

# **Biyani's Think Tank**

Concept based notes

## **Business Accounting**

(BCA Part-I)

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## Preface

I am glad to present this book, especially designed to serve the needs of the students. The book has been written keeping in mind the general weakness in understanding the fundamental concepts of the topics. The book is self-explanatory and adopts the “Teach Yourself” style. It is based on question-answer pattern. The language of book is quite easy and understandable based on scientific approach.

Any further improvement in the contents of the book by making corrections, omission and inclusion is keen to be achieved based on suggestions from the readers for which the author shall be obliged.

I acknowledge special thanks to Mr. Rajeev Biyani, *Chairman* & Dr. Sanjay Biyani, *Director (Acad.)* Biyani Group of Colleges, who are the backbones and main concept provider and also have been constant source of motivation throughout this endeavour. I also extend my thanks to M/s. Hastlipi, Omprakash Agarwal/Sunil Kumar Jain, Jaipur, who played an active role in co-ordinating the various stages of this endeavour and spearheaded the publishing work.

I look forward to receiving valuable suggestions from professors of various educational institutions, other faculty members and students for improvement of the quality of the book. The reader may feel free to send in their comments and suggestions to the under mentioned address.

**Author**

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### Chapter-1

## Departmental Accounts

**Q.1** What is meant by departmental accounts? Discuss various problems arising during the preparation of Departmental Accounts.

**Ans.** Departmental stores are a form of retail trade organisation. When a business establishment is split up in number of departments, the accounts have to be maintained and kept in such a manner to throw light not only on the trading results of the business as a whole, but also on the trading results of each department individually, such accounts are known as departmental accounts. The main objective is to assess the working efficiency of each department so that it becomes easier to classify departments into profitable and non-profitable ones.

Apart from preparing departmental trading and profit & loss account a General Profit & Loss A/c is also prepared to ascertain the profit or loss for the whole business.

Separate columns are introduced for each department according to the size and type of business, in subsidiary books from the very beginning of

the accounting year, so that required information for preparing departmental trading and Profit & loss account can be obtained easily at the end of the year. Accounts of departmental stores main trained in such a way are known as Departmental Accounts.

**Problems arising during the preparation of Departmental Accounts:-**

While adopting departmental accounts the following problems arise:-

- Inter - departmental transfers.
- Allocation of Expenses.
- Common Income.

**(i) Inter-departmental transfers** - Generally, goods and services are transferred from one department to another which is called inter-department transfers. Inter-departmental transfer of goods may be at cost or above cost i.e. invoice price.

The Department receiving the goods or services is debited and the department supplying the goods or rendering the services is credited. When inter-departmental transfer of goods takes place at higher than cost and any department has at the end of the year, in its stock, the goods received from other departments, a 'Reserve for Unrealised profit' is created. For this the following entry is passed at the end of the year:

|                                      |     |
|--------------------------------------|-----|
| General Profit & Loss a/c            | Dr. |
| To Reserve for Unrealised Profit A/c |     |

(Being reserve for unrealised Profit created).

**(ii) Allocation of Expenses:** The expenses incurred by a departmental store can be classified as follows:-

**Direct Expenses** - Direct expenses are those which have been specifically incurred for a particular department. Such expenses are usually under the control of departmental head, for example, wages. These expenses are recorded department-wise from the very beginning.

**Indirect Expenses** - Such expenses which cannot be directly related to a particular department since these are incurred for the store as a whole, are called indirect expenses. While preparing department mental trading and profit & loss account these expenses will have to be apportioned among

the various departments on an equitable basis. Some of these basis are as follows:-

(a) **Sales or Turnover Basis:** Expenses which are mainly related to sales are allocated among various department in the ratio of sales.

Examples of such expenses are, commission on sales, bad-debts, cash discount allowed, advertisement, carriage outward, salary and commission of sales managers etc.

(b) **Purchase Basis:** Some expenses like carriage inward, commission on purchases discount received are apportioned among various departments in the ratio of departmental purchases.

