

EXAM 2 STUDY GUIDE

CHAPTER 8 10 questions (2 are conceptual questions)

Section 8.1

1. To focus on the facts that make a difference in decisions, managers must know how to sort through irrelevant information.
2. **Information Overload**: being overwhelmed by the huge amount of information.
3. **Relevant Information**: meets 2 criteria -
 - **Differential**: differs between alternatives.
 - The differences will occur in the future.
4. **Avoidable Costs**: occur only with the implementation of a particular alternative.
5. **Unavoidable Costs**: incurred no matter what, using any alternative; thus, they are irrelevant.
6. **Sunk Costs**: a cost that has been incurred in the past; they are irrelevant because they occurred in the past, not future.
7. **Incremental (additional) Revenues**: the difference between the 2 alternatives.
8. **Incremental Analysis**: calculations that show the additional impact of one alternative over another.
 - Helps to understand the impact of a decision.
9. 5 Steps to a Decision Model:
 1. What is the decision to be made?
 - Without understanding the decision context, you can't satisfactorily complete any other steps.
 2. What are the available alternatives?
 - Make sure they are relevant to step 1.
 3. What are the relevant revenues/costs?
 - Must be differential & future occurring.
 4. What are the qualitative issues that must be considered?
 - Just as important as quantitative.
 5. Which alternative offers the greatest benefit or least cost?
 - Must go through all steps to provide an accurate answer.

Section 8.2

1. **Robinson-Patman Act of 1936**: prohibits companies from engaging in price discrimination.
2. Sometimes accepting a special order at a loss is worth the future potential gain.
3. Even if the gain is small, if it generates numerous future cash flows, it is a good idea.

EXAMPLE:

Jersey costs \$6.85 in direct materials. New jersey for special project is \$2 less. The alternative jersey will sell at \$10. On a \$10 sale, commission is \$0.50 and shipping is \$0.40. Calculate the gain or loss on 1000 jerseys.

REGULAR JERSEY		NEW JERSEY	
Direct Materials	\$6.85	Direct Materials	\$4.85
Direct Labor	\$1.95	Direct Labor	\$1.95
Variable Overhead	\$1.05	Variable Overhead	\$1.05
Fixed Overhead	\$1.29	Commission	\$0.50
		Shipping	\$0.40
TOTAL	\$11.14	TOTAL	\$8.75

PROFIT/LOSS = (Sale Price - Total Costs for NEW Jersey) x Number of Jerseys

PROFIT/LOSS = \$10 - 8.75 x 1000

PROFIT/LOSS = \$1.25 x 1000 = \$1250.00 \$1,250

- MUST ALSO CONSIDER QUALITATIVE ISSUES:
 - i.e. overtime, consequences of alternative methods, profit that could have been made on regular products, demand increases causing contribution margin to decrease.

Section 8.3

1. **Outsourcing**: moving the production of goods or the delivery of services from within the organization to a provider outside the organization.
 - **Example**: cleaning services, answering services, etc.
2. **Offshoring**: moving a company's business processes to a foreign country.
 - Only when products are made or services performed by an unrelated company is offshoring considered outsourcing.
3. When the outsourcing decision refers to the components of a manufactured product, it is called a **make-or-buy decision**.
 - **Make-or-buy Decision**: when a company indicates they are choosing whether to make something internally or buy it externally.
4. Basic Outsourcing Decision Model

	Relevant Cost to...	
	Produce Internally	Outsource
Direct Materials	0.78	--
Direct Labor	0.48	--
Variable Overhead	0.26	--
Total Unit Cost	= \$1.52	\$1.65
x Letters Required	18,000	18,000
TOTAL RELEVANT COSTS	\$27,360	\$29,700

- It is \$2,340 LESS to produce internally.
 - ADVANTAGE OF \$2,340.
 - Since fixed overhead is unavoidable and occurs regardless, it is omitted.
 - Even though variable costs are usually avoidable and fixed costs are usually unavoidable, that is NOT always the case.
5. When the production of an item is outsourced, resources that are freed up can be put to another use.
 - Considered an **opportunity cost**.
 - **Opportunity Cost**: contribution margin of the next best alternative use of the facilities.

	Relevant Cost to...	
	Produce Internally	Outsource
Direct Materials	0.78	--
Direct Labor	0.48	--
Variable Overhead	0.26	--
Total Unit Cost	= \$1.52	\$1.65
x Letters Required	18,000	18,000
Additional contribution margin from alternative use of resources	--	(15,000)
TOTAL RELEVANT COSTS	\$27,360	\$14,700

- In this case, it is \$12,660 ADVANTAGE to Outsource.
6. Quantitative and qualitative issues must BOTH be considered in order to outsource.

7. Consider quality, stability of price, potential theft of intellectual property.

Section 8.4

1. Contribution Margin per Constrained Resource = Contribution Margin per unit / Constrained Resource per unit
2. **Theory of Constraints**: developed by Eli Goldratt to maximize the performance of a value chain by focusing on constraints that limit an organization's output.
 - 5 Steps required to maximize and improve the performance of a value chain:
 1. **Identify** the constraint.
 2. Decide how to **exploit** the constraint.
 3. **Subordinate and synchronize** everything else to the first 2 decisions.
 4. **Elevate** the performance of the constraint.
 5. If during any of these steps the constraint has shifted, go back to step 1.
3. **Bottleneck Process**: the process that limits total output.
4. **Throughput Contribution = Sales Revenue - Direct Materials Cost**.
 - Theory of Constraints seeks to maximize throughput contribution.

Section 8.5

1. Before managers make a decision to close, they must be certain they are evaluating the information properly.
2. Allocated fixed costs are not generally relevant to decision making.
3. To better analyze costs, managers can split operations in segments.
 - **Segments**: business units.
 - i.e. north division, south division, etc.
4. **Allocated, Assigned and Common**: indicates that costs are not directly caused by the cost object.
 - Makes the irrelevant.
5. The key to a segment margin income statement is the calculation of the segment margin.
 - **Segment Margin: Contribution Margin - Direct Fixed Costs**

CHAPTER 5 14 questions (5 are conceptual questions)

Section 5.1

1. **Strategic Planning**: very broad; helps to identify the overall focus of an organization.
2. **Tactical Planning**: develops concrete actions that turn strategic plan into reality.
3. **Budget**: an operating plan that is expressed primarily in financial terms (dollars).
 - Helps to communicate commitment of funds throughout the organization.
4. Information flows in two directions:
 1. **Top-Down Budget**: executive management creates the budget and then that budget is then pushed down through the rest of the organization.
 - Imposed method.
 - Most efficient.
 2. **Bottom-Up Budget**: budgeting process begins at the lowest levels of management and filters up through the organizations.
 - As it goes up in levels, it is reviewed and altered, if needed.
 - Also referred to as **participative budgeting**: when employees who will be held accountable for meeting the budget participate in its creation.
 - Time consuming.