



THE DECISION-MAKING PROCESS: THE RELEVANCE AND IRRELEVANCE OF COSTS, EXPENSES AND INCOME

Galina BĂDICU, *associate professor, PhD, AESM, gbadiku@mail.ru*

Svetlana MIHĂILĂ, *associate professor, PhD, AESM, sv_mihaila@yahoo.com*

Abstract

The analysis of potential problems that can confront the entity is focused on the prospective, anticipated character of the process of substantiating the decisions, that represents the central moment of any management process. The special importance of the decision-making process requires a constant concern for its improvement, for strengthening the entity's ability to develop quality decisions that would lead to increased efficiency and competitiveness. In this regard, the conducted research focuses on studying the decision-making process, focusing on certain decisions, addressing and differentiating relevant and irrelevant issues with reference to costs, expenses and income - using practical situations. The article presents an investigation based on documenting bibliographic sources regarding the decision-making process and the relevant information.

Keywords: *decision, good decision, decision-making process, relevance in the decision-making process, relevant revenues, costs and expenses.*

Introduction

Currently, in the business environment, which is constantly changing, the complex process of decision-making becomes more and more difficult. It's becoming more and more complicated, due to the growing volume of relevant information for the business, of the number of information resources and the number of technologies used to access and store data. At the same time, the decision support for businesses faces a number of problems, namely: *lack of information (in many cases also lack of time), large volumes of empirical and diverse data, which are chaotic in nature and must be processed in order to be used as relevant facts for the business, necessary knowledge in the analyzed field in order to extract relevant information, facts are evaluated in a broader political, social, ethical etc context.*



Constantly, the management of an entity is faced with the choice of several possibilities. In order to find the optimal solutions, managers must make the best choice of all the possible alternatives, ie to take a managerial decision. A decision is the result of performing a value judgment on a concrete situation. Some decisions are the result of daily, ordinary behavior. Others may even be the result of indecision, because the indecision option is, in fact, a decision [19]. It is believed that a decision-making process is effective if, using a logical analysis of the relevant knowledge, one succeeds in choosing the best decision. In our opinion, a decision that allows to achieve those objectives, within the limits and restrictions imposed by the context of the problem, without other problems occurring, is considered a good decision. Supplier selection, improvement of cooperation contracts, creating a new department, the strategy that is to be implemented are some examples of decisions that are incumbent to the decision-maker. The success or failure of managerial activity, as well as the performances of a leader depend most heavily on the quality of the made decisions. For this reason, the decisions must be well-thought and well-grounded. It is preferable to work worse after good decisions than to work well after bad decisions [18, p. 201]. In order to assess whether a decision is better, it should be reported to some assessment criteria called optimization criteria [18, p. 202].

Description of the situation in the research field and the need to investigate. Concerns about the management decisions have increased steadily during the recent years, which was reflected both in the emergence of numerous papers on the subject, and in shaping an intense decision-making dimension of managers' activity within the entities. Studying the works of local scientists, we find that in the Republic of Moldova there is no complex scientific research, which would examine the relevance and irrelevance of costs, expenses and income in the decision-making process.

We note that some theoretical aspects related to the decision-making process are addressed in the scientific works of local and foreign economic scientists: Bădicu G., Mihaila S. (*the decision-making process and relevant information*) [1, pag. 249-266], Belostecinic Gr. (*the decision and university autonomy*) [2, pag. 9], Bucur V. Bădicu G. (*the decision-making process and the performance measurement in telecommunications entities*) [4, pag. 177-216], Cușmăunsă R., Caraman S. (*the information analysis and management decision-making*) [6, pag. 165-181], Zetia V. (*systematization of the decision concept in economic, managerial, social, legal, cognitive and psychological terms*) [13], Hrișcev E (*the stages of decision-making, decisions under uncertainty and risk*) [16, pag. 112-114], Stihii L. (*optimization of decisions under risk and uncertainty*) [24], Bucșă C. R. (*the concept of decision, the criteria and elements of the decision*) [3, pag. 16-19], Drucker P. (*about the efficient decision*) [12], Horngren Ch., Datar M. și Foster M., I. (*strategic decisions*) [15, pag. 4], (*the decision-making process and relevant information*) [15, pag. 409-452], (*price-calculation decisions*) [15, pag. 451-490], Diaconu P. (*decision-making, introductory elements*) [18, pag. 277-294], Needles B. E., Anderson H.



