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Financial Accounting

Unit 3

BRANCH ACCOUNTING

Q: What is a branch? What are the objectives of Branch Accounting? *(www.prepNext.com)*

Ans.:

A branch may be defined as a section of an enterprise, geographically separated from the rest of the business, controlled by a head office, and generally carrying on the same activities as of the enterprise. As a business grows, it may open up branches in different towns and cities in order to market its products/ services over a large territory and thus increase its profits.

For example, Bata Shoe Co. Ltd. has branches in various cities all over the country.

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OBJECTIVES OF BRANCH ACCOUNTING: (Need for Branch Accounting)

The main object of keeping branch accounts is dependent on the nature of the business and specific needs of a particular branch. The common objectives of keeping the branch accounts are:

- (i) To ascertain the profitability of each branch separately.
- (ii) To ascertain the financial position of each branch on a particular date.
- (iii) To know the cash and goods requirements of the various branches
- (iv) To evaluate the progress and performance of each branch
- (v) To ascertain the amount of commission payable to the managers, if that is based on profits of branch.
- (vi) To know the profitability of each branch and type of business for expansion of the business.
- (vii) To give concrete suggestions for the improvement in the working of the various branches.
- (viii) To meet the requirements of specific enactments as all branches of a company must keep the accounts for audit purposes.
- (ix) To incorporate the profit or loss made by the branch and its assets and liabilities in the firm's final accounts.
- (x) To ascertain whether the branch is yielding a satisfactory rate of return on capital invested in it.
- (xi) To ascertain whether the branch should be expanded or closed.

Q: What are the different types of branches? Explain.

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Ans.:

TYPES OF BRANCHES

From accounting point of view, the following are the main types of branches:

(1) Home Branches:

- (a) Dependent branches or Branches not keeping full system of accounting (where the head office Maintains all the accounts)
- (b) Independent Branches or Branches keeping full system of accounting (where the branch keeps its own accounts)

(2) Foreign Branches:

They almost trade independently and record their transactions in foreign currency.

DEPENDENT BRANCHES

(Branch Not Keeping Full System of Accounting):

When the policies and administration of a branch are totally controlled by the head office, who also maintains its account, the branch is called a dependent branch.

The following are the main features of such branches:

