By
Dr. Shweta Goel
Department of Commerce
Sinha College (Aurangabad)

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Paper 1 : Financial Accounting and Analysis
Key words and formula.

1. **Break even point (B.E.P.)** → This is a situation of no profit no loss. It means contribution is just enough to cover the fixed cost
ie. contribution = fixed cost
It also means contribution generated by all sales beyond break-even point will directly result into profit. So every business should reach B.E.P. as early as possible.

B.E.P. (in quantity) $\frac{F.C.}{\text{Contribution/unit}}$ $\left[\frac{F.C.}{C/\text{unit}}\right]$

B.E.P. (in amount) $\frac{F.C.}{P/V \text{ Ratio}}$

2. **Contribution** = (i) sales − variable cost
(ii) fixed cost + Profit

3. **Fixed cost** → It is the cost that remains fixed or constant irrespective the level of activity. It tends to vary with time rather than amount of activity.

4. **Marginal cost** → It is defined as the amount at any given volume of output by which the aggregate cost are changed if the volume of output is increased or decreased by one unit.

⑤ Margin of safety – These are the sales beyond Break-Even point.

i) M.O.S. = sales – Break Even sales

$$= \text{sales} - \frac{\text{F.C}}{\text{P/V ratio}}$$

$$= \frac{\text{Profit}}{\text{P/V ratio}}$$

⑥ P/V ratio – profit-volume ratio

– This ratio indicates the contribution earned with respect to one rupee of sales.

$$\text{P/V ratio} = \frac{\text{contribution}}{\text{sales}} \times 100.$$

As in the short run, fixed cost remains the same, if there is any changes in profits, that is due to change in contribution.

$$\frac{\text{change in profit}}{\text{change in sales}} \times 100$$

⑦ Variable cost ⇒ The cost varies in direct proportion with the level of activity or volume of operation.