

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>				
	Formula Flexible Budget (per air mile)	Actual (32,000 air miles)	Static Budget (35,000 air miles)	Variance
Passenger revenue .....	<u>\$10.50</u>	<u>\$336,000</u>	<u>\$367,500</u>	<u>\$31,500 U</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 .....	33,000	37,200	33,000	4,200 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.