

Problem 10-6A: Analysis of possible elimination of a department L.O. C1, A1

Elegant Decor Company's management is trying to decide whether to eliminate Department 200, which has produced losses or low profits for several years. The company's 2008 departmental income statement shows the following.

ELEGANT DECOR COMPANY
Departmental Income Statements
For Year Ended December 31, 2008

	Dept. 100	Dept. 200	Combined
Sales	\$ 473,000	\$ 296,900	\$ 769,900
Cost of goods sold	<u>264,000</u>	<u>208,300</u>	<u>472,300</u>
Gross profit	209,000	88,600	297,600
Operating expenses			
Direct expenses			
Advertising	15,000	10,000	25,000
Store supplies used	4,400	4,200	8,600
Depreciation—Store equipment	<u>5,000</u>	<u>3,300</u>	<u>8,300</u>
Total direct expenses	24,400	17,500	41,900
Allocated expenses			
Sales salaries	63,700	38,220	101,920
Rent expense	9,480	4,720	14,200
Bad debts expense	9,500	7,700	17,200
Office salary	18,720	12,480	31,200
Insurance expense	1,600	700	2,300
Miscellaneous office expenses	<u>1,500</u>	<u>700</u>	<u>2,200</u>
Total allocated expenses	<u>104,500</u>	<u>64,520</u>	<u>169,020</u>
Total expenses	<u>128,900</u>	<u>82,020</u>	<u>210,920</u>
Net income (loss)	<u>\$ 80,100</u>	<u>\$ 6,580</u>	<u>\$ 86,680</u>

In analyzing whether to eliminate Department 200, management considers the following:

- a. The company has one office worker who earns \$600 per week, or \$31,200 per year, and four salesclerks who each earn \$490 per week, or \$25,480 per year.
- b. The full salaries of two salesclerks are charged to Department 100. The full salary of one sales clerk is charged to Department 200. The salary of the fourth clerk, who works half-time in both departments, is divided evenly between the two departments.
- c. Eliminating Department 200 would avoid the sales salaries and the office salary currently allocated to it. However, management prefers another plan. Two salesclerks have indicated that they will be quitting soon. Management believes that their work can be done by the other two clerks if the one office worker works in sales half-time. Eliminating Department 200 will allow this shift of duties. If this change is implemented, half the office worker's salary would be reported as sales salaries and half would be reported as office salary.

- d. The store building is rented under a long-term lease that cannot be changed. Therefore, Department 100 will use the space and equipment currently used by Department 200.
- e. Closing Department 200 will eliminate its expenses for advertising, bad debts, and store supplies; 70% of the insurance expense allocated to it to cover its merchandise inventory; and 25% of the miscellaneous office expenses presently allocated to it.

Requirement 1:

Prepare a three-column report that lists items and amounts for (a) the company's total expenses (including cost of goods sold)—in column 1, (b) the expenses that would be eliminated by closing Department 200—in column 2, and (c) the expenses that will continue—in column 3. **(Leave no cells blank - be certain to enter "0" wherever required. Omit the "\$" sign in your response.)**

ELEGANT DECOR COMPANY
Analysis of Expenses under Elimination of Department 200

	Total Expenses	Eliminated Expenses	Continuing Expenses
Cost of goods sold	\$ <input style="width: 80%;" type="text"/>	\$ <input style="width: 80%;" type="text"/>	\$ <input style="width: 80%;" type="text"/>
Direct expenses			
Advertising	<input style="width: 80%;" type="text"/>	<input style="width: 80%;" type="text"/>	<input style="width: 80%;" type="text"/>
Store supplies used	<input style="width: 80%;" type="text"/>	<input style="width: 80%;" type="text"/>	<input style="width: 80%;" type="text"/>
Depreciation—Store equipment	<input style="width: 80%;" type="text"/>	<input style="width: 80%;" type="text"/>	<input style="width: 80%;" type="text"/>
Allocated expenses			
Sales salaries	<input style="width: 80%;" type="text"/>	<input style="width: 80%;" type="text"/>	<input style="width: 80%;" type="text"/>
Rent expense	<input style="width: 80%;" type="text"/>	<input style="width: 80%;" type="text"/>	<input style="width: 80%;" type="text"/>
Bad debts expense	<input style="width: 80%;" type="text"/>	<input style="width: 80%;" type="text"/>	<input style="width: 80%;" type="text"/>
Office salary	<input style="width: 80%;" type="text"/>	<input style="width: 80%;" type="text"/>	<input style="width: 80%;" type="text"/>
Insurance expense	<input style="width: 80%;" type="text"/>	<input style="width: 80%;" type="text"/>	<input style="width: 80%;" type="text"/>
Miscellaneous office expenses	<input style="width: 80%;" type="text"/>	<input style="width: 80%;" type="text"/>	<input style="width: 80%;" type="text"/>
Total expenses	\$ <input style="width: 80%;" type="text"/>	\$ <input style="width: 80%;" type="text"/>	\$ <input style="width: 80%;" type="text"/>

Requirement 2:

Prepare a forecasted annual income statement for the company reflecting the elimination of Department 200 assuming that it will not affect Department 100's sales and gross profit. The statement should reflect the reassignment of the office worker to one-half time as a salesclerk. **(Omit the "\$" sign in your response.)**

ELEGANT DECOR COMPANY
Forecasted Annual Income Statement
Under Plan to Eliminate Department 200

Sales	\$ <input style="width: 80%;" type="text"/>
Cost of goods sold	<input style="width: 80%;" type="text"/>
Gross profit from sales	<input style="width: 80%;" type="text"/>
Operating expenses	
Advertising	<input style="width: 80%;" type="text"/>
Store supplies used	<input style="width: 80%;" type="text"/>

Depreciation of store equipment	<input type="text"/>
Sales salaries	<input type="text"/>
Rent expense	<input type="text"/>
Bad debts expense	<input type="text"/>
Office salary	<input type="text"/>
Insurance expense	<input type="text"/>
Miscellaneous office expenses	<input type="text"/>
Total operating expenses	<input type="text"/>
Net income	\$ <input type="text"/>

Analysis Component

Requirement 3:

Reconcile the company's combined net income with the forecasted net income assuming that Department 200 is eliminated (list both items and amounts). **(Omit the "\$" sign in your response. Amounts in parentheses do not require a minus sign.)**

ELEGANT DECOR COMPANY
Reconciliation of Combined Income with Forecasted Income

Combined net income	\$ <input type="text"/>
Dept. 200's lost sales	(<input type="text"/>)
Dept. 200's eliminated expenses	<input type="text"/>
Forecasted net income	\$ <input type="text"/>