

# Improving Profits

(Cheat Sheet)

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## Improving Profits

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Improving profits or reducing operating losses will likely involve some decisions and some action. Both the decision and the action involve the *future*. The decision and action may involve:

- expanding a product line
- eliminating a product line
- increasing selling prices
- reducing selling prices
- reducing advertising expenses
- increasing advertising expenses
- closing a facility or outlet
- adding a facility or outlet
- many other possibilities

Unfortunately, the amounts that are readily available (such as the amounts in the general ledger accounts) are amounts from the past transactions. To make the best decisions, management needs the future amounts. Since the future has not yet occurred, getting the approximate future amounts will be a challenge.

## Past Amounts Are Not Relevant

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The enormous number of transactions that a company has experienced can be found in the company's accounting records. However, those transactions are history. They are from the past. They are sunk. As a result they are not relevant for today's decisions or future decisions. Hence management accounting textbooks describe these past historical transactions as *irrelevant* as far as decision making.

Even though the past amounts are irrelevant for today's decisions they may help the management accountant to understand how costs behave, which costs to examine, etc. Some past costs could also have an impact on income tax payments or income tax savings that will occur due to a decision regarding the future.

## Future Amounts That Will Be the Same Are Not Relevant

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In making a decision between two alternatives, the costs and/or revenues that will be the same under both alternatives are not relevant and therefore can be omitted from the analysis. For example, if the executives' compensation will be the same whether or not the company expands into ten additional states, the executives' compensation is irrelevant to the decision of whether to expand or not. Therefore, the executives' compensation can be excluded from the analysis.

## Only Future Amounts That Will Differ Among Alternatives Are Relevant

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In order to make the best decisions, management accountants must work to identify, predict and estimate the *relevant future amounts*. However, only the *future costs* and *future revenues* that will be *different* will be relevant.

## Accountants Must Be Careful

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Accountants might know the most about a company's past costs and past revenues. However, when it comes to decision making, management will need information on the future costs and future revenues. Accountants must be cognizant that their familiarity with numbers does not translate into an ability to predict the future.