- Returns of previously purchased goods by a customer
- Cancel part or all of a sale

- **Sales Allowances**
  - Occurs when the customers agrees to keep the goods
  - Reduction made in the original sales price
- **Sales Discounts**
  - **Credit Notes** - Business documents that lists the information regarding a sales return or a sales allowance
  - **Debit Notes** - Customer take the initiative to inform the supplier that goods purchased are to be returned
- **Cash Sales**

	RM	RM
Dr. Sales Returns and Allowances	XXX	
Cr. Cash		XXX
Being return of goods by customer		

- **Credit Sales**

	RM	RM
Dr. Sales Returns and Allowances	XXX	
Cr. Account Receivables		XXX
Being return of goods by customer		

Purchases

- **Cash Purchases**

	RM	RM
Dr. Purchases	XXX	
Cr. Cash		XXX
Being purchases paid in cash		

- **Credit Purchases**

	RM	RM
Dr. Purchases	XXX	
Cr. PQR Manufacturing (AP)		XXX
Being purchases on credit		

Transportation Costs

- Cost of transportation of the goods from the supplier to his premises
- Transportation inwards expense / transportation-in expense / freight inwards / carriage inwards
- Parts of the cost of the purchases
- E.g. Suppose XYZ wholesale stores paid cash of RM 300 for goods purchased

	RM	RM
Dr. Purchases	XXX	
Cr. PQR Manufacturing (AP)		XXX
Being purchases paid in cash		

Other Purchases Costs

- Insurance expense on purchases
- Custom duties on purchases
- Taxation on purchases

Purchases Returns and Purchases Allowances

- **Purchases Returns**
  - Also called return outwards
  - Returns to the supplier of previously purchased goods by a customer
  - Cancel part of all of the purchase
- **Purchases Allowances**
  - Occurs when the buyers agrees to keep the goods
  - Reduction made in the original purchase price
- **Cash Purchases**

	RM	RM
Dr. Cash	XXX	
Cr. Purchases Returns & All		XXX
Being return of goods to suppliers		

- **Credit Purchases**

	RM	RM
Dr. Accounts Payable	XXX	
Cr. Purchases Returns & All		XXX
Being return of goods to suppliers		

Determination of the Costs of Goods Sold

Week 2 Introduction to Hospitality Accounting - Spreadsheet

- Methods of transfer pricing -
  - Cost plus a fixed percentage or mark-up
  - Based on market price
  - Market price less a fixed percentage

Distribution of Indirect Expenses

- Indirect expenses may be distributed to the departments by prorating based on sales revenue of each department, number of employees, floor area, etc. as appropriate
- Distribution of indirect expenses is known as full-cost accounting, and enables a manager to know the minimum revenue required to cover all costs, even though the control of some of those costs is not their responsibility

Worked example

- Distribute (or allocate) total marketing expenses $66,900 to the following departments

Department	Sales Revenue	Direct expense	Contributory income	Contributory income %
Rooms	1,150,200	367,300	782,900	68%
Food	851,600	698,600	153,000	18%
Beverage	327,400	208,300	119,100	36%
Miscellaneous	38,200	19,600	18,600	50%
Total			1,073,600	
Total indirect expense		842,400		
Operating income before tax			231,200	

Sales revenue mix effect

- Changes in the sales revenue mix will affect the net income of the hotel / restaurant even if there is no change in total indirect expenses or in total revenue
- This is due to the change in contributory income

Balance sheet items

- **Assets** - resources of value owned by the business entity. Examples of current assets and fixed assets are:
  - Cash on hand, credit card receivables, cast at bank, marketable securities, inventories, accounts receivables, prepaid expenses, property, plant & equipment, other assets (e.g. china, glassware, silver, linen, uniforms, kitchen utensil), deposits, investments, deferred expenses
- **Liabilities** - debts or obligations owed by the business entity. Examples of current liabilities and long-term liabilities are:
  - Accounts payable - trade, Accrued expenses, Income tax payable, Deposits and credit balances, Dividends payable, Mortgages
- **Ownership equity**
  - Equity - the interest of the owners in the enterprise. Examples: capital stock (share capital), paid-in capital (excess of par), retained earnings
- **Limitation of balance sheet**
  - True value - may not be shown because assets are reported at historical cost
  - Internally generated goodwill is not recorded
  - Employee investment - employees are assets to a hospitality business, but this value is not shown in the balance sheet
  - Judgement calls - many items are a matter of judgement or estimates
  - Changing circumstances - balance sheet is a snapshot of the financial position on a particular date. Changes after the date are not reflected

