**Cost Accounting for Decision-making**

**Case Study**

Questions

Senior Citizen Association (SCA) is a non-profit making organization in Hong Kong. Its mission is to enhance the living quality of the elderly in the community through using technology and people-oriented services. Three major services are provided for seniors.

1. Call and Care service (CC)– It provides a territory-wide 24-hour support and caring services for the elderly and needy.
2. Easy Home service (EH)– It provides high quality, reliable and comprehensive home care services for the silver-aged group and their families. The services include integrated discharge support, home care planning, recover training at home, household supporting and caring services.
3. Life Book Personalized Printing service (LBPP)– It enables the elderly to record their life experience and wisdom.

Revenue and expenses for last year are as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | CC | EH | LBPP | Total |
|  | $’000 | $’000 | $’000 | $’000 |
| Revenue (Includes donation from that service) | 800 | 400 | 200 | 1,400 |
| Less: Variable expenses | 350 | 150 | 100 | 600 |
| Contribution margin | 450 | 250 | 100 | 800 |
| Less: Fixed expenses | 200 | 130 | 150 | 480 |
| Net income | 250 | 120 | (50) | 320 |

Because of economic downturn, the Chief Executive Officer of SCA, Tommy Yeung, is concerned about the organization’s financial position. He wants to save some resources to prepare for the coming recession. After seeing the above data, he considers dropping the LBPP service.

Additional information:

1. The above fixed expenses comprise the following:

|  |  |  |  |
| --- | --- | --- | --- |
|  | CC | EH | LBPP |
|  | $’000 | $’000 | $’000 |
| Depreciation | 60 | 40 | 45 |
| Insurance | 20 | 25 | 35 |
| Salaries | 75 | 30 | 33 |
| Rent | 25 | 15 | 27 |
| General administrative overhead | 20 | 20 | 10 |

1. The depreciation in LBPP is for a printing machine that is used to print the life books for the seniors. If this service terminates, the machine will dispose.
2. Total general administrative overhead and rent will remain the same even SCA drops LBPP service.
3. Insurance and salaries for LBPP will be saved if SCA drops LBPP service.

Required:

1. Prepare a statement for Tommy to assess the long term financial viability of the organization, showing separately the margin of each of the above three services. (8 marks)
2. Should LBPP service be discontinued? Why? (8 marks)
3. What other factors that Tommy should consider before terminating LBPP service. (4 marks)

**Cost Accounting for Decision-making**

**Case Study**

Suggested Solution

(a)

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | | | CC | EH | LBPP | Total |
|  | | | $’000 | $’000 | $’000 | $’000 |
| Revenues (Includes donation from that service) | | | 800 | 400 | 200 | 1,400 |
| Less: Variable expenses | | | 350 | 150 | 100 | 600 |
| Contribution margin | | | 450 | 250 | 100 | 800 |
| Less: Traceable fixed expenses: | | |  |  |  |  |
|  | | Depreciation | 60 | 40 | 45 | 145 |
|  | | Insurance | 20 | 25 | 35 | 80 |
|  | | Salaries | 75 | 30 | 33 | 138 |
| Service margins | | | 295 | 155 | (13) | 437 |
| Less: Common fixed expenses\*: | | |  |  |  |  |
|  | Rent | |  |  |  | 67 |
|  | General administrative overhead | |  |  |  | 50 |
| Net income | | |  |  |  | 320 |

\*Remark: To help Tommy has a clear picture of the financial viability of each of the organization’s services, rent and general administrative overhead should not be allocated. They are common costs that should be deducted from the total service segment margin.

(8 marks)

(b) Impact of dropping LBPP service on net income:

|  |  |  |
| --- | --- | --- |
|  |  | $’000 |
|  | Reduction in contribution margin if LBPP terminates: | (100) |
|  | Cost savings from tracable fixed costs: |  |
|  | Insurance | 35 |
|  | Salaries | 33 |
|  | Decrease in net income | (32) |

As shown from the above calculation, LBPP service should not be terminated. It is because if this service is dropped, the overall net income will be decreased by $32,000.

Remarks: Depreciation for the printing machine is a sunk cost and the machine has no disposal value. The rent and general administrative overhead are allocated and cannot be avoided if LBPP service is dropped; therefore, they are not relevant to the decision. (8 marks)

1. Senior Citizen Association (SCA) is a non-profit making organization which serves the seniors in this community. LBPP service gathers life experience and wisdom of seniors. It can also be shared with their families, friends, and become part of the valuable memories for next generation. The mission for SCA is not profit maximisation, therefore Tommy should weigh non-financial factors more than financial factors when he makes decision. (4 marks)

(Total: 20 marks)