet. Your assignment is to enter formulae into the BUFF-colored cells to complete the table which yields the Payback. You will do this twice, once for good accounting information and again for good financial analysis. You will see the accounting information yields a payback that does not meet the hurdle rate. But, this analysis is bogus. The loads required by accounting for depreciation purposes are not good financial analysis. The payback for the financial analysis is sufficient to justify the project. Using ONLY RELEVANT LOADS is a key to getting such analysis correct.

Using Accounting Loads for Accounting's Needs	Capital Costs					
		Direct	Payroll Load	Supply Chain Load	A&G Load	TOTAL
	Procured Equipment	\$ 1,500,000	\$ -		\$ 525,000	\$ 2,025,000
	Design Labor	\$ 13,200	\$ 11,220	\$ -	\$ 4,620	\$ 29,040
	Install labor	\$ 25,300		\$ -		\$ 25,300
					TOTAL Cap. Costs	\$ 2,079,340
	Savings					
		Direct	Payroll Load	Supply Chain Load	A&G Load	TOTAL
		\$ 307,840	\$ 261,664	\$ -	\$ 107,744	\$ 677,248
		PAYBACK (Using Accounting Info)				
						years

## Specific Instructions

1. Look over the worksheet. Become familiar with the layout of assumptions, tables, and questions.
2. Fill in the BUFF-colored cells on the Accounting Needs table. Use Cell I30 to see an example of the load calculation. It is simply the direct cost times the specific load rate.
3. Answer the five questions (Q1 thru Q5).
4. Fill in the BUFF-colored cells on the RELEVANT LOADS table.
5. Inspect the Payback for both tables. According to payback, does the last table justify the project?
6. Note the additional information below the last table and the *A Tough Call* discussion.

# Relevant Loads Exercise Directions

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## Assumptions

1. The new call center information system is purported to reduce FOUR staff positions in the call center.
2. Their hourly rate is \$37.00 of direct salary.
3. Use 2080 work hours per year.
4. Accounting has developed the following loads:
  - a. Payroll Load of 85% covering 401(k) match, health insurance, and social security. For purposed of estimating the cost of a job for depreciation purposes, tt is applied to all direct payroll dollars.
  - b. Supply Chain Load of 4% applied to the cost of all procured items to allow the supply chain department's cost to be included in depreciation.
  - c. Administrative and General (A&G) Load applied to both direct salary and the cost of procured items to amortize the costs of management, rents, insurance, building operation, etc. to be depreciated.
5. Cost of the New Information System:
  - a. Procurement of equipment: \$1,500,000
  - b. Labor to design the new system (CMI's staff): 120 hours
  - c. Labor to install the new system (CMI's staff): 230 hours
  - d. Cost per hour for design and installation: \$110
6. The payback hurdle rate is three years.

## Checking Your Math

Cell L37 should show a payback of 3.2 years. Cell L61 should show a payback of 2.76 years. If not, check your math in the BUFF-colored cells.

## Conclusion

For this exercise, you will NOT need to enter your answers into the courseware.

Keep these directions on your hard drive. This file is part of the tools you will keep as you complete the BBO course. This may be useful to you on the Final Exam for this course and the Capstone Case in the final BBO course.

Thank you for your work.