R., Caldwell J. C. (*the decision-making process and operational management decisions*) [20, pag. 1130-1154].

In order to select the best alternative, managers often face the following decision situations: *from the entity's internal environment* - production decisions, pricing, financial, decisions on research and development etc, *from the entity's external environment* - decisions on the consumer segment, on the promotional policy, on the funding policy, conquering new market segments etc.

That is why we consider it appropriate and necessary to address the issue of the decision-making process within the entity with reference to the concept of relevance. Naturally, the starting point is the actual definition of the decision, the decision-making process, the relevance of expenditures and revenues. In order to facilitate their knowledge and their rationalization, the presentation of the decision situations through practical applications is particularly useful.

The decision and the decision-making process. For managers, the main task and responsibility is the adoption of decisions, a specific activity that requires from them a high level of professional training and a rich practical experience, with the view of processing and generalizing the initial information. Due to its systematic, homogeneous character and to the diversity of information which it provides, accounting appears as the main provider of information necessary for the decision-making process [25, p. 37]. Thus, it must provide the decision-making process with accurate, timely, exact, information, in time and in an usable form. From the aforementioned, it results that the accounting information holds the key role in the decision-making process and, in this regard, a number of arguments may be made, such as:

- ✓ the vast majority of information circulating in the economy is of accounting nature;
- ✓ enables an accurate representation of economic phenomena and processes;
- ✓ has the greatest degree of certainty;
- ✓ characterizes the size and value of flows that arise in the course of the social reproduction process both at micro and macroeconomic levels;

In this context, managers can not be solely responsible for all the problematic situations. Most managers know when to involve the subordinates in the decision-making process, when to delegate and when to take no attitude [9, cap. IV].

In general, the daily managers' decisions concern various aspects such as: structure, work processes control system, the generation and the allocation of resources, settlement related to problems that occurred in the entity accidentally etc. In this context, managers determine a number of objectives, create action plans and policies to achieve these objectives. Herbert A. Simon thinks the managerial decision is identical to the whole management process [21, p. 45]. Although the decision-making process is natural, a number of factors related to the process of setting targets may impose organizational



limits to the decision-making process. The entities must constantly adapt to the influence of internal and external factors. In essence, the entire activity of managers is a chain of decisions. As Peter Drucker stated taking decisions is the specific task of managers [18, p. 202].

In the category of **internal factors** we can include: the clarity of objectives and performance standards, the knowledge and skills of managers and subordinates, the difficulty of tasks to accomplish, staff motivation, information deficiencies, human resources, inadequate or insufficient resources, working conditions etc.

External factors that can lead to the emergence of the need for decision-making are: the level and rate of change of the sector or industry, information relating to the environment and to the action of factors that can lead to disturbances, functional or structural legislative restrictions etc. In specialty literature there are many definitions for the decision, belonging both to local specialists and some foreign ones.

The first perspective would be the one according to which **the decision** can be defined as the solution chosen from a set of alternatives [14, p. 10] to achieve one or more objectives [7, p. 171]. This treatment is characterized by the fact that the essential element of a decision involves choosing between several possible directions. The limit case may be the one in which the decision-maker may opt not to take any decision, which implicitly means leaving things to chance, leaving the free will to decide. In the opposite case, where he nevertheless opts for an alternative or another, these must be identified in an existing offer or simply manufactured according to the data provided at the time.

Some Romanian scholars believe that the decision must correspond to the following requirements: be scientifically grounded, adopted by people who have escrow, formulated in a clear concise and non-contradictory way, be correlated with previous decisions, be complete, be timely and efficient [18, pp. 183-184].

The Explanatory Dictionary of the Romanian Language defines the **decision** as the judgment taken as a result of the examination of a problem, a situation, the solution adopted from many possible ones [11, p. 266]. We should mention that unlike the **judgment**, which involves choosing between a positive and negative variant, the decision requires the establishment of several action alternatives, which target the positive alternative of the thought purpose.

