Unit 1

Company accounts

A **company**, abbreviated as **co.**, is a legal entity made up of an association of people, be they natural, legal, or a mixture of both, for carrying on a commercial or industrial enterprise. Company members share a common purpose, and unite to focus their various talents and organize their collectively available skills or resources to achieve specific, declared goals. Companies take various forms, such as:

- voluntary associations, which may include non profit organizations
- business entities with an aim of gaining a profit
- financial entities and banks

A company or association of persons can be created at law as a legal person so that the company in itself can accept limited liability for civil responsibility and taxation incurred as members perform (or fail to discharge) their duty within the publicly declared *"birth certificate"* or published policy.

Companies as legal persons may associate and register themselves collectively as other companies – often known as a corporate group. When a company closes, it may need a *"death certificate"* to avoid further legal obligations.

Types of company

(A) On the basis of incorporation:

On the basis of incorporation, companies can be classified as:

(i) Chartered companies

(ii) Statutory companies

(iii) Registered companies

(i) Chartered companies:

The crown in exercise of the royal prerogative has power to create a corporation by the grant of a charter to persons assenting to be incorporated. Such companies or corporations are known as chartered companies. Examples of this type of companies are Bank of England (1694), East India Company (1600). The powers and the nature of business of a chartered company are defined by the charter which incorporates it. After the country attained independence, these types of companies do not exist in India.

(ii) Statutory companies:

A company may be incorporated by means of a special Act of the Parliament or any state legislature. Such companies are called statutory companies, Instances of statutory companies in India are Reserve Bank of India, the Life Insurance Corporation of India, the Food Corporation of India etc. The provisions of the Companies Act 1956 apply to statutory companies except where the said provisions are inconsistent with the provisions of the Act creating them. Statutory companies are mostly invested with compulsory powers.

(iii) Registered companies:

Companies registered under the Companies Act 1956, or earlier Companies Acts are called registered companies. Such companies come into existence when they are registered under the Companies Act and a certificate of incorporation is granted to them by the Registrar.

<u>(B) On the basis of liability:</u>

On the basis of liability the company can be classified into:

(i) Companies limited by shares

(ii) Companies limited by guarantee

(iii) Unlimited companies.

(i) Companies limited by shares:

When the liability of the members of a company is limited to the amount if any unpaid on the shares, such a company is known as a company limited by shares. In a company limited by shares the liability of the members is limited to the amount if any unpaid on the shares respectively held by them. The liability can be enforced during existence of the company as well as during the winding up. Where the shares are fully paid up, no further liability rests on them.

(ii) Companies limited by guarantee:

It is a registered company in which the liability of members is limited to such amounts as they may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up. In the case of such companies the liability of its members is limited to the amount of guarantee undertaken by them. Clubs, trade associations, research associations and societies for promoting various objects are various examples of guarantee companies.

(iii) Unlimited companies:

A company not having a limit on the liability of its members is termed as unlimited company. In case of such a company every member is liable for the debts of the company as in an ordinary partnership in proportion to his interest in the company. Such companies are not popular in India.

(C) On the basis of number of members:

(i) Private company:

A private company means a company which by its articles of association:

(i) Restricts the right to transfer its shares

(ii) Limits the number of its members to fifty (excluding members who are or were in the employment of the company) and

(iii) Prohibits any invitation to the public to subscribe for any shares or debentures of the company.

(iv) Where two or more persons hold one or more shares in a company jointly, they are treated as a single member. There should be at least two persons to form a private company and the maximum number of members in a private company cannot exceed 50. A private limited company is required to add the words “Private Ltd” at the end of its name.

(ii) Public company:

A public company means a company which is not a private company. There must be at least seven persons to form a public company. It is of the essence of a public company that its articles do not contain provisions restricting the number of its members or excluding generally the transfer of its shares to the public or prohibiting any invitation to the public to subscribe for its shares or debentures. Only the shares of a public company are capable of being dealt in on a stock exchange.

(D) According to Domicile:

(i) Foreign company:

It means a company incorporated outside India and having a place of business in India.

According to Section 591 a foreign company is one incorporated outside India:

(a) Which established a place of business within India after the commencement of this Act
(b) Which had a place of business within India before the commencement of this Act and continues to have the same at the commencement of this Act.

(ii) Indian Companies:

A company formed and registered in India is known as an Indian Company.

Difference between public co. & private co.

Point of Difference	Private Company	Public Company
No. of members	2 - 50 members.	7 – no limit members.
No. of Directors	Min. 2 directors to fill quorum.	Min. 3 directors are needed.
Invitation to general public	Does not invite general public to subscribe to its shares, debentures and public deposits.	Does invite general public to subscribe to its shares, debentures, public deposits.
Transfer of Shares	Prior permission required for transfer of shares	Free transfer of shares is permitted.
Prospectus	Need not issue prospectus.	It is compulsory to issue a prospectus or a statement in lieu of prospectus.
Statutory meeting and report	No compulsion for holding Statutory meeting and filling of statutory report.	It needs to hold a statutory meeting and must file a statutory report.
Legal formalities	Exempted from various legal formalities.	Has to comply with many legal formalities.
Min. paid up capital	Rs. 1 lakh	Rs. 5 lakh.

Shares and its types

Shares mean a part in the ownership of the company. Issuing shares to the investors and the general public is a method to raise capital for the company and provide the shareholders with a small wedge of ownership in the business. There are various types of share a company can choose to issue to its potential investors. However, there are 4 most preferred kinds of shares issued by companies in India.

Under the Companies Act, 2013, a share certificate needs to be issued by a business every year post its incorporation, stating the names of persons who are owners of the company's shares. Every company needs to adhere to the Annual Compliance of issuance of share certificate within 2 months after its incorporation.

In case the company defaults in adhering to the compliance relating to the issuance of share certificates, it would be punishable with a minimum fine of Rs. 25,000 that could extend up to Rs. 5 lakhs. Every defaulting officer of the company would also face a fine of Rs. 10,000 which could extend up to Rs. 1 lakh.

