

SPECIFIC OUTCOMES

- Distinguish between the main accounting methods for branch accounting, namely independent keeping of records at the branch (decentralised) and where the branch does not keep records (centralised).
- Recognise the transactions in connection with the head office and branches according to both methods.
- Reconcile the account of the branch in the ledger of the head office with the account of the head office in the ledger of the branch.

19.1 Introduction

It often happens that the owner of an entity wants to extend the activities of her entity. To implement this, there must be a demand for the product in the town, city or area where the entity is situated. If it seems that there is not a demand for more of the specific product in her area, she should start with a similar entity in another town/area.

In such cases the original entity will be the head office and the new entity, say a shop in another town, will be the branch.

It is important to note that the branch is not an independent entity but, in practice, nothing more than an extension of the head office.

19.2 Accounting treatment of branches

Two methods exist according to which the records of branches can be kept:

- centralised; and
- decentralised.

The two methods will be discussed and explained with the aid of examples.

19.2.1 Centralised method

According to this method, all inventories are purchased by the head office. Merchandise required by the branch is dispatched by the head office to the branch, at cost or at selling price. The centralised purchases by the head office have the advantage that administrative expenses decrease and purchase prices are lower due to the larger amounts purchased.

The only accounts that could be kept by the branch in its records are the bank and the petty cash accounts. The head office will keep the following accounts in connection with branch transactions in its records: Goods to branch account, branch inventories account, branch gross profit account and branch profit or loss account.

All the VAT entries will, with the application of this method, be recognised in the head office's VAT output and VAT input account.

(a) Merchandise sent to branch at cost

When merchandise is sent to the branch at cost, the 'branch inventories' account is debited with the cost of goods sent, and the 'goods to branch' or 'purchases' accounts are credited at cost. The 'branch inventories' account is credited with the sales at selling price (excluding VAT), 'bank' or 'receivables' accounts are debited with the selling price including VAT, and the 'VAT output' account is credited with the VAT portion. The balancing figure of the 'branch inventories' account is the gross profit that is transferred to the 'branch profit or loss' account.

Excess cash is transferred to the head office bank account. Sometimes the branch does not even keep a bank account, but transfers all monies received directly to the head office bank account.

All the other expenses are debited in the 'branch profit or loss' account. The balancing figure of this account presents the profit or loss made by the branch, and will be transferred to the head office's 'profit or loss' account.

Example 19.1

Bullah Traders have a head office in Bloemfontein and a branch in Kimberley. Branch transactions are sent electronically to the head office, where 'branch inventory', 'branch profit or loss' and 'branch receivables' accounts are kept. The branch has an account with a bank in Kimberley. Goods are distributed to the branch at cost.

Balances at 1 July 20.5

Branch inventories	R 50 000
Branch receivables	22 800
Branch bank account	1 800

Transactions for July 20.5

Goods sent to branch	(1)	200 000
Goods returned to head office	(2)	15 000
Cash sales by branch	(3)	171 000
Credit sales by branch. An estimated amount of R3 420 discount will be allowed to receivables when payments are received from them.	(4)	216 600
Goods returned by receivables	(5)	
Rent paid by branch	(6)	28 500
General expenses paid by branch	(7)	11 400
Salaries paid by head office	(8)	7 980
Cash received by branch from receivables	(9)	39 900
Discount allowed to receivables (See 7)	(10)	196 080
Bad debts written off	(11)	3 420
Cash transferred to head office	(12)	3 990
Balance at 31 July 20.5	(13)	335 000
Branch inventories	(14)	
	(15)	45 000
	(16)	

Assignment

Prepare the following ledger accounts:

- Branch inventories;
- Goods to branch;
- Branch profit or loss;
- Branch receivables;
- Branch bank account;
- VAT output; and
- VAT input.

Please note: Bullah Traders is registered for VAT.

Solution

(a)		Branch inventories	
Balance (1)	b/f	50 000	15 000
Goods to branch (4)		200 000	150 000
Branch receivables (8)		25 000	187 000
Branch profit or loss (Gross profit)		22 000	c/f 45 000
		<u>R937 000</u>	<u>R937 000</u>
Balance (16)	b/f	45 000	
(b)		Goods to branch	
Branch inventories (5)		15 000	200 000
		<u>15 000</u>	
(c)		Branch profit or loss	
Branch bank (9)		10 000	122 000
Branch bank (10)		7 000	
Head office bank (11)		39 900	
Branch receivables (14)		3 500	
Head office profit or loss		61 600	
		<u>R122 000</u>	<u>R122 000</u>
(d)		Branch receivables	
Balance (2)	b/f	22 800	28 500
Branch inventories + VAT output (7 + 13)		213 180	196 080
		<u>R235 980</u>	3 990
Balance	b/f	7 410	c/f 7 410
			<u>R235 980</u>

continued

(e)		Branch bank account	
Balance (3)		Branch profit or loss + VAT (9)	11 400
Branch inventories + VAT output (6)	b/f 1 800	Branch profit or loss + VAT (10)	7 980
Branch receivables (12)	171 000	Head office bank account (15)	335 000
	196 080	Balance	14 500
			<u>R368 880</u>
Balance			
	b/f 14 500		
		VAT output	
		Branch bank (6)	21 000
		Branch receivables (7)	26 180
(f)			
		VAT input	
		Branch bank (9)	1 400
		Branch bank (10)	980
		Branch receivables (14)	490
(g)			

(b) Merchandise sent to branch at selling price

The head office adds a fixed percentage of gross profit to all merchandise sent to the branch. As a result of this, the head office can exercise strict control over the inventories and sales of the branch. Loss of inventories is recognised in the 'branch inventories' account as the inventories are kept at selling price.