Week 5: Introduction to Hospitality Accounting

28 January 2021 11:50 AM

Ratio Analysis

Ratio Comparisons

- Ratios are comparisons of two fingers which can be expressed in the form of fractions or percentages. Selecting the ratios relevant to a hospitality enterprise is important
- Financial ratios are usually produced from historical accounting information
- For a ratio to have meaning, it must be comparable to a standard or an established base ratio
- A standard ratio could be an industry average
  - Developed through information received from hospitality organization having the same type of activities
  - There can have average operation from which the standard ratios are determined
- Ratio comparisons between similar competitive organizations
- Good technique = compare current operating period ratios with previous operating period ratios
- For example: How does the current room occupancy ratio or seat turnover ratio compare with the same ratio previous month?
- Best method: to evaluate current period ratios to pre-determined standards for that operating period
- The pre-determined standards should consider both internal and external factors affecting the operations
  - **Internal factors**: fixed and variable costs, internal operating policies, changes in sales
  - **External factors**: general economic conditions and what the competition is doing

User of ratio

- **Internal operating management**
  - Responsibility to safeguarding the assets, controlling costs, and maximizing profit for the business operations
  - Ratio evaluation is the technique used by management to monitor the operation's performance against pre-determined standards to determine if the operating budget objective are being achieved
- **Current and potential creditors**
  - Have an equity claim to the assts of the operation - the liabilities
  - A creditor may require the borrower to maintain a specified level of working capital
- **The organization's owners (including shareholders)**
  - Calculate the certain ratios to measure such items as their return on investment or the risk level of their investment

Ratio categories

- **Liquidity ratios**
  - Identify whether the entity is able to meet its short-term obligations (liabilities)
  - **Current Ratio** = Current Assets / Current Liabilities
    - In a hotel, the current ratio is normally higher than 1.5 to 1
  - **Quick Ratio** = (Current Assets - Inventory) / Current Liabilities
    - Also known as the acid test ratio. It shows whether the business is able to pay its current liabilities in the absence of inventory
  - **Working Capital** = Current Assets - Current Liabilities
    - Composition of Current Assets
      - Inventory
      - Accounts receivables
      - Credit card receivables
      - Marketable securities
      - Prepaid expenses
      - Cash
    - Composition of Current Liabilities
      - Accounts payable
      - Accrued expenses
      - Tax payable
      - Current mortgage payable

Current Assets		*Current Liabilities*	
Cash	$30,400		
Credit card receivables	10,208		
Accounts receivable	6,882	Accounts payable	$16,500
Marketable securities	2,000	Accrued expenses	5,000
Inventories	14,700	Taxes payable	20,900
Prepaid expenses	14,900	Current mortgage payable	26,000
	$79,090		$68,400
Working Capital: $CA - CL$ = $79,090 − $68,400 = $10,690			

- **Credit card receivable ratios**
  - May be expressed as a percentage of
    - Total credits sales revenue
    - Total credit card sales revenue
    - Total sales revenue
  - **Average credit card receivables** = (Beginning credit card receivables + Ending credit card receivables) / 2
  - **Credit Card receivables ratio**
    - Average credit card sales / Total credit sales
    - Average credit card receivables / Total credit card sales revenue
    - Average credit card receivables / Total sales revenue
  - **Credit card receivables turnover ratio** = Total credit card sales revenue / Average credit receivables
  - **Credit card receivables average collection period** = 365 days / Credit card receivables turnover ratio
  - **Credit card turnover ratio** = Total credit card sales revenue, Total credit sales revenue, Total sales revenue / Average credit card receivables
- **Account receivables ratios**
  - **Accounts receivable ratio** = Average accounts receivable / Accounts receivable credit sales revenue
  - **Accounts receivable Turnover ratio** = Accounts receivable credit sales revenue / Average accounts receivable
  - **Accounts receivable average collection period** = 365 days / Accounts receivable turnover ratio
- **Profitability ratios**
  - Shows management's effectiveness in income generation

