**Chapter -4-**

**Decision Making and Relevant Information**

Managers usually follow a decision model for choosing among different courses of action.

**A decision model** is a formal method of making a choice that often involves both quantitative and qualitative analysis. Management accountants analyze and present relevant data to guide manager’s decisions.

**Five-step Decision making process:**

1- Identify the problem and uncertainties.

2- Obtain Information (historical costs and other Information).

3- Make predictions about the future.

4- Make decisions by choosing among alternatives.

5- Implement the decision, evaluates performance to provide feedback about actions taken in the previous steps.

**Relevant costs and Relevant Revenues:**

Relevant costs are expected future costs, and relevant revenues are expected future revenues that differ among the alternative courses of action being considered.

Revenues and costs that are not relevant are said to be irrelevant it is important to recognize that to be relevant costs and revenues they must:

\* Occur in the future.

\* Differ among the alternative courses of action.

There are two ways to analyze the data. The first considers “ All revenues and costs”, will the second considers only “Relevant revenues and costs”.

**Key features of Relevant Information:**

\* Historical costs may be helpful as a basis for making predictions; however historical costs themselves are always irrelevant when making decisions.

\* Different alternatives can be compared by examining differences in expected total future revenues and expected total future costs.

\* Not all expected future revenues and costs are relevant, they must be differing among alternatives.

\*Appropriate weight must be given to qualitative factors and quantitative nonfinancial factors.

**One- Time-Only special order:**

One type of decision is accepting or rejecting special order when there is idle production capacity and the special orders have no long run implications. The selling price of special order is less than selling price of quantity sold to regular customers, accepting the special order is not expected to affect the selling price or quantity sold to regular customers.

**Make-versus-Buy Decisions (Insourcing –versus-Out-sourcing):**

Outsourcing is purchasing goods from outside vendors rather than producing the same goods in the company (which is insourcing) Decisions about whether a producer of goods will insource or outsource are also called make-or- buy decisions. The most important factors in this decision are quality, dependability of suppliers and costs.

In these decisions past costs are always irrelevant, all variable manufacturing cost are relevant costs, fixed manufacturing overhead that will continue to be incurred regardless of the decisions made are irrelevant costs, all costs of outside purchase of parts are relevant costs.

**Closing or Adding Branch offices or segment:**

Companies periodically confront decisions about closing or adding branch offices or business segment.

When making these decisions, mangers should focus on only those costs that will change between alternatives and any opportunity costs, mangers should ignore allocated overhead costs, and they should focus on relevant revenues.

**Product-Mix Decisions with Capacity Constraints:**

These decisions arise in the context of capacity constraints that can relaxed in the long run.

To determine product mix, a company maximizes operating income; subject to constrains such as capacity and demand, The manager should always focus on maximizing total contribution margin by choosing products that give the highest contribution margin per unit of the constraining resource.