The functions of the accounts will subsequently be discussed:

■ 'Goods to branch' account

Merchandise purchased to dispatch to the branch must be taken from the purchases or inventory account (credited), and debited to the goods to branch account. The merchandise dispatched by the head office to the branch at selling price is credited to the 'Purchases', the 'Inventories' or the 'Goods to branch' account at cost. Should the branch return some of these merchandise to the head office at selling price, it is debited to the 'Purchases', the 'Inventories' or the 'Goods to branch' account at cost.

■ 'Branch inventories' account

The merchandise dispatched to the branch at selling price is debited in the 'Branch inventories' account at selling price. Should the branch return merchandise at selling price to the head office, it is credited to the 'Branch inventories' account at selling price. Inventories donated by the branch, or stolen at the branch, are credited in the 'Branch inventories' account at selling price.

As explained above, all the transactions are recognised in the 'Branch inventories' account at selling price. At the end of each month the 'Branch inventories' account is balanced and the balance of the inventories at selling price, as determined by a physical inventory count, is recognised in the 'Branch inventories' account. The 'Branch inventories' account should now balance.

Should the 'Branch inventories' account not balance it indicates a deficit or surplus of inventories.

■ 'Branch gross profit' account

Merchandise dispatched by the head office to its branch is credited to the 'Goods to branch' account at cost, and debited to the 'Branch inventories' account at selling price. The difference between the cost and the selling price is credited to the 'Branch gross profit' account. The 'Branch gross profit' account is closed off against the 'Branch profit or loss' account.

■ 'Branch profit or loss' account

The 'Branch gross profit' account is closed against the 'Branch profit or loss' account. Expenses of the branches are written off in this account against the branch gross profit. The balance of the 'Branch profit or loss' account is transferred to the head office 'Profit or loss' account.

19.3 Value-added Tax

The entity with a head office and branches will normally be registered for VAT purposes as a single entity. No VAT is charged on merchandise dispatched from the head office to the branch or from the branch to the head office.

With the purchase of the merchandise, the head office claims the VAT input.

VAT output is charged on all sales.

Should receivables not pay their debts, bad debts exist and VAT input is applicable.

19.4 The recognition of transactions in the records of the head office

The head office sends merchandise to branches at cost plus 20%. This is applicable in examples (a) – (n).

(a) Head office dispatches merchandise to branches

Head office dispatches merchandise with a cost of R1 000 and a selling price of R1 368* (including VAT) to its branch.

Branch inventories	R	R
Goods to branch	1 200	1 000
Branch gross profit		200

* Note: Included in the selling price is VAT of R168. The merchandise is not yet sold by the branch, and therefore no entry for VAT is made in the accounting records.

(b) Branch returns inventories to head office

The branch return merchandise with a selling price of R136,80 (VAT included), and which costs R100, to its head office.

Goods to branch	R	R
Branch gross profit	100	
Branch inventories	20	120

When the branch returns merchandise at selling price to the head office, the 'Goods to branch' account is debited with the cost, the 'Branch inventories' account is credited with the selling price, and the 'Branch gross profit' account is debited with the difference between the selling price and the cost.

Note: At the date the goods were sent to the branch, no entry for VAT was made in the accounting records, and therefore no entry for VAT will be made when these goods are returned by the branch.

(c) Cash sales by branch

The branch sells merchandise at a selling price of R5 130 (VAT included).

Branch bank	R	R
Branch inventories	5 130	4 500
VAT output		630

Goods sold by the branch for cash are credited to the 'Branch inventories' account, and the 'VAT output' account, and are debited to the 'Branch bank' account.

(d) Credit sales by branch

The branch sells merchandise on credit for R3 762 (VAT included).

Branch receivables	R	R
Branch inventories	3 762	3 300
VAT output		462

Goods sold by the branch on credit are credited to the 'Branch inventories' account and the 'VAT output' account, and debited to the 'Branch receivables' account.

(e) Returns by receivables

The receivable returns merchandise for R171 (VAT included).

Branch inventories	R	R
VAT output	150	150
Branch receivables	21	171

(f) Sales by branch at a discount

Cash sales of R171 (including VAT) of obsolete inventories after a discount of 25% has been deducted.

Bank	R	R
Branch inventories	171	150
VAT output		21
and		
Branch gross profit	R	R
Branch inventories	50	50

(R150 × 50/90)

When the branch decreases the selling price of inventories, the 'Branch gross profit' account must be debited with the decreased amount, and the 'Branch inventories' account must be credited.

(Discount of 25% on selling price of 120% = 30%) or $(100/75 \times 150/1) - 150 = R50$

(g) Bad debts

Receivables to the amount of R228 are not able to pay their debts. A decision was taken to write off their debts.

Branch profit or loss	R	R
VAT input	200	200
Branch receivables	28	228

Should the debts of receivables not be collected in full the uncollected portion must be debited to the 'Branch profit or loss' account and the 'VAT input' account, and credited to the 'Branch receivables' account.

(h) Branch donates merchandise

The branch donates merchandise at a cost of R250 (VAT excluded) and a selling price of R342 (VAT included) to a charity organisation.

