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Costs for Decision Making: An Instructional Case of Relevant Costs and Differential Analysis of Cost Reduction Alternatives

Scott McGregor, DPS, CMA, CPA
Assistant Professor of Accounting
Fairleigh Dickinson University

INTRODUCTION

This case is based on a real-life project and takes place in 2010 at the New York City headquarters for the United States operations of AC Global, Inc. (The real name has been changed.) AC Global is a multinational insurance company with its headquarters in France and annual revenue ranking in the top 10 companies globally. The company has significant operations in the United States, Europe, Japan, and Australia, and the operations in each country are separate insurance companies and operate with a large degree of autonomy. Recently, AC Global established insurance operations and a servicing center in India. The servicing center in India primarily provides some information technology (IT) support for the insurance operations in the United Kingdom (U.K.), Belgium, and France. The ongoing global recession has significantly decreased the profitability of AC Global, increasing the importance of reducing costs.

AC Global's operations in the U.S. (AC-US) sell life and annuity products and represent approximately 20% of the group's life and annuity revenues. AC-US has approximately 3,000 employees, with about 1,000 employees based in the New York City headquarters. The remaining employees are located at the company's service centers in New Jersey, Pennsylvania, and North Carolina.

IMPACT ON SHORT-TERM PROFITS

For an insurance company, there are four key line items on the income statement: premium revenue, investment income, benefits/claims expense, and operating expenses. Operating expenses provide the greatest opportunity for short-term improvement in earnings since the other line items are less controllable or the impacts of changes emerge over a long period of time. Investment income is primarily composed of interest and dividends on bonds and common stock investments and is not changed through operating actions. Premium revenue is composed of fees collected for providing insurance coverage and is only modestly impacted by current sales. Benefits and claims are paid to policyholders and their beneficiaries and are also difficult to impact in the short-term.

The global economic downturn that began in late 2008 put intense pressure on the financial services industry. During 2009, U.S. sales of annuity products decreased by 30% while life insurance sales fell by 15%.[1] Like the industry, AC Global has been negatively impacted by the economic downturn. AC-US premium revenue fell 8% cumulatively between 2007 and 2009. In 2010, the company's operations remained stable, but revenue was expected to be similar to 2009.

AC Global's operating earnings decreased over 80% from 2007 to 2008, and AC-US suffered an operating loss in 2008.

Although operating earnings recovered somewhat in 2009 (shown in Figure 1), the earnings for AC Global consolidated and AC-US are still 36% and 40%, respectively, below those in 2007. As a result, the company's stock price is down nearly 50% since the beginning of the crisis in 2008.

AC-US measures operating efficiency based on the expense ratio, which is operating expenses divided by premium revenue. In 2004, AC-US went through a restructuring that reduced personnel overlap and inefficiency. Through the restructuring, AC-US reduced the workforce by 4%, reduced operating expenses by 5%, and improved the expense ratio from 12.7% in 2004 to 10.1% by 2007, 14% better than the expense ratio of 11.7% for AC Global. While operating expenses have grown modestly at 2% since 2007, the expense ratio for AC-US increased from 10.1% in 2007 to over 12.5% in 2009, worse than the 12.1% for AC Global. AC-US has underperformed AC Global in earnings and cost efficiency during 2009, which is concerning for the management of AC-US (see Figure 2).

COST REDUCTION ANALYSIS PROJECT

Peter George is a vice president responsible for financial planning and analysis (FP&A) at AC-US in New York. In his role, George and his team evaluate all significant projects with financial implications. George led the team that analyzed and recommended the restructuring six years ago that significantly improved the expense ratio.

George met with Brian Thomas, the chief financial officer (CFO). Thomas had reviewed the first quarter preliminary revenue and earnings and told George that it is imperative for the company to find ways to reduce expenses to improve earnings. He set a goal of a 10% reduction in operating expenses. If AC-US achieved that goal, he estimated that the company would return the expense ratio to a value below 11% and operating earnings would return to 2007 levels.