Types of Shares

1. **Equity Shares**: Also known as the ordinary shares, equity shares are the most common type of share. Equity shares are equal in value and also impart voting and other rights, dividend and other such rights to the shareholders. Equity shares are traded on the stock exchange are issued are different face values.
2. **Preference Shares:** As the name suggests, preference shares are preferential in nature. In the events of liquidation of the company, the preferential shareholders are paid out first after settling the debts of the creditors of the company. However, preference shareholders do not get a voting right. There are different types of preference shares including:

- **Cumulative Preference Shares:** A cumulative preference shareholder has a right to claim fixed dividend of the current year out of the future profits. The dividend accumulates unless it is paid to the shareholder. The accumulated arrears of dividend are to be paid before anything is paid out of the profits to the holders of any other class of shares.

- **Non-cumulative Preference Shares:** Non-cumulative preference shares are those shares wherein the dividend is paid only out of the profits earned by the company in the financial year and cannot accumulate to be paid out of profits in future. The shareholder cannot claim any dividend if the company has not earned any profits in that financial year.

- **Participating Preference Shares:** In case of participating shares, the shareholders can claim a fixed rate of dividend as well as participate with the equity shareholders in surplus profits remaining after the dividend is paid to equity shareholders.

- **Non-participating Preference Shares**: The shareholder can only claim a fixed rate of dividend and cannot participate in the surplus profits of the company.

- **Convertible Preference Shares:** The shareholders get a right to convert their preference shares into equity shares within a certain period of time.

- **Non-convertible Preference Shares:** These preference shares cannot be converted into equity shares at a later stage.

- **Redeemable Preference Shares**: Redeemable preference shares can be redeemed after a certain period or after giving a certain notice at any time at the will of the company out of the profits of the company or sale proceeds of the new shares.

- **Irredeemable Preference Shares:** Irredeemable preference shares are permanent in nature and cannot be redeemed during the lifetime of the company.

<u>Difference between equity shares & preference shares</u>

DIFFERENCE BETWEEN EQUITY AND PREFERENCE SHARES

Bases of differences	Preferences shares	Equity shares
Rate of dividend	Preference shareholders are paid dividend at a fixed rate	The rate of dividend on equity shares may vary from year to year and depending upon the available of profit.
Arrears of divided	Holders of cumulative preference shares can get the arrears of past dividend.	Equity shareholders cannot get the arrears of past dividends
redeem ability	Preference shareholders do not have the right to participate in the management of the company.	Equity shareholder enjoy voting rights
Voting right	Preference shareholders do not have right to participate in the management of the company.	Equity shareholder enjoy voting rights
Payment of dividend	These shares have a preferential right to receive dividend before any dividend is paid to equity share.	Payment of dividend to equity shares is made only after paying to preference shares.
convertibility	These shares are convertible.	These shares are not convertible.

Debenture

The word ‘debenture’ itself is a derivation of the Latin word ‘debere’ which means to borrow or loan. Debentures are written instruments of debt that companies issue under their common seal. They are similar to a loan certificate.

Debentures are issued to the public as a contract of repayment of money borrowed from them. These debentures are for a fixed period and a fixed interest rate that can be payable yearly or half-yearly. Debentures are also offered to the public at large, like equity shares. Debentures are actually the most common way for large companies to borrow money.

Types of Debentures

There are various types of debentures that a company can issue, based on security, tenure, convertibility etc. Let us take a look at some of these types of debentures.

- ***Secured Debentures:*** These are debentures that are secured against an asset/assets of the company. This means a charge is created on such an asset in case of default in repayment of such debentures. So in case, the company does not have enough funds to repay such debentures, the said asset will be sold to pay such a loan. The charge may be fixed, i.e. against a specific assets/assets or floating, i.e. against all assets of the firm.
- ***Unsecured Debentures:*** These are not secured by any charge against the assets of the company, neither fixed nor floating. Normally such kinds of debentures are not issued by companies in India.
- ***Redeemable Debentures***: These debentures are payable at the expiry of their term. Which means at the end of a specified period they are payable, either in the lump sum or in installments over a time period. Such debentures can be redeemable at par, premium or at a discount.
- ***Irredeemable Debentures:*** Such debentures are perpetual in nature. There is no fixed date at which they become payable. They are redeemable when the company goes into the liquidation process. Or they can be redeemable after an unspecified long time interval.
- ***Fully Convertible Debentures:*** These shares can be converted to equity shares at the option of the debenture holder. So if he wishes then after a specified time interval all his shares will be converted to equity shares and he will become a shareholder.
- ***Partly Convertible Debentures***: Here the holders of such debentures are given the option to partially convert their

debentures to shares. If he opts for the conversion, he will be both a creditor and a shareholder of the company.

- ***Non-Convertible Debentures***: As the name suggests such debentures do not have an option to be converted to shares or any kind of equity. These debentures will remain so till their maturity, no conversion will take place. These are the most common type of debentures.

Trading account

The account which is prepared to determine the gross profit or gross loss of a business concern is called **trading account**.

It should be noted that the result of the business determined through trading account is not true result. The true result is the net profit or the net loss which is determined through profit and loss account. The trading accounting has the following features:

1. It is the first stage of final accounts of a trading concern.
2. It is prepared on the last day of an accounting period.
3. Only direct revenue and direct expenses are considered in it.
4. Direct expenses are recorded on its debit side and direct revenue on its credit side.
5. All items of direct expenses and direct revenue concerning current year are taken into account but no item relating to past or next year is considered in it.
6. If its credit side exceeds it represents gross profit and if debit side exceeds it shows gross loss.

Trading Account

(For the year ended...)

Dr. Cr.

Particulars		Amount	Particulars		Amount
To Opening stock		Xxx	By Sales	xxx	
To Purchases	xxx		Less: Return Inwards	(xxx)	Xxx
Less: Return Outwards	(xxx)	Xxx	By Closing stock		Xxx
To Wages		Xxx	By Gross Loss		Xxx
To Carriage Inwards		Xxx			
To Freight Inwards/cartage		Xxx			
To Gross Profit c/d		Xxx			
		xxx			xxx

Profit & loss account

The account, through which annual net profit or loss of a business is ascertained, is called **profit and loss account**. Gross profit or loss of a business is ascertained through trading account and net profit is determined by deducting all indirect expenses (business operating expenses) from the gross profit through profit and loss account. Thus profit and loss account starts with the result provided by trading account.

