Problem Set A

connect ACCOUNTING

PROBLEM 21.1A
Evaluating a Special Order

D. Lawrance designs and manufactures fashionable men's clothing. For the coming year, the company has scheduled production of 40,000 suede jackets. Budgeted costs for this product are as follows:

	Unit Costs (40,000 units)	Total
Variable manufacturing costs	$50	$2,000,000
Variable selling expenses	20	800,000
Fixed manufacturing costs	10	400,000
Fixed operating expenses	5	200,000
Total costs and expenses	$85	$3,400,000

The management of D. Lawrance is considering a special order from Discount Apparel for an additional 10,000 jackets. These jackets would carry the Discount Apparel label, rather than the D. Lawrance label. In all other respects, they would be identical to the regular D. Lawrance jackets.

Although D. Lawrance regularly sells its jackets to retail stores at a price of $150 each, Discount Apparel has offered to pay only $80 per jacket. However, because no sales commissions would be involved with this special order, D. Lawrance will incur variable selling expenses of only $5 per unit on these sales, rather than the $20 it normally incurs. Accepting the order would cause no change in the company's fixed manufacturing costs or fixed operating costs. D. Lawrance has enough plant capacity to produce 55,000 jackets per year.

Instructions

a. Using incremental revenue and incremental costs, compute the expected effect of accepting this special order on D. Lawrance's operating income.

b. Briefly discuss any other factors that you believe D. Lawrance's management should consider in deciding whether to accept the special order. Include nonfinancial as well as financial considerations.