Before engaging the rest of the organization, the CFO would like the functions he manages to take a leadership position in the cost reductions—not just recommending cost-reduction actions but also providing examples to show they are effective. Thomas reviewed the accounting function first and decided he wants it to reduce expenses by 10% overall to be in line with the company's overall target. He also would like to see a payback period of two years or less for any one-time costs.

Thomas asked George to evaluate potential cost-saving alternatives and provide him with a preliminary analysis within one week. Thomas then informed George that the company has recently began performing some accounting functions in the service center in India and gave George the contact information for Sanjay Delphi, the project manager for the company's India facility.

George believes that in addition to outsourcing (offshoring), increasing the use of electronic payments in accounts payable and relocating some of accounting functions to the service center in N.J. are two other viable ways to reduce costs. George made notes on information regarding expenses relevant for the analysis, including the severance policy (see Table 7, section F).

George also pulled up the organization chart to list all of the various accounting functions as well as their annual expense budgets (Table 1). He assembled information on the staff in each of the accounting functions, including their salaries, benefits, residence, and possible severance based on the years of service and prepared a summary by function (see Table 6).

George meets with two of his team members, Samantha Charleston and Ryan Falkirk, to explain the project. Given the one-week turnaround time for the analysis, George suggests that each of them select one option to analyze over the next four days and then meet to develop their recommendations. George selects offshoring, Charleston decides to analyze electronic check processing, and Falkirk will analyze relocating accounting functions.

OFFSHORING

George reviews some general information on offshoring and finds that global offshoring has grown rapidly. He finds that accounting processes such as accounts payable, accounts receivable, sales ledger, general ledger, financial reporting, and bank processing are increasingly offshored.[2]

George calls Delphi to discuss the services performed at the servicing center in India. Delphi informs George that the service center currently provides some IT support for the insurance operations in the U.K., Belgium, and France; performs some customer service functions; and also recently added a few accounting functions. Delphi emphasized that the service center is just beginning to add staff with accounting expertise and has minimal knowledge of U.S. generally accepted accounting principles (GAAP) state regulatory accounting requirements, and U.S. tax law (the U.S. Internal Revenue Code).

George determines that the first step in his analysis is to identify which accounting functions would be the best candidates for offshoring and then analyze the financial and logistical feasibility of doing that. George prepares a matrix to assist him in analyzing which functions would be the most appropriate to offshore (see Table 2). His matrix takes into account required skill levels, local knowledge (of the U.S. Internal Revenue Code, for example), compliance risk, technological support, and the need for direct management oversight—which may be difficult due to distance and differences in time zones. He rates the functions on each of the criteria as high, medium, and low.

George concludes that the functions that score low or medium on all of the criteria would be the best candidates for outsourcing. Based on the matrix, he believes that the accounts payable and bank reconciliation functions are the best candidates for initial consideration.

The accounts payable function has a separate manager while the bank reconciliation function reports to the manager of general accounting. The Bank Reconciliation Department prepares 50 reconciliations per month (600 per year), and the Accounts Payable Department processes 50,000 checks per month (600,000 per year). George reviews the annual expense budgets (provided in Table 3).

George sends Delphi an email and requests information on the accounts payable and bank reconciliation service functions. Delphi responds that the charges for outsourced services for accounts payable and bank reconciliation are a base monthly fee of $1,250 for each function ($15,000 per year) plus $0.65 per payment for processing accounts payable and $200 per bank reconciliation.

Delphi also informs George that the U.S.-based operations would need to maintain staff to coordinate the transfer of information. Based on a similar project being undertaken by the company's U.K. operations, Delphi estimates that one staff member within the Accounting Department should be sufficient to support both accounts payable and bank reconciliations. Delphi and George discuss the necessary skills. George believes that retaining the accounts payable manager, who likely has the necessary skills, would be a good solution—and he uses that assumption for his analysis.

The accounts payable manager's annual salary is $75,000. The allocated benefits charge is $18,750, but actual benefits and taxes are $19,488. George estimates that the cost for a personal computer, supplies, travel, and all other expenses (excluding postage) would total $15,500. He assumes that the salary, benefits and other expenses associated with the manager would be allocated 65% to accounts payable and 35% to bank reconciliations based upon the estimated time requirements to support each function. George does not include the allocation of rent, corporate expenses, or 50% of IT support in his cost-reduction estimate.

