Segmented Income Statement

Vega Foods, Inc., has recently purchased a small mill that it intends to operate as one of its subsidiaries. The newly acquired mill has three products that it offers for sale—wheat cereal, pancake mix, and flour. Each product sells for $10 per package. Materials, labor, and other variable production costs are $3.00 per bag of wheat cereal, $4.20 per bag of pancake mix, and $1.80 per bag of flour. Sales commissions are 10% of sales for any product. All other costs are fixed.
The mill’s income statement for the most recent month is given below:

Product Line

 Total Wheat Pancake Flour
Sales $ 600,000 $ 200,000 $ 300,000 $100,000

Expenses:
Materials, labor, and other 204,000 60,000 126,000 18,000
Sales commissions 60,000 20,000 30,000 10,000
Advertising 123,000 48,000 60,000 15,000
Salaries 66,000 34,000 21,000 11,000
Equipment depreciation 30,000 10,000 15,000 5,000
Warehouse rent 12,000 4,000 6,000 2,000
General administration 90,000 30,000 30,000 30,000

Total expenses 585,000 206,000 288,000 91,000

Net operating income (loss) $ 15,000 $(6,000) $12,000 $9,000

The following additional information is available about the company:
a. The same equipment is used to mill and package all three products. In the above income statement, equipment depreciation has been allocated on the basis of sales dollars. An analysis of equipment usage indicates that it is used 40% of the time to make wheat cereal, 50% of the time to make pancake mix, and 10% of the time to make flour.
b. All three products are stored in the same warehouse. In the above income statement, the warehouse rent has been allocated on the basis of sales dollars. The warehouse contains 24,000 square feet of space, of which 8,000 square feet are used for wheat cereal, 14,000 square feet are used for pancake mix, and 2,000 square feet are used for flour. The warehouse space costs the company $0.50 per square foot per month to rent.
c. The general administration costs relate to the administration of the company as a whole. In the above income statement, these costs have been divided equally among the three product lines.
d. All other costs are traceable to the product lines.
Vega Foods’ management is anxious to improve the mill’s 2.5% margin on sales.

Required:
1. Prepare a new contribution format segmented income statement for the month. Adjust the allocation of equipment depreciation and warehouse rent as indicated by the additional information provided.

2.
After seeing the income statement in the main body of the problem, management has decided to eliminate the wheat cereal because it is not returning a profit, and to focus all available resources on promoting the pancake mix.

a. Based on the statement you have prepared, do you agree with the decision to eliminate the wheat cereal?

b. Based on the statement you have prepared, do you agree with the decision to focus all available resources on promoting the pancake mix? Assume that an ample market is available for all three products. (Hint: comput the contribution margin ratio for each market.)