(c) **Area occupied:** Some expenses of the departmental stores are related with the area occupied by each department, such as rent of building, depreciation, repairs, maintenance, cleaning expenses, electricity expenses of building etc. These are apportioned on the basis of area occupied by each department.

(d) **Value of Assets Basis:** The expenses relating to depreciation, insurance, repairs & maintenance of the assets can be apportioned on the basis of value of assets used by each department.

(e) **No. of employees:** Employee welfare expenses can be apportioned on the basis of number of employees working in the respective departments.

(f) **Other Basis:** Some expenses of a business are such that they cannot be apportioned on any of the above basis, e.g., lighting, insurance of stock, power, supervision expenses etc. Such expenses will be apportioned on some suitable basis like kilo-watt hours for wages, and value of stock for insurance of stock.

**General Expense** - Some of the expenses, such is, interest on debentures and loans, salary of the general manager, office expenses, etc. cannot be apportioned to different departments on any equitable basis. These expenses should be charged to General Profit & Loss Account.

(iii) **Common Income:** A departmental store may have some items of income which are not related to any particular department, such as fees received on transfer of shares, dividend or inter-rent received on

investments, etc. These are known as common income. These incomes are not divided among different departments but are credited to General Profit & Loss Account. If a general profit and loss a/c is not prepared, such income should be apportioned on some technical estimate basis or some other reasonable basis or on equal basis to all the departments.

**Q.2 Explain the importance of preparing Departmental Accounts?**

**Ans.** By preparing separate departmental trading and profit and loss account, there are many advantages to the management, which are as under:-

1. **Knowledge about profit/loss of each department :** The profit and loss of each department can be ascertained separately by preparing departmental trading and profit and loss account.
2. **Inter departmental comparisons :** It is possible to make inter departmental comparisons as to which department is being carried on efficiently and which department lacks efficiency. Reasons are found out for such an inefficiency and remedial measures can be adopted.
3. **Inter period comparison :** Besides inter departmental comparison, a comparison of the present performance of each department is made with its previous performance.
4. **Helpful in policy making :** On the basis of departmental information, management may decide:
  - (a) which departments are to be expanded.
  - (b) which departments are to be closed.
  - (c) What factors are responsible for poor performance.
5. **Encouragement to healthy competitions :** Departmental system gives birth to healthy competition among different departments, thereby resulting in increase in sales and hence in profit.
6. **Facility in ascertaining bonus for departmental managers :** In addition to salary, if a bonus at a fixed percentage of the net profit of a department is to be paid to its manager, the calculation of the bonus can be easily made.

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## Chapter-2

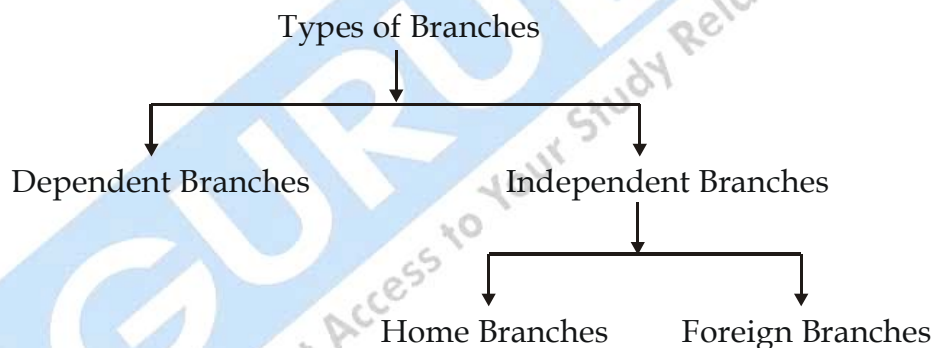
# Branch Accounts

**Q.1 What is Branch? Mention the various types of branches.**

**Ans.** Every business organisation has an intention to maximise profits. This can be achieved either by increasing sales or by increasing profit margin. For increase in sales it is necessary to expand business by opening own offices at different places of the country and abroad with a view to reach customers directly and to market its production over a large territory. These offices are known as “branches” and parent establishment is known as “Head office”. The well known examples of this type of business organisations are Bata Shoes Co., Reliance Industries Ltd. Etc.