Delphi also gives George the data transfer and connectivity specifications to discuss with the IT Department. Josephine Young, of the IT Department, analyzes the requirements and informs George that they would need to improve connectivity and alter the time of the batch processing for accounts payable. She estimates there would be a one-time cost of $100,000 plus $2,500 per month for improved connectivity. The change in the batch processing time will also cause an increase in personnel costs of $2,500 per month. But there are no additional technology requirements for offshoring bank reconciliations.

AUTOMATING ELECTRONIC PAYMENTS

Charleston performs some background research on electronic payments. She finds that the use of electronic payments has increased substantially as the number of checks used in business-to-business transactions rose. The use of paper checks decreased by 5% from 2006 to 2009.[3] The estimated savings from using electronic payment instead of paper checks ranged from 20% to 90%.[4]

Since the accounts payable function issues all of its payments as checks, Charleston believes that there may be significant savings if the company made greater use of electronic payments. Charleston contacts the company's corporate banking representative to inquire about electronic payments alternatives. She finds that the bank charges an average of $0.125 per electronic payment. The bank also provides Charleston with a contact at a company that recently adopted electronic payments (identified as Company XYZ).

As a means to estimate the potential impacts, she contacts Company XYZ's treasurer to discuss how it impacted their staffing needs and costs and is informed that Company XYZ averaged 2 minutes in labor per manual check and only 1.5 minutes for each electronic payment. For recurring payments, Company XYZ experienced an 80% time savings annually. To support her analysis, Charleston requests and receives a report showing the number of the company's checks that are recurring to vendors as well as those to employees and business partners, which are good candidates for electronic payments (see Table 4).

Based on her preliminary analysis, Charleston estimates that the company could process up to 50% of its current payments electronically. Using the results for Company XYZ as a proxy, she estimates that electronic payments would reduce processing time by 25% for each electronic payment. Since recurring payments require minimal work after initial set-up, the potential estimated time savings is 80%. Since 16% of payments are recurring, labor savings would be possible.

Charleston estimates that electronic payment processing would reduce staff, with associated reductions in salaries and benefits as well as other associated costs. To estimate the impact on staff, she uses 10 employees processing 600,000 checks annually and assumes that 50% of the payments could become electronic.[5] To calculate the potential savings in salaries and benefits, she assumes that the staff reductions would involve less-experienced staff and represent 15% of total salaries and benefits for accounts payable. She estimates also that there would be savings in personal computer (PC) costs, IT support, and other costs of $1,775 per employee. Additionally, there would be a reduction in postage costs in direct proportion to the reduction of the number of checks. These savings would be partially offset by an additional cost of $0.125 for each electronic payment that replaces a check. Further, she uses the information from Table 6 to estimate that severance costs would represent 15% of the maximum eligible severance for accounts payable.

RELOCATION

Falkirk meets with the head of corporate facilities to discuss the availability of space in the N.J. service center and the possibility of subleasing any excess space created in the New York office. The head of facilities states that the company currently has more than 4,000 square feet of excess space in N.J. There also is up to an additional 28,500 square feet of space available in the building that could be leased for approximately $25 per square foot. But space must be leased in blocks of 9,500 square feet, which is equivalent to one floor in the building.

Also, the head of facilities states that the company currently has approximately 3,500 square feet of excess space in the New York office and could sublease the space in blocks of 10,000 square feet (equivalent to one floor). But if a block or blocks of 10,000 square feet of space cannot be created, the available space could not be subleased. Given current real estate prices, he estimated the sublease rent would be $65 per square foot. Based on past moves, he estimates the costs to move employees and set up new workstations average $1,000 per position in the new space plus $50,000 per floor to build out and wire the new space.

