Specialized Accounting

Unit 2

What Is Branch Accounting?

Branch accounting is a bookkeeping system in which separate accounts are maintained for each branch or operating location of an organization. Typically found in geographically dispersed corporations, multinationals, and chain operators, it allows for greater transparency in the transactions, cash flows, and overall financial position and performance of each branch.

Branch accounting is a bookkeeping system in which separate accounts are kept for each branch or operating location of an organization. Technically, the branch account is a temporary or nominal ledger account, lasting for a designated accounting period.

Branch accounts can also refer to records individually produced to show the performance of different locations, with the accounting records actually maintained at the corporate headquarters. However, branch accounting usually refers to branches keeping their own books and later sending them into the head office to be combined with those of other units.

Need for Branch Accounting

The main reasons of keeping branch accounts can be summarised as follows:

i. to find out the profit or loss of each branch for the accounting period;
ii. to ascertain the financial position of each branch at the end of the accounting year;
iii. to incorporate the net effect of branch transactions and their assets and liabilities in a firm's final accounts;
iv. to estimate requirements of cash and stock for each branch;
v. to evaluate the progress and performance of each branch;
vi. to calculate the commission for payment to the managers, if based on profit of branch;
vii. to assess the prospects for expansion of business in each branch; and
viii. to meet audit requirements.

Types of Branches

The branches can be divided into the following categories:

1. Branches not keeping full system of accounting;
2. Branches keeping full system of accounting;
3. Foreign branches.

Branches not Keeping Full System of Accounting: The branches not keeping full system of accounting are also called dependent branches. The main features of such branches are:

i. They sell only those goods which are received from the head office and are not usually allowed to make purchases in the open market except with the permission of the head office.
ii. Goods are supplied by the head office to such branches either at cost price or at invoice price.

iii. The branch manager is normally expected to sell the goods for cash, but he may be authorised to sell goods on credit in certain cases.
iv. All major expenses of the branch are paid by the head office. The branch manager is allowed to incur only petty expenses like cartage, postage, etc. out of the petty cash provided to him for which he is required to maintain a simple petty cash book.
v. The amount received from cash sales and debtors is either remitted to the head office daily or deposited in the account of head office in some local bank.
vi. Such branches do not keep complete books of account. They simply maintain record of sales and prepare debtors accounts, if necessary. They are also required to maintain a stock register and furnish weekly or monthly statements giving complete information about stock position and movement of goods to the head office. This enables the head office to keep proper control over stock at branches.

Branches Keeping Full System of Accounting: Branches keeping full system of accounting are called independent branches. They are allowed to purchase goods from the market and also supply to the head office, if necessary. They can incur expenses from the cash realised and operate the bank account in their own names. Thus, they operate as independent units for all practical purposes. Their only link with the head office is that they are owned by the head office and whatever profit they earn or loss they incur ultimately belongs to the head office.

Such branches keep a complete set of books on the double entry system and prepare their own Trial Balance, Trading and Profit & Loss Account and Balance Sheet. Such branches open Head Office Account in their books and record all transactions between the branch and the head office in this account.

Foreign Branches: When a branch is located in a foreign country, it is called a foreign branch. Such branches will keep their books of account in foreign currency. The Distinctive feature of foreign branches is that financial information received from them will be in foreign currency which has to be converted into the currency of the country of the head office before it is incorporated in the head office books. For example, if an Indian company has a branch in Nairobi, the branch Trial Balance will be in Kenyan shillings. The Trial Balance must be converted into rupees before it can be incorporated in head office books. For all practical purposes, however, foreign branches are treated as independent branches.

Branch Accounting Methods

There are several different methods for keeping branch accounts, depending on the nature and complexity of the business and the operational autonomy of the branch. The most common include:

- Debtor system
- Income statement system
- Stock and debtor system
- Final accounts system

Department:

Department refers to activity centre (profit or cost centre) usually located in the same roof but carrying distinct type of activities.

Departmental Accounting:

Department accounting or departmental accounting is a system of financial accounting which is used in the organizations whose all works are done through their different departments or departmental stores. Departmental accounts are prepared separately for each department and trial balance will also be prepared. Departmental P&L Account is prepared to ascertain the profit or loss of each department separately and at the end of the year it is transferred to General profit and loss account of the whole organisation.

Objectives of departmental accounting:

The main objectives of departmental accounting 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, and evolution of performance of each department and for taking various managerial decisions.

Advantages of Departmental Accounting:

1. **Evaluation of performance:** The performance of each department can be evaluated separately on the basis of trading results.
2. **Growth potential of each department:** The growth potential of each department as compared to others can be evaluated.
3. **Justification of capital outlay:** It helps the management to determine the justification of capital outlay in each department.
4. **Judgement of efficiency:** It helps to calculate stock turnover ratio of each department separately, and thus the efficiency of each department can be revealed.
5. **Planning and control:** Availability of separate cost and profit figures for each department facilitates better control. Thus, effective planning and control can be achieved on the basis of departmental accounting information.