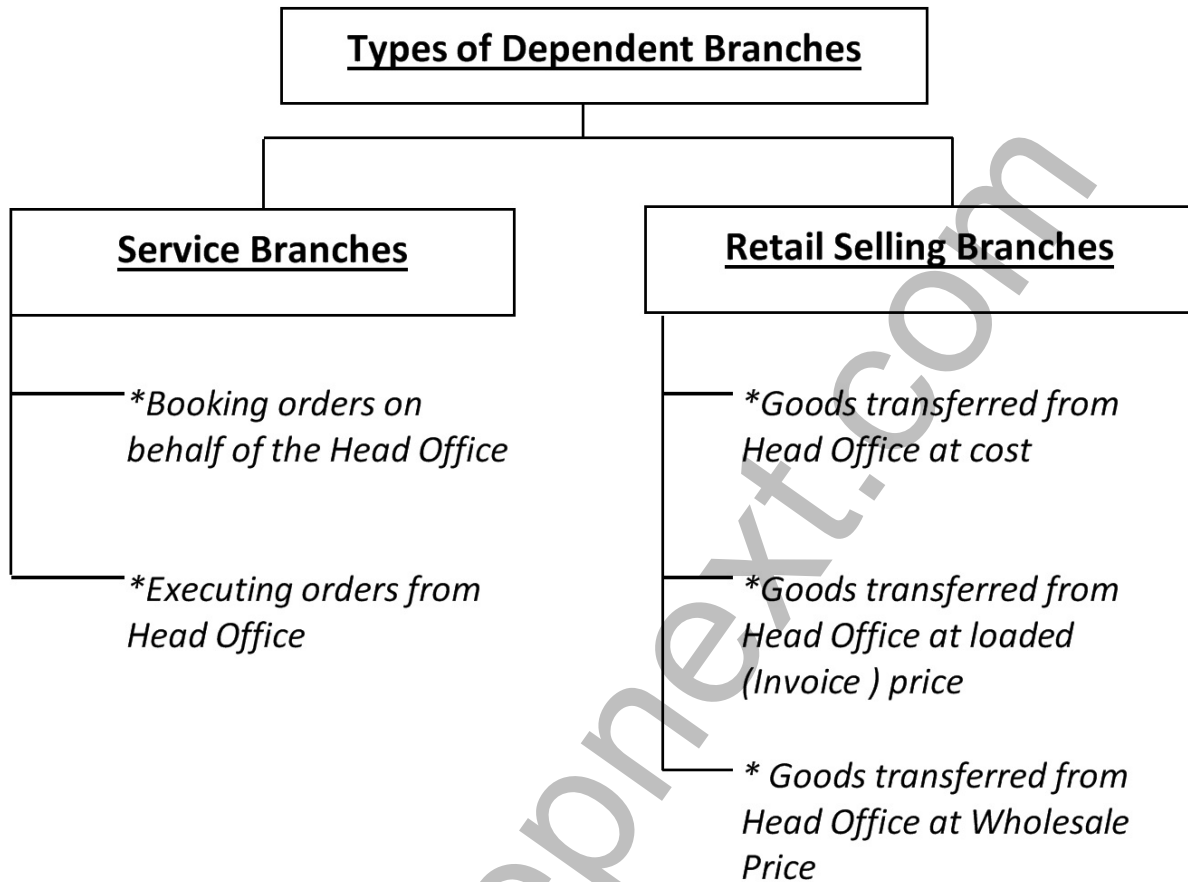
- (i) Such branches sell only those goods which are received from head office and are not usually allowed to make purchases in the open market except with the express permission of head office.
- (ii) Goods are supplied by the Head Office to such branches either at cost price or at invoice price.
- (iii) All expenses of the branch such as rent, salary of staff, advertisement etc. are paid by the head office.

- (iv)** Petty expenses such as cartage, entertainments, freights etc. are paid by the branch manager out of petty cash book balance. Such book is maintained at the branch either as simple petty cash book or on imprest system.
- (v)** The amount received from cash sales or cash received from the debtors is either remitted to the head office daily or deposited in the account of head office in some local bank.
- (vi)** The branch manager is normally expected to sell the goods for cash only but he may be authorised to sell goods on credit in certain cases.
- (vii)** Such branches do not maintain their own books of accounts. All records are maintained by head office.

Branches, not keeping full system of accounting, do not keep proper accounts but accounts are maintained in the head office books only. Thus, the system of accounting for branch to be adopted by the head office depends on the size of the branch, the degree of control sought to be exercised, the nature and volume of business transactions and the special circumstances under which the branch is operating, etc. *The following are the main ways in which the head office may keep the branch accounts in its book:*

- (i)** *Debtors System (Synthetic Method)*
- (ii)** *Final Account System*
- (iii)** *Stock and Debtors System (Analytical Method)*
- (iv)** *Wholesale Branch System*

The following are the different types of dependent branches:



SERVICE BRANCHES: These branches are booking or executing orders on behalf of the head office. The accounts relating to these types of branches consist mainly of expenditure accounts for salaries, wages, travelling and miscellaneous expenses, etc. Generally the branch manager is provided with a small fund (similar to a petty cash fund, which is replenished periodically) to pay for small items of expense.

RETAIL SELLING BRANCHES: For retail selling branches, the head office not only maintains all accounting records but also manufactures or purchases all or most of the required stock in bulk quantity. Head office may send goods to branch either at “cost price” or “selling price” (also called invoice price) or at wholesale price.