The particulars required for the *preparation of profit and loss account* are available from the trial balance. Only indirect expenses and indirect revenues are considered in it. This account starts from the result of trading account (gross profit or gross loss). Gross profit is shown on the credit side of the profit and loss account and gross loss is shown on the debit side of this account. All indirect expenses are transferred on the debit side of this account and all indirect revenues on credit side. If the total of the credit side exceeds the debit side, the result is "net profit" and if the total of the debit side exceeds the total of the credit side, the result is net loss. As the net profit or net loss of a certain accounting period is determined through profit and loss account.

Profit & Loss Account

Dr. (For the year ended…) Cr.

Particulars	Amount	Particulars	Amount
To Gross loss b/d	Xxx	By Gross Profit b/d	Xxx
To Salaries	Xxx	By Discount Received	Xxx
To Office rent, rates and taxes	Xxx	By Commission Received	Xxx
To Printing & stationery	Xxx	By Bank Interest	Xxx
To Telephone expenses	Xxx	By Rent received	Xxx
To Postage & telegram	Xxx	By Dividend on shares	Xxx
To Discount Allowed	Xxx	By Interest earned on debentures	Xxx
To Insurance	Xxx	By Profit on sale of asset	Xxx
To Audit Fees	Xxx	By Net loss	Xxx
To Electricity charges	Xxx		
To Repairs & renewals	Xxx		
To Depreciation	Xxx		
To Advertisement	Xxx		
To Carriage Outwards	Xxx		
To Bad Debts	Xxx		
To Provision for Bad debts	Xxx		
To Selling commission	Xxx		
To Bank Charges	Xxx		
To Interest on loans	Xxx		
To Loss on sale of asset	Xxx		
To Net Profit	Xxx		
	xxx		xxx

Balance sheet

Balance sheet is a list of the accounts having debit balance or credit balance in the ledger. On one side it shows the accounts that have a debit balance and on the other side the accounts that have a credit balance. The purpose of a balance sheet is to show a true and fair financial position of a business at a particular date. Every business prepares a balance sheet at the end of the account year. A balance sheet may be defined as:

1. "It is a statement of assets, liabilities and owner's equity (capital) on a particular date".
2. "It is a statement of what a business concern owns and what it owes on a particular date". What is owns are called assets and what it owes are called liabilities.
3. "It is a statement which discloses total assets, total liabilities and total capital (owner's equity) of a concern on a particular date".
4. "It is a statement where all the ledger account balances which remain open after the preparation of trading and profit and loss account, find place".

Balance sheet is so called because it is prepared with the closing balance of ledger accounts at the end of the year. It has two sides - assets side or left hand side and liabilities side or right hand side. The accounts have a debit balance are shown on the asset side and those have a credit balance are shown on the liabilities side and the total of the two sides will agree.

An asset means all the things and properties under the ownership of the business i.e. building, plant, furniture, machinery, stock, cash etc. Assets also include anything against which money or service will be received i.e. creditors accrued income, prepaid expenses etc.

Liabilities means our dues to others or anything against which we are to pay money or render service, i.e. creditors, outstanding expenses, amount payable to the owner of the business (capital) etc.

Asset side of the balance sheet indicates the different types of assets owned by a concern, while liabilities side discloses the various sources through which funds have been obtained in order to acquire those assets. Balance sheet reveals the financial position of the firm on a particular date at a point of time, so it is also called "***position statement***". It is prepared on the last day of the accounting year and discloses concern for the whole year cannot be determined through the balance sheet because financial position is ever changing.

Balance sheet. As at………………………..

Liabilities	Rs.	Assets	Rs.
share capital		**Fixed assets**	
Authorised :		Goodwill	
2,00,000 equity shares @Rs10 each		Premises	
10,000 10% preference shares		Less: Depriciation	
@Rs. 100 each			
		kitchen equipment	
Issued suscribed & paid-up:		Less: Depreciation	
1,50,000 equity shares of Rs.10		fixtures & fittings	
each fully paid up		Less: Depreciation	
5,000 10% prefrence shares of		office equipment	
Rs.100 each fully paid up		Less: Depreciation	
		office furniture	
Reserves & surplus		Less: Depreciation	
General reserves		Restaurant furniture	
Add: Transfer		Less: Depreciation	
profit & loss A/C			
		Current Assets, Loans & advances	
Secured loans			
6% debentures		A] Current Assets:	
		Glass, china, cutlery	
Current liabilities & Provision		Stock: food	
A] Current liabilities		liquor	
sundry creditors		Tobacco	
O/s debentures interest		Banqueting Debtors	
		Cash at bank	
B] Provisions:		Cash in hand	
Proposed preference dividend			
Proposed equity dividend			

Profit & loss appropriation account

Profit and Loss appropriation Account is prepared after Trading & P/L Account which is prepared to distribute the net profits into general reserve, salary, commission, interest on capital etc.

Profit & loss Appropriation A/c for the period ended …………….

Illustration 1

From the following is the trial balance of Vishal Ltd., prepare the Balance Sheet of the company as on 31st March 2015 as per Schedule **III** of the Companies Act.

Trial Balance as on 31st March 2015

Debit	Rs.	Credit	Rs.
Advances to employees	3,00,000	Equity Share Capital	52,00,000
Cash at Bank	3,14,320	Capital Reserve	60,000
Furniture & Fixture	7,50,000	Loan from SBI	8,00,000
Premises	41,09,940	Provision for Employees Welfare Fund	6,00,000
Patents	10,00,000	Proposed Dividend	1,64,000
Discount on issue of shares(unwritten off)	25,000	Short term loan rom bank	4,90,200
Trade Receivables	3,66,240	Unpaid dividend	64,800
Advance Tax	50,000	Profit & Loss A/c	42,980
8% Govt. Bonds	3,36,000	Bills Payable	85,100
Stock in trade	3,55,600	Sundry Creditors	1,00,020
	========		========
	76,07,100		76,07,100
	========		========

Balance Sheet of Vishal Limited as on 31st March 2014

`Particulars	Note No.	Amount (Rs.)
I.EQUITY AND LIABILITIES		
1 Shareholders' funds:		
(a) Share capital		52,00,000
(b) Reserves and surplus	1	1,02,980
2 Share application money pending allotment:		Nil
3 Non-current liabilities:		
(a) Long-term borrowings		8,00,000
(b) Long-term provisions		6,00,000
4 Current liabilities:		
(a) Short-term borrowings		4,90,200
(b) Trade payables	2	1,85,120
(c) Other current liabilities		64,800
(d) Short-term provisions		1,64,000
TOTAL		**76,07,100**
II.ASSETS		
1.Non-current assets:		
(a)**Fixed assets**		
(i) Tangible assets	3	48,59,940
(ii) Intangible assets		10,00,000