**Types of Branches:**

From accounting point of view the branches can be classified into the following categories:-



**(A) Dependent Branches:** When the working of branch is fully controlled by head office, they are known as dependent branches. These branches are simply selling departments or depot of the head office. Dependent Branches have the following special features:

- (i) All goods are sent to these branches by the Head office.
- (ii) All the expenses of these branches are paid by the Head office in cash or by cheque.
- (iii) Goods are sold on the price determined by the instruction from Head office.

- (iv) The Head office remits petty cash to these branches for Petty Expenses.
- (v) The amount of sales is deposited in the account of Head office.
- (vi) These branches do not prepare any accounts, their accounts are prepared by the Head office.

**(B) Independent Branches:** These branches are not under complete control of the Head office. These Branch are can purchase goods from other places besides the Head office and can sell the same for cash or credit. These branches can keep the money received from the debtors with them and incur all the expenses.

**(C) Foreign Branches:** These branches are situated in other countries. Such branches are independent. They keep their accounts in the same currency where they are situated, hence before adjusting the trial balance of Foreign Branch in the account of Head office, it is to be converted in the currency of Head office.

**Q.2 Explain the various methods of preparing accounts of Dependent Branches by the Head office?**

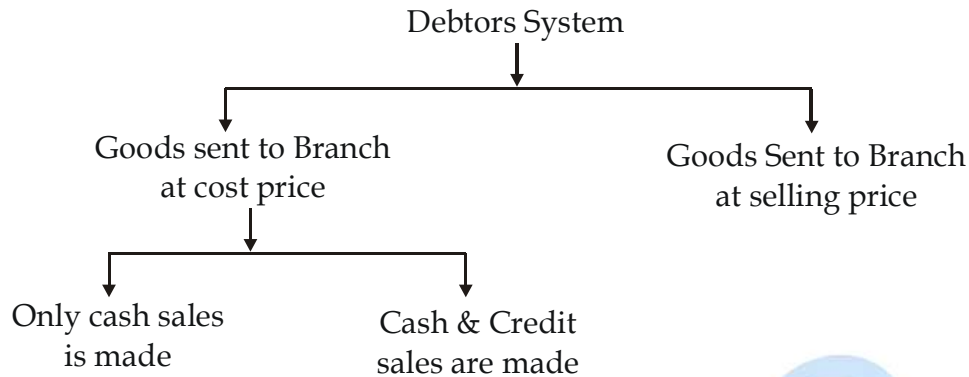
**Ans.** The Head office can maintain branch accounts by one of the following methods:-

1. Debtors system
2. Stock and Debtors system
3. Final accounts system
4. Wholesale Branch system

#### **Debtors System**

In Debtors System the Head office prepares only one account for each branch known as 'Branch Account' which is a Nominal Account in nature. At the end of accounting year the balance of this account will indicate the profit or loss of the branch.

From accounting point of view this system can be divided into two methods:-



Accounting Entries for Goods Sent to Branch at Cost:

(i) For opening balances of Branch Assets:-

Branch a/c Dr.

To Branch Assets a/c

(Opening balances of assets transferred)

(ii) For Goods sent to Branch:-

Branch a/c Dr.

To Goods sent to Branch a/c

(Being goods sent to Branch)

(iii) For payment of branch expenses:-

Branch a/c Dr.

To Cash / Bank a/c

(Branch expenses of paid in cash/cheque by H.O.)

(iv) For goods returned by branch to Head office:-

Goods sent to Branch a/c Dr.

To Branch a/c

(Goods returned to head office by branch)

(v) For receiving cash/cheque from branch (Cash sales, plus collection from debtors).