Branch profit or loss account (250 + 35)	R	R
Branch gross profit	285	285
Branch inventories	150	150
VAT input		300
		35

Should the branch donate inventories for charity the 'Branch inventories' account is credited at selling price (without VAT), the 'Branch profit or loss' account is debited with the cost plus VAT on cost, and the 'Branch gross profit' account is debited with the difference between selling price and cost.

(i) Branch inventories destroyed by fire

Inventories with a selling price of R342 are destroyed by fire.

Branch gross profit	R	R
Branch profit or loss (R300 000 × 100/120)	50	50
Branch inventories	250	250
		300

VAT is not applicable when inventories are destroyed by fire.

(j) Loss of inventories – not material

Should the entity assume that losses of inventories less than R500 are not material and losses of inventories amount to R220, the journal entry with the closing of the 'inventory' account will be as follows:

Branch gross profit	R	R
Branch inventories	220	220

(k) Loss of inventories – material

Should the entity assume that losses of inventories of more than R500 are material and there is a loss of R600 at selling price (excluding VAT), the journal entry with the closing of the 'inventory' account will be as follows:

Branch gross profit (R600 × 20/120)	R	
Branch profit or loss (R600 × 100/120)	100	
Branch inventories	500	
		600

(l) Gross profit: transferred

The branch gross profit, as determined with the closing of the 'Branch gross profit' account, is transferred to the 'Branch profit or loss' account.

Branch gross profit	R	
Branch profit or loss	1 000	
		1 000

(m) Profit of branch transferred to head office

The profit, as determined with the closing of the 'Branch profit or loss' account, is transferred to the 'Head office profit or loss' account.

Branch profit or loss	R	
Head office profit or loss	250	
		250

In the following examples, everything that has been explained above will be further clarified.

Example 19.2

Grove Limited's head office is in Ferndale, with branches throughout the country. Vouchers of branch transactions are sent electronically to the head office, where a 'Branch inventories' account, a 'Branch gross profit' account and a 'Branch profit or loss' account are kept for each branch. The records of the branches' receivables are also kept at the head office, and goods are dispatched to the branches at cost plus 50%.

The following information for the Sandton branch is available for the year ended 30 June 20.4:

1	Branch inventories 1 July 20.3 (selling price)	R	21 600
	Branch inventories 30 June 20.4	?	
	Receivables on 1 July 20.3	13 400	
2	Dispatched from head office (selling price excluding VAT)	16 560	
3	Returns from receivables to branch (including VAT)	456	
4	Cash sales deposited – (cash sales at normal selling price less 15% discount for cash)	7 752	
5	Goods returned by branch (selling price excluding VAT)	2 700	
6	Sales of obsolete inventories at discount of 30%. Cash deposited (This amount is not included in the R7 752 above.)	2 166	

- 7 Normal credit sales R 27 360
- 8 Received from receivables as payment on their accounts 24 984
- 9 Donation to a local orphanage at selling price (excluding VAT) 750

Assignment

- (a) Journalise the above transactions in the records of Grove Limited.
- (b) Show the following ledger accounts in the records of Grove Limited for the Sandton branch, for the year ended 30 June 20.4:

Branch inventories;
Branch gross profit;
Goods to branch;
Branch profit or loss;
Branch receivables control;
Branch bank account;
VAT output; and
VAT input.

Note: Grove Limited is registered for VAT.

Solution

(a)

		R	R	R
1	No journal entry Calculate balance of branch gross profit account Balance of branch inventories ∴ Branch gross profit (21 600 × 50/150)			21 600 7 200
2	Branch inventories Goods to branch Branch gross profit Consignment from head office	16 560		
3	Branch inventories VAT output Branch receivables Returns by receivables to branch	400 56		456
4	Branch bank Branch inventories VAT output Cash sales and Branch gross profit Branch inventories (R6 800 × 15/85) Discount on cash sales	7 752		6 800 952
		1 200		1 200

continued

5	Goods to branch Branch gross profit Branch inventories Goods returned by branch	R 1 800 900	R 2 700
6	Branch bank Branch inventories VAT output Cash sales and Branch gross profit Branch inventories (R1 900 × 30/70)	2 166 814	1 900 266 814
7	Branch receivables Branch inventories VAT output Credit sales	27 360	24 000 3 360
8	Branch bank Branch receivables Receivables pay their debts	24 984	24 984
9	Branch profit or loss account (Donation) (500 + 70) Branch gross profit Branch inventories VAT input Donation of inventories Balance of branch inventories account Balance = R1 436 ∴ Branch gross profit = R1 436 × 50/150 = R479	570 250	750 70
10	Balancing figure in branch gross profit Branch gross profit Branch profit or loss	9 424	9 424
11	Branch profit or loss Head office profit or loss	8 854	8 854

(b) Note: Figures in brackets refer to the information contained in the question itself.

