SUBJECT –MANAGEMENT ACCOUNT (LEC-3)

(B COM)

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IN THIS LECTURE WE ARE GOING TO UNDERSTAND THE TERMS WHICH WOULD HELP US LEARN ABOUT ABSORPTION COSTING

- **Contribution** - Technically or in Costing terminology, contribution means not only profit but also fixed cost. That is why; it is defined as the amount recovered towards fixed cost and profit. Contribution can be computed by subtracting variable cost from sales or by adding fixed costs and profit.
- **Limiting Factor (or) Key Factor** – It indicates the limitation on the particular factor of production. For example - three products take same raw material. A takes 1 kg, B requires 2 kgs, C requires 5 kgs and the raw material is not abundant. In order to arrive at decision of which product to produce, we first find out contribution per unit of key factor and then rank the products.

- **Profit Volume Ratio (P/V Ratio) or Contribution Ratio** – It is the ratio of Contribution to Sales. For example, P/V ratio is 40%, then variable cost ratio is 60%,

- **Break Even Point** - Break Even means the volume of production or sales where there is no profit or loss. In other words, Break Even Point is the volume of production or sales where total costs are equal to revenue.

- **Cash Break-Even Point** - When break-even point is calculated only with those fixed costs which are payable in cash, such a break-even point is known as cash break-even point. This means that depreciation and other non-cash fixed costs are excluded from the fixed costs in computing cash break-even point. Its formula isCash break even point = Cash fixed costs / Contribution per unit.

- **Margin of Safety** - It is the sales point beyond the breakeven point. Margin of safety can be obtained by subtracting break even sales from Total sales. It is useful to determine financial soundness of business enterprise. If margin of safety is high, then the financial position of the enterprise is sound.

Margin of Safety = Total Sales – Break Even Sales
Margin of safety ratio is the ratio of Margin of safety sales to Total sales.

✞ **Standard Cost** - Standard Cost is defined as “the predetermined cost that is calculated at the management’s standards of efficient operations and the relevant necessary expenditure”. The distinction between Standard Costs and Estimated Costs should be clearly understood. Estimated Costs are intended to determine what the costs ‘will’ be. Standard Costs aim at what costs ‘should’ be.