

Part (a) Complete the cost allocation for the ICAO report by allocating the costs to Fly and Grand for 2017			Marks
	Fly	Grand	
	R	R	
Flight operations			
Allocation rate per block hour: R21 300,98 (R1 499 793 / (31 237,92+39 171,67))			1
Allocation: R21 300,98 x 31 237,92 and x 39 171,67)	665 398	834 395	½ C
Aircraft maintenance			
Parts (given)	178 644	251 541	½
Labour costs therefore R166 756 000			1C
Allocation rate per maintenance hour: R1 561,39 (R166 756 000/(36 000+70 800))			1C
Labour allocation (R1 561,39 x 36 000; x 70 800)	56 210	110 546	½C
	234 854	362 087	
Depreciation (given)	240 715	120 357	½
User charges			
Allocation rate per flight: R24 419,69 (R976 812 000/ (18 250+21 751))			1
Allocation (R24 419,69 x 18 250; x 21 751)	445 659	531 153	½C
Passenger services			
Allocation rate per passenger: R109,96 (R596 941 000/(3 102 500 + 2 326 178))			1
Allocation (R109,96 x 3 102 500; x 2 326 178)	341 153	255 788	½C
Ticketing and sales (R759 743 000 x 0,5 / 1,5)	253 248	506 495	1½
General & administration (R593 600 000 x 0,4/1,4)	169 600	424 000	1½
	2 350 627	3 034 275	1C
		<b>Available</b>	<b>12</b>
		<b>Maximum</b>	<b>12</b>
		<b>Total for part (a)</b>	<b>12</b>

Part (b) Critically discuss the allocation bases used to allocate the operating expenses between Fly and Grand.		Marks
1	<b>Flight operations</b>	
1.1	Aircraft fuel and oil, insurance and uninsured losses <b>can be attributable directly</b> to the divisions and <b>should not be allocated</b> .	1
1.2	Grand is the <b>only division that leases aircrafts</b> and thus the related lease costs should be directly attributed to Grand only.	1
1.3	Flight crew salaries and training costs may be a direct or indirect cost depending on <b>whether the crew of the two divisions are interchangeable</b> or only used for their specific airline.	1
1.4	Salaries and expenses and training costs are correctly allocated using a cost driver (block hours) for which a <b>strongest correlation exists</b> between the cost driver and the costs. Alternative: The company should determine the <b>real cost driver of the training costs</b> .	1
1.5	<b>How strong is this correlation?</b> It could be a 10% correlation (which might still be stronger than other measures).	1
1.6	<b>Adding the block hours</b> for all planes together <b>ignores</b> factors such as <b>size of planes</b> , less crew being required on smaller planes than bigger planes. It also assumes that ratio of crew to passenger is constant, irrespective of whether the passenger is a 'Fly passenger' or a 'Grand passenger' etc.	1
2	<b>Maintenance and overhaul</b>	
2.1	<b>Direct costs of parts are correctly attributed</b> to the two divisions and indirect cost of labour is correctly allocated using an appropriate cost driver (labour hours).	1
2.2	Allocations should be <b>based on budgeted labour rates</b> , not actual data, to avoid the inefficiencies of rate negotiations being passed on to the other divisions.	1
3	<b>User charges and station expenses</b>	
3.1	The CFO should <b>consider directly attributing navigation charges</b> instead of allocating them.	1

