

I-19.05

Vinita Ramaswamy recently acquired Wild Country Air. Wild Country has been in business for many years, and provides charter flights for remote fishing and camping enthusiasts. When the company originally started into business, aircraft, insurance, and fuel were relatively inexpensive. Pilot salaries was by far the most significant cost factor, and has continued to be used as the basis for allocating overhead.

Heretofore, the company has classified all costs, other than pilot salaries, as overhead. The company prices trips to customers at 125% of "cost." Vinita is concerned about the appropriateness of the costing/pricing technique and has engaged you to study this issue, with a goal of improving Wild Country's overall operations.

Aggregated data for the most recent year are:

Pilot salaries*	\$ 140,000
Aircraft depreciation (4,500 engine hours)	450,000
Insurance (fixed annual cost)	250,000
Fuel (\$7 per gallon)	630,000
Other costs	70,000

* Includes amounts paid for "wait time" that varies considerably by trip.

Sample data from three specific recent flights is as follows:

	<u>Flight A</u>	<u>Flight B</u>	<u>Flight C</u>
Pilot Salaries	\$200	\$350	\$225
Engine hours on flight	3	1	9
Fuel used	60 gals	20 gals.	180 gals.

- Using the existing scheme, determine the overhead application rate and price for Flights A, B, and C.
- Is "job" costing appropriate for a "nonmanufacturing" business like Wild Country?
- Evaluate the merits of the overhead allocation scheme in use by the company.
- Using engine hours to allocate overhead, and classifying pilot salaries as direct labor and fuel as a direct materials cost, prepare a revised pricing schedule for the three flights (continue to assume that flights are priced at 125% of cost).
- If pricing is revised as described in part (d), what is the likely result on profits?
- If Vinita indicates that she wishes to build a "lean" organization, to what is she generally referring?
- Obviously, safety and quality are important features of air transport. If Vinita embraces "six sigma" concepts, what is her general objective for Wild Country?