Branch inventories (Selling price = 150%)			
Balance	b/f	21 600	6 800
Goods to branch (2)		11 040	1 200
Branch gross profit (receipts) (2)		5 520	1 800
Receivables (3)		400	900
			1 900
			814
			24 000
			500
			250
			396
			c/f
			R38 560
Balance	b/f	396	

continued

Branch gross profit (Gross profit = 50%)			
Branch inventories (cash discount) (4)	1 200		
Branch inventories (returns) (5)	900		
Branch inventories (discount obsolete) (6)	814		
Branch inventories (donation) (9)	250		
∴ Branch profit or loss (10)	9 424		
Balance (396 × 50/150)	132		
	R12 720		R12 720
		Balance	b/f
			132
Goods to branch (Cost)			
Branch inventories (5)	1 800		
∴ Head office trade account	9 240		
	R11 040		R11 040
Branch profit or loss			
Branch inventories (donation) and VAT input (9)	570		
Head office profit or loss (11)	8 854		
	R9 424		R9 424
Branch receivables control			
Balance (1)	13 400		
Branch inventories and VAT output (7)	27 360		
	R40 760		
Balance	b/f	15 320	
			456
			24 984
			15 320
			R40 760
Branch bank account			
Branch inventories and VAT output (4)	7 752		
Branch inventories and VAT output (6)	2 166		
Receivables (8)	24 984		
		VAT output	
			56
			952
			266
			3 360
VAT input			
			70

Calculations

1 Unrealised profit in:

	Opening inventories	Receipts	Returns	Closing inventories
	R	R	R	R
Cost	14 400	11 040	1 800	264
Gross profit	7 200	5 520	900	132
Selling price	<u>R21 600</u>	<u>R16 560</u>	<u>R2 700</u>	<u>R396</u>
%	100			
	50			
	<u>R150</u>			

2 Cash discount

Original selling price	100
Discount	(15)
New selling price	<u>85</u>
$\therefore 15/85 \times R5\ 800$	
= R1 200	

or

Original selling price	150
Discount 15% \times 150%	(22.5)
New selling price	<u>127.5</u>
$\therefore 22.5/127.5 \times R6\ 800$	
= R1 200	

3 Discount on obsolete inventories

Original selling price	100
Discount	(30)
New selling price	<u>70</u>
$\therefore 30/70 \times R1\ 900$	
= R814	

or

Original selling price	150
Discount 30% \times 150%	(45)
New selling price	<u>105</u>
$\therefore 45/105 \times R1\ 900$	
= R814	

Example 19.5

Bookworm is an entity that sells books to the general public. Its head office is situated in Melville and it has two branches, one in Rosebank and the other in Greenside. The branches do not operate independently and the head office recognises all transactions. Only one bank account exists and the branches deposit cash received directly into this account. Branch expenses are paid by the head office.

In the past, the head office sent merchandise to the branches at selling price, that was cost plus 25%. An increase in operating expenses necessitated a profit of 33 1/3% on cost as from 1 June 20.4.

The following information and transactions apply to the Rosebank branch:

	Period 1 January 20.4 to 31 May 20.4	Period 1 June 20.4 to 31 December 20.4
	R	R
Merchandise on hand at cost on 1 January 20.4	35 000	-
1 June 20.4	-	35 940
Cash sales (including VAT)	135 888	181 602
Credit sales (including VAT)	85 500	112 860
Credit sales of stolen goods (see additional information 2)	-	7 980
Goods sent to branch at cost (excluding VAT)	157 500	210 000
Goods returned to head office at selling price (excluding VAT)	1 500	-
Returns by receivables (including VAT)	-	10 488
Payment by receivables	28 500	68 400
Expenses paid by head office:		
Salaries and wages	12 540	20 520
Rent of the building (including VAT)	5 700	15 960
Sundry expenses (including VAT)	4 560	9 918

Additional information

- Included in the cash sales of R181 602 is an amount of R29 841 (period 1 June 20.4 to 31 December 20.4), for merchandise sold at a sale in October 20.4 at a discount of 20% on normal selling price.
- A staff member at the Rosebank branch was found guilty of the theft of merchandise with a selling price of R21 204 in December 20.4. Half of the merchandise was recovered and sold on credit to a regular client of the branch for R7 980. The other half had already been sold by the guilty person. A claim of R10 602 was instituted, but according to the lawyer acting for Bookworm, only R4 560 can be recovered in January 20.5, as the guilty party is insolvent.
- Included in the receivables returns of R10 488 (period 1 June 20.4 to 31 December 20.4) is an amount of R2 394 for merchandise sold on 26 May 20.4 and returned on 5 June 20.4 by the receivable.
- A physical inventory count held on 31 December 20.4 showed merchandise on hand amounts to R53 960 at selling price (excluding VAT).

Assignment

Prepare the following ledger account in the records of the head office of Bookworm for the year ended 31 December 20.4:

Branch inventories – Rosebank;
Branch gross profit – Rosebank;

Solution

Branch inventories (Selling price = 125% / 133 1/3%)		
Balance	b/f	43 750
Goods to branch		157 500
Branch gross profit		38 375
		<u>R240 625</u>
Balance	c/f	44 925
		<u>R240 625</u>
Balance	b/f	44 925
Branch gross profit		2 995
Goods to branch		210 000
Branch gross profit		70 000
Branch receivables		9 200
Branch gross profit (returned) (cal 3)		140
		<u>R337 260</u>
Balance	b/f	53 960
		<u>R337 260</u>
Branch gross profit (Gross profit = 25% / 33 1/3%)		
Branch inventories (returns)		300
Balance	c/f	8 985
Branch profit or loss		38 940
		<u>R48 125</u>
Branch inventories (sale)		6 400
Branch inventories (theft)		2 300
Branch inventories (theft)		2 325
Balance	c/f	13 490
Branch profit or loss		57 605
		<u>R82 120</u>
Branch profit or loss		
Bank - Salaries (12 540 + 20 520)		33 060
- Rent (5 000 + 14 000)		19 000
- Sundry expenses (4 000 + 8 700)		12 700
Branch inventories (theft)		2 975
Head office profit or loss		28 710
		<u>R96 445</u>
Branch profit or loss		
Branch gross profit		38 840
Branch gross profit		57 605
		<u>R96 445</u>