Falkirk prepares a grid (see Table 5) highlighting the level of management and interdepartment interaction as well as the number of N.J. resident employees in each function. He believes that those functions with the lowest level of interdepartment and management interaction would be best for possible relocation and selects the departments with low to medium interdepartment rankings. Additionally, Falkirk prepares a summary list of employees by function and their residence (see Table 6) to estimate the likely number of employees that would be retained and the potential severance costs if a portion of the accounting functions are relocated to N.J.

He assumes that department heads and their assistants would have offices in both the corporate headquarters and the N.J. location. He estimates that 250 square feet of office space per position will be needed for each employee relocated from the New York office and a comparable amount would be available for subleasing. He assumes 100% of all employees who are N.J. residents would be retained. Of the residents not in New Jersey, he assumes all department heads and their assistants would remain while all other employees not from New Jersey would terminate, and severance would be paid to any employee not relocating. Information regarding the company's severance policy is provided in Table 7, section F, and summary employee information by department is in Table 6.

INTERACTION OF ALTERNATIVES

If the company only outsources bank reconciliations, the team has assumed that the bank reconciliation department will need to retain the most experienced employee to support the process. The most experienced employee in the department has eight years of service, a salary of $48,000, health insurance costs of $10,000, 401(k) contributions at 5%, and payroll taxes of 7.65%. In addition to the savings in salaries and benefits for the positions eliminated in bank reconciliations, it is also estimated that there would be a savings of $8,000 in total for expenses other than salaries and benefits. The one time initial costs would consist of severance costs for the positions eliminated.

CASE QUESTIONS

Provide responses, displaying all work, to the following questions:

1. **General Questions:**
   a. What costs are relevant to each of the three alternatives: offshoring, relocating functions, and automating functions?
   b. What are some of the nonfinancial considerations associated with each of these alternatives?
2. **Offshoring Analysis:**
   a. Based on George's assumptions that all of the remaining supervisor's costs are split 65% to accounts payable and 35% to bank reconciliation, and all incremental ongoing technology costs and postage

costs are charged to accounts payable, calculate the annual savings per function through offshoring.

b. What would the impact be on AC-US's costs for the next three years if the two accounting functions are performed in India instead of in the U.S.? (Be sure to include severance in the one-time costs, using information from Table 6 and assume zero inflation).

3. Electronic Processing:

a. Using the information that Charleston gathered on electronic payment processing, determine the potential staff reduction and calculate the potential annual cost savings from electronic processing of 50% of the accounts payable checks.

b. If AC-US outsources bank reconciliations and/or accounts payable, what would be the maximum combined savings of electronic payments and outsourcing over the next three years, including the one-time costs? (Be sure to include severance costs, using information from Table 6, in the one-time costs).

4. Relocation:

a. Using the information that Falkirk gathered on potential real estate savings through relocation, estimate the annual cost savings available through relocating some or all of the accounting functions to New Jersey.

b. What are the impacts on AC-US's costs over the next three years, including the one-time costs? (Be sure to include severance costs, using information from Table 6, in the one-time costs).

5. Recommendation:

Based on your analysis, recommend a course of action for AC-US. Remember Thomas's goal of 10% reduction in the expenses for the accounting function. Your alternatives include retaining operations as they are, adopting electronic payments for accounts payable, relocating accounting functions, and/or offshoring functions. You may recommend a combination of any of the alternative cost savings approaches.

ENDNOTES

[1]*Annual Report on the Insurance Industry,* Federal Insurance Office of the U.S. Treasury, June 2013.

[2]Nora Palugod and Paul A. Palugod, "Global Trends in Offshoring and Outsourcing," *Internal Journal of Business and Social Science*, September 2011.

[3]"The 2010 Federal Reserve Payments Study: Noncash Payment Trends in the United States: 2006 - 2009," updated April 5, 2011, Federal Reserve System.

[4]Matthew Heller, "Electronic Payments 10 Times Cheaper Than Checks," CFO.com, October 12, 2015.

[5]Estimated staff reduction based on 600,000 checks supported by 10 full-time employees (FTEs). Estimate 300,000 checks, or 50%, with similar level of FTE support per check. The necessary FTEs to support electronic payments (34% of payments) assume 25% time savings for electronic payments. The remaining 16% of payments are recurring electronic payments and estimate an 80% time savings.

