Budgeting slp

Finance

Herrestad Company Segmented Income ment For the period ending

December 31, Product A Product B Product C Total Sales 080, 000 320, 000

$180, 000

$2, 580, 000

Variable Cost

Direct material

$(540, 000)

$(420, 000)

$(55, 000)

$(1, 015, 000)

Direct labor

$(120, 000)

$(360, 000)

$(60, 000)

$(540, 000)

Variable overhead

$(170, 000)

$(150, 000)

$(25, 000)

$(345, 000)

Variable selling and admin. exp.

$(26, 000)

$(54, 000)

-

$(80, 000)

Total Variable Cost

$(856, 000)

$(984, 000)

$(140, 000)

$(1, 980, 000)

Contribution Margin

$224, 000

$336, 000

$40, 000

$600, 000

Previously, the contribution margin of the Herrestad Company, for the period ending December 31, 2011 was $ 560, 000. Thus with the addition of Product C into its product line, Herrestad is likely to increase its contribution margin by $ 40, 000 which represents an increase of 6. 67% from the original contribution margin.

IF THE COMPANY DECIDES TO SELL PRODUCT ‘ C’ AT $160 PER UNIT

Herrestad Company

Segmented Income Statement

For the period ending December 31, 2011

Product A

Product B

Product C

Total

Sales

$1, 080, 000

$1, 320, 000

$160, 000

$2, 560, 000

Variable Cost

Direct material

$(540, 000)

$(420, 000)

$(55, 000)

$(1, 015, 000)

Direct labor

$(120, 000)

$(360, 000)

$(60, 000)

$(540, 000)

Variable overhead

$(170, 000)

$(150, 000)

$(25, 000)

$(345, 000)

Variable selling and admin. exp.

$(26, 000)

$(54, 000)

-

$(80, 000)

Total Variable Cost

$(856, 000)

$(984, 000)

$(140, 000)

$(1, 980, 000)

Contribution Margin

$224, 000

$336, 000

$20, 000

$580, 000

If the company decides to sell the product C at $160 per unit, then the contribution margin will increase by $ 20, 000 which shows an increase an 3. 45% from the original profit. Thus with the current cost structure, it is beneficial for the company to sell the product ‘ C’ at $ 180 per unit as at this selling price, the company derives the maximum contribution margin.

There are several other considerations which require consideration before entering into a contract with the customer for the selling of product ‘ C’. It should be evaluated whether the company has enough machine time in order to manufacture the additional units of Product ‘ C’, and this does not compromise the production of other profitable products, in this case product ‘ B’ which has a contribution margin to sales ratio of 25%. In addition, the management should also consider the allocation of fixed overheads and the production of additional units of Product ‘ C’ is likely to increase the fixed overheads. It could be the case that although the product is generating high contribution margin, but ultimately, due to the allocation of the fixed overheads, the product contributing net in the overall segmental income of the firm.