Week 8: Introduction to Hospitality Accounting

20 February 2021 09:04 AM

Costs

Types of Costs

- **Direct cost**
  - Direct cost is one that is traceable to and is the responsibility of a particular operating department or a division
  - Direct costs are also variable costs
  - Costs are controllable
  - Example: sales food and beverages, wages, salaries, operating supplies and services
- **Indirect cost**
  - Indirect cost is one that cannot be identified with and is not traceable to a particular operating department or division
  - Indirect costs are not normally the responsibility of the operating department
  - Indirect costs are also referred to as undistributed costs or overhead costs
- **Controllable and uncontrollable costs**
  - When a manager can influence the amount spent, the cost is controllable. In the short run, some costs are uncontrollable
- **Joint cost**
  - One that is shared by two or more departments or areas
  - For example, a dining room server who serves both food and beverage
  - The server's wages are a joint cost and should be charged partly to the food department and the remainder to the beverage department
- **Discretionary cost**
  - Cost that may or may not be incurred based on the decision of a particular person - e.g. maintenance costs that are not urgent
  - For instance, the building will have to be painted at some time in order to maintain its appearance
- **Relevant and non-relevant costs**
  - A relevant cost is a cost that affects a decision. To be relevant, a cost must be in the future & different between alternatives
- **Sunk Cost**
  - Cost already incurred and nothing can be done about it. It does not affect any future decisions
  - If the same restaurant had spent $250 for an employee to study the relative merits of using mechanical or electronic registers, the $250 is the sunk cost
- **Opportunity Cost**
  - Cost of not doing something. (It is the cost of the next best alternative)
- **Fixed Cost**
  - Cost which do not change in the short run
  - Will not vary with increases or decreases in sales revenue
  - I.e.: management salaries, fire insurance expense
- **Variable Cost**
  - Cost which changes in direct proportion to a sales revenue. If sales revenue is zero, then no variable costs are incurred
- **Semi-fixed or semi-variable costs**
  - Contain both an element of fixed cost and an element of variable cost, e.g. payroll
- **Standard cost**
  - What the cost should be, for a given volume or level of sales

Allocating indirect costs

- Indirect costs are allocated to sales revenue areas or departments on a reasonable basis
- The indirect costs allocated will affect the performance of each department - which is the responsibility of the departmental managers
- Indirect costs are allocated for different management decisions

Management decisions

- Should we operate or rent out?
- Example: Below is the data for a month. We can lease out snack bar for $750 and the new operator will need to pay for the indirect costs $4,650. Should we retain the operations or rent out?

	Dining room	Snack bar	Total
Sales	105,000	45,000	150,000
Direct costs	(75,000)	(39,000)	(114,000)
Contributions	30,000	6,000	36,000
Indirect costs	(16,800)	(7,200)	(24,000)
Operating income	13,200	(1,200)	12,000

- Discussion
  - Distribute Indirect cost Snack bar loss 1,200
  - Lease 750
  - Indirect cost 19,350 assumed by Dining
  - Operating income has decreased 1,800 (13,200-11,400)

Sales revenue	$105,000
Direct costs	(75,000)
Contributory income	$ 30,000
Indirect costs	(19,350)
Income before rent	$ 10,650
Rental income	750
Operating income	$ 11,400

- Adjusted Indirect Cost

	Dining Room	*Snack Bar*	*Total*
Sales revenue	$105,000	$45,000	$150,000
Direct costs	(75,000)	(39,000)	(114,000)
Contributory income	$ 30,000	$ 6,000	$ 36,000
Indirect costs	(19,350)	(4,650)	(24,000)
Operating income	$ 10,650	$ 1,350	$ 12,000

Example 2

- Which piece of equipment should we buy?

