9

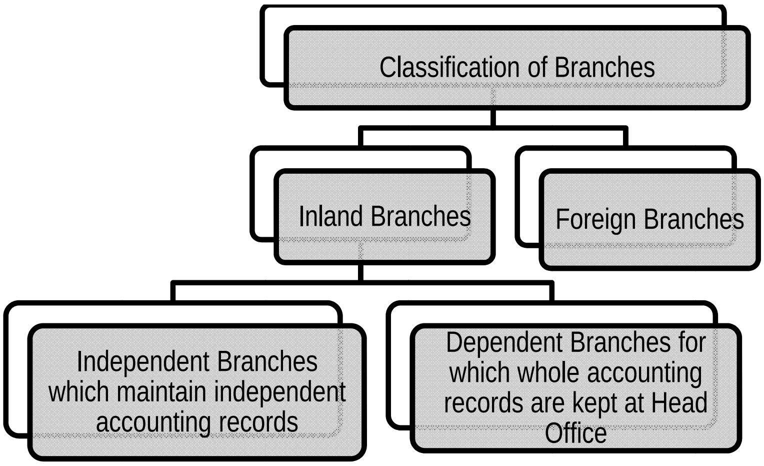
Accounting for Branches Including Foreign Branches

Learning Objectives

- After studying this chapter, you will be able to: Understand concept of branches and their classification from accounting point of view.
- Distinguish between the accounting treatment of dependent branches and independent branches.
- Learn various methods of charging goods to branches.
- Solve the problems, when goods are sent to branch at wholesale price.
- Prepare the reconciliation statement of branch and head office transactions after finding the reasons for their disagreement.
- Incorporate branch balances in the head office books.
- Prepare branch accounts even on the basis of incomplete information.
- Differentiate between integral and non-integral foreign branches.
- Learn the techniques of foreign currency translation.

1. Introduction

As per Section 29 of the Companies Act, 1956, a branch can be described as any establishment carrying on either the same or substantially the same activity as that carried on by head office of the company. It must also be noted that the concept of a branch means existence of a head office for there can be no branch without a head office - the principal place of business. From the accounting point of view, branches may be classified as follows:



2. Distinction Between Branch Accounts And Departmental Accounts

Basis of distinction	Branch Accounts	Departmental Accounts
1. Maintenance of accounts	Branch accounts may be maintained either at branch or at head office.	Departmental accounts are maintained at one place only.
2. Allocation of common expenses	No allocation problem arises since the expenses in respect of each branch can be identified.	Common expenses are distributed among the departments concerned on some equitable basis considered suitable in the case.
3. Reconciliation	Reconciliation of head office and branch accounts is necessary in case of independent branches at the end of the accounting year.	No such problem arises.
4. Conversion of foreign currency figures	At the time of finalization of accounts, conversion of figures of foreign branch is necessary.	No such problem arises in departmental accounts.

3. Dependent Branches

When the business policies and the administration of a branch are wholly controlled by the head office and its accounts also are maintained by it the branch is described as Dependant branch. Branch accounts, in such a case, are maintained at the head office out of reports and returns received from the branch. Some of the significant types of branches that are operated in this manner are described below:

(a) A branch set up merely for booking orders that are executed by the head office. Such a branch only transmits orders to the head office;

(b) A branch established at a commercial centre for the sale of goods (wholesale) supplied by the head office, and under its direction all collections are made by the H.O.; and

(c) A branch for the retail sale of goods, supplied by the head office.

Accounting in the case of first two types is simple. Only a record of expenses incurred at the branch has to be maintained.

But however a retail branch is essentially a sale agency that principally sells goods supplied by the head office for cash and, if so authorised, also on credit to approved customers. Generally, cash collected is deposited into a local bank to the credit of the head office and the head office issues cheques thereon for meeting the expenses of the branch. In addition, the Branch Manager is provided with a 'float' for petty expenses which is replenished from time to time on an imprest basis. If, however, the branch also sells certain lines of goods, directly purchased by it, the branch retains a part of the sale proceeds to pay for the goods so purchased.

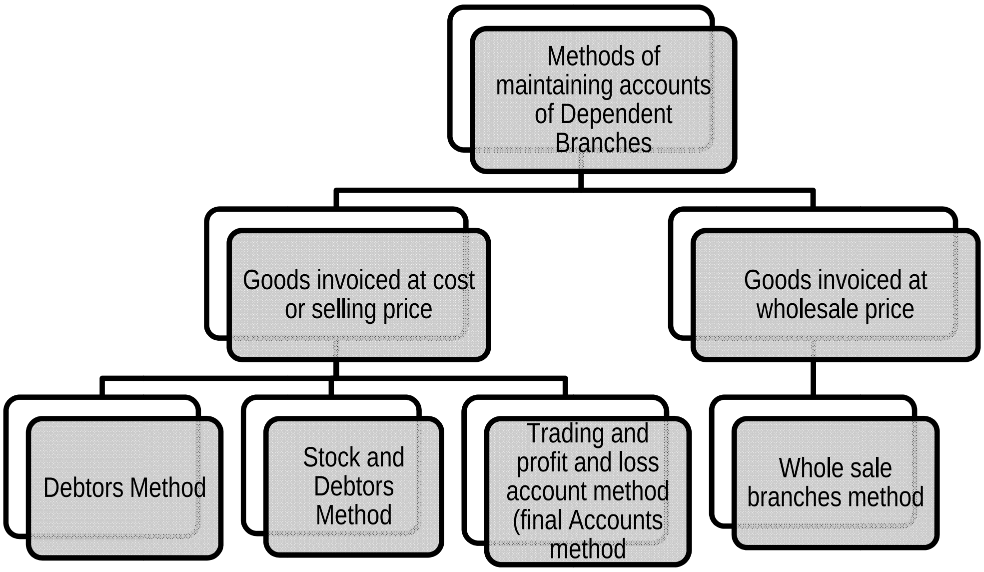
4. Methods of Charging Goods to Branches

Goods may be invoiced to branches (1) at cost; or (2) at selling price; or (3) in case of retail branches, at wholesale price.

Selling price method is adopted where the goods would be sold at a fixed price by the branch. It is suitable for dealers in tea, petrol, vanaspati ghee, etc. In this way, greater control can be exercised over the working of a branch in as much as that the branch balance in the head office books would always be composed of the value of unsold stock at the branch and remittances or goods in transit. The arbitrary price method is usually adopted if the selling price is not known or when it is not considered desirable to disclose to the branch manager the profit made by the branch.

5. Accounting for Dependent Branches

Dependent branch does not maintain a complete record of its transactions. The Head office may maintain accounts of dependent branches in any of the following methods:



5.1 When goods are invoiced at cost: If goods are invoiced to the branch at cost, the trading results of branch can be ascertained by following any of the three methods: (i) **Debtors Method**, (ii)**Stock and Debtors method, (iii) Trading and Profit and Loss Account (Final Accounts) Method.**

For finding out the trading results of branch, it is assumed that the branch is an entity separate from the head office. On the basis, a Branch Account is stated in the head office books to which the price of goods or services provided or expenses paid out are debited and correspondingly, the value of benefits and cash received from the branch are credited.

Debtors method: This method of accounting is suitable for small sized branches. Under this method, separate branch account is maintained for each branch to compute profit or loss made by each branch. The opening balance of stock, debtors (if any), petty cash (if any), are debited to the Branch Account; the cost of goods sent to branch as well as expenses of the branch paid by the head office, *e.g.,* salaries, rent, insurance, etc., are also debited to it. Conversely, amounts remitted by the branch and the cost of goods returned by the branch are credited. At the end of the year, the value of unsold stock, the total of customers' balances outstanding and that of petty cash are brought into the branch account on the credit side and then the branch account will reveal profit or loss; Debit 'balance' will be the loss suffered by the working of the branch and *vice versa*. If the branch is allowed to make small purchases of goods locally as well as to incur expenses out of its cash receipts, it will be necessary for the branch to supply to the head office a copy of the Cash Account, showing details of cash collections and disbursements. To illustrate the various entries which are made in the Branch Account, the proforma of a Branch Account is shown below:

Proforma Branch Account

To Balance b/d Stock Debtors Petty Cash To Goods sent to Branch To Bank A/c Salaries Rent Sundry Expenses To Profit & Loss A/c—Profit (if credit side is larger)		By Bank A/c (Cash remitted) By Return to H.O. By Balance c/d Cash Debtors Petty Cash Fixed Assets Prepaid Expenses By Profit and Loss A/c—Loss (if debit side is larger)	

Note:

1. Having credited the Branch Account by the actual cash received from debtors, it would be wrong to debit the Branch Account, in respect of discount or allowances to debtors.
2. The accuracy of the trading results as disclosed by the Branch Account, so maintained, if considered necessary, can be proved by preparing a Memorandum Branch Trading and Profit & Loss Account, in the usual way, from the balances of various items of income and expenses contained in the Branch Account.

Illustration 1

Fanna Cloth Mills opened a branch at Mumbai on 1st April, 2011. The goods were invoiced to the branch at selling price which was 125% of the cost to the head office.

The following are the particulars of the transactions relating to branch during the year ended 31st March, 2012:

	₹	₹
Goods sent to branch at cost to head office		*42,12,600*
Sales:		
Cash	*18,76,050*	
Credit	*26,61,450*	*45,37,500*
Cash collected from debtors		*23,55,000*
Discount allowed to debtors		*23,550*
Returns from debtors		*15,000*
Spoiled cloth in bales written off at invoice price		*7,500*
Cheques sent to branch for:		

Rent	*1,08,000*	
Salaries	*2,70,000*	
Other Expenses	*52,500*	*4,30,500*

Prepare Branch Account based on invoice price under Debtors method for ascertaining profit for the year ended 31st March, 2012.

Solution

Branch Account

		₹	₹			₹	₹
To	Goods sent to Branch Account		52,65,750	By	Bank-		
To	Bank -				Sales	18,76,050	
	Rent Salaries	1,08,000 2,70,000			Collection from debtors	23,55,000	42,31,050
	Other expenses	52,500	4,30,500	By	Goods sent to Branch Account (Loading)		10,53,150
To	Branch Stock Reserve		1,47,150		(52,65,750x25/125)		
	(7,35,750x25/125)			By	Abnormal Loss		
To	H.O. Profit and Loss Account				-Cost of spoiled cloth (7,500x100/125)		6,000
	-Transfer of profit		4,50,450	By	Balance c/d		
					Branch Stock	7,35,750	
					Branch Debtors	2,67,900	10,03,650
			62,93,850				62,93,850

Working Notes:

1. Memorandum Branch Stock Account

		₹	₹			₹
To	Goods sent to Brach:	.		By	Cash - Sales	18,76,050
	Cost	42,12,600		By	Credit Sales	26,61,450
	Add: Loading @ 25%	10,53,150	52,65,750	By	Abnormal Loss - Spoiled cloth	7,500
To	Returns from Debtors		15,000	By	Balance c/d (Balancing figure)	7,35,750
			52,80,750			52,80,750

2. Memorandum Branch Debtors Account

	₹		₹
To Credit Sales	26,61,450	By Cash collected	23,55,000
		By Discount allowed	23,550
		By Returns	15,000
		By Balance c/d (Balancing figure)	2,67,900
	26,61,450		26,61,450

Illustration 2

Buckingham Bros, Bombay have a branch at Nagpur. They send goods at cost to their branch at Nagpur. However, direct purchases are also made by the branch for which payments are made at head office. All the daily collections are transferred from the branch to the head office.

