ACCOUNTING PROCEDURES

8.1 INTRODUCTION

You cannot imagine running a business which does not maintain proper accounts. Accounting is the language of the business as it reflects what exactly is happening in the business. Every businessman would like to know from time to time as to whether the business is running in Profit or Loss, as also the amount of profit or loss earned during a particular period. Hence, if you want to run even a small business it becomes important that you should be able to write your basic books of accounts and be able to understand what your accountant has written in the accounts books.

8.2 OBJECTIVES

After reading this lesson you will be able to :

- understand the basic language used in accounting;
- describe the procedure of writing the basic books of accounts namely-the journal and the ledger;
- demonstrate the method of preparing Trial Balance;
- describe the basic purchasing procedure for buying raw material for your bakery;
- evolve the accounting procedure of fixing selling price of items prepared in your bakery;
- devise the method of calculating gross profit and net profit earned by your bakery.

8.3 JARGON MADE EASY

Before proceeding further it is important to know certain important "terms" or "words" used in accounting.

(i) **Transaction**: It is the give and take in a business. For a transaction to be complete, the actual give and take should take place, e.g. when we purchase a machine for the business, and pay for it, a transaction has taken place. Further a transaction can either be in cash or on credit. In the example mentioned above, when we pay cash at the time of purchasing the machine we call it **cash transaction**. But when we bring the machine and promise to pay the amount later, then we call it **credit transaction**.

(ii) **Account** : When transaction relating to a particular person, organisation, thing, income or expenditure is recorded under a particular head for a given period it is called an **account,** e.g. Ram's account, goods account, cash account, rent account, sales account etc. Basically there are 3 types of accounts :

(a) Personal account

(b) Real account

(c) Nominal account

(a) **Personal account** : It is the account of persons, companies, Institutions, firms, shops etc. Rahul's account, Taj Hotel Account, Delhi University Account, Reliance Account, etc. are examples of personal accounts. A separate account is opened in the name of each person or business institution, with whom the business has dealings, in order to show the total benefit given or received by each account.

(b) **Real account**: These are accounts of things or property, your business possesses or has acquired, such as furniture, sale or purchase of goods, cash , machinery etc. A separate account is kept for each such property. These things are real and can be seen or felt.

(c) **Nominal account**: These represent the items of expenses or losses, or income or gains. An account is opened for each head of expenditure or loss, or income or gain, such as rent, salary, interest, insurance, commission etc. These things are abstract and cannot be seen or felt.

(iii) **Goods**:They are the main items in which you are doing your business. You are buying goods and selling them to your customers either in the same form or by converting them into finished products. The main intention is **selling** and **making profit** out of it. For a bakery and confectionery business flour, sugar, eggs, cream, etc. are purchased to make cakes, biscuits, bread etc., hence these are all goods. For the sake of convenience, goods account is broken up into four parts, namely, purchase account, sales account, purchases return account, and sales return account.

Purchase account : When goods are purchased, they are written under a separate head known as purchase account.

Sales account- When goods are sold they are written under a separate head known as sales account.

Purchases return account - When goods purchased are returned due to some reason such as being defective or not delivered in time, they are put under purchases return account.

Sales return account — When goods sold by you are returned due to some reason they are put under sales return account.

(iv) **Debit** : When some thing is received, or the receiver of the benefit in a transaction or an expense or a loss is incurred in always debited, e.g. when a machine is purchased, the machine is debited. Or, something is paid to Patel, here Patel is debited or rent is paid, here rent is debited.

(v) **Credit** : When something is given, or the giver of the benefit in a transaction or a gain or an income is received, it is always credited, e.g. sold furniture. Here Furniture is credited, or received cash from Khanna, here Khanna is credited or received commission, here commission is credited.

(vi) **Debtor**: A person who has received some things but has not paid for it becomes a debtor, e.g. you sold goods to Mr. A worth Rs. 100 but Mr. A has not yet paid for the same but promises to pay for it in due course of time. Mr. A becomes your debtor.

(vii) **Creditor**: A person who has given something but you have not paid for it becomes your creditor. e.g. you purchased goods from Mr. B worth Rs. 100 but have not yet paid. You promise to pay him in due course of time. Mr. B becomes your creditor.