Figure 1: Operating Earnings ($ in millions)

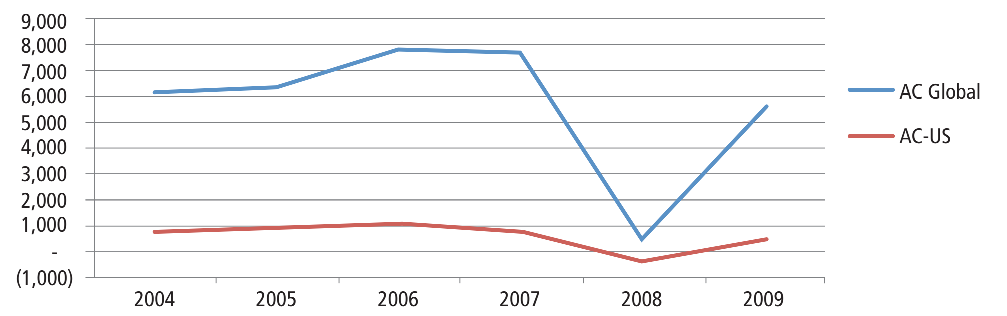

Figure 2: Operating Expense Ratio for AC Global vs. AC-US

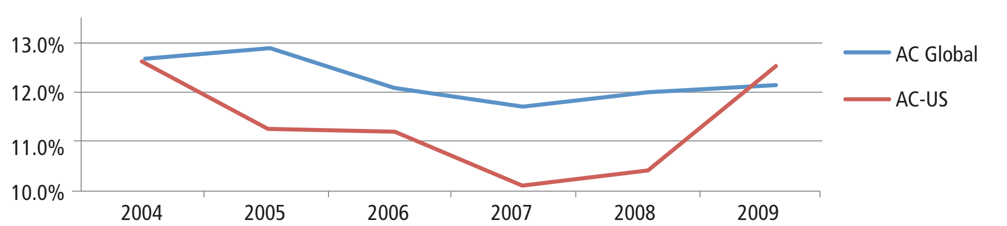

Table 1: Accounting Department Expense Budget Summary

Function	Number of Employees	Annual Salaries	Annual Benefits Load	All Other	Total Budgeted Expenses
Federal tax preparation	8	$802,000	$200,500	$176,500	$1,179,000
State tax preparation	12	812,000	203,000	170,000	1,185,000
Tax management	2	250,000	62,500	72,500	385,000
Controller	2	285,000	71,250	68,750	425,000
SEC reporting	7	525,000	131,250	158,750	815,000
U.S. GAAP reporting	7	575,000	143,750	126,250	845,000
Regulatory financial reporting	6	525,000	131,250	118,750	775,000
Management reporting	6	455,000	113,750	106,250	675,000
Cost accounting	6	385,000	96,250	98,750	580,000
General accounting	10	628,000	157,000	100,000	885,000
Accounts payable	10	470,000	117,500	393,750	981,250
Bank reconciliations	5	215,000	53,750	61,750	330,500
Planning and budgeting	4	325,000	81,250	88,750	495,000
Financial analysis	8	685,000	171,250	108,750	965,000
Totals	**93**	**$6,937,000**	**$1,734,250**	**$1,849,500**	**$10,520,750**

Table 2: Matrix of Potential Accounting Functions for Outsourcing

Function	Skill Level Required	Local Knowleged Required	Mgmt. Support/ Interaction	Technology Support Required	Compliance Risk
Tax Department					
Federal tax preparation	Medium	High	Low	Low	High
State tax preparation	Medium	High	Low	Low	High
Tax planning	High	High	High	Low	Medium
Controller's Department					
SEC reporting	High	High	Medium	Medium	High
U.S. GAAP reporting	High	High	Medium	Medium	High
Regulatory reporting	Medium	High	Medium	Medium	High
Management reporting	Medium	Medium	High	Medium	Low
Cost accounting	Medium	Low	Medium	Medium	Medium
General accounting	Medium	Medium	Medium	Medium	Medium
Accounts payable	Low	Low	Low	Medium	Low
Bank reconciliations	Low	Low	Low	Low	Low
Financial Planning and Analysis					
Planning and budgeting	Medium	Medium	High	Medium	Low
Financial analysis	Medium	Medium	High	Low	Low