Methods of Maintaining Departmental Accounts:

1. Singular method (Separate set of books are kept for each department)
2. Columnar method (Accounts of all departments are kept in one book only)

Singular Method: When separate books of accounts are maintained for each department, the system is called Singular method. This system is very expensive therefore it is not recommended.

Columnar Method: when common books of accounts are maintained for all departments, showing details of each department in columnar form, the system is called columnar method.

Hire-Purchase System & Instalment System

Hire-purchase system is a special system of purchase and sale of goods. Under this system purchaser pays the price of the goods in instalments. The instalments may be annual, six monthly, quarterly, monthly fortnightly etc. Thus hire-purchase means a transaction where the goods are sold by vendor to the purchaser under the following conditions:

- the goods will be delivered to the purchaser at the time of agreement.
- the purchaser has a right to use the goods delivered.
- the price of the goods will be paid in instalments.
- every instalment will be treated to be the hire charges of the goods which is being used by the purchaser.
- if all instalments are paid as per the terms of agreement, the title of the goods is transferred by vendor to the purchaser.
- if there is a default in the payment of any of the instalments, the vendor will take away the goods from the possession of the purchaser without refunding him any amount received earlier in the form of various instalments.

Characteristics of Hire-Purchase System

The characteristics of hire-purchase system are as under:

- Hire-purchase is a credit purchase.
- The price under hire-purchase system is paid in instalments.
- The goods are delivered in the possession of the purchaser at the time of commencement of the agreement.
- Hire vendor continues to be the owner of the goods till the payment of last instalment.
- The hire-purchaser has a right to use the goods as a bailer.
- The hire-purchaser has a right to terminate the agreement at any time in the capacity of a hirer.
- The hire-purchaser becomes the owner of the goods after the payment of all instalments as per the agreement.
- If there is a default in the payment of any instalment, the hire vendor will take away the goods from the possession of the purchaser without refunding him any amount.

Instalment Payment System is system of purchase and sale of goods in which title of goods is immediately transferred to the purchaser at the time of sale of goods and the sale price of the goods is paid in instalments. In the event of default in payment of any instalment, the seller has no right to take back goods from the possession of the purchaser. He can file a suit for the recovery of the outstanding balance of the price of goods sold.

Difference between Hire-purchase system and Instalment payment system

The followings are the differences between Hire-purchase system and Instalment payment system:

- In Hire-purchase system, the transfer of ownership takes place after the payment of all instalments while in case of Instalment payment system, the ownership is transferred immediately at the time of agreement.

- In Hire-purchase system, the hire-purchase agreement is like a contract of hire though later on it may become a purchase after the payment of last instalment while in Instalment payment system, the agreement is like a contract of credit purchase.
- In case of default in payment, in Hire-purchase system the vendor has a right to back goods from the possession of the hire-purchaser while in case of Instalment payment system, the vendor has no right to take back the goods from the possession of the purchaser; he can simply sue for the balance due.
- In Hire-purchase system, if the purchaser sells the goods to a third party before the payment of last instalment, the third party does not get a better title on the goods purchased. But in case of Instalment payment system, the third party gets a better title on the goods purchased.
- In Hire-purchase system the provisions of the Hire-purchase Act apply to the transaction while in case of Instalment payment system, the provisions of Sale of Goods Act apply to the transaction.

Ascertaining the Interest and Cash Price

when the goods are sold on hire purchase, the price so charged by the vendor is always higher than the cash price. The excess price i.e., the difference between the hire purchase price and the cash price, includes the interest charges and the compensation for risk. However, for accounting purposes, the difference between the two prices is treated as the payment for interest. Thus, the hire purchase price includes:

i. the cash price, which is a capital expenditure for purchase of an asset, and
ii. the interest, which is an item of revenue nature.

Ascertainment of Interest

While calculating interest, we may be faced with any of the following two situations:

i. When rate of interest, total cash price and instalments are given.
ii. When total cash price and instalments are given but the rate of interest is not given.

When Rate of Interest, Total Cash Price and Instalments are given:

In this situation, before calculating the element of interest included in each instalment, it will be helpful to ascertain the total amount of interest involved. This will be ascertained by subtracting the Total Cash Price from the hire purchase price. Then the following steps should be followed for calculating the amount of interest on each instalment.

i) Calculate the outstanding cash price at the time of first instalment by subtracting down payment from the total cash price.
ii) Calculate interest on the first instalment. This is to be calculated on the outstanding cash price at the time of first instalment by applying the given rate of interest. In this connection, you should keep in view the mode of instalments i.e., whether the instalment is annual, half-yearly or quarterly. Usually, in case of purchases for heavy equipment, the instalment is annual.
iii) Calculate the amount of cash price included in the first instalment by subtracting the amount of interest as calculated in step (ii) from the amount of the first instalment.

iv) Calculate the outstanding cash price at the time of second instalment by subtracting the amount of cash price of the first instalment from the outstanding cash price at the time of first instalment i.e., (i) - (iii).

v) Calculate, interest on the second instalment by applying the rate of interest to the outstanding cash price at the time of second instalment.