From the following, prepare Nagpur branch account in the books of head office by Debtors method:

	₹		₹
Opening balance (1-1-2012)		*Bad Debts*	*1,000*
Imprest Cash	*2,000*		
Sundry Debtors	*25,000*	*Discount to Customers*	*2,000*
Stock: Transferred from H.O.	*24,000*	*Remittances to H.O.*	
Direct Purchases	*16,000*	*(recd. by H.O.)*	*1,65,000*
Cash Sales	*45,000*	*remittances to H.O.*	
Credit Sales	*1,30,000*	*(not recd. by H.O. so far)*	*5,000*
Direct Purchases	*45,000*	*Branch Exp. directly paid by H.O.*	*30,000*
Returns from Customers	*3,000*	*Closing Balance (31-12-2012)*	
Goods sent to branch from H.O.	*60,000*	*Stock: Direct Purchase*	*10,000*
Transfer from H.O. for Petty		*Transfer from H.O.*	*15,000*
Cash Exp.	*4,000*	*Debtors*	*?*
		Imprest Cash	*?*

Solution

In the Books of Buckingham Bros, Bombay

Nagpur Branch Account

	₹			₹
To Opening Branch Assets		By Bank – Remittances received from branch		
Stock (24,000+16,000)	40,000	Cash Sales	45,000	

	Debtors	25,000		Cash from Debtors	1,20,000	
	Imprest Cash	2,000		Cash from Debtors in transit	5,000	1,70,000
To	Goods sent to Branch A/c	60,000	By	Stock:		
To	Creditors (Direct Purchases)	45,000		Transfer from H.O.		15,000
To	Bank (Sundry exp.)	30,000		Direct Purchase		10,000
To	Bank (Petty cash exp.)	4,000	By	Sundry Debtors (W.N. 2)		24,000
To	Net Profit transferred to		By	Imprest Cash (W.N. 3)		2,000
To	General Profit & Loss A/c	15,000				
		2,21,000				2,21,000

Working Notes:

(1) Collections from debtors:

	₹
Total remittances (₹ 1,65,000 + ₹ 5,000)	1,70,000
Less: Cash sales	(45,000)
	1,25,000

(2) Calculation of Sundry Debtors closing Balance:

	₹
Opening Balance	25,000
Add: Credit Sales	1,30,000
	1,55,000
Less: Returns, Discount, Bad debts & collections (3,000 + 2,000 + 1,000 + 1,25,000)	(1,31,000)
Closing balance	24,000

(3) Calculation of closing balance of Imprest Cash

	₹
Opening Balance	2,000
Add: Transfer from H.O.	4,000
	6,000
Less: Expenses*	(4,000)
Closing balance	2,000

*It is assumed that petty cash expenses of the branch for the year were ₹ 4,000.

Stock and Debtors method

If it is desired to exercise a more detailed control over the working of a branch, the accounts of the branch are maintained under what is described as the Stock and Debtors Method. According to this method, the following accounts are maintained by the Head Office:

Account	Purpose
1. Branch Stock Account (or Branch Trading Account)	Ascertainment of shortage or surplus
2. Branch Profit and Loss Account	Calculation of net profit or loss
3. Branch Debtors Account	Ascertainment of closing balance of debtors
4. Branch Expenses Account	Ascertainment of total expenses incurred
5. Goods sent to Branch Account	Ascertainment of cost of goods sent to branch

If the branch is also allowed to purchase goods locally and to incur expenses out of its cash collections, it would be necessary to maintain (*i*) a Branch Cash Account, and (*ii*) an independent record of branch assets.

The manner in which entries are recorded in the above method is shown below:

	Transaction	Account debited	Account credited
(*a*)	Cost of goods sent to the Branch	Branch Stock A/c	Goods sent to Branch A/c
(*b*)	Remittances for expenses	Branch Cash A/c	(H.O.) Cash A/c
(*c*)	Any assets (*e.g.* furniture) provided by H.O.	Br Asset (Furniture) A/c	(*i*) (H.O.) Cash A/c or (*ii*) Creditors A/c (*iii*) (H.O.) Furniture A/c
(*d*)	Cost of goods returned by the branch	Goods sent to Branch A/c	Branch Stock A/c
(*e*)	Cash Sales at the Branch	Branch Cash A/c	Branch Stock A/c
(*f*)	Credit Sales at the Branch	Branch Debtors A/c	Branch Stock A/c
(*g*)	Return of goods by debtors to the Branch	Branch Stock A/c	Branch Debtors A/c
(*h*)	Cash paid by debtors	Branch Cash A/c	Branch Debtors A/c
(*i*)	Discount & allowance to debtors, bad debts	Branch Expenses A/c	Branch Debtors A/c
(*j*)	Remittances to H.O.	(H.O.) Cash A/c	Branch Cash A/c
(*k*)	Expenses met by H.O.	Branch Expenses A/c	(H.O.) Cash A/c

(*l*) *Closing Stock*: Credit the Branch Stock Account with the value of closing stock at cost. It will be carried down as opening balance (debit) for the next accounting period. The Balance of the Branch Stock Account, (after adjustment therein the value of closing stock), if in credit, will represent the gross profit on sales and vice versa.

Other Steps

(*m*) Transfer Balance of Branch Stock Account to the Branch Profit and Loss Account.

(*n*) Transfer Balance of Branch Expenses Account to the debit of Branch Profit & Loss Account.

(o) The balance in the Branch P&L A/c will be transferred to the (H.O.) Profit & Loss Account.

The credit balance in the Goods sent to Branch Account is afterwards transferred to the Head Office Purchase Account or Trading Account (in case of manufacturing concerns), it being the value of goods transferred to the Branch.

Branch Trading and Profit and Loss Account (Final Accounts Method)

In this method, Trading and Profit and Loss accounts are prepared considering each branch as a separate entity. The main advantage of this method is that, it is easy to prepare and understand. It also gives complete information of all transactions which are ignored in the other methods. It should be noted that Branch Trading and Profit and Loss account is merely a memorandum account and therefore, the entries made there in do not have double entry effect.

Illustration 3

From the information given in the illustration 2, prepare Nagpur Branch Trading and Profit and Loss Account in the books of head office.

Solution

Buckingham Bros. Bombay
Nagpur Branch-Trading and Profit and Loss Account
for the year ending 31st December, 2012

		₹			₹	₹
To	Opening Stock	40,000	By	Sales		
To	Goods transferred from			Cash	45,000	
	Head Office	60,000		Credit sales	1,30,000	
To	Purchases	45,000			1,75,000	
To	Gross Profit c/d	52,000		*Less:* Returns	(3,000)	1,72,000
			By	Closing Stock		25,000
		1,97,000				1,97,000
To	Expenses	30,000	By	Gross Profit b/d		52,000
To	Discounts	2,000				
To	Bad Debts	1,000				
To	Petty Cash Expenses	4,000				
To	Net Profit transferred to					
	General P&L A/c	15,000				
		52,000				52,000

The students may note that Gross Profit and Net Profit earned by the branch are ascertainable in this method and also evaluating the performance of the branch is very much easier in this method than in the 'Debtors method'.

Solving Illustration by all three methods: Given below is a simple problem, the solution whereto has been prepared in all the three methods so as to show the distinguishing features of these methods.

Illustration 4

The Bombay Traders invoiced goods to its Delhi branch at cost. Head Office paid all the branch expenses from its bank account, except petty cash expenses which were met by the Branch. All the cash collected by the branch was banked on the same day to the credit of the Head Office. The following is a summary of the transactions entered into at the branch during the year ended December 31, 2012.

	₹		₹
Balances as on 1.1.2012:			
Stock	*7,000*	*Bad Debts*	*600*
Debtors	*12,600*	*Goods returned by customers*	*500*
Petty Cash,	*200*	*Salaries & Wages*	*6,200*
Goods sent from H.O.	*26,000*	*Rent & Rates*	*1,200*
Goods returned to H.O.	*1,000*	*Sundry Expenses*	*800*
Cash Sales	*17,500*	*Cash received from Sundry*	
Credit Sales	*28,400*	*Debtors*	*28,500*
Allowances to customers	*200*	*Balances as on 31.12.2012:*	
Discount to customers	*1,400*	*Stock*	*6,500*
		Debtors	*9,800*
		Petty Cash	*100*

Prepare: *(a) Branch Account (Debtors Method), (b) Branch Stock Account, Branch Profit & Loss Account, Branch Debtors and Branch Expenses Account by adopting the Stock and Debtors Method and (c) Memorandum Branch Trading and Profit & Loss Account to prove the results as disclosed by the Branch Account.*

Solution

(a) Debtors Method

Delhi Branch Account

2012			₹	₹	*2012*			₹	₹
Jan. 1	To	Balance b/d			Dec. 31	By	Bank		
		Stock	7,000				Cash Sales	17,500	
		Debtors	12,600				Cash from		

		Petty cash	200	19,800			Sundry Debts.	28,500	46,000
Dec. 31	To	Goods sent to Branch A/c		26,000		By	Goods sent to Branch A/c – Returns to H.O.		1,000
	To	Bank:				By	Balance c/d		
		Salaries & Wages	6,200				Stock	6,500	
		Rent & Rates	1,200				Debtors	9,800	
		Sundry Exp.	800	8,200			Petty Cash	100	16,400
	To	Balance being Profit carried to (H.O.) P & L A/c		9,400					
				63,400					63,400
Jan. 1, 2013	To	Balance b/d		16,400					

(b) Stock and Debtors Method

Branch Stock Account

2012			₹	*2012*				₹	₹
Jan. 1	To	Stock	7,000	Dec. 31	By	Sales:			
Dec. 31	To	Goods Sent to Branch A/c	26,000			Cash		17,500	
						Credit	28,400		
	To	Branch P & L A/c	19,900			*Less:* Return	(500)	27,900	45,400
					By	Goods sent to Branch A/c - Return			1,000
					By	Balance c/d (Stock)			6,500
			52,900						52,900
2013 Jan. 1	To	Balance b/d	6,500						

Delhi Branch Debtors Account

2012			₹	*2012*			₹
Jan. 1	To	Balance b/d	12,600	Dec. 31	By	Cash	28,500
Dec. 31	To	Sales	28,400		By	Returns	500
					By	Allowances	200
					By	Discounts	1,400
					By	Bad debts	600
					By	Balance c/d	9,800
			41,000				41,000
2013 Jan. 1	To	Balance b/d	9,800				

Delhi Branch Expenses Account

2012		₹	2012		₹
Dec. 31	To Salaries & Wages	6,200	Dec. 31	By Branch P & L A/c	10,500
	To Rent & Rates	1,200			
	To Sundry Expenses	800			
	To Petty Cash Expenses	100			
	To Allowances to customers	200			
	To Discounts	1,400			
	To Bad Debts	600			
		10,500			10,500

Delhi Branch Profit & Loss Account

2012		₹	2012		₹
Dec. 31	To Branch Exp. A/c	10,500	Dec. 31	By Gross Profit b/d	19,900
	To Net Profit to General P & L A/c	9,400			
		19,900			19,900

(c) Memorandum Branch Trading and Profit and Loss Account

	₹	₹		₹	₹
To Stock		7,000	By Sales:		
To Goods sent			Cash	17,500	
from H.O.	26,000		Credit 28,400		
Less: Returns to H.O.	(1,000)	25,000	*Less:* Returns (500)	27,900	45,400
To Gross profit c/d		19,900	By Closing Stock		6,500
		51,900			51,900
To Salaries & Wages		6,200	By Gross Profit b/d		19,900
To Rent & Rates		1,200			
To Sundry Exp.		800			
To Petty Cash Exp.		100			
To Allowances to Customers		200			
To Discounts		1,400			
To Bad Debts		600			
To Net Profit		9,400			
		19,900			19,900

5.2 When goods are invoiced at selling price

It would be obvious that if Branch Account is debited with the sales price of goods and subsequent to the debit being raised there is a change in the sale price, the amount of debit either has to be increased or reduced on a consideration of the quantity of unsold stock that was there at the branch at the time the change took place. Such an adjustment will be necessary as often as the change in sale price occurs.

Moreover the amount of anticipatory profit, included in the value of unsold stock with the branch at the close of the year will have to be eliminated before the accounts of the branch are incorporated with that of the head office. This will be done by creating a reserve.

It may also be necessary to adjust the value of closing stock on account of the physical losses of stock due to either pilferage or wastages which may have occurred during the year. The last mentioned adjustments are made by debiting the cost of the goods to Goods Lost Account and the amount of loading (included in the lost goods), to the Branch Adjustment Account. The three different methods that are usually adopted for maintaining accounts on this basis are described below:

Stock and Debtors Method

Under this method, when goods are invoiced at selling price, one additional account ie. 'Branch Adjustment account' is also prepared in addition to all the accounts which are maintained on cost basis. (Refer para 5.1)

- .When goods are invoiced at selling price, the following points should be kept in mind under this method:

(*i*) Journal Entries:

₹ Transaction	Accounts debited	Accounts credited
(*a*) Sale price of the goods sent from H.O. to the Branch	Branch Stock A/c (at selling price)	(*i*) Goods sent to Branches A/c with cost of the goods sent. (*ii*) Branch Adjustment A/c (with the loading *i.e.*, Difference between the selling and cost price).
(*b*) Return of goods By the Branch to H.O.	(*i*) Goods sent to Branch A/c (with the cost of goods returned). (*ii*) Branch Adjustment A/c (with the loading)	Branch Stock A/c

(*c*)	Cash sales at the Branch	Cash/Bank A/c	Branch Stock A/c
(*d*)	Credit Sales at the Branch	Branch Debtors A/c	Branch Stock A/c
(*e*)	Goods returned to Branch by customers	Branch Stock A/c	Branch Debtors A/c (at selling price)
(*f*)	Goods lost in Transit or stolen	(*i*) Goods Lost in Transit A/c or Goods Stolen A/c (with cost of the goods) (*ii*) Branch Adjustment A/c (with the loading)	Branch Stock A/c

(*ii*) Closing Stock

The balance in the Branch Stock Account at the close of the year normally should be equal to the unsold stock at the Branch valued at sale price. But quite often the value of stock actually held at the branch is either more or less than the balance of the Branch Stock Account. In that event it will be necessary that the balance in the Branch Stock Account is increased or reduced by debit or credit to Goods Lost Account (at cost price of goods) and Branch Adjustment Account (with the loading). The Stock Account at selling price, thus reveals loss of stock (or surplus) and serves as a check on the branch in this respect.