continued

Calculations

- | | | |
|---|---|---------|
| 1 | Cash sales at discount | R25 600 |
| | R29 184 × 100/114 | R6 400 |
| | R25 600 × 20/80 | |
| 2 | Theft of merchandise | R18 600 |
| | R21 204 × 100/114 | R9 300 |
| | 50% (recovered) | R7 000 |
| | Sales (R7 980 × 100/114) | 2 300 |
| | ∴ Gross profit | R9 300 |
| | 50% (taken by guilty party) | 9 300 |
| | Sales (R4 560 × 100/114) | 4 000 |
| | Gross profit (R9 300 × 33 ¹ / ₃ / 133 ¹ / ₃) | 2 325 |
| | ∴ Profit or loss | 2 975 |
| | | R9 300 |
| 3 | Receivables returns on 5 June 2014 | R2 100 |
| | (R2 394 × 100/114) | (2 240) |
| | Less: R2 100 × 133 ¹ / ₃ / 125 | R140 |

19.5 Decentralised method

According to the decentralised method, the branch is independent, and therefore must keep a complete set of financial records, exercise control over its inventories and prepare a trial balance. Inventories are almost always transferred at cost from the head office to the branch.

When this method is applied the head office will always have, amongst others, a 'Branch' account in its records, while the branch will always have, amongst others, a 'Head office' account in its records.

These two accounts are mirror images of each other. At the end of a period the balances of the two accounts should be the same. If not, a reconciliation is done to reconcile the two accounts to the same balance. The one balance will be a debit balance while the balance in the other set of records will be a credit balance.

19.6 The recognition of transactions

The recognition of transactions is illustrated in example 19.4

Example 19.4

Note: Head office is registered for VAT.

Transaction	Journal of head office		Journal of branch	
	Debit R	Credit R	Debit R	Credit R
Head office opens a branch and transfers cash (R: 5 000) and a vehicle (cost R100 000 and accumulated depreciation R20 000) to the branch	Branch account Accumulated depreciation Bank Vehicles	95 000 20 000 15 000 100 000	Bank Vehicles Accumulated depreciation Head office account	15 000 100 000 20 000 95 000
Head office sends merchandise to branch at cost of R25 000	Branch account Goods to branch	25 000 25 000	Inventories from head office Head office account	25 000 25 000
Branch sells merchandise for cash R5 700	No entry		Bank Sales VAT output	5 700 5 000 700
Branch sells merchandise on credit R8 208	No entry		Receivables Sales VAT output	8 208 7 200 1 008
Head office pays rent on behalf of branch R1 140	Branch account VAT input Bank	1 000 140 1 140	Rent expense Head office account	1 000 1 000
Branch pays telephone account of R456	No entry		Telephone VAT input Bank	400 56 456
Branch writes off bad debts R228	No entry		Bad debts VAT input Receivables	200 28 228

continued

Transaction	Journal of head office		Journal of branch	
	Debit R	Credit R	Debit R	Credit R
Branch writes off depreciation on vehicle R2 000	No entry		Depreciation Accumulated depreciation	2 000 2 000
Branch receives R3 000 from receivables	No entry		Bank Receivables	3 000 3 000
Branch pays salaries R2 500	No entry		Salaries Bank	2 500 2 500

After the transactions, the trial balance of the branch is as follows:

Trial balance as at 31 May 20 2			
	Debit R	Credit R	
Head office account (95 000 + 25 000 + 1 000)			
Vehicles	100 000	121 000	
Accumulated depreciation (20 000 + 2 000)	25 000	22 000	
Receivables (8 208 - 228 - 3 000)	4 980		
Bank (15 000 + 5 700 - 456 + 3 000 - 2 500)	20 744	12 200	
Sales (5 000 + 7 200)			
Rent expense	1 000		
Telephone	400		
Bad debts	200		
Depreciation	2 000	1 708	
Salaries	2 500		
VAT output (700 + 1 008)			
VAT input (56 + 28)	84		
	<u>R156 908</u>	<u>R156 908</u>	

If closing inventories amount to R20 000, the closing entries in the accounting records of the branch are as follows:

	Debit R	Credit R
Trading account Inventories To close off opening inventories	25 000	25 000
Inventories Trading account To recognise closing inventories	20 000	20 000
Sales Trading account To close off sales	12 200	12 200

continued

	Debit R	Credit R
Trading account: Profit or loss account To transfer gross profit to profit or loss account	7 200	7 200
Profit or loss account Rent expense Telephone Bad debts Depreciation Discount allowed Salaries To transfer expenses to profit or loss account	6 100	1 000 400 200 2 000 300 2 500
Profit or loss account Head office account Transfer profit to head office	1 100	1 100

The financial statements of the branch are as follows:

	R
Sales	12 200
Cost of sales	(5 000)
Inventories from head office	
Closing inventories	25 000 (20 000)
Gross profit:	7 200 (6 100)
Expenses	
Rent expense	1 000
Telephone	400
Bad debts	200
Depreciation	2 000
Salaries	2 500
Profit for the month	R1 100

