MarginalCost

"Theamountatanygivenvolumeofoutputbywhichaggregatecostsarechangedifthevolume ofoutputisincreasedordecreasedbyoneunit"

MarginalCosting

"Marginalcostingisatechniqueofdeterminingtheamount ofchangesintheaggregatecostsdue toanincrease ofinunitoverthe existinglevelofproduction"

FeaturesofMarginalCosting

- Itisamethodofrecordingcostsandreportingprofits;
- Alloperatingcostsaredifferentiatedintofixedandvariablecosts;
- Variablecostchargedtoproductandtreatedasaproductcostwhilst
- Fixedcosttreatedasperiodcostandwrittenofftotheprofitandlossaccount

AdvantagesofMarginalCosting

- Itissimpletounderstandre:variableversus fixedcostconcept;

- Ausefulshorttermsurvivalcostingtechniqueparticularlyinverycompetitiveenvironment or recessions where orders are accepted as long as itcovers the marginalcost of the business and the excess over the marginal cost contributes toward fixed costssothatlosses are kepttoa minimum;
- Itsshowstherelationshipbetweencost, priceandvolume;
- Underoroverabsorptiondonotariseinmarginalcosting;
- Stockvaluationsarenotdistortedwithpresentyearsfixedcosts;
- Itsprovidebetter informationhenceisausefulmanagerialdecisionmakingtool;
- Itconcentratesonthecontrollableaspectsofbusinessbyseparatingfixedandvariablecosts
- Theeffectofproductionandsalespoliciesismoreclearlyseenandunderstood.

DisadvantagesofMarginalCosting

- Marginalcosthasitslimitationsinceitmakesuseofhistoricaldatawhiledecisionsbymanagemen trelates tofuture events;
- Itignoresfixedcoststoproductsasiftheyarenotimportant toproduction;
- Stockvaluationunderthistypeofcostingisnotacceptedbytheln landRevenueasitsignorethefix edcostelement;
- Itfailstorecognizethatinthelongrun,fixedcostsmaybecomevariable;
- Itsoversimplifiedcostsintofixedandvariableasifitissosimplytodemarcatethem;
- It's not a good costing technique in the long run for pricing decision as it ignores fixedcost. In the long run, management must consider the total costs not only the variableportion;
- Difficulty to classify properly variable and fixed cost perfectly, hence stock valuation canbe distortediffixedcostisclassifyasvariable.

AspectsofMarginalcosting

1. Ascertainment ofMarginalCost.
2. DerivingofCost-VolumeProfitRelationshipbydifferentiatingfixedcostfromvariablecosts.

MarginalCostStatement

Particulars	**Amount(Rs.)**

Variable	
Costs:DirectMater	Xxx
ialDirect	Xxx
WagesFactoryOve	Xxx
rheads	------
	xxx
FixedCost:Administrativ	Xxx
eExpenses	------
	Xxx
Total	Xxx
CostProfit	-------
	Xxx
Sales	-------

Concepts&TermsUsedinCost–volume-profitAnalysis1.Variable Costs:

Thesecostsarevaryinginproportiontothelevelofproductionandsales.

Ex: DirectMaterial,DirectWages,DirectExpensesandVariableOverheads.

2. FixedCost:

Irrespectiveofthelevelofactivity,thesecosts arefixedinnature.Hence,thesecostsarecalled‘sunkcost’or‘periodcost’or‘time costs’.

Ex: Officerent,FactoryRent,Manager’sSalaryetc.

3. Contribution:

Contributionisthedifferencebetween salesandvariablecost.Contributionistheamountthatiscontributed towardsfixedexpensesandprofit.In Practicemajority ofthemanagerialdecisions are basedontheprinciple ofcontribution.

Contribution = Sales – Variable costContribution=FixedExpenses+Prof itContribution=FixedExpenses-Loss

4. ProfitVolumeRatio(P/VRatio)orContributiontoSalesRatio(C/SRatio):

The proportion of contribution to sale is called P/V ratio.P/V ratio generally expressed as apercentage.A high P/V ratio indicates high profitability and a low P/V ratio indicates lowprofitability.

Formula:

P.V.R=(Contribution/Sales)X100

P.V.R=(ChangesinProfit/ChangesinSales)x100

5. BreakEvenAnalysis

Breakevenanalysisdeterminesatwhatlevelcostandrevenueareinequilibrium.

Assumptions:

1. Allelementsofcostsaredividedintofixedand variablecosts.
2. Variablecostsvaryinrelationtothevolumeofproduction.
3. Fixedcostsremainconstantatallvolumesofoutput.
4. Thesellingpriceremainsconstantatalllevelsofoutput
5. Thevolumeofproductionistheonlyfactorthat influencescost.
6. Thereisonlyoneproductorinthecaseofmultipleproducts, salesmixremainsstable.

6.BreakEvenPoint

The point which breaks the total cost and the selling price evenly to show the level ofoutput or sales at which there shall be no profit or no loss is called " Break Even Point".In otherwords,thepointofsalesvolumeatwhichtotalrevenueisequaltototalcost.

7. Margin ofSafety

The excess of actual or budgeted sales over the break even sales is called the Margin ofsafety.Themarginofsafetyiscalculatedinrupees,unitsoreveninpercentageform.

ThisMarginofsafetycanbeimprovedbyadoptingthefollowingsteps:

1. Byincreasingthe volumeofproduction
2. Byincreasing thesalepriceoftheproduct
3. Byreducingthefixedcostthroughadoptingtheinnovativetechnologies
4. Byreducingthevariablecostbymeansofcostreductionandcostconsciousnessprinciples.
5. Byeliminatingunprofitable products
6. Byadopting the optimalsalesmixtoincrease the viabilityofthe product.