The main features of retail branches are as follows:

1. A separate record of branch assets, liabilities, revenues and expenses is maintained by the head office. These branches maintain records of sales and petty expenses only but **may also keep debtors accounts**, if necessary. They also maintain stock register and furnish weekly or monthly stock statements to the head office.
2. All business documents originating at the branches are transmitted to the head office.
3. Goods are transferred by the head office to such branches either at cost or at loaded (invoice) price which are fixed nationally or on a local basis by the head office. The branch manager has no discretion in the fixation of price and has to sell the goods at agreed upon prices,
4. Except with the permission of the head office, such branches are not allowed to buy goods locally from the open market.
5. Goods are generally sold by such branches in cash. Though granting of credit is usually forbidden, such branches can sell goods on credit with the permission of the head office.
6. The amount collected from cash sales or debtors is either remitted to head office immediately (the same or next day) or banked intact in the account of the head office in some local bank.
7. A working fund for the branch is established and is replenished as needed. All major expenses of the branch are paid, as far as possible, by the head office. The branch manager is allowed to incur petty expenses like postage, telephone, cartage, etc.

***Goods transferred from Head Office at loaded (Invoice) price:**

Sometimes, the head office may prefer to send goods to the branch at a higher price than cost (termed as invoice price). Method of sending goods at invoice price is excellent from the point of view of stock control. As the goods are invoiced at selling price, the head office can dictate pricing policy to its branches, as well as save work at the branch because prices have already been decided. In addition, goods may be invoiced at selling price to keep the margin of profit a secret from the branch manager. Invoicing at selling price is generally done where goods are of standard type, pre-packed and unlikely to fluctuate in price.

***Wholesale Price:**

Sometimes, the head office (particularly, the manufacturing concern) sells goods to actual consumers through its retail shops. In this case, the head office sends goods to the branches at wholesale prices which is cost plus a percentage of profit. The branch is likely to sell those goods at retail prices which is more than the wholesale prices. The real profit earned by the branch is the difference between the retail price and the wholesale price. For example, the cost price of an article is Rs.100, the wholesale price, Rs.160 and the retail price, Rs.180. If an article is sold by the branch, the actual profit is $\text{Rs.180} - \text{Rs.100} = \text{Rs.80}$ but the branch's real profit is $\text{Rs.180} - \text{Rs.160} = \text{Rs.20}$.

This system is followed when the **branch is treated as a profit centre**. The real cost of the branch is the wholesale price of the goods sent. But, we must remember that wholesale prices are fixed above cost. Therefore, if all the goods that have been sent to branch are sold, no problem is created. The real problem arises when a part of the stock remains unsold, which includes an element of profit made by the head office. If there is any closing stock lying at branch, a Stock Reserve Account is opened by

debiting Profit and Loss Account (**head office**) and crediting Stock Reserve Account. The amount of stock reserve is the difference between wholesale price and cost price of head office. If there is any opening stock lying at branch, Stock Reserve Account is debited and head office profit and loss is credited with the loading (i.e., wholesale price of opening less cost price of such goods).

In case there is any **closing stock** lying at branch, the following journal entry is passed at the year-end:

Profit and Loss Account (Head Office)	Dr. (wholesale price – cost)
To Stock Reserve Account	

(In the Balance Sheet, branch stock is shown after deducting stock reserve.)

At the **beginning** of the next year, a reverse entry is passed, i.e.,

Stock Reserve Account	Dr.
To Profit and Loss Account (Head Office)	

INDEPENDENT BRANCHES

OR

BRANCHES KEEPING FULL SYSTEM OF ACCOUNTING

Independent branches are those branches which keep complete set of double entry books and prepare their own trial balance, trading and profit and loss account and balance sheet. Under this system of branch accounting, the branches are treated as separate, independent units. An independent branch is given more freedom of action, with the manager acquiring more responsibility. Apart from receiving goods from the head office, these branches are allowed to

purchase goods from the open market locally. They can also supply goods to the head office, pay expenses from the cash realised and operate the bank account in their own name. The only link an independent branch has with the head office is that they are owned by the head office, because the latter provides and possesses the premises and other physical assets which a branch needs before it can become operational, and the profit or loss of the branch ultimately belongs to the head office.

The accounting arrangements are quite simple. Each branch maintains a 'Head Office Account' in its ledger, whilst the head office maintains an account in the name of each branch, just as if individual branches were 'customers' of it. All transactions between the two are passed through these accounts, which, if book-keeping is up to date and accurate, will have equal and opposite balances.

