

# ADVANCED ACCOUNTING

3<sup>rd</sup> SEMESTER

**TOPIC:**

## DEPARTMENTAL ACCOUNTING

Treatment of Expenses , Preparation  
of departmental profit and loss.

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# Methods and Techniques of Departmental Accounting:

Departmental accounts are prepared in such a manner that all desired information is available and departmental profit can correctly make.

*Here are two methods advocate viz:*

- Where the individual set of books maintains, and.
- Where all departmental accounts maintain columnar- wise collectively.

*They explain below;*

***Where Individual Set of Books are Maintained:***

Under this method, the accounts of each department independently maintain. The departmental results of all the departments collect and take into consideration to find out the net result of the organization.

***Where All Departmental Accounts are Maintained Columnar-Wise Collectively:***

A Departmental Trading and Profit and Loss Account open for each department in a columnar form together with a separate column for 'Total' to ascertain the individual result of the different departments.

And to incorporate the purchase and sale of goods, the subsidiary books and also the nominal accounts into the ledger must be ruled out with extra columns for each department in arriving at the desired departmental figures to prepare departmental final accounts. If there is a larger volume of cash purchase and cash sales, the Cash Book also must maintain separate columns for cash purchases and cash sales of various departments.

## *Appropriateness of some of the apportionment methods – key points:*

- ✓ It can be a very subjective process.
- ✓ The best way to apportion costs base on the greatest benefit- i.e. the department who gets the greatest benefit from the cost must take the greatest amount of the cost.
- ✓ This makes the apportionment process very time consuming and expensive.

- ✓ The more appropriate basis may be for depreciation to base on the book value of assets in each department.
- ✓ Insurance of the assets based on the book value of the assets.

### **Advantages of Departmental Accounting:**

*The most significant advantages of departmental accounts are:*

- ✓ Individual results of each department can know which helps to compare the performances among all the departments, i.e., the trading results can compare.

- ✓ Departmental accounts help to understand or locate the success, failure, rates of profit, etc.
- ✓ It helps the management to make a proper plan of action, policies to increase profit after analyzing the results of the operation of various departments.
- ✓ Departmental accounting helps us to understand which department should be expanded further or which one should close down as per the results of the operation.

- ✓ It also helps to encourage a healthy competitive spirit among the various departments which, ultimately, helps to increase profits of the firm as a whole.
- ✓ For additions or alterations of various departments, departmental accounts help a lot as it supplies the necessary information.
- ✓ As detailed information about the firm is available from departmental accounting the users of accounting information, particularly, the auditors and investors widely benefit.



- ✓ Since departmental accounting presents separate departmental results, the Performance, of a successful department encourages the management, employees and increases the motivation of the staff as a whole.
- ✓ The percentage of gross profit on sales and stock turnover ratio of each department helps to make a comparative study among all departments.

## **Departmental Accounts: Procedure, Expenses and Inter Departmental Transfers**

## **Introduction:**

Departmental Accounts are accounts relating to the several departments or sections of a business drawn up with a view to ascertaining their individual performances. A business may have a number of departments each dealing in a different type of goods. For instance, Departmental Store is an example of large scale trading by a retail trader.

In order to carryout business more efficiently, a businessman divides his store into many sections, each section is called a Department. In order to ascertain the profit or loss made by each department, it is desirable to prepare separate Trading and Profit and Loss Account for each department.

**The preparation of such Trading and Profit and Loss Account separately for each department enables to compare the results of trading activities; in brief:**

1. It enables to compare the performance of one department with that of another and to measure the progress of the department itself by comparing year-wise performance.
2. It enables to measure the profitability of each department. In the absence of departmental accounting, if there is a loss, the businessman thinks that the whole business is at loss.

Thus he may stop the business and may start a new business, because he is unable to understand the performance of each department. But, by preparing departmental accounts separately, the contribution of profit made by each department can be known.

Thus a good profit- making department can be developed and the department which gives small margin of profit or no profit can be closed down.

It is also possible to check the profit of a department, not to be eaten away by the department which makes no profit.

3. It helps in formulating new policies and to adopt new and latest techniques in the departments, thereby further profitability of the department can be expected.

4. Departmental Managers of the profit-making department can be encouraged by adopting a method of commission on the basis of departmental profit. This step will further boost the profit-making department.

## **This system of accounting actually helps the proprietors to:**

- (i) Compare the results among the different departments together with the previous results thereof,
- (ii) Formulate policy in order to extend or to develop the enterprise in the proper line; and
- (iii) Reward the departmental managers on the basis of departmental results.

## **Accounting Procedure:**

**There are two methods of keeping departmental accounts:**

### ***1. Independent Basis:***

In this method, accounts of each department are maintained separately. Each department prepares Trading and Profit and Loss Account. Finally, the profit or loss of each department is transferred to the (General) Profit and Loss Account for all the departments. The independent departmental book-keeping is an expensive one.



## *2. Columnar Basis:*

In this method, there is a single set of books. All accounts of all the departments are maintained together, but in a columnar or tabular form. In order to enable the preparation of departmental trading and profit and loss accounts, various subsidiary books, such as purchases, sales, returns books, are prepared in a columnar form and this shows the record, in detail, for each department.

