

OPPORTUNITY COST AND INCENTIVE SYSTEMS - Case study -

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ABSTRACT

The case study illustrates management accounting issues in higher education organizations. It particularly addresses the benefits of planning research projects with activity-based costing instead of absorption costing. The case continues by explicating hidden transfer pricing systems and opportunity cost in higher education. Students can discuss how small misalignment in management control system leads to unintended and dysfunctional behavior. The case offers opportunity to explore non-financial incentives in the public sector.

Keywords: *Activity-based costing; incentives; transfer pricing; higher education; instructional case study.*

1. INTRODUCTION

Kleiver Business School (KBS) is a European, research-oriented university that offers business degrees from the undergraduate to the postgraduate level. Its campus is located in the city center of a large, vibrant town. KBS is a public university that must use all its funds for creating an inspiring learning and research environment that has a positive impact on society. Its funding mainly stems from the state (based on number of student intake, as well as research output), and organizations (both for profit and non-for profit) who provide external funding for cooperation on projects. KBS has set as its goal to increase the number of PhD graduates, as well as the research output that has value to society.

2. ACTIVITY-BASED COSTING (APPROX. 45 MINUTES)

Kirby Cooper from KBS' cooperation department helps professors in setting up contracts with organizations that want to provide external funding to KBS. Elena Ford is a professor of Marketing. One of her brightest Master students this year would like to continue as a PhD student. This student has worked part-time for a digital marketing agency (DMA) for many years.

Elena proposes a highly innovative, three-year project that is of interest to both KBS and DMA, and it would have substantial value to society. She and DMA agree that DMA provides funding for a part-time PhD position, if the students keeps working at the DMA for one day a week. Kirby develops a contract that lists the external funds DMA would have to pay.

Cost type	Cost per year [EUR]	Total cost (3 years) [EUR]
PhD student salary (incl. fringes)	36,000	108,000
Overhead on salary (45%)	16,200	48,600
Cost of project	52,200	156,600

Elena and DMA agree that the salary is justified. However, they do not understand how a PhD student would incur such an amount of overhead at KBS. Elena makes some calls to find out.

Kirby justifies himself to Elena: *"Besides the PhD salary including fringes¹, I always apply an overhead rate, so KBS does not run a deficit. The overhead rate covers the PhD's office, their IT*

¹ Fringes are fees for social security such as employee pension, health care plans, and unemployment.