HULT International Business School
Managerial Accounting (ACC220)
Outline of the Required Book

Chapter 3 - Cost - Volume - Profit analysis

1. Cost behavior

- ➔ Costs represents the ressources sacrificed to achieve benefits;
- ➔ Fixed costs = remain constant with the volume of output
- ➔ Variable costs vary according to the volume of activity

2. Different types of costs

- ➔ **Fixed costs:** the amount of fixed cost (distance 0F) remains the same irrespective of the volume of activity.
  - rent, insurance, cleaning cost, staff salaries
  - redundancies may incur with fixed costs savings
  - fixed costs are likely to be affected with **inflation** !
  - always **time based:** the level of fixed cost does not stay the same irrespective of the time period involved.
  - fixed costs varies with time but not the level of output !
  - constitutes the bulk of total costs
  - **stepped fixed costs**
- ➔ **Variable costs:** costs varies with the volume of activity (ie. cost of raw materials)
  - costs increases in a straight line as the activity increases.
  - it is assumed that variable costs are varying **constantly/consistently** with the level of output
- ➔ **Semi-fixed/Semi-variable costs** have elements of both
  - analysis with the **high low method:** in a business where TC is not divided into VC and FC we can use this method to calculate the VC and FC separately; based on the assumption that FC remains the same and increase in cost relative to VC.
  - In this method, an assumption is made that the difference between the 2 quarterly figures is caused entirely by the VC
- ➔ **Line of best fit** uses the **least squares regression**; the slope of the line gives the VC

3. Break Even Point

- ➔ BE: where there is neither profit nor loss.

Total revenues = Total costs

Total sales revenue = FC + VC

BEP = FC / (Sales revenue per unit - VC per unit)

BEP point * Sales revenues = BEP in revenues

4. Contribution

- ➔ the denominator of the BEP formula is the contribution per unit
- ➔ Contribution to meeting the fixed costs, if there is any excess then its is in the profit.
- ➔ **Contribution margin ratio:** the contribution of an activity expressed as a percentage of sales

CMR = Contribution / Sales revenue

CMR% = (Sales revenue per unit - VC per unit) / Sales revenue * 100

5. Margin of Safety

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