(viii) **Double entry system of Book-keeping and Accounting**: Whenever a transaction takes place in a business, it has a double effect and at least two accounts are affected by it. One account is the giver of the benefit and the other account is the receiver of the benefit. Hence the transaction is recorded at both the places under the heads of two different accounts. This is called the double entry system. e.g. you receive cash Rs. 100 from Mr. C. In this case Mr. C is the giver of the benefit, hence Mr. C's account is credited with Rs. 100. At the same time cash Rs. 100 has been received, hence your cash account is debited with Rs. 100. In this way in a double entry system, a transaction is recorded at two different places.

(ix) **Assets**: It is something that our business possesses on any given day, e.g. Cash, Bank Balance, property like machines, land etc. Our debtors are also our assets because we have to receive something from them.

(x) **Liabilities**: It is something that our business has to pay. e.g. Bills payable, our creditors, because we have to pay something to them in due course of time.

(xi) **Capital**: It is the money or property brought into the business from outside by the proprietor e.g. cash, land, building etc.

8.4 STAGES OF ACCOUNTING

It is divided into three steps

1. Primary entry
2. Secondary entry or classification
3. Final accounts.

1. **Primary Entry**: Here the entry is first recorded into the journal so that no transaction is forgotten to be recorded. But by looking into the Journal we cannot know things, like how much cash we have with us, how much we have to receive from a debtor, how much we have to pay to a creditor, how much profit we have made or loss incurred during a particular period . We will discuss about the journal after this section.
2. **Secondary entry or classification**: In order to know the position of different accounts in the business we post the entries from the journal into the ledger. We shall discuss how to post the entries from the journal into the ledger later in this topic.
3. **Final accounts**: From the balances of each ledger accounts we prepare the final accounts for a given period, e.g. one year, in order to know our profit or loss and the assets and liabilities we possess on the last day of the year. For this we prepare profit and loss account and balance sheet.

INTEXT QUESTIONS 8.1

Complete the following statements

1. Accounting is a Science because ....
2. Accounting is the .... of the business.
3. Goods means that items in which the business is ....

.... in order to make ....

4. The three types of accounts are ...., ..., and ....

5. Goods account is broken into .... parts for convenience namely ...., ... and ....

6 Debtor is a person from whom we have to ....something.

7 Creditor is a person to whom we have to ....something.

8 In double entry system a transaction is recorded in at least .... places.

9 Asset is something that your business.......................

10 lLability is something that your business has to ....

11 The three stages of accounting are ...., ... and ....

8.5 JOURNAL

The following is the specimen of a Journal

Journal of M/s ....from ....to ....

Date	Particulars	Ledger folio	Amount Debit	Amount credit

Journal is a book of account of Primary or Original entry in which all transactions, as and when they take place, are recorded in the order of dates in an analysed form, showing each transaction in its two fold aspects.

Every transaction has a two-fold effect, involving entries being made in two different account — one of these accounts is a receiving account and the other account is a giving account. So the entry requires that this double effect should be clearly shown in the journal.

The "date" column is meant for writing the date of the transaction. "Particulars" column is used for recording the names of the two accounts affected by the transaction. One account is debited while the other is credited. The "Ledger folio" column is used for writing down the page number of the ledger (secondary book) where these particular accounts are posted from this journal. The "debit amount" column is used for writing the debit amount while the "credit amount", Column is used for writing the credit amount, as each account is either debited or credited with an amount.

The process of entering business transaction in a journal is known as **journalising**.

For passing the Journal entries, the following procedure is adopted:

1. First of all, the particulars two or more accounts covered by the given transaction are as certained

   e.g. Jan 1, 1987, purchased goods from Rahul Rs. 500.

   In this example, "goods" account and "Rahul" account are affected.

2. It is ascertained which account is a receiving account and which account is a giving account.

   In the above example "goods" account is a receiving account because the goods are coming and stock of goods is increasing. "Rahul" account is a giving account.

3. After this, it is found out whether they are personal accounts, or real account or nominal accounts.

   In the above example, goods account is a real account, while Rahul's account is a personal account.

4. After finding out the above information the rules of journalising are applied according to the nature of the account.

The rule of debiting or crediting the different types of accounts are as follows:

1. Personal Account—Debit the receiver and credit the giver.
2. Real Account—Debit what comes in and credit what goes out.
3. Nominal Account—Debit expenses & losses and credit incomes & gains.

In the above example goods have come in and goods account is a real account, hence goods account is debited. Similarly, Rahul's account is a personal account and Rahul is the giver, hence Rahul's account is credited.