Table 3: 2010 Detailed Expense Budget for Accounts Payable and Bank Reconciliations

Expense	Accounts Payable	Bank Reconciliations
Salaries	$470,000	$215,000
Benefits load	117,500	53,750
Rent and related	64,000	42,000
Supplies	16,750	1,750
PCs	12,000	6,000
IT support	11,500	6,000
Postage	270,000	–
Travel and entertainment	11,500	3,000
Corporate expenses	8,000	3,000
Total	**$981,250**	**$330,500**

Table 4: Summary of Checks Processed per Month

	Recurring	Business Partners/ Employees (probably electronic)	All Others	Total
Checks (monthly)	8,000	17,000	25,000	50,000
Percentage	16%	34%	50%	100%

Table 5: Matrix for Evaluating Relocation Prospects

Function	Number of Employees	Management Interaction	Interdepartment Interaction	Employee(s) in N.J.
Tax Department				
Federal tax preparation	8	Low	Low	4
State tax preparation	12	Low	Low	9
Tax planning and management	2	High	Medium	0
Controller's Department				
Controller	2	High	High	1
SEC reporting	7	Medium	Low	5
U.S. GAAP reporting	7	Medium	Low	5
Regulatory financial reporting	6	Medium	Low	4
Management reporting	6	Medium	High	4
Cost accounting	6	Medium	Low	5
General accounting	10	Medium	Low	9
Accounts payable	10	Low	Medium	7
Bank reconciliations	5	Low	Low	3
Financial Planning and Analysis				
Planning and budgeting	4	Medium	High	2
Financial analysis	8	High	High	6
	93			**64**

Table 6: Summary Employee Information for Severance Calculations

	Number of Employees	Weeks of Eligible Severance	Total Annual Salaries	Benefits Load	Actual Costs		
					Health	401(k)	Payroll Taxes
Tax Department:							
Department head and assistant	2	32	$250,000	$62,500	$17,200	$12,500	$19,125
Federal Tax							
N.J. residents	4	76	445,000	111,250	32,200	22,250	34,043
Non-N.J. residents	4	66	357,000	89,250	27,200	17,850	27,311
Total	**8**	**142**	**802,000**	**200,500**	**59,400**	**40,100**	**61,354**
State Taxes							
N.J. residents	9	140	627,000	156,750	76,600	31,350	47,966
Non-N.J. residents	3	52	185,000	46,250	20,000	9,250	14,153
Total	**12**	**192**	**812,000**	**203,000**	**96,600**	**40,600**	**62,119**
Controller's Department:							
Department head and assistant	2	28	285,000	71,250	15,000	14,250	21,803
SEC Reporting							
N.J. residents	5	96	379,000	94,750	34,400	18,950	28,994
Non-N.J. residents	2	36	146,000	36,500	17,200	7,300	11,169
Total	**7**	**132**	**525,000**	**131,250**	**51,600**	**26,250**	**40,163**
U.S. GAAP Reporting							
N.J. residents	5	74	413,500	103,375	37,200	20,675	31,633
Non-N.J. residents	2	30	161,500	40,375	12,200	8,075	12,355
Total	**7**	**104**	**575,000**	**143,750**	**49,400**	**28,750**	**43,988**
Regulatory Reporting							
N.J. residents	4	52	351,000	87,750	27,200	17,550	26,852
Non-N.J. residents	2	30	174,000	43,500	17,200	8,700	13,311
Total	**6**	**82**	**525,000**	**131,250**	**44,400**	**26,250**	**40,163**
Management Reporting							
N.J. residents	4	52	303,000	75,750	27,200	15,150	23,180
Non-N.J. residents	2	30	152,000	38,000	17,200	7,600	11,628
Total	**6**	**82**	**455,000**	**113,750**	**44,400**	**22,750**	**34,808**
Cost Accounting							
N.J. residents	5	70	322,000	80,500	34,400	16,100	24,633
Non-N.J. residents	1	12	63,000	15,750	10,000	3,150	4,820
Total	**6**	**82**	**385,000**	**96,250**	**44,400**	**19,250**	**29,453**
General Accounting							
N.J. residents	9	128	559,000	139,750	69,400	27,950	42,764
Non-N.J. residents	1	18	69,000	17,250	7,200	3,450	5,279
Total	**10**	**146**	**628,000**	**157,000**	**76,600**	**31,400**	**48,042**