Cash/Bank a/c Dr.

To Branch a/c



Here the opening stock, closing stock, goods sent to Branch, goods returned by branch etc. are all shown on cost price.

**(b) Invoice Price Method** - In this method the accounting entries are same as in the cost price method, except that the entries relating to opening stock, Goods sent to Branch, Goods returned to Head office by branch and branch closing stock are recorded at invoice price. Proper adjustment of profit element included in invoice price are carried out at the end of the accounting year by passing the following additional entries:

- (i) For adjustment of profit in opening stock:

|                   |     |
|-------------------|-----|
| Stock Reserve a/c | Dr. |
| To Branch a/c     |     |

(For difference between cost price and invoice price of opening stock)

- (ii) For adjustment of profit in goods sent to Branch (Net, i.e. goods sent-goods returned by branch)

|                          |     |
|--------------------------|-----|
| Goods sent to Branch a/c | Dr. |
| To Branch a/c            |     |

(For profit included in goods sent to branch a/c)

- (iii) For adjustment of profit in closing stock:

|                      |     |
|----------------------|-----|
| Branch a/c           | Dr. |
| To Stock Reserve a/c |     |

(For profit included in Closing stock)

### **Stock and Debtors System**

The branches whose sale is more due to expanded business area than it is difficult to prepare 'Branch a/c' only and there are more possibilities of errors due to more transactions. In this method the head office maintains a number of accounts in place of one account for the branch. This system of accounting can further be classified into two parts:

- (a) When head office sends goods at cost price.
- (b) When head office sends goods at invoice price.

### **When goods are sent to Branch at Cost Price**

In this case head office prepares the following accounts for each branch:-

- 
- (i) **Branch Stock Account:** In this account the transactions of goods are recorded. Initially the account is debited with the branch opening stock at cost price. Further this account is debited with the cost price of goods sent to branch and goods returned by the customers and credited with sales (cash & credit), goods returned to the head office at cost price, and branch closing stock at cost price. The balance of Branch Stock a/c shows the gross profit or loss.
- (ii) **Goods sent to Branch Account :** This account is credited with the cost price of goods sent to branch by head office and is debited with cost price of the goods returned by the branch. The balance of this account is transferred to trading a/c.
- (iii) **Branch Debtors a/c :** This account is debited with the opening balance of branch debtors and credit sales. This account is credited with the cash received from debtors, Bills received from Debtors, discount allowed, bad-debts, goods returned from debtors etc. The balance of this account shows closing balance of debtors.
- (iv) **Branch Expenses a/c :** This account shows the details of branch expenses including bad-debts, discount allowed, depreciation on branch fixed assets etc. The balance of this account is transferred to Branch Profit & Loss A/c.
- (v) **Branch Profit & Loss a/c :** This account shows the net profit or loss of the branch. The gross profit of branch stock a/c is transferred to credit side of this account. It is debited with all branch expenses. The balance of this account is transferred to General Profit & Loss A/c.

#### **When goods are sent to Branch at Invoice Price**

In this method all the transactions of goods are recorded at invoice price and two additional accounts are prepared:

- Branch Stock Reserve Account.
- Branch Adjustment Account.

Remaining accounts will be same as cost price method and Branch profit & loss account is not required to be prepared.

- (vi) **Branch Stock Reserve Account** - This account is prepared to show adjustment of profit included in the opening and closing stock i.e. the

difference between the invoice price and cost price. The adjustment entry is passed through Branch Adjustment Account.

- (vii) Branch Adjustment A/c** - This account is like Trading and Profit and Loss Account. This account is debited with (a) Branch Stock Reserve A/c the difference between invoice price and the cost price of closing stock. (b) Balance of branch expenses a/c. (c) Goods spoiled from Branch stock a/c (d) Difference between cost price and invoice price of goods returned by branch to H.O. It is credited with (a) Branch Stock Reserve a/c. The difference between cost price and invoice price of opening stock (b) The difference between the invoice price and cost price of goods sent to Branch. This will show profit or loss which will be transferred to General Profit & Loss A/c.