The discrepancy in the amount of balance in the Branch Stock Account and the value of stock actually in hand, valued at sale price, may be the result of one or more of the under-mentioned factors:

- An error in applying the percentage of loading.
- Goods having been sold either below or above the established selling price.
- A Commission to adjust returns or allowances.
- Physical loss of stock due to natural causes or pilferage.
- Errors in Stock-taking.

For example, the balance brought down in the Branch Stock Account is ₹ 100 in excess of the value of stock actually held by the branch when the goods were invoiced by the head office to the branch at 20% above cost and the discrepancy is either due to pilferage or loss by fire, the actual loss to the firm would be ₹ 80, since 20% of the invoice price would represent the element of profit. The adjusting entry in such a case would be:

		Dr. ₹	*Cr.* ₹
Goods Lost A/c	*Dr.*	*80*	
Branch Adjustment A/c	*Dr.*	*20*	
To Branch Stock A/c			*100*

If on the other hand, a part of the sale proceeds has been misappropriated, then the adjusting entry would be:

		Dr.	*Cr.*
Loss by theft A/c	*Dr.*	*XX*	
Branch Adjustment A/c	*Dr.*	*XX*	
To Branch Stock A/c			*XX*

Rebates and allowances allowed to customers are adjusted by debiting the amounts of such allowances to Branch Adjustment Account and crediting Branch Stock Account. But, if the gross amount of sale has been debited to Branch debtors Account, this account would be credited instead of Branch Stock Account, since the last mentioned account would have already received credit for the full value.

In the Goods Sent to Branch Account, the cost of the goods sent out to a branch for sale is credited by debiting Branch Stock Account. Conversely, the cost of goods returned by the branch is debited to this account. As such the balance in the account at the end of the year will be the cost of goods sent to the branch; therefore, it will be transferred either to the Trading Account or to Purchases Account of the head office.

The amount of profit anticipated on sale of goods sent to the branch is credited to the Branch Adjustment Account and conversely, the amount of profit not realized in respect of goods returned by the branch to head office or that in respect to stock remaining unsold with the branch at the close of the year is debited. The balance in this account, at the end of year thus will consist of the amount of Gross Profit earned on sale by the branch. On that account, it will be transferred to the Branch Profit and Loss Account.

(*iii*) *Elimination of unrealised profit in the closing stock*: The balance in the Branch Stock account would be at the sale price; therefore it would be necessary to eliminate the element of profit included in such closing stock. This is done by creating a reserve against unrealised profit, by debiting the Branch Adjustment Account and crediting Stock Reserve Account with an amount equal to the difference in the cost and selling price of unsold stock. Sometimes instead of opening a separate account in respect of the reserve, the amount of the difference is credited to Branch Stock Account. In that case, the credited balance of such a reserve is also carried forward separately, along with the debit balance in the Branch Stock Account; the difference between the two would be the value of stock at cost. In either case, the credit balance will be deducted out of the value of closing stock for the purpose of disclosure in the balance sheet, so that the stock is shown at cost.

An Alternative method: Where the gross profit of each branch is not required to be ascertained separately, although the selling price is uniform, the amount of goods sent to the branch is recorded only in two accounts namely - Branch Stock Account and Goods Sent to Branch A/c.

In this method, at the end of the year the Branch Stock Account is closed by transfer of the balance representing the value of closing stock, at sale price, to the Goods Sent to Branch Account. This has the effect of altogether eliminating from the books the value of stock at the branch. The balance of Goods sent to Branch Account is afterwards transferred to the Trading

Account representing the net sale price of goods sold at the branch. In that case, the value of closing stock at the branch at cost will be subsequently introduced in the Trading Account together with that of closing stock at the head office.

Illustration 5

Harrison of Chennai has a branch at New Delhi to which goods are sent @ 20% above cost. The branch makes both cash and credit sales. Branch expenses are met partly from H.O. and partly by the branch. The statement of expenses incurred by the branch every month is sent to head office for recording.

Following further details are given for the year ended 31st December, 2012:

		₹
Cost of goods sent to Branch at cost		*2,00,000*
Goods received by Branch till 31-12-2012 at invoice price		*2,20,000*
Credit Sales for the year @ invoice price		*1,65,000*
Cash Sales for the year @ invoice price		*59,000*
Cash Remitted to head office		*2,22,500*
Expenses paid by H.O.		*12,000*
Bad Debts written off		*750*
Balances as on	*1-1-2012*	*31-12-2012*
	₹	₹
Stock	*25,000 (Cost)*	*28,000 (invoice price)*
Debtors	*32,750*	*26,000*
Cash in Hand	*5,000*	*2,500*

Show necessary ledger accounts in the books of the head office and determine the Profit and Loss of the Branch for the year ended 31st December, 2012.

Solution

Books of Harrison

Branch Stock Account

	₹		₹
To Balance b/d	30,000	By Branch Debtors	1,65,000
To Goods Sent to Branch A/c	2,40,000	By Branch Bank	59,000
To Branch Adjustment A/c	2,000	By Balance c/d	
(Excess of sale		Goods in Transit	
over invoice price)		(₹ 2,40,000 –₹ 2,20,000)	20,000
		Stock at Branch	28,000
	2,72,000		2,72,000

Branch Debtors Account

	₹		₹
To Balance b/d	32,750	By Bad debts written off	750
To Branch Stock	1,65,000	By Branch Cash-collection (bal.fig.)	1,71,000
		By Balance c/d	26,000
	1,97,750		1,97,750

Branch Cash Account

	₹		₹
To Balance b/d	5,000	By Bank Remit to H.O.	2,22,500
To Branch Stock	59,000	By Branch Adjustment A/c	12,000
To Bank (as per contra)	12,000	(exp. paid by H.O.)	
To Branch Debtors	1,71,000	By Branch Adjustment A/c	10,000
		[Bal. fig. (exp. paid by Branch)]	
		By Balance c/d	2,500
	2,47,000		2,47,000

Branch Adjustment Account

	₹		₹
To Stock Reserve (on closing stock (48,000 × 1/6)	8,000	By Stock Reserve opening	5,000
To Gross Profit c/d	39,000	By Goods sent to Branch A/c	40,000
		By Branch Stock A/c	2,000
	47,000		47,000

Branch Profit and Loss Account

To Branch Expenses (paid by HO: ₹ 12,000 and paid by Branch ₹ 10,000)	22,000	By Gross Profit b/d	39,000
To Branch Debtors-Bad debts	750		
To Net Profit	16,250		
	39,000		39,000

Goods Sent to Branch Account

	₹		₹
To Branch Adjustment A/c	40,000	By Branch to Stock A/c	2,40,000
To Purchase A/c - Transfer	2,00,000		
	2,40,000		2,40,000

Debtors Method

Under this method, the principal accounts that will be maintained are:

- The Branch Account;
- The Goods Sent to Branch Account; and
- The Stock Reserve Account.

Entries in these accounts will be made in the following manner:

	Transaction	Account debited	Account credited
(*a*)	Goods sent to Branch at selling price	Branch A/c	Goods Sent to Branch A/c
(*b*)	'Loading being the difference between selling price and cost of goods	Goods Sent to Branch A/c	Branch A/c
(*c*)	Returns to H.O. at selling price	Goods Sent to Branch A/c	Branch A/c
(*d*)	'Loading' in respect of goods returned to H.O.	Branch A/c	Goods Sent to Branch A/c
(*e*)	'Loading' included in the opening stock to reduce it	Stock Reserve A/c	Branch A/c
(*f*)	Closing stock at selling price	Branch Stock A/c	Branch A/c
(*g*)	'Loading' included in closing stock to reduce it to cost	Branch A/c	Stock Reserve A/c

It will be observed that entries in the Branch Account in respect of goods sent to a branch or returned by it, as well as those for the opening and closing stock, will be at selling price. In consequence, the Branch Account is maintained at selling price.

Hence the Branch Account will not correctly show the trading profit of the Branch unless these amounts are adjusted to cost. Such an adjustment is effected by making contra entries in 'Goods Sent to Branch A/c' and 'Stock Reserve Account'. In respect of closing stock at branch for the purpose of disclosure in the Balance Sheet, the credit balance in the 'Stock Reserve Account' at the end of the year will be deducted from the value of the closing stock, so as to reduce it to close; it will be carried forward as a separate balance to the following year, for being transferred to the credit of the Branch Account.

Illustration 6

Take figures from Illustration 5 and prepare branch account following debtors' method.

Solution

Books of Harrison

New Delhi Branch Account

	₹		₹
To Balance b/d		By Balance b/d	
Stock	30,000	Stock Reserve	5,000
Debtors	32,750	By Goods Sent to Branch A/c	40,000
Cash	5,000	By Bank-Remittance	
To Goods Sent to Branch A/c	2,40,000	received from the Branch	
To Bank (Exp. paid by H.O.)	12,000	Cash sales 59,000	
To Net Profit Transferred to	16,250	Debtors Collection 1,63,500	2,22,500
H.O. Profit and Loss A/c		(Net of expense)	
To Balance c/d (Stock reserve		By Balance c/d	
on closing stock)	8,000	Stock (including Transit)	48,000
		Debtors	26,000
		Cash	2,500
	3,44,000		3,44,000

Trading and Profit and Loss Account (Final Accounts) Method

All items of memorandum Branch Trading and Profit and Loss Account are to be converted into cost price if the goods are invoiced to branch at selling price. Other points will remain same as already discussed in Para 5.1 for this method if goods are invoiced at cost.

Illustration 7

Following is the information of the Jammu branch of Best New Delhi for the year ending 31st March, 2012 from the following:

(1) Goods are invoiced to the branch at cost plus 20%.

(2) The sale price is cost plus 50%.

(3) Other information:

	₹
Stock as on 01.04.2011(invoice price)	*2,20,000*
Goods sent during the year(invoice price)	*11,00,000*
Sales during the year	*12,00,000*
Expenses incurred at the branch	*45,000*

Ascertain

(i) the profit earned by the branch during the year.

(ii) branch stock reserve in respect of unrealized profit.

Answer

(i) Calculation of profit earned by the branch

In the books of Jammu Branch
Trading Account And Profit and Loss Account

Particulars	Amount ₹	Particulars	Amount ₹
To Opening stock	2,20,000	By Sales	12,00,000
To Goods received by Head office	11,00,000	By Closing stock (Refer W.N.)	3,60,000
To Expenses	45,000		
To Net profit	1,95,000		
	15,60,000		15,60,000

(ii) Stock reserve in respect of unrealised profit

= ₹ 3,60,000 x (20/120) = ₹ 60,000

Working Note:

Cost Price	100	
Invoice Price	120	
Sale Price	150	
Calculation of closing stock at invoice price	₹	
Opening stock at invoice price	2,20,000	
Goods received during the year at invoice price	11,00,000	
	13,20,000	
Less : Cost of goods sold at invoice price	(9,60,000)	[12,00,000 x (120/150)]
Closing stock	3,60,000	

Illustration 8

Sell Well who carried on a retail business opened a branch X on January 1st, 2013 where all sales were on credit basis. All goods required by the branch were supplied from the Head Office and were invoiced to the branch at 10% above cost.

The following were the transactions:

	Jan. '2013	*Feb. 2013*	*March 2013*
	₹	₹	₹
Goods sent to Branch (Purchase Price)	*40,000*	*50,000*	*60,000*

Sales as shown by the branch monthly report	*38,000*	*42,000*	*55,000*
Cash received from Debtors and remitted to H.O.	*20,000*	*51,000*	*35,000*
Returns to H.O. (Invoice price to Branch)	*1,200*	*600*	*2,400*

The stock of goods held by the branch on March 31, 2013 amounted to ₹53,400 at invoice to branch.

Record these transactions in the Head Office books, showing balances as on 31st March, 2013 and the branch gross profit for the three months ended on that date.