Date	Particulars	Ledger Folio	Amount Debit (Rs.)	Amount Credit (Rs.)
Jan 1,1977	Goods A/c Debit		500	
	To Rahul's A/c (Being goods purchased from Rahul worth Rs. 500)			500

A short description in the particulars column after each entry, is called "narration" e.g. " Being goods purchased from Rahul worth Rs. 500" is **narration**.

If only one goods account is opened for purchases, sales, purchase return, and Sales return, then it creates difficulty in finding out readily the figures of purchases, sales etc. Hence goods account is broken into the above four parts.

In the above example where goods are purchased from Rahul, the goods account can be replaced by purchase account and the following entry can be passed.

Date	Particulars	Ledger Folio	Amount Debit (Rs.)	Amount Credit (Rs.)
Jan 1,1977	Purchases A/c Debit		500	
	To Rahul's AC (Being goods purchased from Rahul worth Rs. 500)			500

Exercise

Journalise the following transaction in the books of Mr. Kumar for January, 1979 —

Jan 1 Mr. Kumar started business with cash Rs. 20,000 and Bank Balance Rs. 10,000.

Jan 2 Purchased goods for cash Rs. 10,000.

Jan 3 Sold goods for cash Rs. 8,000.

Jan 10 Purchased goods from Modem Stores worth Rs. 1,200.

Jan 12 Goods returned to Modem Stores as some of them were defective, Rs. 200.

Jan 15 Sold goods to Mohan on credit Rs. 100

Jan 16 Goods return by Mohan Rs. 50.

Jan 18 Cash sales Rs. 400.

Jan 20 Paid wages Rs. 10.

Jan 24 Cash received from Mohan Rs. 50.

Jan 26 Paid to Modem Stores Rs. 1,000.

Jan 28 Purchased furniture Rs. 500.

Jan 31 Paid salary Rs. 1,000 and rent Rs. 500.

Solution

Journal of Mr. Kumar for Jan 1979

Date	Particulars	LF	Amount (Dr.)	Amount (Cr.)
1979				
Jan 1	Cash A/c Dr.		20,000	
	To Kumar's capital A/c			20,000
	(Being business started with cash)			
Jan 1	Bank A/c Dr.		10,000	
	To Kumar's capital A/c			10,000
	(Being business started with Bank Balance)			
Jan 2	Purchase A/c Dr		10,000	
	To cash A/c (Being			10,000
	goods purchased for cash)			
Jan 3	Cash A/c Dr.		8,000	
	to sales A/c (being			8,000
	goods sold for cash)			
Jan 10	Purchases A/c Dr.		1,200	
	To Modern Stores A/c			1,200
	(Being good purchased form Modern stores)			
Jan 12	Modern store A/c Dr.		200	
	To purchase Return A/c			200
	(Being goods returned to Modern Stores)			

Date	Particulars	LF	Amount (Dr.)	Amount (Cr.)
Jan 15	Mohan A/c Dr. To sales A/c (Being goods sold to Mohan).		100	 100
Jan 16	Sales return A/c Dr. To Mohan A/c (Being goods returned by Mohan)		50	 50
Jan 18	Cash A/c Dr. To sales A/c (being goods sold for cash)		400	 400
Jan 20	Wages A/c Dr. To cash A/c (Being wages paid for cash)		10	 10
Jan 24	Cash A/c Dr. To Mohan A/c (Being cash received from Mohan)		50	 50
Jan 26	Modern stores A/c Dr. To cash A/c (Being cash paid to Modern stores)		1,000	 1,000
Jan 28	Furniture A/c Dr. To cash A/c (Being furniture purchased for cash)		500	 500
Jan 31	Salary A/c Dr. To cash A/c (Being salary paid in cash)		1,000	 1,000
Jan 31	Rent A/c Dr. To cash A/c (Being rent paid in cash)		500	 500
			53010	53010

INTEXT QUESTIONS 8.1

1. What is a journal? Give its importance. (Answer in about 5 lines)
2. (a) In case of personal account the receiver is...............

   (b) An account of things or property is known as .... account.

   (c) An account of abstract things is known as .... account.
3. Enter the following transactions in the Journal of M/S Ratco for october 1994.

1 Oct.	Started business with a capital of Rs. 10,000 cash
3 Oct	Purchased goods for cash Rs. 3,000
7 Oct	Sold goods for cash Rs. 4,000
10 Oct	Purchased from Sood and Co. machine worth Rs. 1,000 on credit
15 Oct	Paid for stationery Rs. 100
19 Oct	Received commission Rs. 400
25 Oct	Paid Rent Rs. 200
31 Oct	Paid salary to staff Rs. 300.