	Statement of financial position as at 31 May 20.2
ASSETS	R
Non-current assets	
Vehicle: Gross carrying amount	100 000
Accumulated depreciation	(22 000)
Total non-current assets	78 000
Current assets	
Inventories	20 000
Receivables	4 980
Bank	20 744
Total current assets	45 724
Total assets	R123 724
EQUITY AND LIABILITIES	
Equity	
Head office account	121 000
Profit for the month	1 100
Total equity	122 100
Current liabilities	
VAT owing (1 708- 84)	1 624
Total equity and liabilities	R123 724

The head office recognises the closing entries of the branch as follows:

	Debit R	Credit R
Branch account	1 100	
Branch profit or loss		1 100

The head office will now combine the branch results with its own results. The purpose is to report on the results of the complete entity, i.e. the head office plus the branch. This can be done by means of a ten-column worksheet. (Assume the amounts in head office's trial balance.)

19.7 Merchandise in transit

Goods may be still in transit at the end of a month or financial period. If this is the case, the accounts of the head office and the branch will not correspond. The accounts have to be reconciled and adjusting entries have to be made.

This principle is illustrated in example 19.5

Example 19.5

Olympia Entity imports merchandise from Hong Kong and sells it through two branches, one in Boksburg and one in Benoni. Olympia Entity is situated in Kempton Park and functions as the head office.

Boksburg branch		Benoni branch	
Debit	Credit	Debit	Credit
R	R	R	R
Head office	52 500	Head office	29 900
Receivables		Receivables	
Bank		Bank	
Opening inventories		Opening inventories	
Goods from head office		Goods from head office	
Goods to head office	5 300	Goods to head office	8 400
Administration fee		Administration fee	
Salaries		Purchased from outside suppliers	
Rent expense		Sales	
Sales	102 200		161 100
	R160 000	R199 400	R199 400

Additional information

- 1 On 31 August goods to the value of R5 600 from the head office had not been received by the Boksburg branch.
- 2 Goods amounting to R1 400 returned by the Benoni branch had not been recognised in the records of the head office.
- 3 During the month, Boksburg needed extra inventories and got them directly from the Benoni branch, value R5 200. This transaction was not recognised in any records.
- 4 A receivable owing R2 100 to the Boksburg branch, paid the amount directly into the head office's bank account, but the Boksburg branch did not recognise it in its records.
- 5 The branches deposit cash weekly in the head office's bank account. At the end of August a deposit of R2 000 by the Boksburg branch has not been recognised by the head office.
- 6 Salaries to the value of R22 000 and rent of R16 500 were paid by the head office on behalf of the Benoni branch, which the Benoni branch did not recognise.
- 7 In the head office's accounting records, the branches had the following balances at the end of the month:

Boksburg branch	R58 000
Benoni branch	R69 800

[illegible]

- 8 On 31 August the branches had the following inventories on hand:

Boksburg branch R26 100
Benoni branch R35 600

- 9 The head office is not registered for VAT purposes.

Assignment

- (a) Prepare the adjusting journals resulting from the information above in the records of the branches.
(b) Prepare the head office account in the records of each branch.
(c) Adjust the ledger accounts of the branches in the records of the head office, by using the information above.
(d) Prepare the profit or loss account for the branches for the month ended 31 August 20.0.

Solution

- (a) Adjusting journal entries in branches' records

Boksburg journal

Goods-in-transit Head office	Debit R	Credit R
Goods-in-transit recognised	5 600	5 600
Goods from Benoni Head office	5 200	5 200
Goods collected from Benoni, recognised in Boksburg's records	2 100	2 100
Head office Receivables		
Payment by receivable, recognised by Boksburg in head office's bank account		

Benoni journal

Head office Goods to Boksburg	Debit R	Credit R
Goods supplied directly to Boksburg, recognised in Benoni's records		5 200
Salaries		
Rent expense	22 000	
Head office	16 500	
Expenses paid by head office recognised		38 500

(b) Boksburg branch

Head office	
Receivables	2 100
Balance	c/f 61 200
	<u>R63 300</u>
Goods-in-transit	b/f 52 500
Goods from Benoni branch	5 600
	<u>5 200</u>
	<u>R63 300</u>
Balance	b/f 61 200

Benoni branch

Head office	
Goods to Boksburg branch	5 200
Balance	c/f 63 200
	<u>R68 400</u>
Salaries	
Rent expense	
Balance	b/f 63 200

(c) Ledger of head office

Boksburg branch	
Balance	b/f 58 000
Goods from Benoni branch	5 200
	<u>R63 200</u>
Balance	b/f 61 200
Benoni branch	
Balance	b/f 69 800
Goods from branch	
Goods to Boksburg branch	
Balance	c/f 63 200
	<u>R69 800</u>
Balance	b/f 63 200

(d) Profit or loss account

Boksburg branch	
Profit or loss account	
Opening inventories	24 800
Goods from head office	76 500
Goods-in-transit	5 600
Goods from Benoni branch	5 200
Gross profit	27 100
	<u>R139 200</u>
Administration fee	8 000
Salaries	16 000
Rent expense	12 000
	<u>R36 000</u>
Gross profit	27 100
Loss for the month	8 900
	<u>R36 000</u>
Benoni branch	
Profit or loss account	
Opening inventories	31 600
Goods from head office	102 900
Purchases from outside supplier	15 800
Gross profit	60 000
	<u>R210 300</u>
Sales	161 100
Goods to head office	8 400
Goods to Boksburg branch	5 200
Closing inventories	35 600
	<u>R210 300</u>

continued

Benoni branch		
Profit or loss account		
Administration costs	8 000	Gross profit
Salaries	22 000	
Rent paid	16 500	
Profit for the month	13 500	
	<u>R60 000</u>	<u>R60 000</u>

Self-assessment questions and answers

Question 19.1

Books Suppliers Limited buys and sells academic books. The head office is situated at UJ. A branch is also operating at Fort Hare, but all records are kept at head office. The Fort Hare branch deposits all cash amounts received daily into the head office's bank account. The head office is responsible for collecting the branch receivables.

