

5.4 Costs

Name: _____ Class: _____ Date: _____

Total: 27 marks

KEY WORDS break-even • fixed costs • contribution
• margin of safety • break-even point

Objective

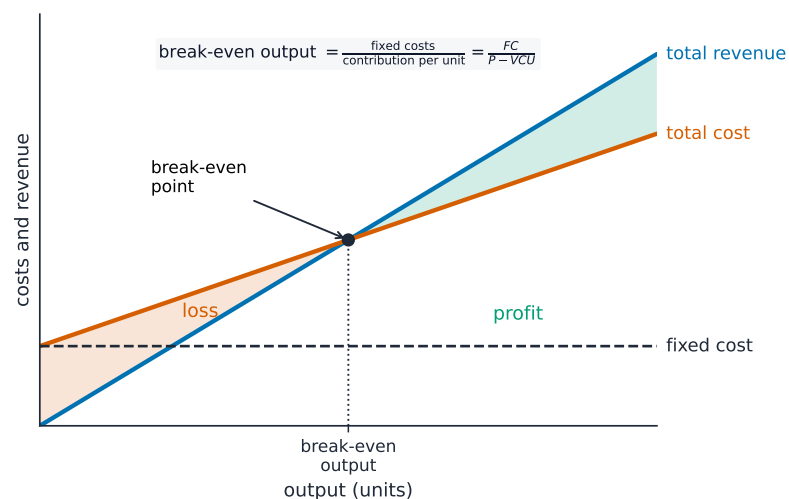
Build the skills to answer exam questions on **costs** – fixed, variable, direct and indirect costs, **contribution**, break-even, and the **margin of safety**.

You must be able to:

- classify costs and calculate contribution per unit
- calculate the **break-even output** and the **margin of safety**
- analyse the uses and limitations of break-even analysis

1 Key knowledge and worked examples

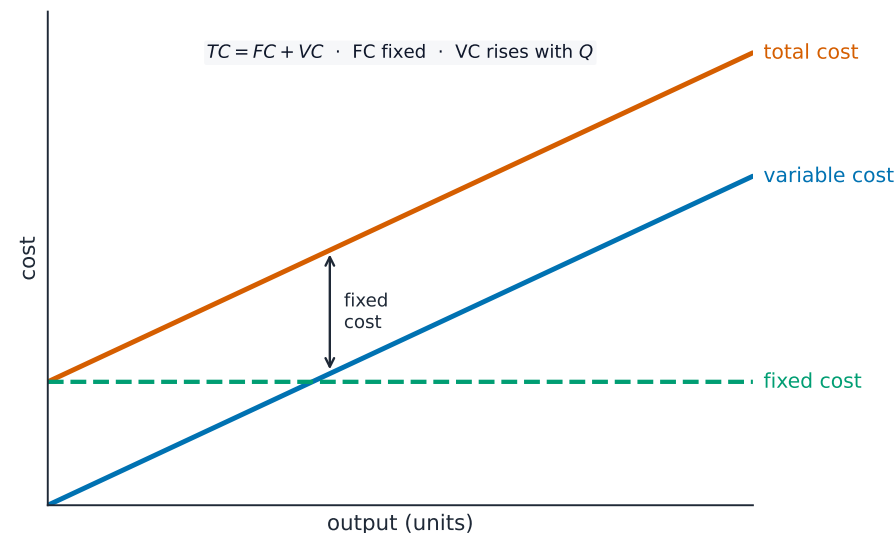
■ Contribution and break-even



Break-even is where total revenue equals total cost

$$\text{contribution per unit} = \text{selling price} - \text{variable cost} \quad \text{break-even} = \frac{\text{fixed costs}}{\text{contribution per unit}}$$

- **Worked:** sell at \$20, variable cost \$12 → contribution = \$8. Fixed costs \$40,000 → break-even = $\frac{40000}{8} = 5,000$ units.
- **Margin of safety** = actual output – break-even output. At 6,000 units → 6000 – 5000 = 1,000 units.
- **Fixed costs** don't change with output (rent); **variable costs** do (materials).



Cost classification: total cost = fixed cost + variable cost

Answer shapes: AO1 + AO2 + AO3 (reasoning chain) + AO4 (a supported judgement *in context*).

2 Practice

2.1 Define the term *fixed cost*.

[2]

2.2 A product sells for \$18 and has a variable cost of \$11. Calculate the contribution per unit.

[2]

2.3 State the difference between a *direct* and an *indirect* cost. [2]

3 Exam-style questions

3.1 Explain one limitation of break-even analysis. [3]

3.2 A firm sells a product for \$25. The variable cost is \$15 per unit and fixed costs are \$50,000.

(a) Calculate the contribution per unit. [2]

(b) Calculate the break-even output. [2]

(c) The firm produces 7,000 units. Calculate the margin of safety. [2]

3.3 Evaluate the usefulness of break-even analysis to a small business. [12]