The Romanian scientists I. Ionașcu, A. Tiberiu and M. Stere define the **decision** as a process of transformation of the primary information of a decision maker into actions, in an organization or in a part of the organization [17, p. 15].

From examining the aforementioned definitions, it follows that the decision necessarily involves several elements: **one or more objectives; identifying more options for reaching the objectives; election or selection**. Based on the data provided by decision-making practice, on the analysis of various viewpoints of scientists, we have formulated **the definition of the decision as being the chosen course of action, that**



leads to the application of the resources with the view to achieve one or more objectives of the entity. Thus, the decision is a matter of choice, but also of the managerial competence, involving - on the one hand - knowledge of the management theory and of decision-making techniques, and on the other - knowledge of the problems of the entity and of the specific solving methods. As such, the decision is the act by which the past, present and, especially, the future of an entity are signed.

Decisions should be seen as a means of achieving goals or realizing objectives, being the result of an information analysis and deliberation process, bearing the name of the decision-making process.

According to the renowned scholars Horngren Ch., Datar M. and Foster M., **the decision-making process** involves gathering information, taking into account future costs and benefits, choosing an alternative, acting consistently with this choice and evaluating the results [15, p. 410].

The undertaken investigations have revealed that the key constituents [23, p. 26] of the decision-making process are:

- ✓ **the decision maker** is represented by a manager or a managerial body, which, by virtue of objectives, tasks, circumscribed competences and responsibilities, adopt the decision in that situation. The dominant trend at the decision-makers level is the maximization of their decision capacity, due to the increasing level of professionalism in management.
- ✓ **the objective or objectives pursued** by adopting a particular course of action;
- ✓ **existence of an information system**, necessary for analyzing the information and data regarding the problem or the arising need;
- ✓ **the multitude of alternatives** – the possible options for action in order to achieve the objectives.
- ✓ **the multitude of variants assessment criteria**: *technical* (raw materials consumption, production cycle length etc.); *economic* (profit, price, duration of return etc.); *social* (labor force, importance of products in the market, etc.).
- ✓ **the multitude of the consequences** of the criteria for assessing different choices.

The process of preparing and making decisions begins with the determination of the objective and tasks facing the entity. For some entities, such a goal may be to maximize the profit, future net flows from cash receipts, widening the outlets etc. [8, p. 93]. To achieve the set goals it is necessary to study the alternative scenarios for possible actions. For each variant it is necessary to collect their corresponding data/information, to calculate the total amount of costs, expenses and income, possible savings of resources and the financial result. Once the necessary information has been collected and processed, the manager must make decisions on choosing the concrete variant. Usually the variant which ensures to the greatest extent the achievement of the set purpose is chosen. In this context, directing the decision-making process at each stage requires the use of different



information, that must be controlled by the accounting department and its compliance with quality requirements, in order to be relevant and useful for the decision-making process. In this context, the information, converted to managerial skills manifests itself as a major source of authority and decision legitimacy [3, p. 22]. In their capacity as decision makers, managers appreciate, increasingly, information as a true resource that can provide the holder with a real competitive advantage, and not just as another element of adopting the decision.

Despite their vast variety, the decision-making processes have much in common, assuming a sequence of activities. The decision-making process is characterized by benchmarking several possible courses of action and choosing the one that which ensures the achievement of the set purpose. Thus, in a typical decision-making process, the decision-maker should decide on the following issues: *defining the problem which must be addressed in a determined time, listing the possible action options, gathering information on the possible alternatives and estimating their effects, identifying the most optimal variant, developing and implementing the adopted variant, evaluating the results.* These are believed to form the six stages of the **DECIDE model** [23, pp. 327-328]. The content and complexity of the decision-making process varies from one situation to another, depending on the issues covered by the decision and that can be of a great variety. For this reason, the decisions must be well-thought and well-grounded. It is preferable to work worse after good decisions than to work well after bad decisions [18, p. 201]. To highlight the role of the decision, we present a practical situation, emphasizing the spontaneous decision of the manager and the negative effects of the decision.

