

## KSB 631 Homework – Week 7

### Problem 1

Vision Sky Tours is a sightseeing tour company based in New England. The firm specializes in aerial tours of the New England countryside and coastline. Until recently, the company had no accounting department. Routine tasks, such as billing, were handled by an individual who had little formal training in accounting. As the business began to grow, however, the owner recognized the need for more formal accounting procedures. Jacqueline Smith was hired as a new controller.

During her first week on the job, Smith was given the following performance report. The report was prepared by Red Sky, the company's manager of aircraft operations, who was planning to present it to the owner the next morning. "Look at these favorable variances for fuel and so forth," Sky noted. "My operations people are really doing a great job." Later that day, Smith looked at the performance report more carefully.

<b>Performance Report For the Month of September</b>				
	<b>Formula Flexible Budget (per air mile)</b>	<b>Actual (32,000 air miles)</b>	<b>Static Budget (35,000 air miles)</b>	<b>Variance</b>
Passenger revenue .....	\$10.50	\$336,000	\$367,500	\$31,500 U
Less: Variable expenses:				
Fuel .....	1.50	\$ 51,000	\$ 52,500	\$ 1,500 F
Aircraft maintenance .....	2.25	70,500	78,750	8,250 F
Flight crew salaries.....	1.20	39,300	42,000	2,700 F
Selling and administrative .....	2.40	74,700	84,000	9,300 F
Total variable expenses .....	<u>\$ 7.35</u>	<u>\$235,500</u>	<u>\$257,250</u>	<u>\$21,750 F</u>
Contribution margin .....	<u>\$ 3.15</u>	<u>\$100,500</u>	<u>\$110,250</u>	<u>9,750 U</u>
	<b>Per Month</b>			
Less: Fixed expenses:				
Depreciation on aircraft .....	\$ 8,700	\$ 8,700	\$ 8,700	\$ 0
Landing fees .....	2,700	3,000	2,700	300 U
Supervisory salaries .....	27,000	25,800	27,000	1,200 F
Selling and administrative .....	<u>33,000</u>	<u>37,200</u>	<u>33,000</u>	<u>4,200 U</u>
Total fixed expenses .....	<u>\$71,400</u>	<u>\$ 74,700</u>	<u>\$ 71,400</u>	<u>\$ 3,300 U</u>
Operating income .....		<u>\$ 25,800</u>	<u>\$ 38,850</u>	<u>\$13,050 U</u>

1. Based on the information in Red Sky's report, prepare a performance report for September using air miles as the cost driver.
2. In spite of several favorable expense variances shown on Red Sky's report, the company's September operating income was only about two-thirds of the expected level. Why?
3. Write a brief memo to the manager of aircraft operations explaining why his variance report is misleading.

## Problem 2

Your next-door neighbor recently began a new job as assistant controller for Continental Company. As her first assignment, she prepared a performance report for March. She was scheduled to present the report to management the next morning, so she brought it home to review. As the two of you chatted briefly, you advised her that you were studying cost control and variance analysis. Thus, she decided to show you the report she had prepared. Unfortunately, your dog thought the report was a toy. The pup made a flying leap and got a firm grip on the report. After chasing the dog around the block, you managed to wrest the report from your dog. The report was torn to bits. Only some data are still legible on the report. This information follows:

Performance Report for the Month of March				
	Direct Material	Direct Labor	Variable Overhead	Fixed Overhead
Standard allowed cost given actual output .....	?	?		
	(? kilograms at \$18 per kilogram)	(2 hours at \$21 per hour)		
Flexible overhead budget .....			?	\$60,000
Actual cost .....	\$283,500	?	?	?
	(14,000 kilograms at \$20.25 per kilogram)	(8,800 hours at ? per hour)		
Direct-material price variance .....	?			
Direct-material quantity variance .....	\$9,000 U			
Direct-labor rate variance .....		\$13,200 U		
Direct-labor efficiency variance .....		4,200 F		
Variable-overhead spending variance .....			\$3,960 U	
Variable-overhead efficiency variance .....			1,800 F	
Fixed-overhead budget variance .....				\$4,875 U
Fixed-overhead volume variance .....				?

In addition to the data still legible on the performance report, your neighbor happened to remember the following facts.

- Planned production of Continental's sole product was 500 units more than the actual production.
- All of the direct material purchased in March was used in production.
- There were no beginning or ending inventories.
- Variable and fixed overhead are applied based on direct-labor hours. The fixed overhead rate is \$6.00 per hour.

Feeling guilty, you have offered to help your neighbor reconstruct the following facts, which will be necessary for her presentation.

1. Planned production (in units).
2. Actual production (in units).
3. Actual fixed overhead.
4. Total standard allowed direct-labor hours.
5. Actual direct-labor rate.
6. Standard variable-overhead rate.
7. Actual variable-overhead rate.
8. Standard direct-material quantity per unit.
9. Direct-material price variance.
10. Applied fixed overhead.
11. Fixed-overhead volume variance.