Formula's

1. P.V.R=(Contribution/Sales)x100
2. P.V.R=(Changesinprofit/Changesinsales)x100
3. B.E.P.(inunits)=Fixedexpenses/Contributionperunit
4. B.E.P(inRs.) =(FixedExpenses/Contributionperunit) xSellingpriceper unit
5. B.E.P(inRs.) =(FixedExpenses/Contribution)xSales
6. B.E.P(inRs.) =Fixed Expenses/PVR
7. MarginofSafety=Profit/PVR(or)Actualsales– BEPSales
8. No.ofunitstobe soldtoearna profitofRs.---

$$= \frac{\text{(FixedExpenses+DesiredProfit)}}{\text{ContributionPerunit}}$$

ApplicationsofMarginalcosting in DecisionMaking

1. PricingDecision
2. Make orBuyDecision
3. Keyor Limiting Factor
4. SelectionofSuitableproductmix

Explain CVP Analysis.

Definition of Cost Volume Profit Analysis (CVP Analysis)

Cost Volume Profit Analysis (CVP) looks at the impact on the operating profit due to the varying levels of volume and the costs and determines a break-even point for cost structures with different sales volumes that will help managers in making economic decisions for short term.

Importance of Cost Volume Profit Analysis

1. Cost Volume Profit Analysis includes the analysis of sales price, fixed costs, variable costs, the number of goods sold, and how it affects the profit of the business.

2. The volume of sales is dependent upon production volume, which in turn is related to costs that are affected by the volume of production, product mix, internal efficiency of the business, production method used, etc.

3. CVP analysis helps management in finding out the relationship between cost and revenue to generate profit.

4. CVP Analysis helps them to BEP Formula for different sales volume and cost structures.

5. With CVP Analysis information, the management can better understand the overall performance and determine what units it should sell to break even or to reach a certain level of profit.

6. CVP analysis helps in determining the level at which all relevant cost is recovered, which is also called the breakeven point.

7. It is that point at which volume of sales equals total expenses (both fixed and variable). Thus CVP analysis helps decision-makers understand the effect of a change in sales volume, price, and variable cost on the profit of an entity while taking fixed cost as unchangeable.

8. CVP Analysis helps in understanding the relationship between profits and costs on the one hand and volume on the other.

9. CVP Analysis is useful for setting up flexible budgets that indicate costs at various levels of activity. CVP Analysis also helpful when a business is trying to determine the level of sales to reach a targeted income.

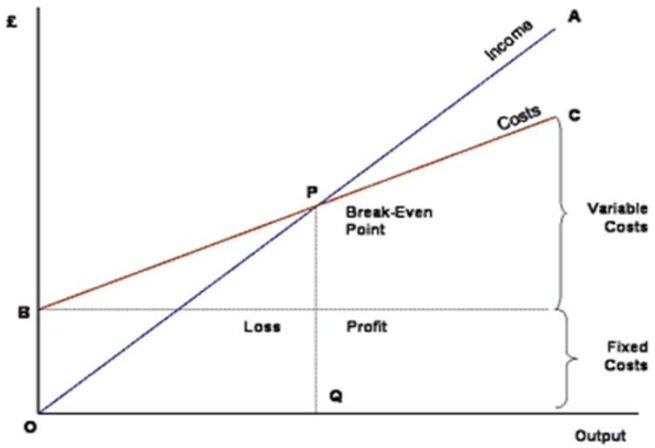
5. BEP Analysis

What is a Break-Even Analysis?

Break-even is a situation where an organisation is neither making money nor losing money, but all the costs have been covered.

Break-even analysis is useful in studying the relation between the variable cost, fixed cost and revenue. Generally, a company with low fixed costs will have a low break-even point of sale. For example, say Happy Ltd has fixed costs of Rs. 10,000 vs Sad Ltd has fixed costs of Rs. 1,00,000 selling similar products, Happy Ltd will be able to break-even with the sale of lesser products as compared to Sad Ltd.

Break-even chart



The break-even analysis assumptions:

1. The total costs may be classified into fixed and variable costs. It ignores semi-variable cost.

2. The cost and revenue functions remain linear.

3. The price of the product is assumed to be constant.

4. The volume of sales and volume of production are equal.

5. The fixed costs remain constant over the volume under consideration.

6. It assumes constant rate of increase in variable cost.

7. It assumes constant technology and no improvement in labour efficiency.

8. The price of the product is assumed to be constant.

9. The factor price remains unaltered.

10. Changes in input prices are ruled out.

11. In the case of multi-product firm, the product mix is stable.

The advantages of break-even point are as follows-

1. The breakeven point concept gives an accurate estimate of the number of units that must be sold to start making actual profits for the organization

2. The point helps to identify the variable and fixed costs and coordinate the relationship between them

3. It is a measurement tool that is used effectively to set targets

4. The breakeven point can predict the consequence of cost and efficiency changes on the profitability of a business.

5. The breakeven point can help a company to calculate the profit and loss figures at various level of sales and production

6. The organization uses a breakeven point to evaluate future demand

7. It helps to make a viable forecast about the probable effect of the change on the sales price

8. The information provided by the breakeven point helps the management in making important decisions for example while applying for loans, in setting prices and while preparing competitive bids

Limitations of Break-Even Analysis:

1. In the break-even analysis, we keep everything constant.

2. In the break-even analysis since we keep the function constant,.

3. It is not an effective tool for long-range use.

4. Profits are a function of not only output, but also of other factors like technological change, improvement in the art of management, etc.,

5. When break-even analysis is based on accounting data may suffer from various limitations.

6. Selling costs are specially difficult to handle break-even analysis.

7. The simple form of a break-even chart makes no provisions for taxes, particularly corporate income tax.

8. It usually assumes that the price of the output is given .