Table 6: Summary Employee Information for Severance Calculations (continued)

	Number of Employees	Weeks of Eligible Severance	Total Annual Salaries	Benefits Load	Actual Costs: Health	401(k)	Payroll Taxes
Accounts Payable							
N.J. residents	7	106	333,000	83,250	46,600	16,650	25,475
Non-N.J. residents	3	60	137,000	34,250	25,000	6,850	10,481
Total[a]	**10**	**166**	**470,000**	**117,500**	**71,600**	**23,500**	**35,956**
Bank Reconciliation							
N.J. residents	3	42	137,000	34,250	30,000	6,850	10,481
Non-N.J. residents	2	24	78,000	19,500	12,200	3,900	5,967
Total[a]	**5**	**66**	**215,000**	**53,750**	**42,200**	**10,750**	**16,448**
Financial Reporting & Analysis Department:							
Budgeting							
N.J. residents	2	28	177,000	44,250	12,200	8,850	13,541
Non-N.J. residents	2	26	148,000	37,000	15,000	7,400	11,322
Total	**4**	**54**	**325,000**	**81,250**	**27,200**	**16,250**	**24,863**
Financial Analysis							
N.J. residents	6	72	526,000	131,500	39,400	26,300	40,239
Non-N.J. residents	2	30	159,000	39,750	17,200	7,950	12,164
Total	**8**	**102**	**685,000**	**171,250**	**56,600**	**34,250**	**52,403**

[a] The severance and continuing benefits for the accounts payable manager total $29,073, and the severance and continuing benefits for the most experienced staff member in bank reconciliations is $19,714.

Note: When calculating severance using the total salaries, you must first find the average weekly salary (salaries/number of employees/52 weeks) and multiply by the number of weeks of severance. Follow a similar process for health benefits. For 401(k) and payroll taxes, you may either follow the same process or apply the rate.

Table 7: Supplemental Information on Relevant Expenses

A. The benefits load of 25% of salaries is designed to represent the costs to provide health, dental and vision insurance, the employer contribution to the 401(k) plan, and employer payroll taxes.
   1. The company's share of health benefits (including dental and vision insurance) is $10,000 per year for family (F), $7,200 for parent/children or employee/spouse (P/C), and $5,000 for single (S) employees.
   2. The employer portion of payroll taxes is 7.65% of salaries.
   3. The company contribution to the 401(k) plan is 5% of salaries.

B. The company has eight years remaining on its lease and is unlikely to be able to reduce space unless it can create 10,000 square feet (one floor) of available space for sublease. Based on an average of 250 square feet per employee, staff in the New York office would need to be reduced by 40 or more.
   1. The company pays $65 in rent per square foot in New York. The standard workstation is approximately 250 square feet per employee, and office space of a department head and assistant are 500 square feet in total.
   2. The rent per square foot is $25 in the service center in N.J., located just across the Hudson River from the New York headquarters.

C. The corporate expense allocation is for the company cafeteria and an on-site gym; the company's costs are unlikely to fall if staff in the Accounting Department is reduced.

D. PCs are leased, and the company can return them with no penalty; 50% of the IT support costs are variable and can be saved when the PCs are eliminated.

E. The postage costs in accounts payable would not change by offshoring or relocation as the checks would be printed and mailed from the company's office in the U.S.

F. The company severance policy calls for two weeks of salary for each year of service with minimum payment of 12 weeks. Health benefits and retirement plan contributions continue to be provided during the severance period. Payroll taxes would also apply.