The main features of the accounting system of an independent branch are as under:

- 1) The branch maintains its entire books of account under double entry system.
- 2) The branch in its books opens a Head Office Account to record all the transactions that take place between head office and the branch. This account is personal in nature. It is credited by the amount of goods received from head office and the allocated head office expenses charged to the branch, and is debited with the amount of cash sent to head office and goods returned.
- 3) The head office maintains a Branch Account to record the above transactions. This is a reciprocal account of the Head Office Account maintained by the branch. This account is debited by the amount of goods sent to the branch and the allocated head office expenses charged to the branch, and is credited with the amount of cash received from branch and goods returned.

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- 4) At the end of the accounting period, the branch prepares its Trial Balance and Trading and Profit and Loss Account, and sends copies of these statements to the head office for incorporation.
- 5) After receiving the final statements from the branch, the head office reconciles between the two balances – Branch Account as would appear in the books of head office with the Head Office Account as would appear in the books of the branch. The differences are investigated and required adjusting entries are passed in the head office books to reconcile these two balances.
- 6) Lastly, the head office passes necessary Journal Entries to incorporate the branch Trial Balance in its books.

FOREIGN BRANCHES

When a branch is located in a foreign country it is called a foreign branch. The accounting arrangements for a foreign branch are exactly the same as for any independent branch, up to the Trial Balance. But, such branch maintains its books of accounts in foreign currency to correspond with the local conditions. The main problem which the Head Office has to face under this type of branch is to convert the branch trial balance from the foreign currency to the currency of that country where the head office is situated, in order to incorporate the branch trial balance in the books of head office.

Q: What are the rules for converting Branch Trial Balance into the Books of Head Office? *(www.prepNext.com)*

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Ans.:

RULES FOR CONVERTING THE BRANCH TRIAL BALANCE INTO THE BOOKS OF HEAD OFFICE:

The following are the main rules which should be taken into consideration while converting the figures of foreign trial balance in the books of the head office for the purpose of their incorporation in the books of head office:

Rules for Conversion of Branch Trial Balance when Exchange Rates are 'Stable':

Exchange rate is said to be stable, when it does not vary to a great extent from time to time. If the fluctuations in the rate of exchange are neither frequent nor violent, a **fixed exchange rate** can be used to convert the branch Trial Balance into the currency of the Head Office with the exception of: (a) Remittances; and (b) Head Office Current Account.

- (a) **Remittances:** These are converted at the actual rates at which they were made.
- (b) **Head Office Current Account:** The actual figures shown for the Branch Current Account in the books of the Head Office (after taking into consideration in-transit items).

When the foreign branch Trial Balance is converted into local currency, a new Trial Balance takes birth – both sides of which are not likely to tally. As a result of the difference in the Trial Balance, a separate account known as “Difference on Exchange Account” is opened to make the Trial Balance agree.

Rules for Conversion of Branch Trial Balance when Exchange Rates are Fluctuating:

Exchange rate is said to be fluctuating when it is subject to frequent and violent fluctuations. In this case, the following rules are to be adopted for converting various items of the Branch Trial Balance.

1. **Opening Stock:** It should be converted at the rate of exchange prevailing at the beginning of the accounting period.
2. **Closing Stock:** It should be converted at the rate prevailing at the end of the accounting period.
3. **Fixed Assets:** They should be converted at the rate of exchange prevailing on the date of their acquisition or on the dates when the contracts for purchase were made.
4. **Fixed Liabilities (debentures, long-term loans, etc.) :** These should be converted at the rate of exchange ruling on the date when such liabilities were incurred or the payment was made.
5. **Current Assets and Current Liabilities:** These are converted at the rate of exchange ruling at the date of the Balance Sheet.
6. **Revenue Items:** These items are assumed to have taken place evenly throughout the year. Therefore, these items should be converted at the average rate of exchange ruling during the period under review. If fluctuations are violent then these should be converted each month at the average rate prevailing during that month.
7. **Depreciation:** It is converted at the rate applicable to the asset to which it relates.
8. **Remittances:** These are converted at the actual rates at which these were made.
9. **Head Office Current Account:** At the actual figures shown for the Branch Account in the books of the Head Office (after taking into consideration in-transit items). It is converted at the same figure at which branch account appears in the head office books.

