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Short-term Decisions Making and Management Reporting

Short-Term Decision Making & Management Reporting

- Focuses on decisions within a short time horizon
- Uses relevant costing and contribution analysis
- Supports operational and tactical decisions

Introduction to Short-Term Decisions

- **What are Short-Term Decisions?**
- Decisions made based on immediate operational conditions
- Examples:
  - Accept special order
  - Make or buy
  - Product discontinuation
  - Equipment replacement
- Objective:

Maximise contribution or minimise avoidable costs

Key Principles

Principles of Decision Making

✓ Focus on relevant costs and revenues
✓ Ignore sunk costs
✓ Consider opportunity costs
✓ Avoid using allocated fixed costs blindly

Only costs that change are relevant

Relevant Costs

Relevant Costs

Relevant costs are:

- ✓ Future costs
- ✓ Differential costs
- ✓ Incremental costs
- ✓ Opportunity costs

Example

Special order:

Item	Rs.
Selling price	950
Variable cost	800
Contribution	150

Relevant because these change with the decision

Irrelevant Costs

Irrelevant Costs

- ✗ Sunk costs
- ✗ Allocated fixed costs
- ✗ Committed costs
- ✗ Non-cash costs

Example

Factory rent allocated = Rs. 250/unit

Paid whether order accepted or not

Therefore irrelevant

Relevant vs Irrelevant Cost Table

Relevant Cost	Irrelevant Cost
Future cost	Past cost
Incremental	Sunk
Avoidable	Unavoidable
Opportunity cost	Allocated overhead

Special Order Decision

Scenario

- Selling price = Rs. 950
- Variable cost = Rs. 800
- Spare capacity available

Analysis

- Contribution = 950 – 800 = Rs. 150 per unit
- Total order = 20,000 units
- Total contribution = Rs. 3,000,000

Decision

Accept the order

Qualitative Factors for Special Order

Factor	Example
Customer relationship	Reaction from existing customers
Brand image	Premium image damage
Future opportunity	Entry to new market
Capacity impact	Operational disruption

Make or Buy Decision

- Scenario

Item	Make	Buy
Materials	20,000	-
Labour	15,000	-
Variable OH	5,000	-
Purchase price	-	45,000

- Relevant Cost to Make

= 20,000 + 15,000 + 5,000
= Rs. 40,000
Saving = 45,000 – 40,000
= Rs. 5,000

✅ **Decision**

👉 Make internally

Make or Buy Qualitative Factors

Factor	Example
Supplier reliability	Delivery delays
Quality control	Defective materials
Employee morale	Outsourcing impact
Strategic control	Dependence on supplier

Product Discontinuation

◆ Scenario
Contribution from product = Rs. 50 Mn
Avoidable fixed cost = Rs. 30 Mn

◆ **Analysis**
Net impact if discontinued:
= 30 – 50
= (20 Mn)

✅ **Decision**
👉 Continue the product

Because contribution exceeds avoidable costs

Qualitative Factors in Discontinuation

Factor	Example
Customer loyalty	Loss of loyal customers
Employee morale	Job losses
Brand image	Market perception
Complementary products	Reduced cross-sales

Equipment Replacement Decision

◆ **Scenario**

New machine cost = Rs. 5 Mn
Annual savings = Rs. 1.5 Mn
Life = 5 years

◆ **Analysis**

Total savings = 1.5 × 5
= Rs. 7.5 Mn
Net benefit = 7.5 – 5
= Rs. 2.5 Mn

✅ **Decision**

👉 Replace equipment

Opportunity Cost

◆ **Definition**

👉 Benefit sacrificed by choosing one alternative over another

◆ **Example**

Factory can produce:

•Product A contribution = Rs. 50,000

•Product B contribution = Rs. 70,000

Choosing A means losing B contribution

Opportunity cost = Rs. 70,000

Management Reporting

◆ **Purpose**

👉 Communicate findings clearly to management

Good report should:

✓ Be concise

✓ Be logical

✓ Support decision making

Structure of Management Report

- Executive summary
- Problem definition
- Quantitative analysis
- Qualitative analysis
- Recommendation
- Implementation plan

Example of Management Recommendation

Recommendation

Accept special order

Because:

•Generates positive contribution

•Uses spare capacity

•Supports market expansion

But:

•Monitor pricing impact on regular customers

Strategic Role of Accountant

Modern accountant acts as:
✓ Analyst
✓ Advisor
✓ Strategic storyteller

👉 Converts data into decisions

Common Exam Mistakes

❌ Including sunk costs
❌ Using full cost instead of relevant cost
❌ Ignoring opportunity cost
❌ Ignoring qualitative factors

Chapter Summary

✓ Focus on relevant costs
✓ Ignore irrelevant costs
✓ Combine quantitative and qualitative analysis
✓ Use structured management reporting
✓ Support strategic decisions