

## 6 Assumptions of CVP

This chapter has presented information on how to apply CVP for business analysis. Most of this analysis is keyed to a model of how profitability is impacted by changes in business volume. Like most models, there are certain inherent assumptions. Violating the assumptions has the potential to undermine the conclusions of the model. Some of these assumptions have been touched on throughout the chapter:

1. Costs can be segregated into fixed and variable portions
2. The linearity of costs is preserved over a relevant range (i.e., variable cost is constant per unit, and fixed cost is constant in total)
3. Revenues are constant per unit and multiple-product firms meet the expected product mix ratios

One additional assumption is that inventory levels are fairly constant, with the number of units produced equaling the number of units sold. If inventory levels fluctuate, some of the variable and fixed product costs may flow into or out of inventory, with a variety of potential impacts on profitability.