All workings should form part of your solution.

Solution

Books of Sell Well

Branch Account

	₹			₹
To Goods sent to Branch A/c [$\frac{110}{100} \times 1{,}50{,}000$]	1,65,000	By Cash-collected from debts		1,06,000
		By Goods sent to Branch-returns		4,200
To Stock Reserve (W.N.2)	4,855	By Goods sent to Branch (W.N. 1)		14,618
To Profit (bal.) transferred to General Profit & Loss A/c	37,363	By Balance c/d		
		Stock	53,400	
		Debtors	29,000	82,400
	2,07,218			2,07,218

Memorandum Branch Debtors Account

	₹		₹
To Balance b/d	-	By Cash/Bank	1,06,000
To Sales	1,35,000	By Balance c/d	29,000
	1,35,000		1,35,000

Goods Sent to Branch Account

	₹		₹
To Branch A/c (Returns)	4,200	By Branch A/c	1,65,000
To Branch A/c (Loading)	14,618		
To Purchases A/c	1,46,182		
	1,65,000		1,65,000

Working Notes:

1. Loading on Goods sent to Branch = 1/11 of (₹ 1,65,000 – ₹ 4,200) = ₹ 14,618
2. Stock Reserve = 1/11 of 53,400 = ₹ 4,855

Illustration 9

Hindustan Industries Mumbai has a branch in Cochin to which office goods are invoiced at cost plus 25%. The branch sells both for cash and on credit. Branch Expenses are paid direct from head office, and the Branch has to remit all cash received into the Head Office Bank Account.

From the following details, relating to calendar year 2012, prepare the accounts in the Head Office Ledger and ascertain the Branch Profit. Branch does not maintain any books of account, but sends weekly returns to the Head Office:

	₹
Goods received from Head Office at invoice price	*6,00,000*
Returns to Head Office at invoice price	*12,000*
Stock at Cochin as on 1st Jan., 2012	*60,000*
Sales in the year - Cash	*2,00,000*
Credit	*3,60,000*
Sundry Debtors at Cochin as on 1st Jan. 2012	*72,000*
Cash received from Debtors	*3,20,000*
Discount allowed to Debtors	*6,000*
Bad debts in the year	*4,000*
Sales returns at Cochin Branch	*8,000*
Rent, Rates, Taxes at Branch	*18,000*
Salaries, Wages, Bonus at Branch	*60,000*
Office Expenses	*6,000*
Stock at Branch on 31st Dec. 2012 at invoice price	*1,20,000*

Solution

Books of Hindustan Industries, Mumbai
Cochin Branch Stock Account

	₹		₹
To Balance b/d	60,000	By Bank A/c (Cash sales)	2,00,000
To Goods sent to Branch A/c	6,00,000	By Branch Debtors (Cr. sales)	3,60,000
To Branch Debtors A/c (sales return)	8,000	By Goods sent to Branch (Ret. to H.O.)	12,000
To Branch P & L A/c (surplus)	24,000	By Balance c/d (closing stock)	1,20,000
	6,92,000		6,92,000

Cochin Branch Stock Adjustment Account

	₹		₹
To Goods sent to Branch A/c (1/5 of ₹ 12,000) (on returns)	2,400	By Balance b/d (1/5 of ₹ 60,000)	12,000
To Branch P & L A/c (Profit on sale at invoice price)	1,05,600	By Goods sent to Branch A/c (1/5 of ₹ 6,00,000)	1,20,000
To Balance c/d (1/5 of ₹ 1,20,000)	24,000		
	1,32,000		1,32,000

Goods Sent to Branch Account

	₹		₹
To Cochin Branch Stock Adjustment A/c	1,20,000	By Cochin Branch Stock A/c	6,00,000
To Cochin Branch Stock A/c (Ret.)	12,000	By Cochin Branch Stock Adj. A/c	2,400
To Purchases A/c	4,70,400		
	6,02,400		6,02,400

Branch Debtors Account

	₹		₹
To Balance b/d	72,000	By Bank	3,20,000
To Branch Stock A/c	3,60,000	By Branch P & L A/c	
		By Discount 6,000	
		By Bad Debts 4,000	10,000
		By Branch Stock (Sales Returns.)	8,000
		By Balance c/d	94,000
	4,32,000		4,32,000

Branch Expenses Account

	₹		₹
To Bank A/c (Rent, Rates & Taxes)	18,000	By Branch Profit & Loss A/c (Transfer)	84,000
To Bank A/c (Salaries & Wages)	60,000		
To Bank A/c (office exp.)	6,000		
	84,000		84,000

Branch Profit & Loss Account for the year ending 31st Dec. 2012

	₹		₹
To Branch Expenses A/c	84,000	By Branch Stock Adj. A/c	1,05,600

	Discount 6,000		By	Branch stock A/c	
	Bad debts 4,000	10,000		(Sale over invoice price)	24,000
To	Net Profit transferred to				
	Profit & Loss A/c	35,600			
		1,29,600			1,29,600

Illustration 10

Arnold of Delhi, trades in Ghee and Oil. It has a branch at Lucknow. He dispatches 25 tins of Oil @ ₹ 1,000 per tin and 15 tins of Ghee @ ₹ 1,500 per tin on 1st of every month. The branch incurs some expenditure which is met out of its collections; this is in addition to expenditure directly paid by Head Office.

Following are the other details:

		Delhi	Lucknow
		₹	₹
Purchases	Ghee	14,75,000	-
	Oil	29,32,000	-
Direct expenses		3,83,275	-
Expenses paid by H.O.		-	14,250
Sales	Ghee	18,46,350	3,42,750
	Oil	27,41,250	3,15,730
Collection during the year (including Cash Sales)		-	6,47,330
Remittance by Branch to Head Office		-	6,13,250

	(Delhi)	
Balance as on:	1-1-2012	31-12-2012
Stock : Ghee	1,50,000	3,12,500
Oil	3,50,000	4,17,250
Debtors	7,32,750	-
Cash on Hand	70,520	55,250
Furniture & Fittings	21,500	19,350
Plant/Machinery	3,07,250	7,73,500

	(Lucknow)	
Balance as on:	1-1-2012	31-12-2012
Stock : Ghee	17,000	13,250
Oil	27,000	44,750
Debtors	75,750	-
Cash on Hand	7,540	12,350
Furniture & Fittings	6,250	5,625
Plant/Machinery	-	

Addition to Plant/Machinery on 1-1-2012 ₹6,02,750.

Rate of Depreciation: Furniture / Fittings @ 10% and Plant / Machinery @ 15% (already adjusted in the above figures).

The Branch Manager is entitled to 10% commission after charging such commission whereas, the General Manager is entitled to 10% commission on overall company profits after charging such commission. General Manager is also entitled to a salary of ₹ 2,000 p.m. General expenses incurred by H.O. ₹24,000.

Prepare Branch Account in the head office books and also prepare the Arnold's Trading and Profit and Loss A/c (excluding branch transactions).

Solution

In the books of Arnold

Lucknow Branch Account

	₹		₹
To Balance b/d		By Bank (Remittance to H.O.)	6,13,250
Opening stock:		By Balance c/d	
Ghee	17,000	Closing stock:	
Oil	27,000	Ghee	13,250
Debtors	75,750	Oil	44,750
Cash on hand	7,540	Debtors (W.N. 1)	86,900
Furniture & fittings	6,250	Cash on hand (W.N. 2)	12,350
To Goods sent to Branch A/c		Furniture & fittings	5,625
Ghee	2,70,000		
Oil	3,00,000		
To Bank (Expenses paid by H.O.)	14,250		
To Branch Manager commission			
(₹ 58,335 × 1/11)	5,303		
To Net Profit transferred			
to General P & L A/c	53,032		
	7,76,125		7,76,125

Arnold

Trading and Profit and Loss account for the year ended 31st December, 2012

(Excluding branch transactions)

	₹		₹
To Opening Stock:		By Sales:	
Ghee	1,50,000	Ghee	18,46,350

	Oil		3,50,000		Oil	27,41,250
To	Purchases:			By	Closing Stock:	
	Ghee	14,75,000			Ghee	3,12,500
	Less: Goods sent to Branch	(2,70,000)	12,05,000		Oil	4,17,250
	Oil	29,32,000				
	Less: Goods sent to Branch	(3,00,000)	26,32,000			
To	Direct Expenses		3,83,275			
To	Gross Profit		5,97,075			
			53,17,350			53,17,350
To	Manager's Salary		24,000	By	Gross Profit	5,97,075
To	General Expenses		24,000	By	Branch Profit transferred	53,032
To	Depreciation					
	Furniture @ 10%	2,150				
	Plant & Machinery @ 15%	1,36,500	1,38,650			
To	General Manager's Commission @ 10% (*i.e.*, 4,63,457 × 1/11)		42,132			
To	Net profit		4,21,325			
			6,50,107			6,50,107

Working Notes:

(1) Debtors Account

	₹		₹
To Balance b/d	75,750	By Cash Collections	6,47,330
To Sales made during the year:		By Balance c/d	86,900
Ghee	3,42,750		
Oil	3,15,730		
	7,34,230		7,34,230

(2) Branch Cash Account

	₹		₹
To Balance b/d	7,540	By Remittance	6,13,250
To Collections	6,47,330	By Exp. (Balance fig.)	29,270
		By Balance c/d	12,350
	6,54,870		6,54,870

5.3 Goods invoiced at wholesale price to retail branches

Under this method, the Head Office (particularly, the manufacturing concern) supplies goods to its retail branches at wholesale price which is cost plus wholesale profit. The profit attributable to such branches is the difference between the sale proceeds of goods at the shops and the wholesale price of the goods sold. For the purpose, it is assumed that the manufacturer would always be able to sell the goods on wholesale terms and thereby realizes profit equal to the difference between the wholesale price and the cost. Many concerns, therefore, invoice goods to such shops at wholesale price and determine profit or loss on sale of goods on this basis. Accordingly, Branch Stock Account or the Trading Account is debited with:

(*a*) the value of opening stock at the Branch; and

(*b*) price of goods sent during the year at wholesale price.

It is credited by:

(*a*) sales effected at the shop; and

(*b*) closing stock of goods valued at wholesale price.

The value of goods lost due to accident, theft etc. also is credited to the Branch Stock Account or Trading Account calculated at the **wholesale price**. At this stage, the Branch Stock or Trading Account will reveal the amount of gross profit (or loss). It is transferred to the Branch Profit and Loss Account. On further being debited with the expenses incurred at the shop and the wholesale price of goods lost, the Branch Profit and Loss Account will disclose the net profit (or loss) at the shop.

Since the closing stock at the branch has to be valued at wholesale price, it would be necessary to create a stock reserve equal to the difference between its wholesale price and its cost (to the head office) by debiting the amount in the *Head Office Profit and Loss Account.* This Stock Reserve is carried down to the next year and then transferred to the credit of the (Head Office) Profit and Loss Account.

Illustration 11

M/s Rahul operates a number of retail outlets to which goods are invoiced at wholesale price which is cost plus 25%. These outlets sell the goods at the retail price which is wholesale price plus 20%.

Following is the information regarding one of the outlets for the year ended 31.3.2012:

	₹
Stock at the outlet 1.4.11	*30,000*
Goods invoiced to the outlet during the year	*3,24,000*
Gross profit made by the outlet	*60,000*

Goods lost by fire	*?*
Expenses of the outlet for the year	*20,000*
Stock at the outlet 31.3.12	*36,000*

You are required to prepare the following accounts in the books of Rahul Limited for the year ended 31.3.12 :

(a) Outlet Stock Account.

(b) Outlet Profit & Loss Account.

(c) Stock Reserve Account.

Answer

Outlet Stock Account

	₹		₹
To Balance b/d	30,000	By Sales (Working Note 1)	3,60,000
To Goods sent to outlet	3,24,000	By Goods lost by fire	18,000
To Gross Profit c/d	60,000	By Balance c/d	36,000
	4,14,000		4,14,000

Outlet Profit & Loss Account

	₹		₹
To Expenses	20,000	By Gross Profit b/d	60,000
To Goods lost by fire (W.N. 2)	18,000		
To Profit transferred	22,000		
	60,000		60,000

Stock Reserve Account

	₹		₹
To HO P & L A/c – Transfer	6,000	By Balance b/d	6,000
To Balance c/d (Stock Res. required)	7,200	By HO P&L A/c (W.N. 3)	7,200
	13,200		13,200

Working Notes :

			₹
(1)	Wholesale Price	100+25	= 125
	Retail Price	125 + 20%	= 150
	Gross Profit at the outlet		
	Wholesale Price – Retail Price	(150 – 125)	25

Retail sales value = 60,000 × $\frac{150}{25}$ = ₹ 3,60,000

(2) Goods lost by fire

Opening Stock + Goods Sent + Gross Profit – Sales – Closing Stock

30,000 + 3,24,000 + 60,000 – 3,60,000 – 36,000 = ₹ 18,000

(3) Stock Reserve

Opening Stock = 30,000 × $\frac{25}{125}$ = ₹ 6,000

Closing Stock = 36,000 × $\frac{25}{125}$ = ₹ 7,200

6. Accounting for Independent Branches

When the size of the business is big, it is desirable that the branch maintains complete records of its transactions. These branches are called independent branches and each independent branch maintains comprehensive account books for recording their transactions; therefore a separate trial balance of each branch can be prepared. The head office maintains one ledger account for each such branch, wherein all transactions between the head office and the branches are recorded.