4. Journalise the following transactions in the books of Rayon & Co. for Dec. 1994.

Dec 1	Started business with cash Rs. 500,000 and Bank Balance Rs. 100,000
Dec 7	Purchased goods from cannon & co. worth Rs. 7000
Dec 14	Sold goods to Rahim worth Rs. 20,000
Dec 19	Cash sales Rs. 9000
Dec 22	Cash purchases Rs. 10,000
Dec 27	Paid wages Rs. 2000
Dec 31	Received cheque from Rahim of Rs. 19,000.

8.6 LEDGER

When the transactions of a business for a particular period have been recorded in the Journal, the next step is to classify the enteries made therein according to their nature. The necessity of classification arises because the journal cannot give the picture of total purchases, sales, expenses, income etc. of that period, and the amount payable to creditors and amount receivable from debtors. In brief it can be said that the transactions relating to one particular person or article or profit or loss or expenditure are collected together and written at one place in a consolidated form. This consolidated record in known as an **account**. These accounts are opened in a separate book which is called the "ledger", which is the main book of the business. Ledger is the second stage of accounting.

The ledger is usually in the form of a bound register. The following is the specimen of a ledger. It has two side, the debit side and credit side, the column being identical on both sides.

Ledger Account

Dr Cr

Date	Particulars	J/F	Amount Rs. P.	Date	Particulars	J/F	Amount Rs. P.

Note : Dr = Debit; Cr = Credit

"Posting" of Journal entries into the Ledger

The process of transferring entries from journal into the ledger is called "**Posting**". In the ledger a particular account is opened for a particular period, normally one year, and the entries made in the journal are sorted out and transferred into the related account in the ledger. For every transaction a new account is not opened. If the account is already appearing in the ledger for that period then all entries relating to that account are collected and written together in a consolidated form through that period in that account. A new account is opened only if that account is not appearing in the ledger. In this way posting is the work of preparing ledger accounts with the help of the Journal.

Every Journal entry involves at least two accounts, indicating the accounts to be debited or credited.

Example : Feb 1, 1977 sold goods for cash Rs. 1000

In the example, cash account will be debited and sales account will be credited because cash has come in and goods have gone out. The following Journal entry will be passed.

Feb 1'77	Cash A/c Dr To sales A/c (Being goods sold for cash)		Rs. 1000	 Rs. 1000

In the ledger two accounts will be opened—one, cash account and the second, sales account. In cash A/c following details will be written on the debit side because cash Account is debited.

Date column — 1 Feb 1977
Particulars column — To sales A/c
J/F column — page number of the Journal from where it has been transferred
Amount column — Rs. 1000

At this stage nothing will be written on the credit side. The credit side of this account is utilised either when the payment is made and cash goes out of the business or when at the end of the period the account is closed and balance is to be taken out.

Dr Cr

Date Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
1 Feb'77 To sales A/c		1000				

Similarly in sales account, the following details will be written on the credit side because goods are going out .

Date column - 1 Feb 1977

Particular column - By Cash Account

J/F Column - Page number of Journal from where it has been transferred

Amount column - Rs. 1000

At this stage nothing will be written on the debit side of the sales account. When the sales account is closed then the balance will be written on the debit side.

Dr Cr

Date Particulars	J/F	Amount Rs.	Date	Particulars	J/F	Amount Rs.
			Feb 1, 77	By cash A/c		1000

When entry is made on the debit side of any account in the ledger, the word "To" is used in the particulars column along with the name of the account. Similarly when entry is made on the credit side of an account the word "By" is used in the particulars column along with the name of the account.

Balancing of account—balancing of accounts is done normally when you want to close an account and want to know the balance that is in hand or has to be received or paid. The following procedure is adopted for balancing the ledger accounts.

1. Total up the two sides of an account and write these totals on a rough paper.
2. Find out the difference between the totals of the two sides.
3. This difference is known as "**balance carried down**" (balance c/d). If the total of the debit side is more than this difference of balance c/d is written on the credit side in the ledger account to make the totals of both the sides equal. If the total of the credit side is more then this balance c/d is written on the debit side of the ledger account.
4. After this, a single line is drawn in the amount columns of both debit and credit sides after the last posting or balance c/d on the case may be. The lines of the debit and credit amount columns should be in the same level. Then the total of the debit side should be written on the debit side in the amount column and the total of the credit side be written in the amount column of the credit side. These two totals will always be equal because the difference has already been written on the lighter side in the form of balance c/d. These two totals will always be on the same horizontal level.
5. If any account shows balance c/d then that particular account is reopened in the next period. The closing balance of the previous period becomes the opening balance of the new period as balance b/d.