(b) **Other non-current assets**		25,000
2 . Current assets:		
(a) Current investments		3,36,000
(b) Inventories		3,55,600
(c) Trade receivables		3,66,240
(d) Cash and cash equivalents		3,14,320
(e) Short-term loans and advances		3,00,000
(f) Other current assets		50,000
TOTAL		**76,07,100**

Solution: Notes to the Financial Statement:

1. Reserve and Surplus

Capital Reserve	60,000
Profit & Loss A/c (Cr. Bal.)	42,980
Total	**1,02,980**

2. Trade Payables

Sundry creditors	1,00,020
Bills payable	85,100
Total	**1,85,120**

3. Tangible Fixed Assets

Premises	41,09,940
Furniture & Fixture	7,50,000
Total	**48,59,940**

************************ **Illustration 2.**

From the following Ledger balances of Varun LTD., prepare the Balance Sheet of the company as on 31st March 2014 as per Schedule III of the Companies Act.

Particulars	Rs.	Particulars	Rs.
Plant & machinery	6,00,000	Immovable property	10,00,000
8% Debenture	8,00,000	Public deposit	5,00,000
Employee's provident Fund	1,30,000	Provision for taxation	1,80,000
Securities premium	80,000	Drafts on hand	5,00,000
Cash at bank	34,000	Bills Receivable	2,40,000

24000 fully paid Equity shares of Rs.100 each Rs. 50 called up	12,00,000	Brokerage on issue of shares	1,10,000
Sundry Creditors	1,16,000	Bank overdraft	1,50,000
Loan to Manager	70,000	Security Deposit	1,24,000
Deposits with ICICI Bank(5 years)	1,98,000	Trade marks	1,80,000
Prepaid insurance	1,00,000		

Solution

Balance Sheet of VARUN LTD. as on 31st March 2014

Particulars	Note No.	Amount (Rs.)
I.EQUITY AND LIABILITIES		
1. Shareholders' funds:		
(a) Share capital	1	12,00,000
(b) Reserves and surplus		80,000
2. Share application money pending allotment:		Nil
3. Non-current liabilities:		
(a) Long-term borrowings	2	13,00,000
(d) Long-term provisions		1,30,000
4. Current liabilities:		
(a) Short-term borrowings		1,50,000
(b) Trade payables		1,16,000
(d) Short-term provisions		1,80,000
TOTAL		**31,56,000**
II.ASSETS		
1.Non-current assets:		
(a) Fixed assets		
(i) Tangible assets	3	16,00,000
(ii) Intangible assets		1,80,000
(b) Non-current investment		1,98,000
(c) Long-term loans & advances		1,24,000
(e) Other non-current assets		1,10,000

2 .Current assets:		
(a) Trade receivables		2,40,000
(b) Cash and cash equivalents	4	5,34,000
(c) Short-term loans and advances		70,000
(d) Other current assets		1,00,000
TOTAL		**31,56,000**

Notes to the Financial Statement:

1 .Share Capital

Authorised Capital (24000 Equity shares of Rs.100 each)	**24,00,000** ============
Issued & Subscribed capital (24,000 Equity shares of Rs.100 each)	**24,00,000** ============
Called up & Paid up capital (24000 Equity shares of 80 each)	**12,00,000**
TOTAL	**12,00,000**

2 .Long Term borrowings

8% Debentures	8,00,000
Public deposits	5,00,000
TOTAL	**13,00,000**

3. Tangible Assets

Plant & Machinery	6,00,000
Immovable property	10,00,000
TOTAL	**16,00,000**

4. Cash & Cash equivalent

Cash in hand	34,000
Drafts on hand	5,00,000
TOTAL	**5,34,000**

Illustraion 3.

From the following ledger balances of Regal Limited as on 31st March 2015. You are required to prepare the Balance Sheet as on 31st March 2015 as per Revised schedule III of the Indian Companies Act.

Particulars	Rs	Particulars	Rs
Office Equipment	4,80,600	General Reserve	4,15,000
9% Debentures in APCO Ltd,	2,45,000	Creditors for Goods	1,68,500
Loose Tools	1,63,000	Creditors for expenses	36,000
Plant & machinery	18,00,000	Cash Credit	75,000
Computer Software	83,250	Mortgage loan	3,10,000
Debtors for goods	1,90,000	8%Preference share capital	5,50,000
Advertisement (unwritten off)	30,000	Equity Share Capital	15,00,000
Stores & Spares	1,00,200	Staff Welfare Fund	85,000
Interest accrued on investment	51,000	Provision for Taxation	26,550
Cash at Bank	23,000		

Solution:

Balance Sheet of Regal Limited as on 31st March 2014

Particulars	Note No.	Amount (Rs.)
I.EQUITY AND LIABILITIES		
1 Shareholders' funds:		
(a) Share capital : i)Equity Share Capital		15,00,000
ii)Preference Share Capital		5,50,000
(b) Reserves and surplus		4,15,000
2. Share application money pending allotment:		Nil
3. Non-current liabilities:		
(a) Long-term borrowings		3,10,000
(d) Long-term provisions		85,000
4 .Current liabilities:		
(a) Short-term borrowings		75,000
(b) Trade payables	1	2,04,500
(d) Short-term provisions		26,550

TOTAL		**31,66,050**
II.ASSETS		
1.Non-current assets:		
(a)Fixed assets		
(i) Tangible assets	2	22,80,600
(ii) Intangible assets		83,250
(e) Other non-current assets		30,000
2. Current assets:		
(a) Current investments		2,45,000
(b) Inventories	3	2,63,200
(c) Trade receivables		1,90,000
(d) Cash and cash equivalents		23,000
(e) Other current assets		51,000
TOTAL		**31,66,050**

Notes to the Financial Statement:

1. Trade payables

Creditors for Goods	1,68,500
Creditors for expenses	36,000
Total	**2,04,500**

2. Tangible Fixed Assets

Office Equipment	4,80,600
Plant and machinery	18,00,000
Total	**22,80,600**

3 Inventories

Loose tools	1,63,000
Stores & Spares	1,00,200
Total	**2,63,200**

Unit 2

Chapter 2

Uniform system of accounting for lodging industry

INCOME STATEMENT

'The Profits & Loss A/c is also represented in the form of Income Statement or the Statement of Operations. Hotels prefer preparing monthly Income Statements in order to know the operational results. as it reveals both revenues and expenses to a specific period. Revenues are inflows of assets like cash generated from the sale of' rooms, bar, food and other services to customers, whereas expenses are the use of assets in order to generate revenue. Thus, profit or gain denotes increases in assets or reduction in liabilities, whereas losses or expenses denote decrease in assets or increase in liabilities. When the revenues exceed the expenses. the hotel earns profits or income and when expenses exceed revenue, the hotel incurs a loss. Such income statement is prepared for internal use of the management and may be submitted to certain organisations such as financial institutions and investors. in an abbreviated Corm, if required, for any specific purpose.