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When the foreign branch Trial Balance is converted into local currency, a new Trial Balance takes birth – both the sides of which are not likely to tally since different exchange rates for different items are applied. As a result of the difference in the Trial Balance, a separate account, known as “Difference in Exchange Account” is opened to make the Trial Balance agree. If the difference is small, it is closed by transfer to profit and loss account but if the difference is big, it should be put under a separate account called ‘Exchange Fluctuations Account’ and will be

The rules for conversion of a foreign branch Trial Balance are summarised as follows:

Sl. No.	Items	Conversion Rules
1.	Fixed assets and depreciation thereon	Rate applicable on the date of purchase
2.	Fixed liabilities	Rate applicable when incurred
3.	Current assets/ liabilities	Rate prevailing at the year-end.
4.	Opening stock	Rate prevailing at the beginning of the year
5.	Revenue items	Average rate of the period
6.	Closing stock	Rate prevailing at the year-end
7.	Remittances	Actual rates at which these were made
8.	H.O. Current Account	At the actual figures shown for the Branch Account in the books of the H.O.

Q: Write short notes on:

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- i) Goods in transit
- ii) Cash in transit
- iii) Inter-branch transactions

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I) GOODS IN TRANSIT:

It is quite common that the head office and the branch send goods to each other very frequently. The head office is to send goods to the branch at regular intervals as per the requirement of the branch and branch also returns goods to the head office what it cannot sell at a profit. When the head office sends goods to the branch, it immediately debits the Branch Account in its books and credits the Goods Sent to Branch Account. But the branch will pass entry (in respect of this transaction) only when it receives the goods. Similarly, when branch sends or returns some goods to the head office, it immediately debits Head Office Account and credits Goods Returned to Head Office Account. But the head office will pass entry (in respect of this transaction), only when it receives the goods. These goods which are on the way to branch/ head office are called 'Goods-in-transit'.

Some accounting adjustment is required, if there are still some goods in transit at the end of the year. For 'goods-in-transit' the balance in the Head Office Account in the books of the branch will not tally with that of Branch Account in the books of the head office. For reconciling these balances, adjustment entry may be passed **either** in the books of the head office or in the books of the branch, **but not in both sets of books.**

Example:

Suppose, the head office sent goods to the branch on 25th December, when the accounts are closed on 31st December, but those goods were received by the branch on 5th January (next year). Head office must have debited the account of branch in its books but there will be no corresponding credit to head office account in the books of branch; so on the last day of accounting year, i.e., 31st December the following adjustment entry will be passed.

(a) When the adjustment entry is passed in the books of the head office:

Goods in Transit A/c Dr.
To Branch A/c

OR

(b) When the adjustment entry is passed in the books of the branch:

Goods-in-Transit Account Dr.
To Head Office Account.

II) CASH IN TRANSIT:

Branch may send cash to head office at regular intervals. Sometimes the branch is remitting the cash to the head office before the close of the accounting year, but the remittance may be received by the head office after the closing date of accounting year. At the end of the accounting period, if there is any cash-in-transit it should be adjusted. Here, adjustment entry may be passed **either** in the head office books **or** the branch books

Example:

Suppose the branch is remitting the cash to the head office on 25th December, when the accounts are closed on 31st December. While remitting the cash to the head office, the branch will debit the head office account but if the remittance is received by the head office after the closing date of accounting year, say on 5th January, then head office will not give a credit for the same amount of remittance on 31st December, so the two balances i.e. H.O. A/c (in Branch books) and Branch Account in (H.O. books) will differ. In order to reconcile these balances, an adjustment entry will be passed in the books of branch **or** head office (if the intimation of such remittance is received by the head office).