Salient features of accounting system of an independent branch are as follows:

1. *Branch maintains its entire books of account under double entry system.*
2. *Branch opens in its books a Head Office account to record all transactions that take place between Head Office and branch. The Head Office maintains a Branch account to record these transactions.*
3. *Branch prepares its Trial Balance, Trading and profit and loss Account at the end of the accounting period and sends copies of these statements to Head Office for incorporation.*
4. *After receiving the final statements from branch, Head Office reconciles between the two – Branch account in Head Office books and Head Office account in Branch books.*
5. *Head office passes necessary journal entries to incorporate branch trial balance in its books.*

The Head Office Account in branch books and Branch Account in head office books is maintained respectively.

	Transactions	Head office books	Branch books
(*i*)	Dispatch of goods to branch by H.O.	Branch A/c Dr. To Good sent to Branch A/c	Goods received. from H.O. A/c Dr. To Head Office A/c

(*ii*)	When goods are returned by the Branch to H.O.	Goods sent to Branch A/c Dr. To Branch A/c	Head Office A/c Dr. To Goods recd. from H.O. A/c
(*iii*)	Branch Expenses are paid by the Branch	No Entry	Expenses A/c Dr. To Cash A/c
(*iv*)	Branch Expenses paid by H.O.	Branch A/c Dr. To Bank	Expenses A/c Dr. To Head Office A/c
(*v*)	Outside purchases made by the Branch	No Entry	Purchases A/c Dr. To Bank (or) Crs. A/c
(*vi*)	Sales effected by the Branch	No Entry	Cash or Debtors A/c Dr. To Sales
(*vii*)	Collection from Debtors of the Branch recd. by H.O.	Cash or Bank A/c Dr. To Branch A/c	Head office A/c Dr. To Sundry Drs. A/c
(*viii*)	Payment by H.O. for purchase made by Branch	Branch A/c Dr. To Bank	Purchase (or) Sundry Creditors A/c Dr. To Head Office
(*ix*)	Purchase of Asset by Branch	No Entry	Sundry Assets Dr. To Bank (or) Liability
(*x*)	Asset purchased by the Branch but Asset A/c retained at H.O. books	Branch Asset A/c Dr. To Branch A/c	Head office Dr. To Bank (or) Liability
(*xi*)	Depreciation on (*x*) above	Branch A/c Dr. To Branch Asset	Depreciation A/c Dr. To Head Office A/c
(*xii*)	Remittance of funds by H.O. to Branch	Branch A/c Dr. To Bank	Bank A/c Dr. To Head Office
(*xiii*)	Remittance of funds by Branch to H.O.	Reverse entry of(*xii*) above	Reverse entry of (*xii*) above
(*xiv*)	Transfer of goods from one Branch to another branch	(Recipient) Branch A/c Dr. To Supplying Branch A/c	Supplying Branch H.O. A/c Dr. To Goods Received from H.O. A/c Recipient Branch Goods Received from H.O. A/c Dr. To Head Office A/c

Students may find a few further practical situations and it is hoped that they can pass entries on the basis of accounting principles explained above.

The final result of these adjustments will be that so far as the Head Office is concerned, the branch will be looked upon either as a debtor or creditor, as a debtor if the amount of its assets is in excess of its liabilities and as a creditor if the position is reverse.

A debit balance in the Branch Account should always be equal to the net assets at the branch. The important thing to remember, when independent sets of accounts are maintained, is that the branch and head office books are connected with each other only through the medium of the Branch and the Head Office Account which are converse of each other.; also when accounts of the branch and head office are consolidated both the Branch and Head Office Accounts will be eliminated.

7. Adjustment and Reconciliation of Branch and Head Office Accounts

If the branch and the head office accounts, converse of each other, do not tally, these must be **reconciled** before the preparation of the final accounts of the concern as a whole.

For example if Head Office has sent goods worth ₹ 50,000 but the branch has received till the closing date goods only ₹ 40,000, then the branch should treat ₹ 10,000 as goods in transit and should pass the following entry :

		Dr.	Cr.
Goods in transit A/c	Dr.	10,000	
To Head Office A/c			10,000

However, there will be no entry in Head office books being the point where the event has been recorded in full, hence no further entries in Head office books.

7.1 Reasons for Disagreement

Following are the possible reasons for the disagreement between Branch A/c in Head office books and Head office A/c in Branch books on the closing date:

- Goods dispatched by the Head office not received by the branch. These goods may be in transit or loss in transit.
- Goods returned by the branch to Head Office may have been received by the H.O. Again, these goods may be in transit or lost in transit.
- Amount remitted by Head office to branch or *vice versa* remaining in transit on the closing date.
- Receipt of income or payment or expenses relating to the Branch transacted by the head office or *vice versa*, hence not recorded at the respective ends wherein they are normally to be recorded.

The technique of reconciliation has been illustrated through the example given below :

	Head office		Branch	
	Dr.	Cr.	Dr.	Cr.
Goods sent to Branch		1,50,000	-	
Goods recd. from H.O. A/c		-	1,40,000	
Branch A/c	1,12,000			
Head office A/c	-	-	-	78,500

On analysis of Branch A/c in Head office books and Head office A/c in branch books, you find:

- ₹ 15,000 remitted by the branch has not been received, hence not recorded in the head office books.
- Direct collection of ₹ 10,500 from a customer of the branch by Head office not informed to the branch, hence not recorded by the branch.
- A sum of ₹ 14,500 paid by branch to the suppliers of head office not recorded at Head office.
- Head office expenditure allocation to the branch ₹12,000 not recorded in the branch.
- ₹ 7,500 being FD interest of head office received by the branch on oral instructions from H.O., not recorded in the head office books.

			Head Office Books			Branch Books	
			Dr. ₹	Cr. ₹		Dr. ₹	Cr. ₹
(*i*)	*Goods in transit* (₹ 10,000)		-	-	Goods in Transit A/c To Head office A/c	10,000	 10,000
(*ii*)	*Cash in Transit*:	Cash in Transit A/c To Branch A/c	15,000	 15,000	(No Entry)		
(*iii*)	*Direct Collection by H.O. on behalf of the Branch*				Head Office A/c To Debtors A/c	10,500	 10,500
(*iv*)	*Direct payment of ₹14,500 by Branch on behalf of H.O*	Sundry Crs. A/c To Branch A/c	14,500	 14,500			
(*v*)	*Expenditure Allocated to Branch*				Branch Exp. A/c To H.O. A/c	12,000	 12,000
(*vi*)	*Fixed Deposit interest of ₹ 7,500 directly received by the Branch*	Branch A/c To Sundry Income	7,500	 7,500			

In Branch Books

Head Office Account

	₹		₹
To Sundry Debtors A/c	10,500	By Balance b/d	78,500
To Balance c/d	90,000	By Goods in transit	10,000
		By Branch expenses	12,000
	1,00,500		1,00,500
		By Balance b/d	90,000

In the Books of Head Office

Branch A/c

	₹		₹
To Balance b/d	1,12,000	By Cash in Transit	15,000
To Sundry Income	7,500	By Sundry Creditors	14,500
		By Balance c/d	90,000
	1,19,500		1,19,500
To Balance b/d	90,000		

Important Points to be noted:

(*i*) the balance of Head Office A/c in Branch books and Branch A/c in Head Office books have tallied.

(*ii*) Adjustment are made only at the point:

Where the recording has been omitted, and

Other than the point where action has been effected.

7.2 Other points

(1) Inter-Branch Transactions

Inter-branch transactions are usually adjusted as if they were entered into only with the head office. It is a very convenient method of treating such transaction especially where the number of branches are large. Suppose Kolkata Branch incurred an expenditure on advertisement of ₹ 1,000 on account of Delhi Branch, the entries that would be made in such a case would be as follows:

		Dr.	Cr.
		₹	
In Kolkata Books:			
Head Office A/c	Dr.	1,000	
To Cash			1,000
In Delhi Books:			
Advertisement A/c	Dr.	1,000	
To H.O. A/c			1,000
In H.O. Books:			
Delhi Branch A/c	Dr.	1,000	
To Kolkata Branch A/c			1,000

(2) **Fixed Assets**

Often the accounts of fixed assets of a branch are kept in the head office books; in such a case, at the end of the year, the amount of depreciation on the assets is debited to the branch concerned by recording the following entry:

Branch Account	Dr.
To Branch Asset Account	

The branch will pass the following entry:

Depreciation Account	Dr.
To Head Office Account	

(3) **Head office Expenses charged to Branch**

Usually the head office has to devote considerable time in attending to the affairs of the branch; on that account, it may decide to raise a charge against the branch in respect of the cost of such time. In such a case the amount is debited to the branch as 'Expenses' and is credited to appropriate revenue head such as Salaries Accounts, General Charges Account, Entertainment Account etc. The branch credits the H.O. Account and debits Expenses Account.

8. Incorporation of Branch Balance in Head Office Books

The method that will be adopted for incorporating the trading result of the branch with that of the head office would depend on whether it is desired to prepare separate Profit & Loss Account and Balance Sheet of the branch and the Head Office or consolidated statement of account of both branch and head office.

In the first-mentioned case, the amount of profit or loss shown by the Profit & Loss Account of the branch only will be transferred to Head office Account in the branch books and a converse entry will be passed in the Head Office books by debit to the Branch Account. This method has already been illustrated above. In such a case, not only the Profit & Loss Account of the branch and that of the head office would be prepared separately but also there would be separate Balance Sheet for the branch and the head office. The branch Balance Sheet would show the amount advanced by the head office to it, as capital. In the head office Balance Sheet, the same amount would be shown as an advance to the branch.

If however, it is desired to prepare a consolidated Profit & Loss Account and Balance Sheet, individual balances of all the revenue accounts would be separately transferred to the Head Office Account by debit or credit in the branch books and the converse entries would be passed in the head office books. The effect thereof will be similar to the amount of net profit or loss of the branch having been transferred since it would be composed of the balances that have been transferred. In case it is also desired that consolidated balance sheet of the branch and the head office should be prepared, it will also be necessary to transfer the balance of assets and liabilities of the branch to the head office. The adjusting entries that would be passed in this respect are shown below:

(*a*) Head Office Account Dr.
To Asset (individual) Account

(*b*) (Individual) Liability Account Dr.
To Head Office Account

Converse entries are passed in the head office books.

It is obvious that after afore-mentioned entries have been passed, the Branch Account in the Head Office books and Head Office Account in the branch books will be closed and it will be necessary to restart them at the beginning of the next year.

In consequence, at the beginning of the following year, the under-mentioned entry is recorded by the branch:

Asset Account (In Detail) Dr.
To Liability Accounts
To H.O. Account (The difference between assets and liabilities)

Illustration 12

Messrs Ramchand & Co., Hyderabad have a branch in Delhi. The Delhi Branch deals not only in the goods from Head Office but also buys some auxiliary goods and deals in them. They, however, do not prepare any Profit & Loss Account but close all accounts to the Head Office at the end of the year and open them afresh on the basis of advice from their Head Office. The fixed assets accounts are also maintained at the Head Office.

The goods from the Head Office are invoiced at selling prices to give a profit of 20 per cent on the sale price. The goods sent from the branch to Head Office are at cost. From the following prepare Branch Trading and Profit & Loss Account and Branch Assets Account in the Head Office Books.