The form of presentation of an Income Statement in the Hotel Industry differs a bit from the form of Income Statement, i.e., Vertical Trading and Profit & Loss Statement prepared in other industries dealt with in earlier chapters. The first part of the Income Statement corresponds with the Trading A/c. The Trading A/c is prepared to find out the gross profit earned by the organization. By listing the revenue receipts on the credit side and direct cost and expenses on the debit side. The gross profit is arrived at by deducting the direct cost and expenses from the revenue receipts (sales). Likewise, in case of Income Statements. the statement starts with the sales revenue, and the cost of food sold. i.e., cost of sales is deducted from the revenue. Direct expenses are not deducted. The remainder is the gross income (profit) earned. From the gross income, all operating expenses (direct and indirect) are deducted to arrive at the operating income/ profit. From the operating profit non-operating expenses or fixed charges are deducted and non-operating incomes are added in order to arrive at the net income/ profit before tax, from which tax is deducted to arrive at the net income/ profit or the net profit after tax. A simple format of the income statement is as under :

Income Statement

Revenue (Sales) Less : Cost of Sales	
GROSS PROFIT Less : Operating Expenses	
OPERATING PROFIT Less : Fixed Charges / Non-operating Expenses	
: Non-operating Incomes NET PROFIT BEFORE TAX	
I.ess : Income Tax NET PROFIT AFTER TAX	

COMPONENTS OF INCOME STATEMENT

The following are the components of the income statement:

l) Sales/ Revenue/ Income of each revenue-earning department (Point of Sale).

2) Cost of Sales (Food Cost).

3) Operating Expenses.

I) Sales/ Revenue/ Income: Sales refers to the net sales, i.e., sales minus sales return. Generated through various point of sales of a hotel. In case of a departmental income statement net sales will consist of the net

sales of the individual departments, whereas in case are consolidated income statement. it will consist of the net sales of all the departments.

cost of Sales/ Food Cost : The cost of food sold is that portion of the food prepared sold to the customer. The of cost sales of is food only produced that portion is the of total cost of cost food of food produced / ingredients which is used sold or to customers consumed for in production. price. It is. whereas therefore, food, necessary in order to to ascertain arrive at the the quantity, cost of sales and thereby, or food cost cost and of ingredients thereby the consumed gross revenue. in the A production format of of total cost or sales is given below :

2) Cost of Sales

Opening stock		
: Net purchases including stores issues		
Total stock available for consumption		
Less : Closing stock		
Total stock consumed in production		
Less : Staff Meals		
Guest Food Complimentary		
Transfer to other Departments		
Other credits to cost		
Food Cost (Cost of Sales		

Cost of Staff Meals : Hotels normally provide free food to the employees while on duty. Cost of the total food prepared includes cost of meals served to employees. Cost of stalT meals does not form the cost of food sold to customers but forms the cost of employee welfare expenses. Therefore, cost of staff meal is deducted from the food cost and is added to employees' payroll or welfare expenses. Therefore. while preparing the Income Statement. cost of staff meals must be deducted from the cost of sales and added to the employees payroll or welfare cost.

Cost of Complimentary Food : As in case of staff meals, certain portion of the food may have been served free to some hotel guests as complimentary with the objective of promoting business. This portion of food which is served to the customers free of cost is deducted from the cost of sales, as it does not form cost of food sold to customers for a price. However. it forms cost of sales promotion just like advertisement. and hence, must be added to operating expenses while preparing the Income Statement.

Transfer To Other Departments : In some hotels having centralised kitchen with different point of sales, some portion of the food may be transferred from one department to another for sale. The cost of such food is deducted from the total cost of food prepared by the kitchen, since it does not form pan of the food sold to customers directly by the kitchen. The cost of food transferred is deducted from the cost of rood produced. However, the department to which it is transferred will be charged with cost of transtér, and will have to account for it. The concerned department will show it as cost of food and sell it for a price. It will, thus, amount to food revenue of_the respective departments to which it has been transferred. The food revenue less cost of food will reveal the gross profit of that department.

Other Credits To Cost : Sometimes, some portion of the food is not saleable or for some reason not sold. for example, it may be spoiled. spilt or wasted. Cost of such food is ascertained and deducted from the total cost of food produced, as it is not sold to earn revenue. However, such loss due to wastage. spoilage or shortage amounts to expenses and losses and as such shown as operating expenses or overhead cost in the Income Statement.

Organizations place more emphasis on calculating gross profit for the purpose of measuring its operating performance and for control of financial activities. although gross profit is not an actual indicator of the net operating results of the organization. This reliance on the gross profit method of control is due to the inability of the organization to obtain the required information as and when required for the purpose of preparing the Income Statement. in order to know the actual net profit at the end of every month. As gross profit is the result of sales less cost of sales, it enables the management to draw reasonable conclusions in respect of the working of the organizntion as regards its sales and cost of sales.