<p>The created situation:<i>the manager of the entity has been informed by the economic director of the fact that the most important client – entity A – cannot pay in time for a debt of 700 000 lei.</i></p>	<p>The negative effects of this decision:</p> <ul style="list-style-type: none">✓ a decrease in sales volume (no new customers were attracted to replace the lost one);✓ the loss of a powerful client;✓ reducing the use of production capacities;✓ misuse of labor;✓ late payment of wages etc.
<p>The manager's decision: without thinking much, the manager has decided to break the relations with the entity, considering it frivolous, although up to that moment there were no other phenomena of the kind in collaboration with this entity.</p>	

Source: drafted by the author based on the generalized information from [18, pag. 202].

The results and conclusions of research. In order to take valid decisions, it is necessary that the used information is qualitative, authentic and useful. Only the relevant information is useful. **Relevant** is considered the information that must [15, pag. 411]:



✓ *occur in the future* – every decision is related to the selection of a course of action based on expected future results;

✓ *be different depending on the alternative directions for action* – the data and information which do not differ cannot be important and, thus, will not have any relevance for the decision-making process.

For example, *the problem on the replacement of old lathe with a new computerized production line is being addressed*. The aim of lathe replacement is to increase the volume of production, and respectively, the sales volume, reducing the direct material costs and direct costs related to wages and improving work conditions. In this context, **the relevant information** will be characterized by indicators whose value changes as a result of taking decisions on replacing old lathe with a new production line. The information on indirect production costs and the expenses of the period, which are not related to the replacement of lathe with a new production line **is not relevant**, as it does not change following the decision-making. Consequently, the division (delimitation) of information into relevant and irrelevant allows the manager to focus his attention during the decision-making process only on the relevant information, that facilitates the analysis of the existing variants and accelerates the process of choosing the most optimal decision.

The concept of relevance applies to all decision situations [15, p. 412]. In order to select the best alternative, managers face different situations. Next, we will present some of these situations.

We begin by examining the decisions that affect the production levels. For example, one type of decision affecting production levels is **accepting or rejecting special orders** when there is unused production capacity and the special orders do not have long-term implications.

Practical application 1. *The entity manufactures quality products. It has a production capacity of 4000 units of product per month. The actual monthly production volume is 2 700 products and the expected results are presented in Table 1.*

Table 1. Excerpt from the profit and loss statement (forecast values)

Nr. crt.	Indicators	Sum, lei	
		total	per unit
1.	Sales revenues (2 700×210)	567 000	210
2.	Sales costs (2 700×149)	402 300	149
3.	Gross profit (r.1-r.2)	164 700	61

The 149 lei cost of sales consists of the following items, which are presented in Table 2.



Table 2. Excerpt from production costs statement (forecast values)

Nr. crt.	Indicators	Variable cost per unit	Fixed cost per unit	Total cost per unit
1.	Material costs, lei	92	-	92
2.	Staff costs, lei	37	5	42
3.	Indirect costs, lei	11	4	15
4.	Production costs (r.1+r.2+r.3)	140	9	149

A network of stores has offered to buy in December 201X - 1300 units of product at the price of 146 lei. There are no other sales to this store network anticipated for the future. The fixed production costs are related to the production capacity of 4000 units, regardless of the used production capacity. If the entity accepts the special order, it will use the existing unused capacity to produce the 1300 units. The fixed production costs and fixed distribution expenses will not be affected by the special order. At the same time, there will be no variable distribution costs for this order. The acceptance of this special order will not affect the selling price or the quantity of products sold to ordinary customers. Should the entity accept the store network's offer?

Calculations, analysis and conclusions:

Since there is no need for fixed distribution costs, we can focus only on production costs. On the basis of the 149 lei sales cost, which is higher than the unit price of 146 lei offered by the store network, the manager could reject the offer. In Table 3, the data is presented in the form of a profit and loss statement with a focus on the contribution margin (sales revenue-variable costs). The marginal contribution is intended to cover fixed costs and expenses, subsequently contributing to profit. Once the fixed costs are completely covered, the remaining marginal contribution increases the profit.