Trial Balance of the Delhi Branch as on 31-12-2012

Debit	₹	*Credit*	₹
Head office opening balance on 1-1-12	*15,000*	*Sales*	*1,00,000*
Goods from H.O.	*50,000*	*Goods to H.O.*	*3,000*
Purchases	*20,000*	*Head Office Current A/c*	*15,000*
Opening Stock		*Sundry Creditors*	*3,000*
(H.O. goods at invoice prices)	*4,000*		
Opening Stock of other goods	*500*		
Salaries	*7,000*		
Rent	*3,000*		
Office expenditure	*2,000*		
Cash on Hand	*500*		
Cash at Bank	*4,000*		
Sundry Debtors	*15,000*		
	1,21,000		*1,21,000*

The Branch balances as on 1st January, 2012, were as under: Furniture ₹ 5,000; Sundry Debtors ₹ 9,500; Cash ₹ 1,000, Creditors ₹ 30,000; Stock (H.O. goods at invoice price) ₹ 4,000; other goods ₹ 500. The closing stock at branch of the head office goods at invoice price is ₹ 3,000 and that of purchased goods at cost is ₹ 1,000. Depreciation is to be provided at 10 per cent on branch assets.

Solution

Delhi Branch Trading and Profit & Loss Account
for the year ended 31st Dec., 2012

			₹				₹
To	Opening Stock:			By	Sales		1,00,000
	Head office Goods	3,200		By	Goods from Branch		3,000
	Others	500	3,700	By	Closing Stock :		
To	Goods To Branch		40,000		Head Office goods	2,400	
To	Purchases		20,000		Others	1,000	3,400
To	Gross Profit c/d		42,700				
			1,06,400				1,06,400
To	Salaries		7,000	By	Gross profit b/d		42,700
To	Rent		3,000				
To	Office Expenses		2,000				
To	Dep. on furniture @ 10%		500				
To	Net profit		30,200				
			42,700				42,700

Branch (Fixed) Assets Account (In Head Office Books)

2012			₹	2012			₹
Jan. 1	To	Balance b/d	5,000	Dec. 31	By	Delhi Branch A/c (Depreciation)	500
					By	Balance c/d	4,500
			5,000				5,000
2013							
Jan. 1	To	Balance b/d	4,500				

Working Notes:

Cash/Bank Account (Branch Books)

		₹	₹			₹
To	Balance b/d		1,000	By	Salaries	7,000

To Sales Proceeds			By Rent	3,000
Sales	1,00,000		By Office Exp.	2,000
Opening balance			By Creditors*	47,000
of Debtors	9,500		By Head Office (Balancing fig.)	32,000
	1,09,500		By Cash Balance	500
Less: Closing balance	(15,000)		By Bank Balance	4,000
To Cash Received	94,500	94,500		
		95,500		95,500

*Opening Balance + Purchases – Closing balance = Payment

₹ 30,000 + ₹ 20,000 – ₹ 3,000 = ₹ 47,000.

Trial Balance of Delhi Branch as on 1-1-2012

			Dr. ₹	Cr. ₹
Debtors			9,500	
Cash			1,000	
Stock	H.O. Goods	4,000		
	Others	500	4,500	
Creditors				30,000
Head Office Account			15,000	
			30,000	30,000

Head Office Account

	₹		₹
To Balance (transfer)	15,000	By Goods from Head Office	50,000
To Cash	32,000		
To Goods sent	3,000		
	50,000		50,000

Credit balance in Head Office Account before this transfer will be ₹ 15,000 credit.

Note : Furniture A/c is maintained in Head office books; it is not a part of either opening or closing balance.

Illustration 13

Ring Bell Ltd. Delhi has a Branch at Bombay where a separate set of books is used. The following is the trial balance extracted on 31st December, 2012.

Head Office Trial Balance

	₹	₹
Share Capital (Authorised: 10,000 Equity Shares of ₹ 100 each):		
Issued: 8,000 Equity Shares		*8,00,000*
Profit & Loss Account - 1-1-2012		*25,310*
Interim Dividend paid - Aug. 2012	*30,000*	
General Reserve		*1,00,000*
Fixed Assets	*5,30,000*	
Stock	*2,22,470*	
Debtors and Creditors	*50,500*	*21,900*
Profit for 2012		*82,200*
Cash Balance	*62,730*	
Branch Current Account	*1,33,710*	
	10,29,410	*10,29,410*

Branch Trial Balance

	₹	₹
Fixed Assets	*95,000*	
Profit for 2012		*31,700*
Stock	*50,460*	
Debtors and Creditors	*19,100*	*10,400*
Cash Balance	*6,550*	
Head Office Current Account		*1,29,010*
	1,71,110	*1,71,110*

The difference between the balances of the Current Account in the two sets of books is accounted for as follows:

(a) Cash remitted by the Branch on 31st December, 2012, but received by the Head Office on 1st January 2013 - ₹ 3,000.

(b) Stock stolen in transit from Head Office and charged to Branch by the Head Office, but not credited to Head Office in the Branch books as the Branch Manager declined to admit any liability (not covered by insurance) - ₹ 1,700.

Give the Branch Current Account in Head Office books after incorporating Branch Trial Balance through journal. Also prepare the company's Balance Sheet as on 31st December, 2012.

Solution

The Branch Current Account in the Head Office Books and Head Office Current Account in the Branch Books do not show the same balances. Therefore, in order to reconcile them, the following journal entries will be passed in the Head Office books :

Journal Entries

2012			Dr. ₹	Cr. ₹
Dec., 31	Cash in Transit A/c	Dr.	3,000	
	To Branch Current A/c			3,000
	(Cash sent by the Branch on 31st Dec., 2012 but received at H.O. on 1st Jan., 2013)			
	Loss by theft A/c	Dr.	1,700	
	To Branch Current A/c			1,700
	(Stock lost in transit from H.O. to Branch)			

In order to incorporate, in the H.O. books, the given Branch trial balance which has been drawn up after preparing the Branch Profit & Loss Account, the following journal entries will be necessary:

Journal Entries

2012			₹	₹
Dec. 31	Branch Current Account	Dr.	31,700	
	To Profit & Loss Account			31,700
	(Branch Profit for 2012)			
	Branch Fixed Assets	Dr.	95,000	
	Branch Stock	Dr.	50,460	
	Branch Debtors	Dr.	19,100	
	Branch Cash	Dr.	6,550	
	To Branch Current Account			1,71,110
	(Branch assets brought into H.O. Books)			
	Branch Current A/c	Dr.	10,400	
	To Branch Creditors			10,400
	(Branch creditors brought into H.O. Books)			

Branch Current Account

	₹		₹
To Balance b/d	1,33,710	By Cash in transit	3,000
To Profit & Loss A/c	31,700	By Loss of theft	1,700
To Branch Creditors	10,400	By Sundry Branch Assets	1,71,110
	1,75,810		1,75,810

Profit and Loss Account for 2012

	₹		₹
To Loss by Theft	1,700	By Balance b/d	25,310
To Interim Dividend for Aug., 2012	30,000	By Year's Profit : H.O.	82,200
To Balance c/d	1,07,510	Branch	31,700
	1,39,210		1,39,210

Balance Sheet of the Company as on 31st Dec., 2012

Particulars	Note No	Amount (₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	8,00,000
(b) Reserves and Surplus	2	2,07,510
(2) Current Liabilities		
Trade payables	3	32,300
Total		10,39,810
II. Assets		
(1) Non-current assets		
Fixed assets	4	6,25,000
(2) Current assets		
(a) Inventories	5	2,72,930
(b) Trade Receivables	6	69,600
(c) Cash and cash equivalents	7	72,280
Total		10,39,810

Notes to Accounts

			₹
1.	Share Capital		
	Authorised capital :		
	10,000 Equity Shares of ₹ 100 each		10,00,000
	Issued and Subscribed Capital :		
	8,000 Equity Shares of ₹ 100 each fully paid		8,00,000
2.	Reserves and Surplus		
	General Reserve	1,00,000	
	Profit & Loss Account	1,07,510	2,07,510

3.	Trade payables		
	Creditors		
	H.O.	21,900	
	Branch	10,400	32,300
4.	Fixed Assets		
	H.O.	5,30,000	
	Branch	95,000	6,25,000
5.	Inventories		
	H.O.	2,22,470	
	Branch	50,460	2,72,930
6.	Trade Receivables		
	H.O.	50,500	
	Branch	19,100	69,600
7.	Cash and cash equivalents		
	Cash in Hand :		
	H.O.	62,730	
	Branch	6,550	69,280
	Cash in Transit		3,000
			72,280

Illustration 14

KP manufactures a range of goods which it sells to wholesale customers only from its head office. In addition, the H.O. transfers goods to a newly opened branch at factory cost plus 15%. The branch then sells these goods to the general public on only cash basis.

The selling price to wholesale customers is designed to give a factory profit which amounts to 30% of the sales value. The selling price to the general public is designed to give a gross margin (i.e., selling price less cost of goods from H.O.) of 30% of the sales value.

KP operates from rented premises and leases all other types of fixed assets. The rent and hire charges for these are included in the overhead costs shown in the trial balances.

From the information given below, you are required to prepare for the year ended 31st Dec., 2012 in columnar form.

(a) A Profit & Loss account for (i) H.O. (ii) the branch (iii) the entire business.

(b) Balance Sheet as on 31st Dec., 2012 for the entire business.

	H.O.		*Branch*	
	₹	₹	₹	₹
Raw materials purchased	*35,000*			
Direct wages	*1,08,500*			
Factory overheads	*39,000*			
Stock on 1-1-2012				

Raw materials	*1,800*			
Finished goods	*13,000*		*9,200*	
Debtors	*37,000*			
Cash	*22,000*		*1,000*	
Administrative Salaries	*13,900*		*4,000*	
Salesmen's Salaries	*22,500*		*6,200*	
Other administrative & selling overheads	*12,500*		*2,300*	
Inter-unit accounts	*5,000*			*2,000*
Capital		*50,000*		
Sundry Creditors		*13,000*		
Provision for unrealized profit in stock		*1,200*		
Sales		*2,00,000*		*65,200*
Goods sent to Branch		*46,000*		
Goods received from H.O.			*44,500*	
	3,10,200	*3,10,200*	*67,200*	*67,200*

Notes:

(1) On 28th Dec., 2012 the branch remitted ₹ 1,500 to the H.O. and this has not yet been recorded in the H.O. books. Also on the same date, the H.O. dispatched goods to the branch invoiced at ₹ 1,500 and these too have not yet been entered into the branch books. It is the company's policy to adjust items in transit in the books of the recipient.

(2) The stock of raw materials held at the H.O. on 31st Dec., 2012 was valued at ₹ 2,300.

(3) You are advised that:

- *there were no stock losses incurred at the H.O. or at the branch.*
- *it is KP's practice to value finished goods stock at the H.O. at factory cost.*
- *there were no opening or closing stock of work-in-progress.*

(4) Branch employees are entitled to a bonus of ₹ 156 under a bilateral agreement.

Solution

In the books of KP

Trading and Profit & Loss Account for the year ended 31st Dec., 2012

	H.O. ₹	*Branch* ₹	*Total* ₹		*H.O.* ₹	*Branch* ₹	*Total* ₹
To Material consumed	34,500	-	34,500	By Sales	2,00,000	65,200	2,65,200
To Wages	1,08,500	-	1,08,500	By Goods Sent to			

To Factory Overheads	39,000	-	39,000	Branch	46,000	-	-
To Opening stock of finished goods	13,000	9,200	22,200	By Closing stock	15,000	9,560	24,560
To Goods from H.O.		46,000					
To Gross Profit c/d	66,000	19,560	85,560				
	2,61,000	74,760	2,89,760		2,61,000	74,760	2,89,760
To Admn. Salaries	13,900	4,000	17,900	By Gross Profit b/d	66,000	19,560	85,560
To Salesmen Salaries	22,500	6,200	28,700				
To Other Admn. & Overheads	12,500	2,300	14,800				
To Stock Reserve (increase)	47	-	47				
To Bonus to Staff	-	156	156				
To Net Profit	17,053	6,904	23,957				
	66,000	19,560	85,560		66,000	19,560	85,560

Balance Sheet as on 31st Dec., 2012

		₹	H.O. ₹	Branch ₹	Total ₹		H.O. ₹	Branch ₹	Total ₹
Capital			50,000	-	50,000	Fixed Assets	-	-	-
Profit :	H.O.	17,053				Current Assets:			
	Branch	6,904	23,957		23,957	Raw material	2,300		2,300
Trade Creditors			13,000		13,000	Finished Goods	15,000	9,560	23,313 *
Bonus Payable				156	156	(Less Stock Res.)			
H.O. Account				10,404		Debtors	37,000	-	37,000

Stock Reserve			1,247			Cash (including transit item) Branch A/c	23,500 10,404*	1,000	24,500
			88,204	10,560	87,113		88,204	10,560	87,113

*9,560 × 100/115 *i.e.,* (8,313 + 15,000) = ₹ 23,313

** (5,000 + 6,904) – 1500 = ₹ 10,404.

9. Incomplete Information in Branch Books

If it is desired that profitability of the branch should be kept secret from the branch staff, the head office would hold back some key information from the branch, e.g., amount of opening stock, cost of goods sent to the branch, etc. The head office, in such a case would maintain a record of goods sent to the branch by passing the entry:

Goods Supplied to the Branch Account Dr.