#### **Final Accounts Method**

Under this system, head office prepares a 'Branch Trading and Profit & Loss A/c', to determine the branch profit or loss. In this account the goods are recorded only at cost price. This accounts provide complete information of all transactions. The important advantage of this account is that it shows gross profit as well as net profit/loss of the branch. This account is merely a memorandum account and not being a part of double entry system.

#### **Wholesale Branch Method**

Sometimes the manufacturing organisations (head office) sell their products through wholesalers as well as through own branches. In case the head office decides two prices (i) Wholesale price; and (ii) retail price. Goods are supplied to the whole-seller and branches at wholesale price, that is, cost plus profit. The branches are supposed to sell these goods at retail price which is greater than the wholesale price. It means the branches earn more profit than the head office. But the total profit (Retail price-cost) cannot be considered as branch profit. The real profit of the branch shall be the difference between the wholesale price and retail price.

The wholesale price means cost plus profit. Therefore in the books of head office Branch Stock Account shall be maintained at wholesale price. At the end of the accounting period, the problem arises only when the goods received from head office remains unsold at branch, because it includes a part of profit which has been charged by the head office. To calculate the

proportion of profit, the value of unsold goods shall be reduced from wholesale price to cost price.

At the end of accounting year the following entry shall be made:-

|                          |     |
|--------------------------|-----|
| Profit & Loss a/c (H.O.) | Dr. |
| To Stock Reserve a/c     |     |

(Reserve created for the difference in the wholesale price and cost price of Branch closing stock)

**Q.3 How are the accounts of an independent branch incorporated in the books of Head office? Give necessary journal entries for the same.**

**Ans.** The independent branches which have their own accounting system prepare the trail balance and sent a copy of this statement to the head office. The head office incorporates the items of branch trial balances in its own books to prepare consolidated financial statements of the organisation as a whole.

There are three methods of incorporating the branch trial balance in the books of head office:-

**First Method:** Incorporation of Branch trial balance by opening separate accounts for each item into Head office Books:

In this method the head office pass journal entry for each item of branch trial balance. All debit items in branch trial balance are debited and branch account is credited with the total of these items. Similarly all credit items in branch trial balance are credited and branch account is debited with the total of these items.

It should be noted that the balance of head office account in branch trial balance should not be included in the above entries. A separate entry should be passed for the incorporation of Branch Closing Stock.

The entry will be:-

|                          |     |
|--------------------------|-----|
| Branch Closing Stock a/c | Dr. |
| To Branch a/c            |     |

(Branch closing stock taken into books)



Branch a/c Dr.

To Branch Profit & Loss a/c

(Being all the gains & incomes of Branch incorporated)

6. To close the profit & Loss a/c of the Branch:

(i) In case of Profit

Branch Profit & Loss a/c Dr.

To General Profit & Loss a/c

(Being the net profit of branch incorporated)

(ii) In case of loss- Reverse Entry will be passed.

7. For the liabilities of Branch:

Branch a/c Dr.

To Branch Liabilities a/c

(Being branch liabilities incorporated)

8. For the assets of Branch:

Branch assets a/c Dr.

To Branch a/c

(Being branch assets incorporated)

### **Third Method:**

This method is used when profit and loss and assets and liabilities are given. Under this condition the following entries will be passed:-

1. For Profit of branch:

Branch a/c Dr.

To General Profit & Loss a/c

(Being the branch profit incorporated).

2. For Loss of Branch: Reverse Entry

3. For Assets:

Branch Assets a/c Dr.

To Branch a/c

(Being branch assets incorporated)

4. For Liabilities:

|   |     |
|---|-----|
| Branch a/c                              | Dr. |
| To Branch Liabilities                   |     |
| (Being branch liabilities incorporated) |     |

**Q.4 What are the causes for differences between the Branch Account and Head office Account? How are they reconciled?**

**Ans.** In the head office books, a Branch Account is prepared for recording transactions relating to the branch and in branch books, a Head office account is prepared. At the end of the year, when a copy of the branch trial balance is received in the head office, first of all, a comparison is made of the balance of Head office a/c (shown in the trial balance) with the balance of branch A/c prepared in the head office books.