In the above example the accounts will be closed in the following manner.

Dr. Cash Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
Feb 1 '77	To sales A/c		1000	Feb 28 '77	By Bal c/d		1000
			1000				1000
Mar 1 '77	To bal b/d		1000				

Dr. Sales Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
Feb 28 '77	To Bal. A/c		1000	Feb 1 '77	By Cash a/c	1000	
			1000				1000
				Mar 1 '77	To bal b/d		1000

Exercise

Enter the following transaction into the Journal and Post them into the ledger. Also, balance the ledger accounts.

March 1, 90	Gopal & Sons started business with a capital of Rs. 50,000 cash.
March 3	Purchased goods for cash Rs. 10,000
March 7	Sold goods for cash Rs. 5000
March 10	Purchased stationery for Rs. 200
March 14	Purchased goods from Hemant Rs. 4000 on credit
March 17	Paid to Hemant Rs. 2000
March 19	Purchased goods from Hemant Rs. 3000 on credit
March 23	Paid to Hemant Rs. 1000
March 24	Cash sales Rs. 2000
March 31	Paid for rent Rs. 500

Journal of Gopal & Sons for March 1990

Date	Particulars	L/F	Amount Rs.	Amount Rs.
March 1'90	Cash A/c Dr. (Being cash brought into business as capital by Gopal & Son)		50,000	50,000
March 3	Purchase A/c Dr. To cash A/c (Being goods purchased for cash)		10,000	10,000
March 7	Cash A/c Dr To sales A/c (Being goods sold for cash)		5,000	5,000
March 10	Stationery A/c Dr To cash A/c (Being stationery purchased for cash)		200	200

Date	Particulars	L/F	Amount Rs.	Amount Rs.
March 14	Purchase A/c Dr To Hemant's A/c (Being goods purchased from Hemant on credit)		4000	4000
March 17	Hemant's A/c Dr To cash A/c (Being cash paid to Hemant)		2000	2000
March 19	Purchase A/c Dr To Hemant's A/c (Being goods purchased from Hemant on credit)		3000	3000
March 23	Hemant's A/c Dr To cash A/c (Being cash paid to Hemant)		1000	1000
March 24	Cash A/c Dr To sales A/c (Being goods sold for cash)		2000	2000
March 31	Rent A/c Dr To cash A/c (Being rent paid in cash)		500	500
			77,700	77,700

Ledger A/c of Gopal & Son for March '90

Dr. Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
			Cash A/c				
Mar. 1	To Gopal & Son A/c		50,000	Mar 3	By purchase A/c		10,000
Mar 7	To sales A/c		5,000	Mar 10	By stationery A/c		200
Mar 24	To sales A/c		2000	Mar 17	By Hemant's A/c		2000
				Mar 23	By Hemant's A/c		1000
				Mar 31	By Rent A/c		500
				Mar 31	By bal c/d		43,300
			57,000				57,000
April 1	To bal b/d		43,000				

Capital A/c

Dr. Cr

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
Mar 31	To bal c/d		50,000	Mar 1	By cash A/c		50,000
			50,000				50,000
				April 1	By bal b/d		50,000

Purchase A/c

Dr. Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
Mar 3	To cash A/c		14000	Mar 31	By bal c/d		17,000
Mar 14	To Hemant's A/c		4000				
Mar 19	To Hemant's A/c		3000				
			17000				17000
April 1	To bal b/d		17000				

Sales A/c

Mar 31	To bal c/d		7000	Mar 7	By cash A/c		5000
				Mar 24	By cash A/c		2000
			7000				7000
				April 1	By bal b/d		7000

Stationery A/c

Mar 10	To cash A/c		200	Mar 31	By bal b/d		200
			200				200
April 1	To bal b/d		200				

Hemant's A/c

Mar 17	To cash A/c		2000	Mar 14	By purchase A/c		4000
Mar 23	To cash A/c		1000	Mar 19	By purchase A/c		3000
Mar 31	To bal b/d		4000				
			7000				7000
				April 1	By bal b/d		4000

Rent A/c

Mar 31	To cash A/c		500	Mar 31	By bal c/d		500
			500				500
April 1	To bal b/d		500				

INTEXT QUESTIONS 8.2

1. What is a ledger ? Explain in 4 lines
2. How many sides does a ledger have? (Answer in one line)
3. What is balancing of ledger accounts?
4. Post the journal entries of Q.No. 3 on the topic on Journal into the ledger.
5. Post the journal entries of Q.No. 4 on the topic of Journal into the ledger.