To Purchases Account

The value of the closing stock will also be adjusted only in head office books.

In such a case, for closing its books at the end of the year, the branch will simply transfer various revenue accounts to the head office without drawing up a Trading and Profit & Loss Account.

On that basis, supplemented by the record of transactions maintained at the head office, it will be possible to construct the Trading and Profit & Loss Account of the branch.

Illustration 15

AFFIX of Kolkata has a branch at Delhi to which the goods are supplied from Kolkata but the cost thereof is not recorded in the Head Office books. On 31st March, 2012 the Branch Balance Sheet was as follows :

Liabilities	₹	*Assets*	₹
Creditors Balance	*40,000*	*Debtors Balance*	*2,00,000*
Head Office	*1,68,000*	*Building Extension A/c closed by transfer to H.O. A/c*	---
		Cash at Bank	*8,000*
	2,08,000		*2,08,000*

During the six months ending on 30-9-2012, the following transactions took place at Delhi.

	₹		₹
Sales	*2,40,000*	*Manager's Salary*	*4,800*
Purchases	*48,000*	*Collections from Debtors*	*1,60,000*

Wages paid	*20,000*	*Discounts allowed*	*8,000*
Salaries (inclusive of advance of ₹ 2,000)	*6,400*	*Discount earned*	*1,200*
		Cash paid to Creditors	*60,000*
General Expenses	*1,600*	*Building Account (further payment)*	*4,000*
Fire Insurance (paid for one year)	*3,200*	*Cash in Hand*	*1,600*
Remittance to H.O.	*38,400*	*Cash at Bank*	*28,000*

Set out the Head Office Account in Delhi books and the Branch Balance Sheet as on 30-9-2012. Also give journal entries in the Delhi books.

Solution

Journal Entries

2012 30 Sept.		Dr. ₹	Cr. ₹
Salary Advance A/c	Dr.	2,000	
To Salaries A/c			2,000
(The amount paid as advance adjusted by debit to Salary Advance Account)			
Prepared Insurance A/c	Dr.	1,600	
To Fire Insurance A/c			1,600
(Six months premium transferred to the Prepaid Insurance A/c)			
Head Office Account	Dr.	88,400	
To Purchases A/c			48,000
To Wages A/c			20,000
To Salaries A/c			4,400
To General Expenses A/c			1,600
To Fire Insurance A/c			1,600
To Manager's Salary A/c			4,800
To Discount Allowed A/c			8,000
(Transfer of various revenue accounts (Dr.) to the H.O. Account for closing the accounts)			
Sales Accounts	Dr.	2,40,000	
Discount Earned A/c	Dr.	1,200	
To Head Office A/c			2,41,200
[Revenue accounts (Cr.) transferred to H.O.]			
Head Office Account	Dr.	4,000	
To Building Account			4,000
(Transfer of amounts spent on building extension to H.O. A/c)			

Head Office Account

2012		₹	2012		₹
Sep. 30	To Cash-remittance	38,400	April 1	By Balance b/d	1,68,000
	To Sundries (Revenue A/cs)	88,400	Sep. 30	By Sundries (Revenue A/cs)	2,41,200
	To Building A/c	4,000			
	To Balanced c/d	2,78,400			
		4,09,200			4,09,200

Balance Sheet of Delhi Branch as on Sept. 30, 2012

Liabilities	₹	*Assets*	₹
Creditors Balances	26,800	Debtors Balances	2,72,000
Head Office Account	2,78,400	Salary Advance	2,000
		Prepaid Insurance	1,600
		Building Extension A/c transferred to H.O.	—
		Cash in Hand	1,600
		Cash at Bank	28,000
	3,05,200		3,05,200

Cash and Bank Account

	₹			₹
To Balance b/d	8,000	By Wages		20,000
To Collection from Debtors	1,60,000	By Salaries		6,400
		By Insurance		3,200
		By General Exp.		1,600
		By H.O. A/c		38,400
		By Manager's Salary		4,800
		By Creditors		60,000
		By Building A/c		4,000
		By Balance c/d		
		By Cash in Hand	1,600	
		By Cash at Bank	28,000	29,600
	1,68,000			1,68,000

Debtors Account

	₹			₹
To Balance b/d	2,00,000	By	Cash Collection	1,60,000

To	Sales	2,40,000	By	Discount (allowed)	8,000
			By	Balance c/d	2,72,000
		4,40,000			4,40,000
To	Balance b/d	2,72,000			

Creditors Account

	₹		₹
To Cash	60,000	By Balance b/d	40,000
To Discount (earned)	1,200	By Purchases	48,000
To Balance c/d	26,800		
	88,000		88,000
		By Balance b/d	26,800

Illustration 16

The following Trial balances as at 31st December, 2012 have been extracted from the books of Major Ltd. and its branch at a stage where the only adjustments requiring to be made prior to the preparation of a Balance Sheet for the undertaking as a whole.

	Head Office		*Branch*	
	Dr. ₹	*Cr.* ₹	*Dr.* ₹	*Cr.* ₹
Share Capital		*1,50,000*		
Fixed Assets	*75,125*		*18,901*	
Current Assets	*1,21,809*		*23,715*	*(Note 3)*
Current Liabilities		*34,567*		*9,721*
Stock Reserve, 1st Jan., 2012 (Note 2)		*693*		
Revenue Account		*43,210*		*10,250*
Branch Account	*31,536*			
Head Office Account				*22,645*
	2,28,470	*2,28,470*	*42,616*	*42,616*

Notes :

1. *Goods transferred from Head Office to the Branch are invoiced at cost plus 10% and both Revenue Accounts have been prepared on the basis of the prices charged.*
2. *Relating to the Head Office goods held by the Branch on 1st January, 2012.*
3. *Includes goods received from Head Office at invoice price ₹ 4,565.*

4. *Goods invoiced by Head Office to Branch at ₹ 3,641 were in transit at 31st December, 2012, as was also a remittance of ₹ 3,500 from the Branch.*
5. *At 31st December, 2012, the following transactions were reflected in the Head Office books but unrecorded in the Branch books.*

The purchase price of lorry, ₹ 2,500, which reached the Branch on December 25th; a sum received on December 30, 2012 from one of the Branch debtors, ₹ 750.

You are required:

(i) to record the foregoing in the appropriate ledger accounts in both sets of books;

(ii) to prepare a Balance Sheet as at 31st December, 2012 for the undertaking as a whole.

Solution

H.O. Books

Branch Account

2012		₹	*2012*		₹
Dec. 31	To Balance b/d	31,536	Dec. 31	By Cash in transit	3,500
				By Balance b/d	28,036
		31,536			31,536

Cash in Transit Account

2012		₹	*2012*		₹
Dec. 31	To Branch A/c	3,500	Dec. 31	By Balance c/d	3,500

Stock Reserve Account

2012		₹	2012		₹
Dec. 31	To Balance c/d	746	Jan. 1	By Balance c/d	693
				By Reserve A/c	53
		746			746

Revenue Account

2012		₹	2012		₹
Dec. 31	To Stock Reserve	53	Dec. 31	By Balance c/d	43,210
	To Balance c/d	43,157			
		43,210			43,210

Branch Books

Head Office Account

2012		₹	2012		₹
Dec.31	To Current Assets	750	Dec. 31	By Balance b/d	22,645
	To (Debtors)			By Goods in transit	3,641
	Balance c/d	28,036		By Motor Vehicle	2,500
		28,786			28,786

Goods in Transit Account

2012		₹	2012		₹
Dec. 31	To Head Office	3,641	Dec. 31	By Balance c/d	3,641

Motor Vehicle Account

2012		₹	2012		₹
Dec. 31	To Head Office	2,500	Dec. 31	By Balance c/d	2,500

Sundry Current Assets A/c

2012		₹	2012		₹
Dec. 31	To Balance b/d	23,715	Dec. 31	By H.O. (Remittance by Debtor)	750
				By Balance c/d	22,965
		23,715			23,715

Balance Sheet of Major Ltd. as on 31st Dec., 2012

Particulars	Note No	Amount (₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
Share Capital		1,50,000
(2) Non-Current Liabilities		
Long-term borrowings	1	53,407
(3) Current Liabilities		44,288
Total		2,47,695
II. Assets		
(1) Non-current assets		
Fixed assets		96,526
(2) Current assets		1,51,169
Total		2,47,695

Notes to Accounts

		₹
	Long term borrowings	
	Secured Loans	53,407

Working Notes:

		₹
(*i*) Fixed Assets:	Head Office	75,125

	Branch Motor Vehicle	18,901 2,500 96,526
(*ii*) Current Assets :	Head Office Cash in transit Branch (23,715–750) Stock in transit *Less* : Stock Reserve	1,21,809 3,500 22,965 3,641 1,51,915 (746) 1,51,169
(*iii*) Revenue Account	Head Office (43,210 – 53) Branch	43,157 10,250 53,407
(*iv*) Current Liabilities :	Head Office Branch	34,567 9,721 44,288

10. Foreign Branches

Foreign branches generally maintain independent and complete record of business transacted by them in currency of the country in which they operate. Thus problems of incorporating balances of foreign branches relate mainly to translation of foreign currency into Indian rupees. This is because exchange rate of Indian rupee is not stable in relation to foreign currencies due to international demand and supply effects on various currencies. The accounting principles which apply to inland branches also apply to a foreign branch after converting the trial balance of the foreign branch in the Indian currency.

11. Accounting for Foreign Branches

For the purpose of accounting, AS 11 (revised 2003) classifies the foreign branches may be classified into two types:

- Integral Foreign Operation;
- Non- Integral Foreign Operation.

Let us discuss these two types of foreign branches in detail.

11.1 Integral Foreign Operation (IFO)

It is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. The business of IFO is carried on as if it were an extension of the reporting enterprise's operations. Generally, IFO carries on business in a single foreign currency, ie. of the country where it is located. For example, sale of goods imported from the reporting enterprise and remittance of proceeds to the reporting enterprise.

11.2 Non-Integral Foreign Operation (NFO)

It is a foreign operation that is not an Integral Foreign Operation. The business of a NFO is carried on in a substantially independent way by accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowing in its local currency. An NFO may also enter into transactions in foreign currencies, including transactions in the reporting currency. An example of NFO may be production in a foreign currency out of the resources available in such country independent of the reporting enterprise.

The following are the indicators of Non- Integral Foreign Operation-

- *Control by reporting enterprises* - While the reporting enterprise may control the foreign operation, the activities of foreign operation are carried independently without much dependence on reporting enterprise.
- Transactions with the reporting enterprises are not a high proportion of the foreign operation's activities.
- Activities of foreign operation are mainly financed by its operations or from local borrowings. In other words it raises finance independently and is in no way dependent on reporting enterprises.
- Foreign operation sales are mainly in currencies other than reporting currency.
- All the expenses by foreign operations are primarily paid in local currency, not in the reporting currency.
- Day-to-day cash flow of the reporting enterprises is independent of the foreign enterprises cash flows.
- Sales prices of the foreign enterprises are not affected by the day-to-day changes in exchange rate of the reporting currency of the foreign operation.
- There is an active sales market for the foreign operation product.

The above are only indicators and not decisive/conclusive factors to classify the foreign operations as non-integral, much will depend on factual information, situations of the particular case and, therefore, judgment is necessary to determine the appropriate classification.

Controversies may arise in deciding the foreign branches of the enterprises into integral or non-integral. However, there may not be any controversy that subsidiary associates and joint ventures are non-integral foreign operation.

In case of branches classified as independent for the purpose of accounting are generally classified as non-integral foreign operations.

12. Change in Classification

When there is a change in classification, accounting treatment is as under-

12.1 Integral to Non-Integral

(i) Translation procedure applicable to non-integral shall be followed from the date of change.

(ii) Exchange difference arising on the translation of non-monetary assets at the date of re-classification is accumulated in foreign currency translation reserve.

12.2 Non-Integral to Integral

(i) Translation procedure as applicable to integral should be applied from the date of change.

(ii) Translated amount of non-monetary items at the date of change is treated as historical cost.

(iii) Exchange difference lying in foreign currency translation reserve is not to be recognized as income or expense till the disposal of the operation even if the foreign operation becomes integral.

