{BUS 121: Chapter 8 Vocab}

** All vocab can be found on page 477.*

Absorption Cost

- MOH costs are included into each item. This includes both fixed and variable costs.
- In this chapter, this should be avoided when deciding on whether or not to accept a special order.

Avoidable Fixed Costs

- Fixed costs that can be eliminated as a result of taking a particular course of action.

Common Fixed Costs (Expenses)

- Costs that cannot be traced to a particular product line.
- A fixed expense that is common among all product operations.

Constraint

- A factor that restricts the production or sale of product.

Contract Manufacturers

- Manufacturers that make products for other companies, not for themselves.

Cost-Plus Pricing

- An approach to pricing used by price-setters; cost-plus pricing begins with the product's total costs and adds the company's desired profit to determine a cost-plus price.
- (Total Cost (to create / produce)) plus (Desired Profit) = Cost-Plus Price

Incremental Analysis Approach

- We look at how operating income would change or differ under each alternative (potential decisions).

Incremental Costs

- The variable costs of an order and any additional fixed costs.

Offshoring

- Having work performed overseas. Offshored work can be performed either by the company itself or by outsourcing the work to another company.

Opportunity Cost

- The benefit forgone by choosing a particular alternative course of action.
- "This is the opportunity cost we lost / will lose because we took / will take this course of action."

Outsourcing

- **Contracting an outside company to produce a product or perform a service. Outsourced work can be done domestically or overseas.**

Price Setter

- You set the price
- Typically uses Cost-Plus Pricing

Price Taker

- Price is given
- Typically uses Target Costing

Product Line Income Statement

- An income statement that shows the operating income of each product line, as well as the company as a whole.
- Same as the normal income statement except that this one is more catered towards details about the operating income of each product line.

Relevant Information

- Expected *future* data that *differ* among alternatives.

Segment Margin

- The income resulting from subcontracting only the direct fixed costs of a product line from its contribution margin. The segment margin contains no allocation of common fixed costs.

Segment Margin Income Statement

- A product line income statement that contains no allocation of common fixed costs. Only direct fixed costs that can be traced to specific product lines are subtracted from the product line's contribution margin. All common fixed costs remain unallocated and are shown only under the company total.

Special Order

- Occurs when a customer requests a one-time order at a reduced sales price.
- Often for large quantities (ordered in bulk).

- **Questions**:

  1. Do we have excess capacity available to fill this order?
  2. Will the reduced sales price be high enough to cover the incremental costs of filling the order (the variable costs of filling the order and any fixed costs)?
  3. Will the special order affect regular sales in the long run?

Sunk Cost

- A past cost that cannot be changed regardless of which future action is taken.
- This cost is gone for good so forget about it.

Target Pricing (Costing)

- An approach to pricing used by pricetakers; target costing begins with the revenue at market price and subtracts the company's desired profit to arrive at the target total cost.
- (Revenue at Market Price) minus (Desired Profit) = Total Cost

Triple-Bottom-Line Approach

- Impact on people, the environment, and how profitable a decision will be.

Unavoidable Fixed Costs

- Fixed costs that will continue to be incurred even if a particular course of action is taken.

6 Short-Term decisions made in this chapter

1. Pricing
2. Special Orders
3. Discontinuing Products, Departments, or stores
4. Product mix when resources are constrained
5. Outsourcing (make or buy)
6. Selling as is or processing further

Reminders / Keep in Mind

1. Focus on relevant revenues, costs and profits.
2. Use a contribution margin approach that separates variable costs from fixed costs.

What to Avoid

1. Avoid including sunk costs in your analysis.
2. Avoid using unit costs unless they are purely variable in nature.

Price Takers

- Product lacks uniqueness
- Not a brand name
- Heavy competition
- Pricing approach emphasizes target costing

Price Setters

- Product is more unique
- Product is branded
- Less competition
- Pricing approach emphasized cost-plus pricing

Never compare the special-order sales price with the absorption cost per unit or your analysis will be flawed. Rather, use the contribution margin approach.