3) Operating Expenses : Operating expenses and losses are those expenses and losses which are directly or indirectly connected with the operating of the organization. These are controllable expenses and losses and as such. the operational efficiency of the organization is revealed by effective control of such expenses and losses. Operating expenses can be bifurcated as under:

a) Pavroll and Related Expenses : These expenses are related to the staff of the organization and include :

- Salaries
- Wages
- Dearness allowance
- House rent allowance/ accommodation cost
- Paid leave
- Traveling allowance
- Conveyance
- Medical allowance
- Bonus
- Staff welfare expenses
- Gratuity
- Staff uniform expenses
- Employer's Provident Fund contribution

- Employer's F.SIS contribution
- Stipend to trainees
- Cost of employee recruitment

b) Marketing & Selling Expenses : These are expenses related to selling, distribution, advertising sales promotions and related expenses such as:

- Advertisement expenses

- commission paid to travel agents.
- airport representatives.
- airlines and
- any other commission on sales
- print
- Radio and Televisions
- Selling aids
- Agency Fees
- Franchise Fees
- Entertainment expenses
- Gifts & novelties
- Others

- Neon sign and hoarding charges
- Guest food complimentary
- Sales promotion expenses

c) Administrative and General Expense : These will consist of all other operating expenses other then those listed above, which are incurred in course of business such as :

- Gas charges
- Electricity charges
- Printing and stationery
- Postage and telegrams
- Telephone and fax
- Bånk charges
- Legal and professional charges
- Magazines & subscriptions
- Repairs and maintenance
- Carriage or transportation expenses
- Audit fees

- Flower arrangement, supplies & decoration
- Banquet expenses
- Hire charges of equipments & machinery
- Sundry operating expenses
- Stores and supplies
- Glassware, China vases & table vases
- Glasses and mirrors replacement

- License fees

Operational expenses are deducted from the gross profit to arrive at the operational income or income from operations. The higher the operating expenses the lesser the operating profit and vice-versa. 'lhus. in order to increase the operating proit, operating expenses should be kept under control.

4) Fixed Charges / Non-operating Expenses : Fixed charges are those charges or expenses that do not arise on account of operational activities of the organization. Whether the organization conducts its operating activities or not, such charges have to be paid. •lthese charges are : Property rates and taxes..

Non-operating losses are losses that arise on account or fire, theft, accident or on sale o assets:

5) Non-operating Income : Income that does not arise on account of operational activities of the organization are termed as non-operating income. Thesc incomes are :

- Interest received on loans given, deposits given or on investments.
- Rent received
- Dividend received
- Profit on sale of assets or investments

These are to be added to the operating profit in order to arrive at the net profit before tax, on which tax is calculated and deducted. The remainder is the actual net profit or net profit after tax.

INCOME STATEMENT

• REVENUE (SALES)	XXXXXX
Less: Cost of Sales	xxx
GROSS PROFIT	YYYY
Less: Operating Expense	yy
OPERATING PROFIT	ZZZZ
Less: Fixed Charges	zz
Operating Income Before Tax	AAA

Q.1. From the following information, prepare an income statement for A restaurant for the month ending 31st December 2012: In `	
Sales Food	3,50,000/-
Beverage	1,00,000/-
Cost of Sales	30% of food sale
10% of beverage sale	
Salaries & wages	25,000/-
Employee's benefits	20,000/-
Music & entertainment	5,000/-
Marketing expenses	5,000/-
Energy & utility expenses	2,000/-
Administrative & general expenses	8,000/-
Rent	5,000/-
Interest	2,000/-
Depreciation	8,000/-
Income tax	7,500/-
Other income	6,000/-

Particular		Amount
Revenue: Food Beverages	3,50,000 1,00,000	 4,50,000
Less: **Cost of sales**: Food Beverages	1,05,000 10,000	(1,15,000)
Gross Profit		3,35,000
Less: **operating expense** : Salary Employee Benefit Music & ent Marketing exp Energy & utility Administrative exp	25,000 20,000 5,000 5,000 2,000 8,000	 (65,000)
Operating Profit		2,70,000
Less: **Fixed Charges**: Rent Interest Depreciation	5,000 2,000 8,000	 (15,000)
Operating income		2,55,000
Add: **Non-operating Income** (Other income) Earning before Income tax	6,000	 2,61,000
Less: Income tax **NET INCOME**	7,500	 **2,68,500**

Q2) From the following information, prepare an Income Statement of A Hotel Ltd. In accordance with the Uniform System of Accounting for Hotels for the year ending 31st December 2015:

- **Net Sales: In Rupees**
- Rooms 6,50,000/-
- F & B 2,90,000/-
- **Cost of Sales:**
- F&B 1,60,000/-
- Others 40,000/-
- **Rental and Other Income :** 1,25,000/-
- **Payroll and Related Expenses:**
- Rooms 55,000/-
- F & B 39,000/-
- Telephone 6,000/-
- Other Departments 4,000/-

- **Fixed Charges:**
- Interest 6,000/-
- Depreciation 5,000/-
- Rent 2,500/-
- Property Tax 2,800/-
- **Other Expenses:**
- Room 65,000/-
- F&B 20,000/-
- Telephone 4,000/-
- Other department 1,000/-
- **Income Tax** 40%
- **Profit on Sale of Fixed Assets** 15,000/-

Particular		Amount
Revenue: Rooms F&B	6,50,000 2,90,000	 9,40,000
Less: **Cost of sales:** F&B Others	1,60,000 40,000	(2,00,000)
Gross Profit		7,40,000
Less: **operating expense:** Payroll Exp: Room F&B Telephone expense Other Deptt Other expenditure	 55,000 39,000 6,000 4,000 90,000	 (1,94,000)
Operating Profit		5,46,000
Less: **Fixed Charges:** Rent Interest Depreciation Property Tax	2,500 6,000 5,000 2,800	 (16,300)
Operating income		5,29,700
Add: **Non-operating Income** (Other income) Earning before Income tax	1,25,000	 6,54,700
Less: Income tax **NET INCOME**	(2,61,880)	 **3,92.820**

Q3. From the following information you are required to prepare an Income statement of rooms.

Room Sales	2,50,000Rs	Rooms Allowances	96,000Rs
Payroll & related exp.	36,000Rs	Cable & television	21,000Rs
Commission paid	15,000Rs	Contract service	12,000Rs
Guest transportation	10,000Rs	Laundry	6,000Rs
Travel Agent commission	3,000Rs	Operating supplies	3,500Rs
Telecommunication	9,000Rs	Training	9,000Rs
Staff uniforms	2,000Rs		

Unit 3

Chapter I

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NIGHT AUDIT

The front office guest bill must be kept upto date at all time ready for presentation to the guest whenever the guest is ready to check-out. In most or the hotels, especially in hotels accommodating foreigners, check-out occurs early in the morning. There tore, guest charges must be accumulated during the period beginning just before mid-night, i.e., by I p.m. and early morning, i.e., before 7a.m.. after thorough checking, so that strict control is maintained over all guest transactions to ensure recovery all guest charges of each day, by eliminating possible loss of revenue due to errors of omission or commission, fraud, misuse or misappropriation of funds. An accurate bill, free from such errors, must be presented to the guest at the time of check out. This process of' checking guest accounts at mid-night has coined to be known as "Night Audit". The person, who is an employee of the hotel. is normally assigned the responsibility of carrying out such an audit of the guest sale accounts at night, and is called a Night Auditor.