3.2	Perhaps consider <b>alternative suggestions</b> , e.g. station expenses may be a measure of how long an aircraft is standing still at an airport – therefore consider as an example the time per flight x number of flights as the allocation base.	1
3.3	There is no cause and effect relationship between flights flown and the <b>airport office charges</b> . This allocation is therefore <b>arbitrary</b> ;	1
3.4	<b>Adding the number of flights together</b> , assumes they are all identical irrespective of where they are flying. This is <b>unrealistic</b> given that Grand flies to African destinations and therefore these costs are likely to differ (exchange fluctuations etc).	1
<b>4</b>	<b>Passenger services</b>	
4.1	The correct allocation base that reflects the <b>cause and effect relationship is used</b> .	1
4.1 a	Alternative: The allocation might NOT be correct, as the passengers on the more luxurious planes might require additional effort (e.g. their baggage is heavier, more snacks need to be packed, they might be more demanding, etc.).	
<b>5</b>	<b>Ticketing, sales, promotion and administration</b>	
5.1	Allocation of these costs is <b>arbitrary</b> and counter-productive. It is based purely on the <b>CFO's opinion</b> without any empirical data evidence showing some form of correlation.	1
5.2	Appropriate cost drivers should be used for the allocation of ticketing costs ( <b>e.g.</b> use of the <b>number of passengers transported</b> which would be facilitated by the new IT system).	1
5.3	Sales, promotion, general and administration expenses are probably unavoidable and <b>should arguably not be allocated</b> to divisions as this is not under their control.	1
<b>6</b>	<b>Depreciation and amortisation</b>	
6.1	It is unclear what the allocation base for <b>depreciation and amortisation</b> was, however, given that the planes are distinctive, the cost should be <b>directly attributed to each division</b>	1
<b>7</b>	<b>Other</b>	
7.1	The importance of selecting appropriate cost drivers is more critical when cost allocations are used for decision making. Therefore, it might not be worth it to implement some of the above recommendations if the allocation is only for the purpose of reporting to <b>ICAO and not for decision-making purposes</b> as the cost v benefit may not be justified.	1
7.2	Accurate allocation of costs (and therefore selection of appropriate allocates bases) for <b>low cost providers</b> such as Fly is <b>extremely important</b> to their pricing and tracking efficiency, as opposed to the <b>premium priced luxury</b> , where cost allocations will be <b>less important</b> .	1
7.3	<b>Fly</b> will likely be a lot <b>more cost conscious</b> , and attempt to save costs, whereas Grand may have more focus on customer experience, and therefore not be as careful in minimizing costs. Therefore a <b>straight base per unit of allocation</b> would be <b>inappropriate</b> .	1
7.4	It is not clear where the cost of the <b>refreshments served</b> on the flights and the cost of the passengers accessing the <b>airport lounges</b> have been included, but these costs are <b>directly attributable to Grand</b> and should therefore be isolated to Grand and not allocated to Fly.	1
	<b>Available</b>	<b>21</b>
	<b>Maximum</b>	<b>14</b>
	<i>Communication skills – logical argument</i>	<b>1</b>
	<b>Total for part (b)</b>	<b>15</b>

<b>Part (c) Discuss the factors that demonstrate Fly could have a competitive advantage in the low-cost airline market</b>		<b>Marks</b>
1	Fly <b>compares positively with the norm</b> in the market with respect to <b>punctuality</b> , resulting in <b>heightened levels of customer satisfaction</b> (85% compared to 81%).	1
2	Fly appears to have <b>tapped into the corporate traveller market</b> , with numerous corporates now placing staff on low-cost carriers in a bid to cut costs.	1
3	This provides Ta-ta SA with a <b>source of year-round revenue</b> rather than being reliant on the tourist market which is more seasonable.	1
4	It has entered into <b>strategic partnerships with foreign airlines</b> , enhancing its ability to use <b>these airlines as feeders</b> of passengers into the Fly network.	1
5	<b>No significant safety incidents</b> took place at Fly during the period under review, <b>impacting positively on the reputation</b> of the airline.	1
5a	<b>Alternatively: The newer aircraft reduces the risk of safety incidents, impacting positively on the reputation</b> of the airline.	
6	The newer aircraft result in a <b>more pleasant flying experience</b> and may also be perceived to be safer for the passengers resulting in <b>increased customer satisfaction</b> .	1

