ADVANCED ACCOUNTING

3rd SEMESTER

TOPIC:

DEPARTMENTAL ACCOUNTING

Need, Features, Basis for Allocation of Expenses

M.BHUVANESWARI

LECTURER IN COMMERCE

Introduction

Departmental Accounting refers to maintaining accounts for one or more branches or departments of the company. Revenues and expenses of the department are recorded and reported separately. The departmental accounts are then consolidated into accounts of the head office to prepare financial statements of the company.

The departmental stores are the example of large-scale retail selling just under a single roof. Different departments involve in different goods to be sold out.

To calculate the net result of the whole organization, full-fledged trading, and profit, and loss account are to prepare. But to evaluate individual department, it will be creditworthy to prepare individual trading and profit and loss account.

For example, a textile mill which is having head office and factory. Separate accounts are maintained for production facilities and then the final results are sent to the head office which then incorporates by the head office in their accounts.

Maintenance of separate accounts for each branch of a bank or financial institution also falls under the category of departmental accounting. The bank then prepares its financial statement after consolidating accounts of all branches.

A departmental accounting system is an accounting information system that records the activities and financial information about the department. Departmental Accounting is a vital one for large prosperous business organizations.

It controls wastage & misusing, compensates the employee in terms of profit and commission, compares performance and progress of year to year or department to department or similar type of firm to firm. Departmental

Meaning of Departmental Accounting:

Where a big business with diverse trading activities conduct under the same roof the same usually divide into several departments and each department deals with a particular kind of goods or service.

For example, a textile merchant may trade in cotton, woolen and jute fabrics. The overall performance for this type of business depends, however, on departmental efficiency.

Each unit, department or subsidiary gives the free use of some of the assets of the firm and some responsibilities which can be profit-making, revenue generation or cost control. As expenses incur by the firm on behalf of all its departments, indirect expenses are to apportion to the departments, if each department is to present a financial statement or if the statement is to prepare by the company on a departmental basis.

Departmental accounting is about the preparation of final accounts taking into consideration divisional performance before the overall performance. With that system of accounting, companies that departmentalize can easily conclude as they are very well’ performing units, averagely or moderately performing units. Departmental accounting aims at separating the several activities of a business to compare results and to assist the proprietors/owners in formulating policies.

Methods of Departmental Account

There are two methods of keeping Departmental Accounts –

- Separate Set of Books for each department
- Accounting in Columnar Books form

Separate Set of Books for each Department

Under this method of accounting, each department is treated as a separate unit and separate set of books are maintained for each unit.

Financial results of each unit are combined at the end of accounting year to know the overall result of the store.

Due to high cost, this method of accounting is followed only by very big business houses or where to do so is compulsory as per the law. Insurance business is one of the best examples, where to follow this system is compulsory.

Accounting in Columnar Books Form

Small trading unit generally uses this system of accounting, where accounts of all departments are maintained together by central accounts department in the columnar books form. Under this method, sale, purchase, stock, expenses, etc. are maintained in a columnar form.

It is necessary that to prepare a departmental Trading and Profit and Loss Account, preparation of subsidiary books of accounts having different columns for the different department is required. Purchase Book, Purchase Return Book, Sale Book, Sales return books etc. are the examples of the subsidiary books.

Specimen of a Sale Book is given below −

Sales Book

Sales Book

Date	Particulars	L.F.	Department A	Department B	Department C	Department D

A Trading account in columnar form is prepared to know the department wise gross profit of the concern.

Function wise classification may also be done in a business unit like Production department, Finance department, Purchase department, Sale department, etc.

Allocation of Department Expenses

- Some expenses, which are specially incurred for a particular department may be charged directly to the respective department. For example, hiring charges of the transport for delivery of goods to customer may be charged to the selling and distribution department.

- Some of the expenses may be allocated according to their uses. For example, electricity expenses may be divided according to the sub meter of each department.
- Following are the examples of some expenses, which are not directly related to any particular department may be divide as −
- **Cartage Freight Inward Account** − Above expenses may be divided according to purchase of each department

- **Depreciation** – Depreciation may be divided according to the value of assets employed in each department.
- **Repairs and Renewal Charges** – Repair and renewal of the assets may be divided according to the value of the assets used by each department.
- **Managerial Salary** – Managerial salary should be divided according to the time spent by the manager in each department.

- **Building Repair, Rents & Taxes, Building Insurance, etc.** – All the expenses related to the building should be divided according to the floor space occupied by each department.
- **Selling and Distribution Expenses** – All the expenses relating to selling and distribution expenses should be divided according to the sales of each department, such as freight outward, travelling expenses of sales personals, salary and commission paid to salesmen, after sales services expenses, discount and bad debts, etc.

- **Insurance of Plant & Machinery** – The value of such Plant & Machinery in each department is the basis of the insurance.
- **Employee/worker Insurance** – Charges of a group insurance should be divided according to the direct wage expenses of each department.
- **Power & Fuel** – Power & fuel will be allocated according to the working hours and power of the machine (i.e. Hours worked x Horse power).

Inter-Department Transfer

An inter-department analysis sheet is prepared at a regular interval such as weekly or monthly basis to record all the inter-departmental transfers of goods and services. It is necessary, as each department is working as a separate profit center. Transfer of the prices of such transactions can be cost base, market price, or duel basis.

Following Journal entry will pass at the end of that period (weekly or monthly) −

Journal Entry Receiving Department A/c Dr

To Supplying Department A/c

Inter-Department Transfer Price

There are three types of transfer prices −

Cost based transfer price − Where the transfer price is based on standard, actual, or total cost, or marginal cost is called cost based transfer price.

Market based transfer price – Where the goods are transferred at selling price from one department to another is known as market based price. Therefore, unrealized profit on the goods sold is debited from the selling department in the form of a stock reserve for both the opening and the closing stock.

Dual pricing system – Under this system, the goods are transferred on the selling price by the transferor department and booked at the cost price by the transferee department

Objectives of Departmental Accounting:

- *The main objectives of departmental accounting are:*
- To check out an interdepartmental performance.
- To evaluate the performance of the department with the previous period result.
- The gross profit of each department can ascertain.
- Unprofitable departments will reveal.
- The result of operations can use to determine the remuneration of managers of each department.

- The progress of each department can monitor for appropriate actions to take.
- To help the owner formulating the right policy for the future.
- To assist the management in deciding to drop or add a department.
- It helps in determining the commission of the department manager when it links to profit achieved by their department.
- It can help the management in deciding which department should develop more and which should close to maximize the profitability of the whole company.

- To provide detail information about the entire organization, and.
- To assist management for cost control.
- It also helps in allocating costs to various departments and therefore helps in better control of the cost of the departments of the company.
- For a company that is dealing with multiple products, it is much easier to control and monitor several departments based on the products they sell rather than controlling it as one single business.

THANK YOU