All inventories, delivered by head office to the Fort Hare branch, are at cost plus 25% – which is the Fort Hare branch's selling price.

The company assumes that inventory losses of R500 (selling price) and less may occur per month due to poor control, but does not regard this as material. Inventory losses larger than R500 per month must be investigated and reported.

1 On 31 July 2014 the following balances appeared in the ledger of the head office:

Fort Hare branch inventories account	R 8 730
Fort Hare branch gross profit account	1 746

2 The monthly physical inventory count, held on 1 August 2014, showed that the Fort Hare branch had inventories worth R6 504 (at cost).

The following information about the Fort Hare branch was available for the period 1 August 2014 to 31 August 2014:

3 Goods supplied to the branch at selling price (excluding VAT)	R 5 000
4 Goods returned by branch at selling price (excluding VAT)	500
5 Proceeds of credit sales at normal selling price	6 840
6 Proceeds of cash sales at a discount of 10% on selling price	1 026
7 Goods sold on credit but returned at selling price to the branch by dissatisfied customers	228
8 Payments received from branch receivables	6 300
9 Inventory count on 31 August 2014 showed that inventories of R4 000 (at cost) was on hand at the Fort Hare branch.	

Additional information

10 During August 2014 inventories with a selling price of R110 (excluding VAT) were given away as promotional material by the Fort Hare branch manager.

11 Inventories with a selling price of R285 (including VAT) were totally destroyed by a fire in August 2014. Fortunately the fire was extinguished quickly and no other inventories were damaged.

Assignment

Show the following accounts in the ledger of the head office for the period 1 August 2014 to 31 August 2014:

- Fort Hare branch inventories;
- Fort Hare branch gross profit;
- Goods to branch;
- Fort Hare profit or loss;
- VAT output; and
- VAT input.

Note: Head office is registered for VAT.

Solution

Fort Hare branch inventories (Selling price = 125%)		
Balance	b/f	(1) 8 730
Goods to branch		(3) 4 000
Branch gross profit		(3) 1 000
Receivables		(7) 200
		<u>R13 930</u>
Balance	b/f	5 000
For: Hare branch gross profit (Gross profit = 25%)		
Branch inventories (deficit)	(2) 120	
Branch inventories (returns)	(4) 100	
Branch inventories (cash discount)	(6) 100	
Branch inventories (promotion)	(10) 22	
Branch inventories (fire)	(11) 50	
Balance (5 000 × 25/125) c/f	(9) 1 000	
Branch inventories (deficit)	470	
Head office profit or loss	884	
	<u>R2 746</u>	
Balance	b/f	<u>R2 746</u>
Fort Hare branch inventories (Selling price = 125%)		
Branch profit or loss account (deficit)	(2) 480	
Branch gross profit (deficit)	(2) 120	
Goods to branch	(4) 400	
Branch gross profit (returns)	(4) 100	
Receivables	(5) 6 000	
Bank	(6) 900	
Branch gross profit (cash discount)	(6) 100	
Branch profit or loss (promotion)	(10) 88	
Branch gross profit (promotion)	(10) 22	
Branch profit or loss (fire loss)	(11) 200	
Branch gross profit (fire) c/f	(11) 50	
Balance	(9) 5 000	
Branch gross profit (deficit)	470	
	<u>R13 930</u>	
Balance	b/f	<u>R13 930</u>

(c)		Goods to branch (Cost)		(3)		4 000	
Branch inventories	(4)	400	Branch inventories	(3)			
∴ Branch trade account		3 600					
		<u>R4 000</u>					<u>R4 000</u>
(d)		Fort Hare branch profit or loss		(3)		884	
Branch inventories (deficit)	(2)	480	Branch gross profit	(3)			
Branch inventories (promotion)	(10)	88					
+ VAT	(11)	200					
Branch inventories (fire)		116					
Head office profit or loss		<u>R884</u>					<u>R884</u>
(e)		VAT output		(5)		840	
Receivables	(7)	28	Receivables (sales)	(5)			
			Bank (sales)	(6)			126
(f)		VAT input		(10)		12	
			Fort Hare branch profit or loss	(10)			

Note 1

The deficit on the opening inventories is R600. This is more than the agreed upon R500, and that is why the gross profit portion (R120) and the cost portion (R480) should be separated.

Note 2

The deficit on the closing inventories is R470 and is smaller than the agreed upon R500. That is why the total deficit is debited against the 'Gross profit' account.