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Branch Books

Cash in Transit A/c Dr.
To Head Office A/c

OR

Head Office Books

Cash in Transit A/c Dr.
To Branch A/c

N.B : Cash in transit or goods in transit will be shown as an asset in the balance sheet.

III) INTER-BRANCH TRANSACTIONS:

If the head office has many branches, there is a possibility that some branch may supply goods or send cash to the other branch directly, with of course, the consent of the head office. Such transactions among the branches are called inter-branch transactions. *Such transactions may be recorded either by maintaining a current account of a branch in another branch's books or such transactions may be recorded by all branches by passing entries through head office account.* For example, if goods are supplied by Kolkata branch to Delhi branch and the head office is at Mumbai, then the following journal entries will be passed in the books of head office and the branches:

Mumbai Books (H.O)

Delhi Branch A/c Dr.
To Kolkata Branch

Kolkata Books

Head Office A/c Dr
To Goods Supplied to
Other Branches A/c

Delhi Books

Goods Received from
Other Branches A/c Dr.
To Head Office A/c

Q: What are the differences between an Independent Branch and a Dependent Branch?

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Ans.:

Differences Between Independent and Dependent Branch

Basis	Independent Branch	Dependent Branch
System of Accounting	It keeps full system of accounting at its place.	Its accounts are maintained at head office level. Only Cash Register and Debtors Register are maintained at branch.
Type of Goods Sold	Such branch sells goods both received from head office and that of purchases made by them.	Such branches sell only those goods which are received from head office. They are not allowed to make own purchases in the ordinary course of business.
Payment of Expenses	Such branches keep amount of cash required to meet regular nature of expenses themselves.	Expenses of regular nature like salary, rent, etc. are normally paid by head office. Branch managers normally are allowed to incur petty expenses only.
Remittance of Cash	Such branches are not required to remit all daily collections of cash to head office.	All daily collections from sales and debtors will be deposited in head office account in some local bank or remitted to head office.
Trial Balance	Such branches extract trial balance from the ledger maintained at branch level.	No trial balance is required to be extracted as accounts are maintained at head office.
Reconciliation	Reconciliation between the accounts maintained at branch and head office is to be made before finalising the accounts.	No need of any reconciliation as accounts are maintained at head office level.

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Preparation of Final Accounts	Trading and Profit and Loss Account is prepared in normal way as the accounts are kept following double entry system.	Different methods as Debtors System, Final Account System, Stock and Debtors System, etc. are followed for preparation of accounts under dependent branches.
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DEPARTMENTAL ACCOUNTING

Q: What do you understand by the term 'department'? What are the objectives and advantages of Departmental Accounting?

(www.prepNext.com)

Ans.:

A business is generally split up into a number of departments when it sells different types of goods or carries on several activities under the same roof. Such departments are found in businesses of all sizes (particularly in urban areas). A business may have a number of departments, each dealing in a different type of goods. For example, one department may be dealing in medicines, the other may be dealing in textiles, still another may be dealing in provisions etc.

Each department is treated as a separate profit centre, though none of the departments is separated geographically from the rest of the departments. This type of organisational subdivision creates a need for internal information about the operating results of each department. In order to ascertain the profit or loss made by each Department, it will be advisable to prepare separately Trading and Profit & Loss Account of each Department at the end of the accounting year.

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OBJECTIVES OF DEPARTMENTAL ACCOUNTS:

When all the divisions of a business are located under one roof and it is desired to ascertain the profit or loss of each department or class of goods separately, then departmental accounts are prepared. "Departmental Accounts" are nothing more than as many trading and profit and loss accounts as there are departments.

The main objects of preparing such accounts are:

- (i) To have comparison of the results of a particular department with previous year and also with the other departments of the same concern.
- (ii) To help the proprietor in formulating policy to expand the business on proper lines so as to optimize the profits of the concern.
- (iii) To allow departmental managers' commission on the basis of the profits of their departments; and
- (iv) To generate information which may be helpful for planning, control, evaluation of performance of each department and for taking various managerial decisions.
- (v) To help in appropriate rewarding or penalising the Departmental employees on the basis of the results shown by them.