Table 3. Excerpt from the profit and loss statement (forecast values)

Nr. crt.	Indicators	2 700 units that are to be sold, without the special order		4 000 units that are to be sold, including the special order	Difference: Values relevant for the 1 300 units, lei
		per unit, lei	total, lei	total, lei	
1.	Sales revenues	210	567 000	756 800	189 800
2.	Variable costs	140	378 000	560 000	182 000
3.	Marginal contribution (r.1-r.2)	70	189 000	196 800	7 800
4.	Fixed costs	9	24 300	24 300	0
5.	Gross profit (r.3-r.4)	61	164 700	172 500	7 800



The data presented in the table illustrates two points regarding the costs and revenues analysis relevant for the decision-making: *the differentiation of relevant and irrelevant costs and revenues; the use of the profit and loss statement with a focus on the marginal contribution in order to highlight the effect of the selected alternative, taking into account the variable and fixed costs.*

Thus, the relevant revenues and costs are expected future revenues and costs that differ as a result of acceptance of the special offer: revenues of 756 800 lei [567 000 lei + (1 300 un. × 146 lei)] and variable production costs of 560 000 lei (4000 un. × 140 lei). Fixed production costs are irrelevant in this case. This is because these costs will not change in their totality if the special order is accepted or not.

Conclusion: In this situation, the comparison of the total amounts for 2700 units with 4000 units helps us avoid any eventual confusions that would result from comparing the sales price of 146 lei per unit with the production cost of 149 lei per unit, which includes both variable and fixed production costs. The entity may earn an extra 7800 lei (189 800 lei - 182 000 lei) by accepting the special order and can at the same time promote its products without additional distribution expenditures. But we must be careful about the assumptions that all the variable costs are relevant and all fixed costs are irrelevant. In some cases, the additional manufacturing of products may increase fixed production costs and the entity may incur some distribution costs. The best way to avoid some potential problems is to focus on total revenues and costs and on the concept of relevance.

We further apply the concept of relevance in making a strategic decision: **the decision on the production of a piece or the purchase from a supplier.** The aim of the analysis of decisions of this kind is to identify the costs of each alternative and its effects on the revenues and expenses and to select the most profitable variant. Frequently, managers face the option of producing a certain component of the product, within the entity, or to buy it from a supplier. Passing over the technical implications, the decision is usually based on quality, reliability of the supplier and the cost [15, p. 416]. Normally, one compares the variable costs generated by the production with the market price. The purpose of the analysis of decisions of this kind is to identify the costs of each alternative and its effects on revenues and expenditures and to select the most profitable variant. **If the piece to be produced requires the reduction of the volume of production of other components/parts, the lost marginal contribution will have to be added to the cost of the produced piece/component.**

Practical application 2. *An entity studies the problem relating to the production of a certain component A or its acquisition. This can be bought in batches of 10 000 pieces with the input cost of 9.75 lei apiece, and the variable cost of the piece A is 7,15 lei. As such, the entity may manufacture the necessary quantity of pieces per car, which is already working to its full capacity and manufacture another piece X. In the result of the*



manufacture acceptance, the entity would have losses of 1000 pieces of piece X. This occurs with a variable cost of 90 lei apiece and sells with 125 lei apiece. **What decision should the entity take?**

Calculations, analysis and conclusions:

In order to make the right decision, the outcome in the event of manufacturing of component A will be determined, as follows:

1. The variable cost of piece A = $7,15 \text{ lei} \times 10\,000 \text{ pieces} = \mathbf{71\,500 \text{ lei}}$
2. The marginal (lost) contribution related to not producing piece X = $35 \text{ lei} \times 1\,000 \text{ pieces} = \mathbf{35\,000 \text{ lei}}$
3. **Total = 106 500 lei, relevant unit cost= 10,65 lei.**

The relevant costs expected for 10 000 units constitute 106 500 lei or 10,65 lei for each manufactured component.

Conclusion: the key concepts of relevance in this application are the following - current cost data does not play any role, because for the decision of the „to produce or to buy” type, starting with the next year, these costs are historical costs, and therefore irrelevant. It seems that the entity should buy this component, because the cost of entry (9,75 lei) is less than the relevant one (10,65 lei). The 9 000 lei (97 500-106 500) are future costs that differ between alternatives and thus become relevant for the decision of the „to produce or to buy” type. We should mention the fact that supplying decisions can be influenced by some strategic and qualitative factors. The greater the dependence of an entity on its suppliers, these can raise the prices and can leave the quality and performance in terms of delivery fall. Therefore, in order to minimize risks, it is necessary to conclude long-term contracts with suppliers, stating the costs, quality and delivery schedules.