13. Techniques for Foreign Currency Translation

13.1 Integral Foreign Operation (IFO)

Following are the standard recommendations for foreign currency translation:

(1) All transactions of IFO be translated at the rate prevailing on the date of transaction. This will require date wise details of the transaction entered by that operation together with the rates. Weekly or monthly average rate is permitted if there are no significant variations in the rate.

(2) Translation at the balance sheet date-

   (i) Monetary items[1] at closing rate;

   (ii) Non-monetary items[2]: The cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If tangible fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation.

   (iii) The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realizable value is translated applying exchange rate when realizable value is determined which is generally closing rate.

---

[1] Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money. Cash, receivables and payables are examples of monetary items.

[2] Non-monetary items are assets and liabilities other than monetary items. Fixed assets, investments in equity shares, inventories are examples of non-monetary assets.

(iv) Exchange difference arising on the translation of the financial statement of integral foreign operation should be charged to profit and loss account.

13.2 Non-Integral Foreign Operation

Accounts of non-integral foreign operation are translated using the following principles:

- Balance sheet items i.e. Assets and Liabilities both monetary and non-monetary – apply closing exchange rate.
- Items of income and expenses – At actual exchange rates on the date of transactions. However, accounting standard allows average rate subject to materiality.
- Resulting exchange rate difference should be accumulated in a "foreign currency translation reserve" until the disposal of "net investment in non-integral foreign operation".

Illustration 17

On 31st December, 2012 the following balances appeared in the books of Chennai Branch of an English firm having its HO office in New York:

	Amount in ₹	*Amount in ₹*
Stock on 1st Jan., 2012	*2,34,000*	
Purchases and Sales	*15,62,500*	*23,43,750*
Debtors and Creditors	*7,65,000*	*5,10,000*
Bills Receivable and Payable	*2,04,000*	*1,78,500*
Salaries and Wages	*1,00,000*	*-*
Rent, Rates and Taxes	*1,06,250*	*-*
Furniture	*91,000*	*-*
Bank A/c	*5,68,650*	
New York Account	*-*	*5,99,150*
	36,31,400	*36,31,400*

Stock on 31st December, 2012 was ₹ 6,37,500.

Branch account in New York books showed a debit balance of $ 13,400 on 31st December, 2012 and Furniture appeared in the Head Office books at $ 1,750.

The rate of exchange for 1 $ on 31st December, 2011 was ₹ 52 and on 31st December, 2012 was

₹ 51. The average rate for the year was ₹ 50.

Prepare in the Head Office books the Profit and Loss a/c and the Balance Sheet of the Branch.

Solution

In the books of English Firm (Head Office in New York)

Chennai Branch Profit and Loss Account

for the year ended 31st December, 2012

	$		$
To Opening stock	4,500	By Sales	46,875
To Purchases	31,250	By Closing stock	12,500
To Gross profit c/d	23,625	(6,37,500 / 51)	
	59,375		59,375
To Salaries	2,000	By Gross profit b/d	23,625
To Rent, rates and taxes	2,125		
To Exchange translation loss	2,000		
To Net Profit c/d	17,500		
	23,625		23,625

Balance Sheet of Chennai Branch

as on 31st December, 2012

Liabilities	$	$	Assets	$
Head Office A/c	13,400		Furniture	1,750
Add : Net profit	17,500	30,900	Closing Stock	12,500
Trade creditors		10,000	Trade Debtors	15,000
Bills Payable		3,500	Bills Receivable	4,000
			Cash at bank	11,150
		44,400		44,400

Working Note:

Calculation of Exchange Translation Loss

Chennai Branch Trial Balance (converted in $)

as on 31st December, 2012

	Dr.	Cr.	Conversion	Dr.	Cr.
	₹	₹	Rate	($)	($)
Stock on 1st Jan., 2012	2,34,000		52	4,500	
Purchases & Sales	15,62,500	23,43,750	50	31,250	46,875
Debtors & creditors	7,65,000	5,10,000	51	15,000	10,000
Bills Receivable and Bills Payable	2,04,000	1,78,500	51	4,000	3,500

Salaries and wages	1,00,000		50	2,000	
Rent, Rates and Taxes	1,06,250		50	2,125	
Furniture	91,000			1,750	
Bank A/c	5,68,650		51	11,150	
New York Account		5,99,150			13,400
Exchange translation loss (bal. fig.)				2,000	
	36,31,400	36,31,400		73,775	73,775

Illustration 18

S & M Ltd., Bombay, have a branch in Sydney, Australia. Sydney branch is an integral foreign operation of S & M Ltd.

At the end of 31st March, 2013, the following ledger balances have been extracted from the books of the Bombay Office and the Sydney Office:

	Bombay		*Sydney*	
	(₹ thousands)		*(Austr dollars thousands)*	
	Debit	*Credit*	*Debit*	*Credit*
Share Capital	–	*2,000*	–	–
Reserves & Surplus	–	*1,000*	–	–
Land	*500*	–	–	–
Buildings (Cost)	*1,000*	–	–	–
Buildings Dep. Reserve	–	*200*	–	–
Plant & Machinery (Cost)	*2,500*	–	*200*	–
Plant & Machinery Dep. Reserve	–	*600*	–	*130*
Debtors / Creditors	*280*	*200*	*60*	*30*
Stock (1.4.2012)	*100*	–	*20*	–
Branch Stock Reserve	–	*4*	–	–
Cash & Bank Balances	*10*	–	*10*	–
Purchases / Sales	*240*	*520*	*20*	*123*
Goods sent to Branch	–	*100*	*5*	–
Managing Director's salary	*30*	–	–	–
Wages & Salaries	*75*	–	*45*	–
Rent	–	–	*12*	–
Office Expenses	*25*	–	*18*	–
Commission Receipts	–	*256*	–	*100*
Branch / H.O. Current A/c	*120*	–	–	*7*
	4,880	*4,880*	*390*	*390*

The following information is also available:

(1) Stock as at 31.3.2013:

Bombay ₹ 1,50,000

Sydney A $ 3,125

You are required to convert the Sydney Branch Trial Balance into rupees;

(use the following rates of exchange :

Opening rate	*A $ = ₹ 20*
Closing rate	*A $ = ₹ 24*
Average rate	*A $ = ₹ 22*
For Fixed Assets	*A $ = ₹ 18).*

Solution

Sydney Branch Trial Balance (in Rupees)
As on 31st March, 2013

(₹ '000)

Conversion	rate per A$	*Dr.*	*Cr.*
Plant & Machinery (cost)	₹ 18	36,00	
Plant & Machinery Dep. Reserve	₹ 18		23,40
Debtors / Creditors	₹ 24	14,40	7,20
Stock (1.4.2012)	₹ 20	4,00	
Cash & Bank Balances	₹ 24	2,40	
Purchase / Sales	₹ 22	4,40	27,06
Goods received from H.O.	–	1,00	
Wages & Salaries	₹ 22	9,90	
Rent	₹ 22	2,64	
Office expenses	₹ 22	3,96	
Commission Receipts	₹ 22		22,00
H.O. Current A/c			1,20
		78,70	80,86
Exchange loss (balancing figure)		2,16	
		80,86	80,86

Illustration 19

M/s Carlin has head office at New York (U.S.A.) and branch at Mumbai (India). Mumbai branch is an integral foreign operation of Carlin & Co.

Mumbai branch furnishes you with its trial balance as on 31st March, 2013 and the additional information given thereafter:

	Dr.	Cr.
	Rupees in thousands	
Stock on 1st April, 2012	300	–
Purchases and sales	800	1,200
Sundry Debtors and creditors	400	300
Bills of exchange	120	240
Wages and salaries	560	–
Rent, rates and taxes	360	–
Sundry charges	160	–
Computers	240	
Bank balance	420	–
New York office a/c	–	1,620
	3,360	3,360

Additional information:

(a) *Computers were acquired from a remittance of US $ 6,000 received from New York head office and paid to the suppliers. Depreciate computers at 60% for the year.*

(b) *Unsold stock of Mumbai branch was worth ₹ 4,20,000 on 31st March, 2013.*

(c) *The rates of exchange may be taken as follows:*

- *on 1.4.2012 @ ₹ 40 per US $*
- *on 31.3.2013 @ ₹ 42 per US $*
- *average exchange rate for the year @ ₹ 41 per US $*
- *conversion in $ shall be made upto two decimal accuracy.*

You are asked to prepare in US dollars the revenue statement for the year ended 31st March, 2013 and the balance sheet as on that date of Mumbai branch as would appear in the books of New York head office of Carlin & Co. You are informed that Mumbai branch account showed a debit balance of US $ 39609.18 on 31.3.2013 in New York books and there were no items pending reconciliation.

Solution

M/s Carlin
Mumbai Branch Trial Balance in (US $)
as on 31st March, 2013

	Conversion rate per US $ (₹)	*Dr.* US $	*Cr.* US $
Stock on 1.4.12	40	7,500.00	–
Purchases and sales	41	19,512.20	29,268.29
Sundry debtors and creditors	42	9,523.81	7,142.86
Bills of exchange	42	2,857.14	5,714.29
Wages and salaries	41	13,658.54	–
Rent, rates and taxes	41	8,780.49	–
Sundry charges	41	3,902.44	–
Computers	–	6,000.00	–
Bank balance	42	10,000.00	–
New York office A/c	–	–	39,609.18
		81,734.62	81,734.62

Trading and Profit & Loss Account
for the year ended 31st March, 2013

	US $		*US $*
To Opening Stock	7,500.00	By Sales	29,268.29
To Purchases	19,512.20	By Closing stock	10,000.00
To Wages and salaries	13,658.54	By Gross Loss c/d	1,402.45
	40,670.74		40,670.74
To Gross Loss b/d	1,402.45	By Net Loss	17,685.38
To Rent, rates and taxes	8,780.49		
To Sundry charges	3,902.44		
To Depreciation on computers (US $ 6,000 × 0.6)	3,600.00		
	17,685.38		17,685.38

Balance Sheet of Mumbai Branch
as on 31st March, 2013

Liabilities		*US $*	*Assets*	*US $*	*US $*
New York Office A/c	39,609.18		Computers	6,000.00	
Less : Net Loss	(17,685.38)	21,923.80	*Less:* Depreciation	(3,600.00)	2,400.00
Sundry creditors		7,142.86	Closing stock		10,000.00
Bills payable		5,714.29	Sundry debtors		9,523.81
			Bank balance		10,000.00
			Bills receivable		2,857.14
		34,780.95			34,780.95

Summary

- Types of branches
  - ✓ Dependent branches
  - ✓ Independent branches
- Classification of Branches from accounting point of view
  - ✓ Branches in respect of which the whole of the accounting records are kept at the head office (Dependent Branches)
  - ✓ Branches which maintain independent accounting records (Independent Branches), and
  - ✓ Foreign Branches.
- Systems of accounting followed by Dependent Branches
  - ✓ Debtors System: under this system head office makes a branch account. Anything given to branch is debited and anything received from branch would be credited.
  - ✓ Branch trading and profit and loss account (Final accounts) method /branch account method: Under this system head office prepares (a) profit and loss account (b) branch account taking each branch as a separate entity.
  - ✓ Stock and debtors system: Under this system head office opens:
    - Branch Stock Account
    - Branch Profit and Loss Account

  - Branch Debtors Account
  - Branch Expenses Account
  - Goods sent to Branch Account
  - Branch Asset Account
- Maintenance of comprehensive account books by Independent Branches Preparation of separate trial balance of each branch in H.O.books.
- Types of Foreign branches
  - ✓ Integral Foreign Operation (IFO): It is a foreign operation, the activities of which are an integral part of those of the reporting enterprise.
  - ✓ Non-Integral Foreign Operation (NFO): It is a foreign operation that is not an Integral Foreign Operation. The business of a NFO is carried on in a substantially independent way by accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowing in its local currency.
- Non-Integral Foreign Operation -translation
  - ✓ Balance sheet items i.e. Assets and Liabilities both monetary and non-monetary – apply closing exchange rate.
  - ✓ Items of income and expenses – At actual exchange rates on the date of transactions
  - ✓ Resulting exchange rate difference should be accumulated in a "foreign currency translation reserve" until the disposal of "net investment in non-integral foreign operation".
- Integral Foreign Operation (IFO) - translation
  - ✓ at the rate prevailing on the date of transaction
- Translation at the balance sheet date-
  - ✓ Monetary items at closing rate;
  - ✓ Non-monetary items: The cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If tangible fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation.
  - ✓ The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realizable value is translated applying exchange rate when realizable value is determined which is generally closing rate.
  - ✓ Exchange difference arising on the translation of the financial statement of integral foreign operation should be charged to profit and loss account.