Duties of Night Auditor :

The duties of the night auditor are as follows :

l) To reconcile all sales accounts to ensure that all charges incurred by the guest are correctly posted to the right guest account .

2) To compare what has been posted to the guest account with that which was actually charged in the departmental sales sheets.

3) To set things right if' any discrepancies arc found and prepare a proper report with reconciliation of all charges and present it to the Accounts Department.

Functions of Night Auditor :

The following are the functions of the night auditor :

l") To check it-the previous balances have been properly brought forward i.e., pick balances.

2) To reconcile the record in "Arrival & departure register with receipt and payments in the "F.O.

Cashier's Summary" as well as With guest bills or those who have checked in and checked out to that the advance received from the guest have checked in and recoveries against checked out guests cross tallies.

3) To examine the arithmetical accuracy or charging, percentage calculations. addition and deductions the guest bills or those who have checked out during the day and find out whether all the folios have been accounted tor.

4) To ensure that front office guest bills for all resident guests as per hotel register. arrival & departure register and the room report. have been opened and properly charged with charges becoming due.

5) To Check the arrivals as shown in guest register with arrivals shown in arrival register and cross check with guest folios to ensure that the guest folios have been opened and maintained for all guest who have cheeked in.

INTERNAL AUDIT

Internal audit is the process of verifying accuracy and completeness of accounting records on a regular basis. This routine work is entrusted to one or more individuals either from among the employees of the organisation or from outside either on part time or contract basis. Persons who are adequately qualified and experienced to perform the job of internal audit of all the recorded transaction, are entrusted with the audit responsibility. It is conducted on the basis of internal audit schedule.Ensuring complete examination of each and every recorded financial transaction, from the beginning till the end of the financial year. In the process. errors found and irregularities are detected. If any.are reportedto the concerned authority. Corrective measures are then implemented to avoid recurrence oF' the same.

Tools of Internal Audit :

The following are the tools of internal audit :

i. check-list : To ensure that no operating areas and transactions go unchecked. a schedule of check lists is prepared, which covers the important areas, aspects and transactions to be checked.

ii. Flow Chart : To ensure systematic and chronological order in the process of checking. a flow chart. revealing the order in which to proceed in the system of control, is prepared.

iii. Statistical Sampling : It involves random as well as scheduled checking of individuals and their performances.

iv. Walk through : It involves systematic and complete check or records and each and every transaction from the beginning till the end.

The method of internal audit is similar to statutory audit. The auditor checks all the records of transactions maintained in various books on the basis or supporting documentary evidence on a daily basis. The statutory auditor of theompany cannot function as an internal auditor, as the internal auditor is in the position of an employee under the management. If the statutory auditor functions as an internal auditor. he will not be able,to give an independent and objective report under section 227 of the Companies Act. 1956. The internal auditor is appointed by the management of the organisation and is, therefore, required to report to the management. However the statutory auditor is appointed by the shareholders of the company in accordance with the provisions of section 224 of the Companies Act, 1956 and, therefore, is required to report to the shareholders in the form of Auditor's Repon. The intemal auditor is required to perform his duties strictly in accordance with the needs of the management.

STATUTORY AUDIT

At the end oF every financial year company's accounts are required to be prepared and audited By a person who is a Chartered Accountant within the meaning or the Chartered Accountant Act. 1949. 1

Statutory Auditor is appointed by the company under section 224 of the Companies Act. 1956. and is required to his duties in accordance with the provisions of section 227 of the said Act. For the purpose. the company is required to provide to the auditors all books. records. documents and information. as is required tor auditing. Statutory audit is a check on the company by the members (shareholders) as well as the government in order to find out whether the company has been functioning properly. and whether the picture of the company as portrayed by the management. is true, The statutory auditor has to check each and every record. transaction. Sheet statement and book of the company in order to ascertain the accuracy and correctness of the records maintained. This report is known as Auditor's Report. I f the auditor is satisfied with the books of accounts and information provided, he will make a clear and unqualified report, that in his opinion. and to the best of his intimation. Knowledge and belief and on the basis of provided. the accounts or the company reflect a true and fair view of the company's affairs.

Distinction between Statutory Audit and Internal Audit :.

	Statutory Audit	Internal Audit
1	Statutory audit should be conducted by a statutory/ qualified Chartered Accountant.	Internal audit can be conducted by any person with accounting knowledge and experience.
2	It is a statutory obligation.	It is a management requirement.
3	It is conducted at the end of' relevant accounting year.	It is a continuous process throughout the relevant accounting year.
4	It stresses on compliance with the provisions of law.	It stresses on accuracy in recording transactions and maintaining proper books of accounts in support of and to enable statutory audit.
5	Audit report is required to be placed before the statutory annual general meeting of the shareholders of the company.	Auditors remarks are placed before the management, for action.

Unit III

Chapter 3

Standard costing

What is variance?

Variance is the difference between budgeted and actual level of activity

Thus, variance analysis can be defined as the segregation of total cost variances into different elements in such a way as to indicate or locate clearly the cause for such variances and persons held responsible for them.

TYPES OF VARIANCES

There is a need of knowing types of variances before measuring the variances. Generally, the variances are classified on the following basis.

A. **On the basis of Elements of Cost**.

1. Material Cost Variance.
2. Labour Cost Variance.
3. Overhead Variance.

B. **On the basis of Controllability**

1. Controllable Variance.
2. Uncontrollable Variance.

C. **On the basis of Impact**

1. Favorable Variance.
2. Unfavorable Variance

D. **On the basis of Nature**

1. Basic Variance.
2. Sub-variance.

Material Costing:-

a) Material Price Variance: It is that portion of material cost variance which arises due to difference between the standard price specified and the actual price paid. It reflects the price paid on the units purchased. If the actual price is more than standard price, the variance would be adverse and in case the standard price is more than the actual price, it would result in a favourable variance. It is calculated as under:

Reasons for Material Price Variance : The following are the reasons for deviation or variation in the price of materials :

i. Fluctuations in market prices of material.
2. Emergency purchases made at higher cost.
3. Failure to take advantage of low seasonal prices.
4. Failure to purchase at a time when supplies of material in the market are more at low prices.

