Paper- Management Accounting

course-B.COM(P),6th semester, Section C

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Decision making

Decision making is a process of selecting the best alternative among the different choice available in order to attain the desired objective.

The effective and accurate decision making process generally involve the following steps:

. identify and define the problem

. Identify the different alternative available

. Evaluate each alternative in the term of non cost factor

. Select the best alternative on the basis of quantitative and qualitative analysis

. Follow up and review of the decision

Special type of cost for decision making

Relevant cost

Relevant cost expected future cost which differ under different alternatives. These cost are affected by managerial decisions and take into consideration for taking a particular decision.

For example, while taking a decision about whether to retain or replace and old machine, the realisable value of old machine are relevant cost but the book value of the old machine is irrelevant cost.

These are the cost and revenues which have the capacity to influence the decision in a particular situation because of variability in nature ,relevant cost has a bearing on the decision.

Relevant cost include two types of cost:

differential cost and opportunity cost.

Differential cost:

differential cost is the difference in total cost under the two alternative situations. These are the increase or decrease in total cost that result from the adoption of an alternative course of action. The alternative cost of action may arise due to change in sales volume, alternative method of production, change in product, sale mix, addition of new product, exploring a new market, decision to drop a product line etc.

Differential cost may be referred to as either incremental cost or decremental cost.

When there is an increase in the cost due to increase in the level of production it is called incremental cost and when there is decrease in the cost due to decrease in the level of production it is called decremantal cost.

Opportunity cost: opportunity cost is the cost of the next best opportunity that would be forgone if the alternative course of action is adopt. it is the benefit to be lost if the alternative course of action is adopt. These are not recorded in financial accounting but are considered at the time of decision making.

Irrelevant cost: relevant cost are those cost, not have any impact on the decision in a particular situation therefore considered is irrelevant. Cost.sunk cost is one of the example of irrelevant cost.sunk cost are the cost already incurred in the past and cannot be changed by any further decision.These cost are non recoverable.these cost do not involve any cash outflow at present are irrelevant for decision making.

Relevant cost vs variable cost

It must be remembered that all variable cost are do not relevant cost as only those variable cost which differ under different alternative are relevant cost. Variable cost which remain unchanged under different alternative are not relevant cost are these are relevant to the decision.

Relevant cost vs fixed cost

It must be noted that all fixed cost are not remain constant for all time and for all decision. Video picks coast which remain constant under different alternatives are irrelevant cost but fix cost which change under different alternative are relevant cost be considered while taking a decision.