8.7 TRIAL BALANCE

Trial Balance is a statement which is prepared with the balances of the ledger accounts in order to check the arithmetical accuracy of the entries that were made by the accountant in the Journal and posted into the ledger.

According to Double Entry system of accounting as and when any transaction takes place in a business, it is to be recorded in the journal, then two postings are made in the ledger, one account being debited and the other account being credited with the same amount. When the accounts are balanced, equal debits and credits are cancelled, and the total of all debit balances must be equal to the total of all credit balances. To check this arithmetical accuracy, a statement is prepared, which is known as **"Trial Balance"**. The total of debit sides of Trial Balance must be equal to total of credit side. If the totals do not agree, then it is assumed that there is some mistake either in passing the journal entries or postings done in the ledger.

Objectives of Preparing Trial Balance

1. To check the arithmetical accuracy of the journal entries and ledger postings
2. To get the balances of all ledger accounts at one place. The management will know the position of all accounts and can

compare the figures of one year with the figures of other years.

3. To make the staff more carefull and alert as trial balance can be prepared on any day and it can disclose the error. Hence the staff making such mistakes can be held responsible.

4. To help in preparing Final account i.e. Profit and Loss account and Balance sheet which will in turn disclose the profit or loss made during the year and the position of assets and liabilities of the business at any particular moment.

Exercise

Prepare a trial balance from the Exercise given under "Ledger".

Trial balance as on 31/03/90

Sr. No.	Ledger Accounts	L/F	Debit (Rs.	Credit (Rs.)
1.	Cash Account		43,300	
2.	Gopal & Sons Capital Account		50,000	
3.	Purchase Account		17,000	
4.	Sales Account			7,000
5.	Stationery Account		200	
6.	Hemant's account			4,000
7.	Rent account		500	
	Total		61,000	61,000

The balances shown as balance b/d is either a debit or a credit balance depending on which side of the ledger it is written. This is then transferred to the Trial Balance as the case may be.

From the Trial Balance the final accounts are prepared which is the third and last stage of accounting for which you require a professional.

INTEXT QUESTIONS 8.3

Fill in the Blanks :

1. Trial Balance is prepared from .... of .... accounts.
2. Trial Balance g ves .... accuracy of ledger accounts.
3 Final accounts are prepared from......................balance.

8.8 HOW TO PURCHASE RAW MATERIAL

Purchasing raw material is an art. If purchasing is not done correctly it results in increasing material cost, directly affecting the selling price of your finished product. It may also result in poor quality of finished product if the raw material purchased is of poor quality. Therefore your objective during purchasing raw material should be of purchasing raw material according to your requirement both quality and quantity wise, at the minimum possible price.

Purchasing can be done from two sources :

(i) From a supplier

(ii) From open market

(i) Purchasing from a supplier

You should float tenders giving clearly your specifications (requirement) of raw material, mentioning clearly what type of material you require. The supplier who quotes the minimum rates should be given the contract of supplying raw material. The supplier will supply you the material at your premises for the contract period. The material should be checked for quality and rates at the time of supply.

(ii) Purchasing from open market

Here the purchasing is done from the market by you or some other person for which you should know the following :

(a) Places from where different raw material is available.

(b) The specifications required by you e.g. the size, weight of eggs required by you.

(c) The desirable and undesirable qualities of raw material, i.e. how would you check that a particular raw material is good or bad.

(d) The present market rates of raw material required by you.

(e) The keeping quality of raw material required by you i.e. for how long you can store a raw material and at what conditions.

(f) The storing space available with you so that you purchase the raw material according to storing space available with you.

8.9 COSTS

There are 3 types of costs, namely,

(i) Material Cost

(ii) Overhead Cost

(iii) Labour Cost

(i) Material Cost

The cost of material used in preparing a product is calculated and that gives the material cost of a product e.g. you can take receipes of the products you are preparing, calculate the price of each material that you have used and then calculate the total material cost of that receipe.

