Cost Analysis and Decision Making

Incremental Analysis

- Neglect sunk costs (past cash outlays): irrelevant
  - Costs or revenue that stay the same regardless are also irrelevant.
- Focus on relevant costs and profit potential.
  - Relevant costs are the costs that will change if decision is made.
  - Also include any cash inflows or revenues that depend on decision.
- Opportunity costs represent the benefit through income, gain or expense reduction that could be realized through another course of action.
- Out of pocket costs are small costs that are also relevant to the decision.

Types of Decisions

- Special sales order considers: capacity, expenses saved, special costs
  - Additional Revenue: Add
  - Additional Costs: Subtract
  - Fixed Costs-change: Add/Subtract
    - A positive financial result is O.K, but consider:
      - Special sales orders can haunt a company when others want special sales
- Limited resource decisions
  - Constraints on production limit what company can make
  - Should favor the one whose CM per limiting factor is greatest
- Make or buy
  - Consider: costs to purchase, savings in fixed and variable costs
  - Set up with Make on left and Buy on the Right (Total and Per Unit for each)
  - Sometimes if a company buys a component, this frees up factory space for rent or other use and is relevant
- Joint product- proceed or sell
  - Costs up to split off are joint costs allocated to both
    - Net realizable value is used as basis for allocation
  - Separable costs go to particular categories
- Delete or add product or department
  - Consider: save or add variable costs, changes in fixed costs, addition to sales volume
  - Fixed costs will be either avoidable or unavoidable
    - Avoidable will not continue if an ongoing operation is changed or deleted
    - Unavoidable costs will continue regardless (common costs)

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<tr>
<th>Total before change</th>
<th>Effect of decision</th>
<th>Total after decision</th>
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