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Query :

Why we have not considered sale of scrap Rs. 21,000 as an opportunity cost for Alternative 1 and Alternative 2 ? Please explain.

Solution :

(1) In the answer dictated to you in the classroom, we have evaluated total 3 alternatives and we got the incremental profit as follows :

- (a) Sale of obsolete material XY as scrap = Rs. 21,000
- (b) Covert obsolete material XY into a specialised product = Rs. 41,000 and
- (c) Adopting obsolete material for use as sub-assembly = Rs. 33,000

Here, all the 3 alternatives are compared with base 'Zero'.

(2) If you want to evaluate only 2 alternatives (i.e. other than sale of scrap), then you may treat sale of scrap Rs. 21,000 as opportunity cost in the remaining 2 alternatives. In such case, the answers of incremental profit will be as follows :

- (a) Covert into a specialised product = Rs. 41,000 - 21,000 = Rs. 20,000 and
- (b) Adopting for use as sub-assembly = Rs. 33,000 - 21,000 = Rs. 12,000

However, in such case, this incremental profit shall be over and above sale of scrap i.e. in addition to sale of scrap. Because, we have considered 'Sale of scrap' as a base.

Note 1 : If you want to evaluate all the 3 alternatives and wish to consider 'Sale of scrap' as a revenue in one case and 'Opportunity Cost' in the remaining 2 cases, then we will create a total difference of Rs. 42,000 between these answers.

Hence, either consider it as a 'Revenue' or as an 'Opportunity Cost', not both at a time.

Note 2 : This matter is already discussed in the lecture towards the end of the solution. If you listen to the lecture carefully again, you will find it there.