

**UNIVERSITY OF THE PHILIPPINES MANILA  
COLLEGE OF PHARMACY**

**PHAR 125: Pharmaceutical Accounting  
1st Semester AY 2020-2021**

**Differential Analysis  
Supplementary Notes**

*General reminder:* Only include the relevant costs in conducting the differential analysis. If there are costs and/or revenue that do not differ across the alternatives, exclude that from the analysis.

**Special Orders**

- If the special orders can be produced within existing plant capacity, the special order will not increase fixed costs.
- If the plant is operating at full capacity, then the fixed costs will be affected if special orders will still be accepted.
- If the special orders will not be accepted, there will be no additional revenue to the company and there will be no additional costs.
- Conduct the differential analysis only on the basis of accepting or rejecting the special order. Do not include in the analysis the costs and revenues that do not differ between the alternatives (i.e. the current sales of the manufacturing plant since it will not be affected when you accept or reject the special order).

**Make or Buy**

- Deciding to buy parts/components of the product will eliminate costs such as materials, labor, and variable manufacturing costs. However, consider if the fixed manufacturing cost will change or be retained since the plant will still operate to make the rest of the product.

**Process or Sell**

- Basic decision rule: *“Process further as long as the incremental revenue from such processing exceeds the incremental processing costs.”*

**Repair, Retain, or Replace**

- Consider the change in the variable manufacturing cost over the total useful life of the new machine being considered.
- Sales from the old machine is relevant to the decision but it can only be obtained in the alternative wherein in company chooses to replace the equipment.
- Do not include sunk costs (such as the book value of the old machine) in differential analysis since it cannot be changed by any present or future decision.

**Eliminate**

- Remember that eliminating a product line does not eliminate the fixed costs allotted to it. Instead, the fixed cost of the eliminated product line might have to be absorbed by the other products since the plant is still manufacturing products incurring fixed manufacturing costs.