

Heartland.1

Heartland Watches Case (10 points)

Imagine that you have just started working at Heartland Watches, a manufacturer of women's wristwatches. Heartland Watches was founded by John A.F. Whitney in 1974 in Kansas. After John Whitney's passing in 1992, his eldest daughter Marianne Whitney served as the company's president. Following is the income statement of Heartland Watches for the last fiscal year.

Heartland Watches
Income Statement for the Year Ended December 31, 2016

Sales	\$40,000,000
Less: Cost of goods sold	\$22,000,000
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Gross Margin	\$18,000,000
Less: Selling and administrative expenses	\$15,000,000
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Net Income	\$3,000,000

Heartland Watches had manufactured 2 million watches, which had been sold to various department stores. At the start of 2017, the president, Marianne Whitney, unexpectedly decided to hike the Pacific Crest Trail following a difficult divorce. Her younger sister, Jodie Velasquez, became the new president. Jodie had worked for 15 years in the marketing department of the business. She knew very little about accounting and manufacturing, which were her sister's strengths. Jodie has several questions, including inquiries about pricing of special orders.

Requirement 1 (2 points):

To prepare better answers, you decide to convert the traditional income statement shown into a Contribution Format Income Statement. Total variable manufacturing cost was \$18 million. Total variable selling and administrative expenses, which were mostly sales commissions, shipping expenses, and advertising allowances paid to customers based on units sold, were \$9 million.

Prepare the revised Contribution Format Income Statement.

Requirement 2 (2 points):

Jodie asks, "I can't understand financial statements until I know the meaning of various terms. In scanning my sister's assorted notes, I found the following pertaining to both total and unit costs: product costs, variable costs, gross margin, and contribution margin. Using our data for 2016, please give me a list of these costs showing both their totals, and their per-unit amounts."

Complete the following table for Jodie, including your calculations:

	Total	Per Unit
Product Costs		
Variable Costs		
Gross Margin		
Contribution Margin		

Requirement 3 (3 points):

She also says, "Near the end of 2016, I brought in a special order from Target for 100,000 watches at \$16 each. I said I'd accept a flat \$20,000 sales commission instead of the usual 6% of selling price, but my sister refused the order. She usually upheld a relatively rigid pricing policy, saying that it was bad business to accept orders that did not at least generate full manufacturing cost plus 80% of full manufacturing cost.

That policy bothered me. We had idle capacity. The way I figured, our manufacturing costs would go up by $100,000 \times \$11 = \$1,100,000$, but our selling and administrative expenses would go up by only \$20,000. That would mean additional operating income of $100,000 \times (\$16 - \$11)$ minus \$20,000, or \$500,000 minus \$20,000, or \$480,000. That's too much money to give up just to maintain a general pricing policy. Was my analysis of the impact on operating income correct? If not, please show me the correct additional operating income."

*Prepare a memo for Jodie summarizing your response. This memo must be **no more** than 1-page long, single spaced, size 12 font. Note that you may be able to answer the question in significantly less space. Answers must include supporting calculations to receive credit.*

Requirement 4 (3 points):

After receiving the explanations offered in Requirement 2 and 3, Jodie said, "Forget that I had the Target order. I had an even bigger order from Lands' End. It was for 500,000 units and would have filled the plant completely. I told my sister I'd settle for no commission. There would have been no selling and administrative costs whatsoever because Lands' End would pay for the shipping and would not get any advertising allowances.

Lands' End offered \$8.70 per unit. Our fixed manufacturing costs would have been spread over 2.5 million instead of 2 million units. Wouldn't it have been advantageous to accept the order? Our old fixed manufacturing costs were \$2.00 per unit. The added volume would reduce the cost more than our loss on our variable costs per unit. Am I correct? What would have been the impact on total operating income if we had accepted the order?"

*Prepare a memo for Jodie summarizing your response. This memo must be **no more** than 1-page long, single spaced, size 12 font. Note that you may be able to answer the question in significantly less space. Answers must include supporting calculations to receive credit.*

Heartland Case Grading Guidelines

- **Answers with no supporting calculations will receive a zero (0%) on this assignment.**
- You do not need to type your responses, nor are you required to use Excel for this assignment. However, your answers must be legible and labelled.
- You must turn in a copy of your answers as a PDF or WORD document. If complete the case by hand, you must submit a scanned copy of your answers.
- You may work on this assignment with others from the class. You may discuss this assignment with others in the class. However, each student is expected to turn in their own assignment. You may not put more than one name on each assignment.

Case Grading Rubric

- **Requirement 1 (2 points total)**
 - 1 point awarded for accuracy, PLUS
 - 1 point awarded for effort
 - Must include supporting calculations
- **Requirement 2 (2 points total)**
 - 1 point awarded for accuracy, PLUS
 - 1 point awarded for effort
 - Must include supporting calculations
 - Must provide all 8 numbers asked in the requirement
- **Requirement 3 (3 points total)**
 - 2 points awarded if answer is correct (i.e., no incorrect statements are included in the answer), OR
 - 1 point awarded if the answer contains some information that is correct (i.e., answer may contain some incorrect information and some correct information), PLUS
 - 1 point awarded for effort
 - Must include supporting calculations or numbers calculated in earlier requirements
 - Must follow all instructions
- **Requirement 4 (3 points total)**
 - 2 points awarded if answer is correct (i.e., no incorrect statements are included in the answer), OR
 - 1 point awarded if the answer contains some information that is correct (i.e., answer may contain some incorrect information and some correct information), PLUS
 - 1 point awarded for effort
 - Must include supporting calculations or numbers calculated in earlier requirements
 - Must follow all instructions