7	The following <b>cost reduction strategies and improved cost efficiencies</b> result in an <b>improvement</b> in Fly's ability to compete in the market by more aggressive ticket pricing, the ability to spend more on customer services etc:	1
7.1	<ul style="list-style-type: none"> <li><b>Improvements in the Fly load factors</b> – improved occupancies result in <b>economies of scale and increased competitive advantage through cost efficiencies</b>, which in turn improve the airline's ability to compete in the market that is <b>experiencing reduced load factors</b>.</li> </ul>	1 1
7.2	<ul style="list-style-type: none"> <li>The quantity of <b>fuel burned per passenger</b> has been decreasing over the last three years which ties in with the replacement of older aircraft. The airline has therefore been able to reduce its <b>fuel consumption and hence its fuel bill</b>.</li> </ul>	1
7.3	<ul style="list-style-type: none"> <li>As evidenced by the <b>reduction in maintenance hours per aircraft</b>, the newer aircraft enable <b>cost containment</b> in respect of its maintenance expenses.</li> </ul>	1 1
7.4	<ul style="list-style-type: none"> <li>The <b>reduction in maintenance hours means</b> that the aircraft are on the ground for less <b>thereby increasing available flying time</b> and potentially revenue.</li> </ul>	1
7.5	<ul style="list-style-type: none"> <li>Utilising a <b>single type of aircraft</b> in its fleet <b>reduces complexity and hence cost</b>, particularly in terms of maintaining the aircraft.</li> </ul>	1
7.6	<ul style="list-style-type: none"> <li><b>Upgrading the the reservation and on-line check-in systems</b> results in <b>improvements in operating and cost efficiency</b> (through a reduction in Fly's dependency on human intervention in the reservation process as well as check-in process) <b>and customer satisfaction</b>.</li> </ul>	1 1
8	The newer technology aircraft have positively impacted on the amount of <b>fuel burnt</b> by the Fly aircraft, reducing the airline's <b>carbon footprint</b> , which is <b>likely to afford the airline more legitimacy</b> [alt: improve the airline's reputation] in the market and improving its competitive positioning.	1 1
9	<b>Faster turnaround time than the industry norm: now 32,86 minutes v industry norm of 39,24 minutes.</b> Faster turnaround times lead to <b>increased capacity</b> (flying time) <b>and increased customer satisfaction</b> .	1 1
	<b>Available</b>	<b>21</b>
	<b>Maximum</b>	<b>16</b>
	<i>Communication skills – clarity of expression</i>	<b>1</b>
	<b>Total for part (c)</b>	<b>17</b>

<b>Part (d) Provide an explanation of the over/(under) allocation or recovery of the fixed overheads in response to Dokata's query.</b>		<b>Marks</b>
1	The need to adjust for an over/(under) recovery of fixed overheads <b>arises</b> where a <b>budgeted overhead allocation rate</b> is used to allocate the fixed manufacturing overheads to production or services based on an actual volume of activity.	1
2	In addition, an over/(under) allocation will only arise if there is a <b>difference between budgeted and actual volumes / or cost</b> .	1
3	Since Ta-ta SA does <b>not use a budgeted overhead allocation rate</b> (as they do not absorb fixed manufacturing overheads but recognises the actual fixed overheads as they are incurred), <b>an over/(under) allocation of fixed overheads will not occur</b> .	1
	<i>Alternative to points 2-3</i>	
2a	<i>As Ta-ta SA are not absorbing fixed costs they must be using a <b>variable costing system</b></i>	
3a	<i>With a variable costing system, fixed costs are <b>treated as a period cost</b> and therefore no over/(under) allocation of fixed costs can arise</i>	
4	As Ta-ta SA does not allocate its fixed overheads based on the services it delivers, there is <b>no shortcoming</b> in the accounting system.	1
5	However, from a <b>cost control and pricing decision perspective, benefit can be gained</b> by allocating overheads to products and services.	1
6	From a <b>cost control perspective</b> , the allocation of fixed overheads enables any under or over-recoveries to be analysed in detail and separated between that part of the under/over recovery that was <b>controllable</b> (therefore not part of the service cost) and that part which was <b>unavoidable</b> (therefore included in the cost of the service).	1
7	From a <b>pricing decision perspective</b> , the allocation of fixed overheads to services helps ensure that all <b>committed costs are recovered in the long-term</b> .	1
	<b>Available</b>	<b>7</b>
	<b>Maximum</b>	<b>6</b>
	<b>Total for part (d)</b>	<b>6</b>