- Number of seats available x Seat turnover expected x Average check per meal period x Operating days = Breakfast total sales revenue
- In a rooms department, sales estimations may be as follows:
  - Forecasted occupancy percentage x Average room rate x Number of rooms available x Operating days available = Total rooms sales revenue
- In a bar setting, industry average may be used:
  - Average annual sales revenue per seat x Number of seat available = Total annual sales revenue
- Beverage figures depends on industry guidelines; in a coffee shop serving beer and wine, beverage sales is about 8%-18% of food sales revenue. In a dining room, alcoholic beverage is about 24%-34% of food sales revenue

Zero based budgeting
- Zero-based budgeting requires each department to justify in advance the entire annual budget from a zero base
- No expenses can be budgeted for unless they are justified in advance. E.g. - indirect or undistributed expenses that include general administration, marketing, property operation and maintenance, utilities
- Thus, this method helps managers to control costs and may lead to cost reduction
- Each department is broken down into decision units (e.g. marketing department is divided into sales, advertising, public relations & research units)
- For each decision unit, the department head will document the following:
  - The unit's objective
  - The unit's current activities
  - Justification for continuing the unit's activities
  - Any alternate ways to carry out activities
  - Recommended alternatives
  - Required budget
- Following that, the general manager begins the review process by ranking all activities in order of importance
- The completed ranking and approved expenditures constitute the new budgets which are then incorporated into the regular budget process

Advantages of zero-based budgeting
- Concentrates on the monetary cost of department activities, not on percentages
- Funds can be reallocated to areas providing the greatest benefit to the organization
- Provides quality information about the organization
- Involves all levels of management
- Managers are forced to identify inefficient or obsolete functions within their area

Disadvantages of zero-based budgeting
- Implies that the budgeting method in use is not adequate, which may not be true
- Requires great deal more time, cost, effort and paperwork than traditional budgeting methods
- Cost-effective areas may be over-ranked by more vocal but less cost-effective department heads

Variance analysis
- When comparing budget figures and actual results, the variance may be favourable or adverse

Sales analysis
- Budgeted sales = budgeted guest x budgeted average check
- Actual sales = actual guest x actual average check
- Sales variance = budgeted sales - actual sales
  - Sales price variance = (budgeting price - actual price) x actual guest
  - Sales volume variance = (budgeted guest - actual guest) x budgeted price
  - Total sales variance = sales price variance + sales volume variance

Cost variance
- Example: Laundry expense
- Budget 3000 rooms x $2.75/room = $8250
- Actual 3100 rooms x $3.00/room = $9300
- Laundry cost variance = $1050 adverse
- Note:
  Cost variance = (3 - 2.75) x 3100 = $775
  Volume variance = (3100-3000) x 2.75 = 275
  Total Cost variance = $1050 Adverse

Percentage variance
- Percentage variance = dollar variance divided by the budgeted figure for that item, and this ratio is expressed in %
- A percentage variance depends entirely on the type and size of an establishment

Forecasting
- Reliable techniques are needed to help in forecasting as accurately as possible, e.g.:
  - Moving Averages: used to remove random variations in order to identify the trend
  - Regression Analysis: the forecast of a department depends on what happens to another factor, given by the regression equation y = a + bx, where
    - Y is the dependent variable (e.g. no. of meals)
    - X is the independent variable (e.g. no. of guests)
    - A is constant, or the value of y when x = 0
    - B = (nExy - ExEy) / [nEx2 - (Ex) 2]

Limitation of forecasting
- Data used for forecasting may not be very accurate, or may not be available
- Mathematical approaches do not consider the variables that can be controlled by management
- Experience, individual judgement and other qualitative factors are key considerations
- Forecasting involves the future - this is always unpredictable and uncertain