Chapter 2 - Relevant costs and benefits for decision making

1. Cost-benefit analysis
   - **Cost benefit analysis**: assess the likely outcome of each course of action being taken: prospective benefits vs the costs involved.

2. What is meant by cost?
   - **Opportunity cost**: the value of the opportunity foregone in order to pursue the other course of action
     - rarely taken into account in the routine accounting processes (as they do not involved out-of-pocket expenditure)
   - **Historic cost**: cannot logically ever be used to make a decisions on the total costs (never relevant)
     - to say that historic cost is an irrelevant cost is not to say that the effect of having incurred that cost are always irrelevant.

3. Relevant costs
   - **Outlay costs**: amount that will have to be spent in order to pursue a particular course of action.
   - **Relevant costs** = satisfy all 3 of the criteria:
     - must relate to the objectives of the business (must have a effect on the wealth of the business)
     - must be a future cost
     - must vary with the decision

4. Irrelevant costs
   - **Sunk cost** = past cost
   - **Committed cost** = irrevocable decision that has been made to occur (legally binded contract)

5. Sunk cost fallacy
   - **Sunk cost fallacy**: the refusal to abandon an attachment to an irrevocable investment (behavioral economics)

6. Determining the relevant cost of labour and materials

7. Non measurable costs and benefits
   - [1] only actual increase of the cost should be taken into account as a result of accepting a new project
   - [2] general overheads (rent, utility cost, admin, etc) should always be ignored in the company’s policy of allowing of the cost (fair share allocation).