(ii) Overhead Cost

These include rent, rates, gas and electricity charges, telephone, stationery, insurance premium, advertising, repairs and depreciation of assets.

(iii) Labour Cost

These include wages, salaries, cost of staff meal, staff accommodation, staff training costs.

8.10 PROFIT

There are two types of profits, namely

(a) Gross profit

(b) Net profit

(a) Gross profit

Gross profit is the difference between the price at which a product is sold and the material cost of the product

Hence, **Gross Profit = Selling Price — Material cost**

Remember : Gross Profit is not the actual profit

Example :

The selling price of a cake is Rs. 50. The cost price of the material used in making that cake is Rs. 20. Therefore the Gross Profit is Rs. 30.

(b) Net Profit

In finding out gross profit only material cost is taken into consideration but the other two costs, namely overhead cost and labour cost must also be considered for finding the net profit which is the actual profit.

Net Profit is therefore the difference between the price at which the product is sold and the total cost, i.e. material cost, overhead cost and labour cost. In other words it can also be said that Net Profit is equal to Gross Profit minus overhead cost and labour cost.

$$\boxed{\text{Hence, Net Profit = Gross Profit – Overhead Cost}}$$

Example

The cost of material used in preparing a cake is Rs. 27. The overhead expenses were estimated to be Rs. 18 and the labour cost involved was Rs. 17. If the cake was sold at Rs. 100 find the net profit.

Solution

Selling price		= Rs. 100
Total cost —	Material	= Rs. 27
	Labour	= Rs. 17
	Overhead	= Rs. 18
		= Rs. 62

∴ Net Profit = Rs. 100 — Rs. 62 = Rs. 38

8.11 SELLING PRICE

Wrong pricing policy can quickly ruin a business. Hence it becomes very essential to fix the selling price very carefully. Over-pricing can make a product unpopular while under-pricing may result in losses.

One should know the limit of each type of cost, beyond which the result may not be good.

(i) Material cost should not exceed more than 40% of the selling price.

(ii) Overhead cost should not be more than 20% of the selling price.

(iii) Labour cost should not be more than 15% of the selling price

Hence the total cost should never be more than 75% of the selling price. It should be tried and brought down to 70% or even less.

Formula to Remember

$$\boxed{\textbf{Total Cost + Profit = Selling Price}}$$

Hence, in the above example

Total Cost = 40 + 20 + 5 =75

If Selling Price = 100

Then, Net Profit = 100 - 75 = 25

Examples

1. Find the selling price to achieve a gross profit of 60% on selling price, if the material cost is Rs. 36.

   Solution

   Cost + Profit (60%) = Selling Price (100%)

   ∴ Material cost = 40% (100% – 60%)

   Now the material cost is given as Rs. 36

   ∴ Rs. 36 = 40%

   ∴ 36/40 = 1%

   ∴ 100% = 36/40 × 100 (Selling Price)

   = Rs. 90

   ∴ Selling price must be Rs. 90 to get a gross profit of 60% on Selling Price.

2. Find the sales necessary to achivé a net profit of 10% on sales if the total cost are Rs. 19.18

   Solution

   If net profit is 100%, then total cost are 90%

   ∴ Rs 19.8 (cost) — 90%

   ∴ 19.80/90 x100 = 100% Selling Price

   = Rs. 22.00 (Selling Price)

INTEXT QUESTIONS 8.4

1. Gross Profit is the difference between .... and material cost.
2. Total cost is calculated by adding .... cost, ... cost and .... cost.
3. Net profit is gross profit minus .... cost.
4. If a Bakery made sales of Rs. 16500 in one month and the material cost is Rs. 6500 during the same month, find the gross profit in rupees and express it as percentage of sales.

5. A confectionery made a gross profit of Rs. 1000. If labour cost were Rs. 450 and overhead cost Rs. 425 Find the Net Profit.

6. Find the selling Price necessary to achive a gross profit of 65% on selling price if the cost of raw material of a cake is Rs. 18.

8.12 ANSWERS TO INTEXT QUESTIONS

8.1 1. Refer to the text.
    2. (a) person/company/institution/firm
       (b)

8.2 Please refer to the text.

8.3 1. Balances, ledger.
    2. With material
    3. Trial balance.

8.4 1. Selling price
    2. Material cost, labour cost, overhead cost.
    3. Overhead
    4. Rs. 100.00 ; 71.4%
    5. Rs. 125
    6. Rs. 51.40