Calculations

1 Gross profit: percentage

	R	%	%
Cost	6 984	80	or 100
Gross profit	1 746	20	25
Selling price	<u>8 730</u>	<u>100</u>	<u>125</u>

2 Deficit on opening inventories

	Theoretical R	Physical R	Difference R
Cost	6 984	6 504	480
Gross profit	1 746	1 626	120
Selling price	<u>8 730</u>	<u>8 130</u>	<u>600</u>

3 Unrealised gross profit in

	%	Receipts R	Returns R	Promotion R	Fire R	Closing inventories R
Cost	80	4 000	400	88	200	4 000
Gross profit	20	1 000	100	22	50	1 000
Selling price	<u>100</u>	<u>5 000</u>	<u>500</u>	<u>110</u>	<u>250</u>	<u>5 000</u>
4 Cash discount		%	R		%	
Selling price		100	1 000	of	125	
Discount		(10)	(100)		(12,5)	
New selling price		<u>90</u>	<u>900</u>		<u>112,5</u>	

Question 19.2

The following trial balances were extracted on 30 June 20.3 from the records of the head office, Oriental Limited and its branch in Bloemfontein:

Head office

	R	R
Capital (ordinary R1 shares)		20 000
Land and buildings	12 000	
Machinery at carrying amount	3 000	
Furniture and equipment at carrying amount	600	
Receivables control account	3 100	1 369
Payables control account		
Inventories on 1 July 20.2	2 790	
Purchases	25 420	
Sales		29 860
Wages and salaries	1 500	
Sundry expenses	2 000	
Branch account	9 000	
Goods to branch account		8 421
Returns from branch account	105	
Cash in bank	195	
Retained earnings		60
	<u>R59 710</u>	<u>R59 710</u>

Bloemfontein branch		
Head office account	R	R
Land and buildings		8 464
Furniture	6 500	
Receivables control account	500	
Goods from head office account	1 900	
Inventories account – balance on 1 July 20.3 at cost	8 106	
Sales	1 260	
Returns to head office		12 150
Wages and salaries		126
Sundry expenses	900	
Cash in bank	1 200	
	374	
	<u>R20 740</u>	<u>R20 740</u>

Additional information

- The head office dispatches goods to the branch at cost.
- The branch sells items provided exclusively by the head office.
- On 30 June 20.3 it was found that:
 - goods to the value of R315 were in transit from the head office to the branch;
 - goods to the value of R21 were in transit from the branch to the head office; and
 - R200 cash from the branch had not yet been received by the head office.
- All non-current assets, excluding land and buildings, must be depreciated at 10% per annum on carrying amount.
- Provision for bad debts must be provided at 5% of receivables.
- On 30 June 20.3 inventories were valued as follows:

Head office	R3 000 at cost
Branch	R1 890 at cost

Assignment

- Reconcile the 'Branch' account and the 'Goods to branch' account in the records of the head office, with the 'Head office' account and the 'Goods from head office' account in the records of the branch.
- Prepare a combined statement of profit or loss for the year and a statement of financial position as at 30 June 20.3 for internal use.

Note: Oriental Limited is not registered for VAT.

continued

Solution

(a)

Records of head office			
Ledger			
Branch account			
Balance	b/f	9 000	21 200 c/f 8 779 <u>R9 000</u>
Balance	b/f	8 779	<u>R9 000</u>
Goods to branch			
Returns		105	b/f 8 421
Branch account (see journal)		21	
Balance	c/f	8 295	<u>R8 421</u>
Balance	b/f		<u>R8 421</u>

Journal			
Goods to branch		Debit:	Credit
Cash-in-transit		R	R
Branch account		21	
The recognition of items in transit		200	221

Records of branch			
Ledger			
Head office account			
Balance	b/f	8 464	
Goods from head office		315	
		<u>R8 779</u>	
Goods from head office			
Balance	b/f	8 106	126
Head office account (see journal)		315	c/f 8 295
Balance	b/f	<u>R8 421</u>	<u>R8 421</u>

Journal		
	Debit R	Credit R
Goods from head office		315
Head office account	315	
Recognition of items in transit		

(b)

ORIENTAL LIMITED			
Combined statement of profit or loss for the year ended 30 June 20.3			
	Head office R	Branch R	Total R
Sales	29 860	12 150	42 010
Cost of sales	(16 894)	(7 350)	(24 244)
Opening inventories	2 790	1 260	4 050
Purchases	25 420		25 420
Goods to branch	(8 295)		(8 295)
Goods from head office		8 295	8 295
Goods available for sale	19 915	9 555	29 470
Closing inventories (3 000 + 21) (1 890 + 315)	(3 021)	(2 205)	(5 226)
Gross profit	12 966	4 800	17 766
Expenses	(4 015)	(2 245)	(6 260)
Salaries and wages	1 500	900	2 400
Sundry expenses	2 000	1 200	3 200
Depreciation	300	50	350
Machinery	60		60
Furniture	155	95	250
Bad debts			
Profit for the year	R8 951	R2 555	R11 506

ORIENTAL LIMITED	
Combined statement of financial position as at 30 June 20.3	
ASSETS	R
Non-current assets	
Land and buildings	18 500
Furniture (600 + 500 - 60 - 50)	990
Machinery (3 000 - 300)	2 700
Total non-current assets	22 190
Current assets	
Inventories (3 021 + 2 205)	5 226
Receivables (3 100 + 1 900 - 155 - 95)	4 760
Bank (195 + 374 + 200)	769
Total current assets	10 745
Total assets	R32 935
EQUITY AND LIABILITIES	
Equity	
Share capital	20 000
Retained earnings (60 + 11 506)	11 566
Total equity	31 566
Current liabilities	
Payables	1 369
Total equity and liabilities	R32 935