The following is the specimen of a purchase book and a sales book:

**Departmental Purchase Book**

Date	Particulars	L.F.	Total	Dept. 1	Dept. 2	Dept. 3

**Departmental Sales Book**

Date	Particulars	L.F.	Total	Dept. 1	Dept. 2	Dept. 3

## Principles of Departmental Accounting:

Preparation of final accounts of a departmentalized business requires the following:

- ✓ That the gross profit or loss and the net profit or loss of each department determine separately before taking. The totals to the appropriate account or the balance sheet of the business, and.
- ✓ That there should be some bases of apportioning gains and expenses to the departments or units of the business. And, that should be done as fair and equitable as possible.

Sometimes control accounts have to resort to determine the creditors' or debtors' value to the business. In any case, as the departmental values show. The total figures, for the business as a whole, are, to sum up.

For instance, rent, depreciation, selling expenses, welfare expenses, advertising etc. Allocation of such expenses among the various departments becomes indispensable on an equitable basis at the date of account.

The important point in such cases is to fix the basis on which the different revenue items are to be split up. It is neither possible nor desirable to sub-divide all items on equal basis.

### **Allocation of Common Expenses:**

Normally, all direct expenses are charged to the respective departments, in case of indirect or general expenses, proper allocation among the departments must be made in order to ascertain the profit and loss made by each department. Each department is charged with proper business expenses. If the basis for such allocation is not specially mentioned, then the following procedure may be followed.

<i>Indirect Expenses</i>	<i>Basis of Allocation</i>
1. Expenses on Purchases, for instance, Carriage, Freight, Duty, Octroi, etc.	In the ratio of departmental Net Purchases. (But ignore inter-departmental purchases)
2. Expenses on Selling, for instance, Selling Commission, Bad Debts, Discount Allowed, Advertisements, Carriage out etc.	In the ratio of Net Sales of various departments. (Ignore inter-departmental sales)

3. Expenses on Land and Building, for instance, Rent, Rates, Depreciation, Repairs,	On the basis of space occupied by each department.
4. Expenses on Machinery, for instance, Depreciation, Repairs etc.	On the basis of value of machineries of each department.
5. Expenses on Electricity, for instance, Lighting, Heating etc.	On the basis of Meter reading or points or space occupied by each department.
6. Expenses on Insurance	On the basis of Stock value or/and cost of machineries or actual premiums.
7. Expenses on Welfare, Canteen, Recreation etc.	On the basis of number of employees of each department.
8. Expenses on workmen's compensation.	On the basis of wages of each department.
9. Salary of Factory Manager.	On the basis of time devoted by him for each department.
10. Non-departmental expenses	When allocation of some expenses is impossible, they can be charged to General Profit and Loss Account.

Some expenses cannot be apportioned and no basis of apportionment is practicable. For instance, interest on Loan, Income Tax, Salary to General Manager, Share Transfer expenses, Bank charges, Audit fees etc. Here these expenses can safely be transferred to General Profit and Loss Account.

Similarly, income of general nature such as Interest on Calls-in-arrears, Interest on Investment, fees on share transfer etc. credited to General Profit and Loss Account.



The Departmental Trading Account shows the Gross Profit or Loss and Departmental Profit and Loss Account shows the Net Profit or Loss earned or suffered by each department.

### **Inter-Departmental Transfers:**

Goods are often supplied from one Department to another – Inter-Departmental transfer. Such transfer must be credited to Supplying Department and debited to Receiving Department.

If the transfers are made at cost price, then it can be treated as mere transfer. No further adjustment is needed.

However, if the transfers of goods are made at selling price, then a profit is earned by the supplying department of the same organisation. When the goods, transferred from one department to another, still remain unsold with the transferee department, at the end of the accounting period, there arises a necessity to eliminate the unrealised profit on such stock on hand.

This is because, so much of issuing department's profit (notional) remain unrealized from the viewpoint of the firm as a whole. The reserve will be equal to the profit included in respect of unsold goods at the end of closing.

**The entry is:**

General Profit and Loss Account Dr.  
To Stock Reserve

In certain cases, the transferee department may have some stock in the beginning of the accounting period, against which stock reserve was already created in the previous year, will also be transferred to General Profit and Loss Account by means of Journal entry:

Stock Reserve Account Dr.

To General Profit and Loss Account

Alternatively, a single journal entry can be passed for the unrealized profit on the basis of the difference between unrealized profit included in opening and closing stock.

## **Methods and Techniques of Departmental Accounts:**

Departmental accounts are prepared in such a manner that all desired information are available and departmental profit can correctly be made.

**However, two methods are advocated viz:**

- (a) Where individual set of books are maintained;
- (b) Where all departmental accounts are maintained columnar- wise collectively.

***(a) Where Individual Set of Books are Maintained:***

Under this method, accounts of each individual department are independently maintained. The departmental results of all the department are collected and taken into consideration to find out the net result of the organization

***(b) Where All Departmental Accounts are Maintained Columnar-Wise Collectively:***

A Departmental Trading and Profit and Loss Account is opened for each individual department in a columnar form together with a separate column for 'Total' in order to ascertain the individual result of the different departments and also as a whole. But the Balance Sheet is prepared in a combined form.

And in order to incorporate the purchase and sale of goods, the subsidiary books and also the nominal accounts into the ledger must be ruled out with extra columns for each department in arriving at the desired departmental figures to prepare departmental final accounts. If there is a larger volume of cash purchase and cash sales, the Cash Book also must maintain separate columns for cash purchases and cash sales of various departments.



**THANK YOU**