The amount of the subsequent instalments can be worked out in the same manner i.e., by first calculating the outstanding cash price at the time of the instalment due and then applying the rate of interest to this amount. However, the amount of interest on the last instalment is worked out differently. This can be done by simply subtracting the outstanding cash price at the time of last instalment from the amount of the last instalment.

Example 1:

A Ltd. purchased a Machine on hire purchase from Z Ltd. on January 1, 2016, paying Rs. 8,000 immediately and agreeing to pay three annual instalments of Rs. 8,000 each on December 31, every year. The cash price of the machine is Rs. 29,800 and the vendors charge interest @ 5% per annum. Calculate the amount of interest paid by the buyer to the seller every year.

Solution:

The total interest = Hire Purchase Price - Cash Price

Hire Purchase Pric = Cash Down Payment + Instalments

= 8,000 + 3(8,000)

= 8,000 + 24,000

= Rs. 32,000

Cash Price = Rs. 29,800

So Total Interest = 32,000 - 29,800 = Rs. 2,200

Now, we can calculate the interest on each instalment as follows.

i) Outstanding Cash Price at the time of first instalment

Total Cash Price - Down Payment
= 29,800 - 8,000
= Rs. 21,800

ii) Interest on first instalment

Outstanding Cash Price × Rate of Interest/100
= 21,800 × 5/100
= Rs. 1,090

iii) Cash Price of first instalment

Instalment - Interest on first instalment
= 8,000 - 1,090
= Rs. 6,910

iv) Outstanding Cash Price at the time of second instalment

= 21,800 - 6,910

= Rs. 14,890

v) Interest on second instalment

14,890 × 5/100 = Rs. 745

vi) Cash Price of second instalment

= 8,000 - 745 = Rs. 7,255

vii) Outstanding Cash Price at the time of last instalment

= 14,890 - 7,255 = Rs. 7,635

viii) Interest on the last instalment

= Instalment - Outstanding Cash Price at the time of last instalment
= Rs. 8,000 - 7,635
= Rs.365

For Steps from (i) to (viii) following table would he helpful.

	(1) Total Cash Price Rs.	**(2) Instalment Paid Rs.**	**(3) Interest Paid Rs.**	**(2-3) Cash Price of the Instalment Rs.**
Total Cash Price	29,800			
Less Down Payment	8,000	8,000		8,000
Amount outstanding at the time of 1st Instalment	21,800	8,000	(21,800×5/100)	(8,000-1,090)
Cash price of the Instalment	6,910		1,090	6,910
Amount outstanding at the time of 2nd Instalment	14,890	8,000	(14,890×5/100)	(8,000-745)
Cash price of the Instalment	7,255		745	7,255
Amount outstanding at the time of 3rd Instalment Cash	7,635	8,000	(8,000-7,635)	7,635
	7,635		365	

When Total Cash Price and Instalments are given, but rate of interest is not given:

When the total cash price, down payment and the amount of each instalment is given, but the rate of interest is not given, the interest will be calculated by procedure mentioned below.

i) Calculate the total interest by subtracting the total cash price from the total hire purchase price.

ii) Calculate the amounts of hire purchase outstanding at the beginning of each year after subtracting the down payment.

iii) Find out the ratio of outstanding amounts calculated in step (ii). If the amount of each instalment is equal, the ascertainment of ratio is simple. For example, if there are four instalments of equal amounts, the ratio will be 4 : 3 : 2 : 1 and if there are three instalments of equal amounts, it will be 3 : 2 :1.

iv) Apply this ratio to the total interest and calculate the interest on each instalment.

Example 2:

Taking the relevant data from example 1 excluding the rate of interest element in each instalment.

Hire Purchase Price Rs. 32,000 [8,000 + 3 (8,000)]
Cash Price Rs. 29,800
Down Payment Rs. 8,000

Solution:

Total Interest = Rs. 32,000 - 29,800

= Rs. 2,200

Beginning of the year	**Amount (Rs.) Outstanding**	**Ratio**	**Interest (Rs.)**
1	24,000	3	1,100
	(32,000-8,000)		(2,200*3/6)
2	16,000	2	733
	(24,000-8,000)		(2,200*2/6)
3	8,000	1	367
	(16,000-8,000)		(2,200*1/6)
			2,200