Sometimes the balances in two accounts do not tally and there is found a difference in the two balances. There may be various reasons for this difference. For example, some transactions might have been recorded in Branch Account in the head office books but they have not been recorded in Head office Account in branch books, and vice-versa. In both the circumstances, it is necessary to reconcile the balances in two accounts.

The following are the transactions on which this difference is found:-

**(1) Cash in transit:** If the cash sent by branch to H.O. or the cash sent by H.O. to branch has not been received by the other party upto the end of the year, it is known as cash in transit. There is a difference in the balances of two accounts on account of this transaction also. To reconcile the two balance, the following journal entry is passed in H.O. books at the end of the year:

|                     |     |
|---------------------|-----|
| Cash in Transit a/c | Dr. |
| To Branch a/c       |     |

(Cash in transit taken into books)

At the beginning of the next year, reverse entry will be passed.

**(ii) Goods in transit:** When goods are dispatched by the head office to branch and the branch does not receive it even upto the end of the year, it is known as goods in transit. In the same way when goods are returned by

branch to head office and the head office does not receive it upto the end of the year it is also known as goods in transit.

It is quite understandable that a difference should arise in the balances of two accounts due to these transactions. Therefore, to reconcile, the following journal entry will be passed in head office books in both the circumstances:

|                                     |     |
|-------------------------------------|-----|
| Goods in Transit a/c                | Dr. |
| To Branch a/c                       |     |
| (Goods in transit taken into books) |     |

In the Balance Sheet of Head office both the above items will be shown as an asset.

**Q.5 What is the foreign Branch? Discuss the method of conversion of trial balance of foreign branch into the local currency of Head office.**

**Ans.** In modern times, a number of business houses have their branches in foreign countries. When a branch is established outside the territory of a country, it is known as foreign branch. The foreign branch operates as an independent branch.

The accounting system of foreign branch is exactly similar as maintained by the independent branch with an exception that the trial balance of foreign branch requires the conversion of branch currency into the currency of head office. For example, a Head office in India has foreign branches in London and Tokyo. At the end of the year, the items in Trial Balance sent by London branch will be in pound sterling and Tokyo branch will be in Yen. The accounts in Head office books in India will be in rupee currency. Hence, unless the items in London and Tokyo branch trial balances are converted into H.O. currency (Rupee), the items cannot be incorporated in Indian H.O. books.

Rules for conversion of Branch Trial Balance in the Head office currency:-

| S.No. | Items   | Exchange Rate   |
|-------|---|---|
| 1.    | Opening stock   | Opening Exchange Rate   |
| 2.    | Current Assets  | Closing Exchange Rate   |
| 3.    | Current Liabilities   | Closing Exchange Rate   |
| 4.    | Revenue 'items like purchases, sales, rent, salaries, wages, etc. | Average Exchange Rate   |
| 5.    | Fixed Assets  | Any exchange rate prevailing on the date of:<br>(i) the contract<br>(ii) Delivery<br>(iii) Payment<br>(iv) Remittances made by the H.O. |
| 6.    | Fixed Liabilities   | Exchange rate prevailing on the date of the contract or the date when liability was incurred.   |
| 7.    | Depreciation  | Exchange rate applicable to the concerned assets.   |
| 8.    | Remittances   | Actual rate on which these were made.   |
| 9.    | Goods sent to branch and return to H.O.                           | Actual cost/ Actual Exchange rate   |
| 10.   | Head office current a/c   | Actual figures shown by the branch account in the books of the H.O.   |

If both the sides of the converted trial balance does not tally then the difference should be put on the shorter side as "Difference in Exchange" and taken to Branch Profit and Loss Account.

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