The analysis and maximization of profits are possible only when the profitability of all product lines is known. Still, the problem is which of the products contributes most or least to the profitability of the entity. If an entity has a product range which is unprofitable, it will have to consider the **product opt-out option**. In this context, the same decision-making approach is used, but the objective is to eliminate unprofitable product lines.

Practical application 3. *The entity manufactures and sells 3 products A, B and C - using the same production equipment. The entire production capacity is used. As a result of the sale of Product A, the entity obtains loss. In order to demonstrate the fact that the manufacturing of the products leads (or doesn't lead) to obtaining a loss and to present to the entity's management relevant information for the adoption (or not) of the decision to refuse the production of unprofitable products, the revenues and costs are analyzed based on the profit and loss statement with a focus on the marginal contribution, table 4.*



Table 4.Excerpt from the profit and loss statement

Nr. crt.	Indicators	Product A	Product B	Product C	Total
1.	Sales revenues	32 000	50 000	45 000	127 000
2.	Variable costs	24 000	33 330	30 000	87 330
3.	Marginal contribution	8 000	16 670	15 000	39670
4.	Fixed costs	12 000	4 670	4 000	20 670
5.	Gross profit	(4 000)	12 000	11 000	19 000

By analyzing the data presented in Table 4, the managers may give up the manufacture of product A. In this context, in order to make the right decision, a comparative profit and loss statement is drafted, presented in Table 5, which includes only the profitable products, except for product A.

Table 5.Excerpt from the comparative profit and loss statement

Nr. crt.	Indicators	Product B	Product C	Total
1.	Sales revenues	50 000	45 000	95 000
2.	Variable costs	33 330	30 000	63 330
3.	Marginal contribution	16 670	15 000	31670
4.	Constant costs	X	X	20 670
5.	Gross profit	X	X	11 000

From the performed calculations, we see that the entity will earn a profit of 11 000 lei. The difference of 8000 lei (19 000-11 000) is equal to the marginal contribution of the product A. Therefore, by giving up the product A, the apparent loss of 4000 lei will lead to a reduction of the profit of 8000 lei, resulting from the gross loss of product A. The fixed production costs are irrelevant in this case. This happens because these costs will not change in their totality whether or not product A is given up.

Conclusion: If by giving up product A, the fixed costs will be reduced by more than 8000 lei, then the variant will be optimal.

In some cases, the managers may choose and can benefit from the **decisions on reducing the sale price**. Inevitably, these decisions involve a dose of risk. These are decisions that impact the quantity sold, the marginal contribution and, respectively, the profit.

***Practical application 4.** Let's assume that the entity expects to sell 50 units. It plans to reduce the sales price from 200 lei to 180 lei per unit. The cost of entry of goods is 120 lei per unit. In accepting the decision on reducing the sales price, the supplier will*



sell the unit with 115 lei per unit instead of 120 lei per unit. The fixed costs remain unchanged. **Should the entity reduce the selling price?**

Calculations. To answer this question, the marginal contribution is considered, in case of reduction and in case of maintaining the sales price.

1. The marginal contribution in case of reducing the price to 180 lei: $(180-115) \times 50 = 3250$ lei
2. The marginal contribution in case of maintaining the price at 200 lei: $(200-120) \times 50 = 4000$ lei
3. Changing marginal contribution due to reducing the price: (750 lei)

Conclusions: Reducing the price by 20 lei will decrease the total marginal contribution by 750 lei, and because the fixed costs remain unchanged, this will lead to decreasing the profit by 750 lei. In this context, managers can examine other options that would allow them to increase their profit. In each case, they will compare the modification of the marginal contribution with the changing of fixed costs and will choose the option that generates the most profit.

In conclusion, we note that the decision is the act through which the past, present and, especially, the future of an entity are signed. It is a matter of choice, but also of the managerial competence, involving - on the one hand - knowledge of the management theory and of the decision-making techniques, and on the other hand - knowledge of the entity's problems and of the specific ways of solving them. At the same time, we would like to emphasize that the right decision will be adopted by managers only in case of disposition of some relevance criteria.

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