



SNS College of Technology

Coimbatore - 35



23BAT605 – FINANCIAL STATEMENT ANALYSIS
Unit IV – MARGINAL COSTING

Topic: Guess?????



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Topic....

WHAT IS A MARGIN
OF SAFETY?





MARGIN OF SAFETY

A business is profitable when revenue exceeds the costs. A part of the revenue is used to cover the breakeven costs, while the remaining part is profit.

This remaining part is called the Margin of Safety.

DEFINITION

It is the difference between revenue and breakeven point.

Margin of Safety (in Ratio terms)
(Revenue-Breakeven Point)/Revenue

FORMULAE

Margin of Safety (in Amount Terms)
Total Revenue – Break Even Point

Margin of Safety (in Unit Terms)
(Total Revenue-Breakeven Point)/(Selling Price per Unit)





Margin of Safety

$$\text{Margin} = \frac{(\text{Current sales level} - \text{breakeven point})}{\text{Current sales level}} \times 100$$





MARGIN OF SAFETY

- ▶ Margin of safety represents the strength of the business. It enables a business to know what is the exact amount it has gained or lost and whether they are over or below the break even point.
- ▶ margin of safety = (current output – breakeven output) OR
- ▶ Margin of safety = actual sales – BEP sales
- ▶ margin of safety% = $(\text{current output} - \text{breakeven output}) / \text{current output} \times 100$





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Margin of Safety Example

Sales	\$	4,200,000
Variable Expenses	\$	1,000,000
Contribution Margin	\$	0.76
Fixed Expenses	\$	3,015,000
Break Even Point	\$	3,957,188
Margin of Safety		5.8%





BREAKEVEN POINT v s . MARGIN OF SAFETY

BREAK EVEN POINT

It is the level of sales where a total of fixed and variable cost equals total revenues. No profit and no loss situation.

MARGIN OF SAFETY

It is difference between actual/budgeted sales and level of breakeven sales.

Lower the BEP, better is for company. Higher the margin of safety, better is for company.

A D V A N T A G E S

- ✓ Helps in understanding the relationship between FC, VC and profitability.
- ✓ Provides minimum level of sales to be achieved
- ✓ Indicates impact on profitability due to change in selling price
- ✓ Helps in decision making

A D V A N T A G E S

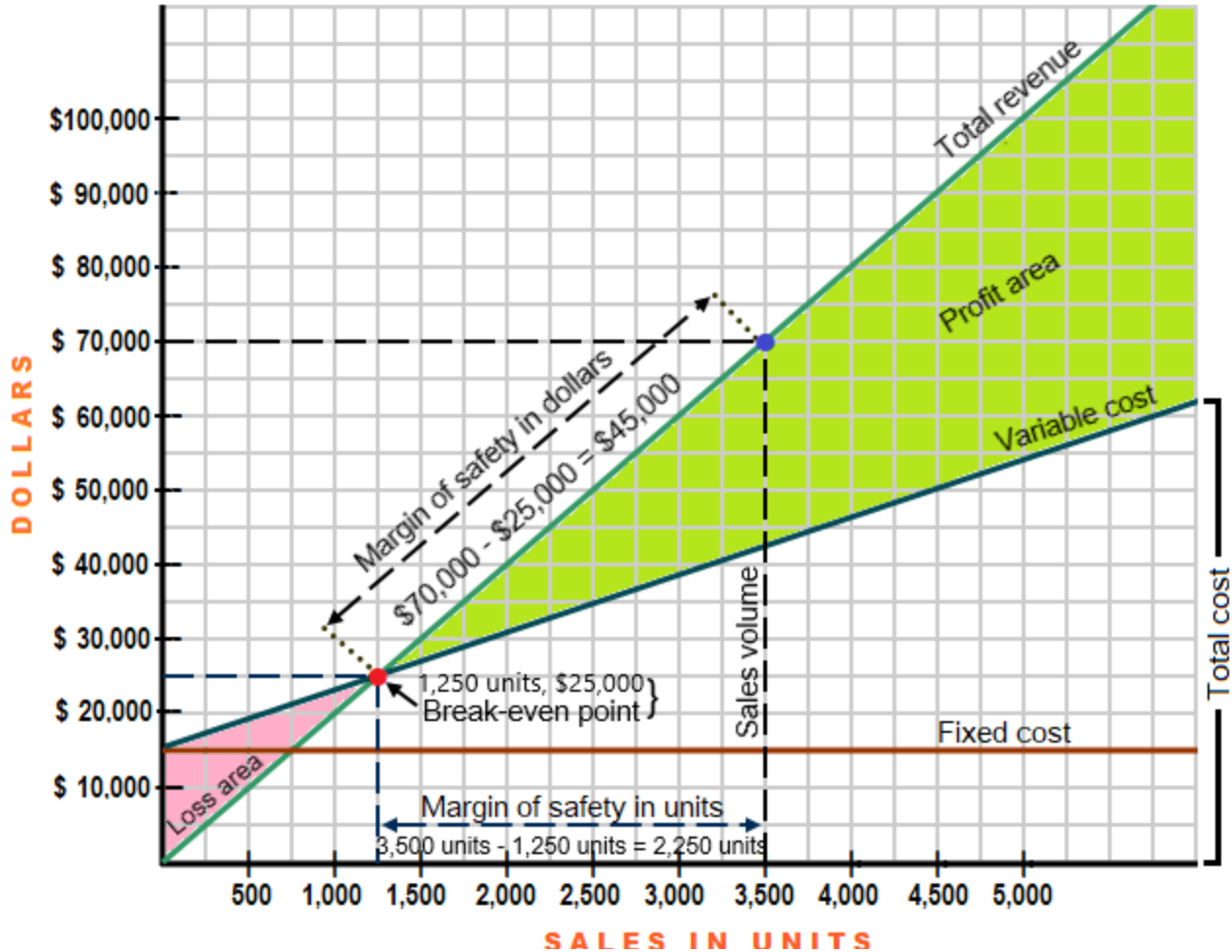
- ✓ Helps in understanding the level of cushion that company has.
- ✓ Helps in making decision about altering selling price to gain market share.
- ✓ Allows the company to spend on advertisement to increase the sales.

D I S A D V A N T A G E S

- ✓ Fails to give results when the analysis being made is of multiple product scenario.

D I S A D V A N T A G E S

- ✓ The margin of safety, if turns out to be very high, may cause management to lead to inappropriate use of excess funds.





Example

- The Fine Distributors is a trading firm. It provides you the following data:
- Actual sales: \$75,000
- Margin of safety: \$15,000
- Calculate break-even sales of Fine Distributors.





Solution

- Margin of safety = Actual sales –
Break-even sales
 $\$15,000 = \$75,000 - \text{Break-even sales}$
Break-even sales = $\$75,000 -$
 $\$15,000$
Break-even sales = $\$60,000$





Time for the assessment...



What is Margin of Safety if Sales is 20,000 units and B.E.P is 15,000 units.

- a) 35,000 units
- b) 5,000 units
- c) Rs 5,000
- d) Rs 35,000





Summary

Margin of safety





References...



- <https://www.accountingformanagement.org/margin-of-safety/>
- <https://corporatefinanceinstitute.com/resources/knowledge/finance/margin-of-safety-formula/>



Thank
you





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