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2.Material Usage Variance / Material Volume Variance : It is that portion of material cost variance which arises due to difference between standard quantity or material specified and actual quantity used. If the actual quantity used is more than standard quantity, the itvariance would be adverse and in case the standard quantity is more than the actual quantity used, it would result in a favourable variance.

Reasons ror Material Usage Variance: The following are the reasons for deviation or variation in the usage of materials:

i.Improper examination of material while purchasing. ii.
Careless and abnormal wastage of material. iii. Purchase
of sub-standard material.
iv. Improper methods and procedures of work.
v.Inefficient and inadequately qualified or experienced employees at work.
vi. Too rigid purchase specifications and methods of inspection causing excessive rejection of materials thereby increasing purchase cost.
vii. Use of poor or substandard quality as substitute material in place of standard quality material.
viii. Machinery and equipment are not in proper working conditions. thereby, causing frequent breakdowns, resulting in excess use of material.

Formulas;

Direct material = Standard Cost - Actual Cost
standard CostVariance =StandardPricexStandardQuantity
Actual cost=ActualPricexActual Quantity
Material priceVariance=Actual Quantityx(Standard Price–Actual Price)
Materialusage Variance=StandardRatex(StandardQuantity-Actual Quantity)For actual output

DIRECT LABOUR COST VARIANCE

It reveals the difference between the standard direct wages fixed for the desired activity and the actual direct wages paid. The cost of labour depends upon two factors : wage rate and number of hours worked. The labour variance is worked out as under :

Labour cost Variance = Standard Cost – Actual Cost

StandardRatexStandardTime   Actual RatexActual Time

LabourRate(Wage) Variance=ActualTimex(StandardRate-ActualRate)

LabourEfficiency=Standardrate x(StandardTime-Actualrate)

a) Labour Rate (Wages) Variance : variance is that pan of the labour cost variance, which occurs due to difference between the actual rate paid and the standard rate of pay fixed. If the actual rate is higher than the standard rate, the variance would be adverse and in case the standard rate is more than the actual rate, it would result in a favourable variance.

Reasons for Wage Rate Variance : Following are the reasons for deviation or variation in the rate of labour:

i. Change in wage rate or wage structure.
ii. Overtime wages paid for emergency work or paid in excess of standard rate fixed.
iii. Denying normal or full wages to new employees.
iv. iv. Adopting different methods of wage payments.
v.

b) Labour Efficiency (Time) Variance: It is that part of the labour cost variance, which occurs due to difference between the standard labour hours specified for the activity achieved and the actual labour hours spent for the activity

Reasons for Wage Rate Variance: Following are the reasons for deviation or variation in the rate of labour:

a) Increased labour turnover, which is more in hotel industry.
b) Improper working environment not conducive for efficient working.
c) Dissatisfied employees due to unsatisfactory employer-employee relations.
d) Improper, inadequate, outdated or defective machinery and equi0pments used.
e) .e) Improper or inadequate supervision and control over the activities.
t) Use of substandard material.
g) Improper selection of employees.
h) Inefficiency due to improperly or inadequately qualified and trained personnel working under improper systems and instructions.

Labour variance sums-

Q1) Standard Output=300units   Actual output =180units
Standardtime perunit=3hrs Actual time = 3hrs 30min
Standardrate perunit=Rs.9   Actual rate=Rs.7.50per

StandardCost =Standard ratex Standard time (For actual output)
= 9 x 3 x 180
=4860

Actual cost=actual rate x actual time
=7.50x3.5x180
=4725

Labour cost Variance = Standard Cost – Actual Cost

= 4860 –4725
= 135

Labour Ratevariance= Actual time x(Standard rate-Actualrate)
= 3.5 x 180 (9-750)
= 945

LabourEfficiency=Standardrate x(StandardTime-Actualrate)
=9 x (3 x 180 - 3.5 x 180)
=810

Direct LabourVariance

Direct Cost=StandardCost–ActualCost

Eg. Actual hours = 6000

Actual wage paid = Rs.8,130

Standard rate per hour = Rs.3

Standardhoursproduced=4200

Standard Cost = Standard Rate x Standard Time

=3 x4200=12600

Actual cost =actual rate x actual time

=1.355x 6000= 8130

Labour cost Variance = Standard Cost – Actual cost

=12600 – 8130

= 4470

LabourRateVariance=Actualtimex(StandardRate–ActualRate)

= 6000 x (3 – 1.355)

= 9870

3.Labour EfficiencyVariance=StandardRatex(StandardTime–Actual TIme)

= 3 x (4.200 – 6000)

=(5400)

MATERIAL VARIANCE

For producing 1 Unit

Material x : 6kg @Rs.8per kg

Material Y : 4kg @ Rs.10perkg

In a week , 1000 units were produced and actual consumption was:-

Material x = 5900 kg @Rs.9perkg

Material Y = 4800 kg @Rs.9.50kg

Material price Variance = Actual Quantity x (Standard Price – Actual Price)

X = 5900 x (8-9) = (5900)

Y = 4800 x (10-9.50) = 2400

Material Usage Variance = Standard Rates x (Standard Quantity –Actual Quantity)

X = 8 x (6000 – 5900) = 800

Y = 10 (4000 - 4800)

= (8000)

Material cost Variance = Material Price Variance + Material Usage Variance

= (3500)+(7200)

= (10700) (Actual)

Q.2)

	Quantity	Rate	Variance	Quantity	Rate	Variance
MaterialP	100	Rs.2	200	135	2.40	342
Material	200	RS.3	600	240	2.60	624
TOTAL	300		800	375		948

Material Cost Variance = Standard Cost – Actual Cost
= 800 –948
= (148)

Material Price Variance = Actual Quantity -(Standard Price – Actual Price)
(p)
=135–(2.240)=(54)
(Q)
240(3-2.60)=96

Material Usage Variance = Standard Ratex(Standard Quantity – Actual Quantity)

p=2x(100–135)   Q = 3 x (200 – 240)
= 2x-35   = (120)
= (70)

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