## 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 c**onsiders: 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)

| Total before change | Effect of decision | Total after decision |
|---|---|---|