ADVANTAGES OF DEPARTMENTAL ACCOUNTING

When there are a number of departments, it is clearly advantageous to prepare a trading and profit and loss account for each department. If only one trading and profit and loss account is prepared for the whole business, losses or deficiencies in one department would be covered by profits and gains in other departments.

The main advantages of departmental accounting are as follows:

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1. The performance of each department can be evaluated separately on the basis of trading results. An endeavour may be made to push up the sales of that department which is earning maximum profit.
2. The profitability of each department helps the management to decide whether to drop a department or add a new one.
3. The growth potential of a department as compared to others can be evaluated.
4. More detailed information can be provided to the users of the accounting information like the shareholders, investors, creditors etc.
5. Friendly rivalry between different departments may help to increase the overall profit of the organization.
6. Departmental managers and staff can be suitably rewarded on the basis of results.
7. It helps the management to determine the justification of capital invested in each department.
8. It helps to have comparison of the results of each department with the previous period or with other departments of the same concern.
9. It helps to know the efficiency of each department by calculating stock turnover ratio of each department to reveal the fast or slow movement of various items of stock.
10. The information provided by departmental accounting may be helpful to the management for future intelligent planning and control.
11. It helps in formulating policy to expand the business on proper lines so as to optimize the profits of the concern. New profitable lines of production or trading can be taken up while the existing lines of production or trading which are giving a loss can be closed down.

Q: Differentiate between Departmental Accounts and Branch Accounts. *(www.prepNext.com)*

Ans.:

Distinction Between Departmental Accounts and Branch Accounts

Basis	Departmental Accounts	Branch Accounts
Maintenance of Accounts	All accounts are maintained at one place and Departmental Trading and Profit and Loss Account is prepared accordingly.	In case of a dependent branch, all important accounting records are kept at the head office. The branch maintains only Cash Account and Customers Account (if necessary). However, an independent branch, usually maintains its own books of account and prepares its own Trading and Profit and Loss Account.
Allocation of Common Expenses	Departments are not geographically separated from each other, so problem of allocation of common expenses among different departments arises.	As branches are geographically separated from each other so the problem of allocation of common expenses among different branches does not arise.
Adjustments and Reconciliation of Accounts	The question of adjustments and reconciliation of accounts does not arise in departmental accounts.	In case of independent branch some adjustments and reconciliation of head office and the branch accounts are required to be done at the end of the year.

Problem of foreign currency	The problem of conversion of foreign currency into home currency does not arise.	The problem of conversion of foreign branch figures may arise at the time of finalisation of accounts of head office.
Geographical Distance	A business may be and generally is split into many parts or divisions. If the various parts are located under the same roof, they are known as departments.	If the various divisions are located in different places of the same town or in different towns, they are known as branches.

Q: Explain in brief the basis for departmentalisation of expenses.

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Ans.:

DEPARTMENTALISATION OF EXPENSES

In order to ascertain the profit or loss made by each department, it is necessary that each department is charged with a proper share of the various business expenses. The expenses of a business can be broadly divided into following two categories:

- (1) Direct Expenses:** Expenses relating to a particular department are called direct expenses. They are charged to respective department. For example, wages, staff salaries, packing material etc.
- (2) Indirect Expenses.** Expenses relating to more than one department are called indirect expenses. They are further divided into –
 - (a)** Expenses which can be allocated
 - (b)** Expenses which cannot be allocated.

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The following basis may be adopted for departmentalisation of such expenses:

(i) ALLOCATION OF DEPARTMENTAL EXPENSES:

Expenses incurred specifically for a particular department should be directly charged to that department. For example, salaries payable to each of the departmental managers will be charged to the respective departments. Similarly if there are separate electricity meters for each of the departments, the electricity expenses should be charged to each of the departments on the basis of the electricity bills received for each of them.

(ii) APPORTIONMENT OF DEPARTMENTAL EXPENSES:

Expenses which have been incurred for the business as a whole are distributed among the departments on some suitable basis. Such expenses which cannot be directly related to a particular department or cannot have precise allocation, should be charged to the different departments on following basis:

Basis for apportionment of some important expenses

	<u>Expenses</u>	<u>Basis</u>
1.	(a) Travelling salesman's salary and commission (b) Selling Expenses (c) After-sales service (d) Discount allowed (e) Freight outwards (f) Provision for discounts on debtors (g) Sales manager's salary and other benefits	Sales of each department
2.	(a) Rent, rates and taxes (b) Air conditioning expenses (c) Heating	Area or value of floor space
3.	Lighting	Light points

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4.	Insurance on Stock	Average stock carried
5.	Insurance on Building	Area
6.	Insurance on Plant & Machinery	Value of Plant & Machinery
7.	Group insurance premium	Direct wages
8.	Power	H.P or $H.P \times \text{Hours worked}$
9.	(a) Depreciation (b) Repairs and renewals	Value of assets in each department
10.	(a) Canteen expenses (b) Labour welfare expenses (c) Expense of personnel and time keeping departments	Number of employees
11.	Works manager's salary	Time spent in each department
12.	Carriage inwards	Purchases of each department

(iii) Expenses which cannot be allocated or apportioned over different departments in a reasonable manner, should be charged to the total profit of all the departments taken together. For this purpose, the profit shown by the different departments should be brought down in one account which will be termed as the General Profit & Loss Account and all such expenses should be charged there. General Manager's salary. Directors' fees. Auditors' remuneration, Interest on Debentures etc. are some of the expenses which fall in this category.

Q: Explain Inter – Departmental Transfers. (www.prepNext.com)

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Ans.: INTER – DEPARTMENTAL TRANSFERS

Transfers of goods or services may take place from one department to another. While preparing the Departmental Trading and Profit and Loss Account, the department receiving the goods or services should be debited with the value of the goods or services so supplied and department providing such goods or services should be credited with the same amount.

Since each department is considered as a separate profit centre, it is necessary to have separate records for inter – departmental transfer. Generally a weekly or monthly Departmental Transfer Analysis Sheet is prepared to arrange all inter-departmental transfer. The sheet may be in the following form:

Departmental Transfer Analysis Sheet

Date	Supplying Departments			Receiving Departments		
	Dept. X	Dept. Y	Dept. Z	Dept. X	Dept. Y	Dept. Z
2001 April 3	400	---	---	---	400	---
April 10	---	500	---	500	---	---
April 20	---	---	300	---	300	---
April 30	200	---	---	---	---	200
	600	500	300	500	700	200

At the end of the week/ month, the transfer is recorded by passing the following entry:

Receiving Department A/c Dr. [Transfer price]
 To Supplying Department A/c

Transfer prices can be cost-based or market-based. Dual pricing is also sometimes used. They are discussed below:

COST – BASED TRANSFER PRICE:

Under cost-based transfer pricing, the price may be based on actual cost, total cost or standard cost. Marginal cost is also sometimes used as a basis of ascertaining transfer price. Standard cost is preferred to actual cost since the inefficiency of one department cannot be passed on to another department.

MARKET – BASED TRANSFER PRICE:

To avoid passing on inefficiencies of one department to the other, market based transfer prices may be used. It does not give any advantage to either the selling or buying department, compared with trading with the outsiders. Sometimes a standard market price may also be used.

If the goods are transferred by one department to another department at a profit and at the end of the accounting period such goods still remain unsold, an appropriate reserve must be made for unrealised profit on stock. Such reserves are to be made both for opening and closing stocks by passing following entries:

(i) For closing stock

General Profit and Loss A/c	Dr.
To Provision for Unrealised Profit on Stock or Stock Reserve A/c	

(ii) At the beginning of the next year reverse entry will be passed,

Provision for Unrealised Profit on Stock or Stock Reserve A/c	Dr.
To General Profit & Loss A/c	

Alternatively, a single journal entry may be passed for the unrealised profit on the basis of the difference between unrealised profit included in the opening and closing stocks.

DUAL PRICING:

To motivate both the departments, buying and selling departments may be debited and credited respectively with two different prices. For example, buying department may be debited with the cost price and selling department credited with the market price.