Departmental Accounts

Use of departmental accounts

Preparation of Departmental Accounts may help the management in following ways:

- Easy to assess performance of each department which is more meaningful than the overall income statements.
- Poor performance can be highlighted and investigated
- Comparison between departments may help management to take measures to improve profitability
- If Departmental accounts are made using marginal costing then management may decide to close the departments generating negative contribution
- It ensures the losses within one particular department are not hidden by the overall profits of the business.

Illustration

some items of accounting information are more useful than others. For a retail store with fivedepartments, it is better to know that the store has made $100,000 gross profit than not to knowwhat the gross profit was. However, it would obviously be better if we knew how much grossprofit was made in each department.

Assume that the gross profits and losses of a business's departments were as follows:

Department	***Gross profit***	***Gross loss***
	$	$
A	40,000	
B	30,000	
C	50,000	
D		(80,000)
E	60,000	
Total	180,000	(80,000)

Total Gross profit of the business is $100,000.

Allocation of expenses

the expenses of the business are often split between the various departments, and then the net profit for each department is calculated. Each expense is divided between the departments on what is considered to be the most logical basis. This will differ considerably between businesses.

Apportionment formula

$$\frac{\text{Departmental Base}}{\text{Total Base}} \times \text{Total Overhead}$$

Expense	**Basis of Apportionment**
Selling / General Exp / Advertising / Distribution / Carriage Outward	Sales Value
Rent and Rates / Other Building Related Expenses	Floor Area
Canteen / Employee Related Costs	No of Employees / No of Hrs
Power / Heating and Lighting / Gas	Metered Units / Floor Area
Insurance	Value of Assets Insured
Depreciation	Cost / Book Value of NCA

ARD Cash n Carry

Departmental Income Statement

for the year ended 31 Dec 2015

	Food Department		**Cosmetics Department**	
	$	$	$	$
Sales		**XXX**		**XXX**
Less: Cost of Sales				
Opening Inventory	XX		XX	
Add: Purchases	XX		XX	
Less: Closing Inventory	(XX)		(XX)	
Cost of Sales		**(XXX)**		**(XXX)**
Gross Profit		**XXX**		**XXX**
Less: Expenses				
Rent	X		X	
Electricity	X		X	
Heating &Lightning	X		X	
Staff Wages	X		X	
Miscellaneous	X	**(XX)**	X	**(XX)**
Net Profit / (Loss)		**XXX**		**(XXX)**

Departmental Balance Sheet

Departmental Balance sheet is normally prepared in similar manner except closing inventories for each department are shown separately.

Factors to be considered before closure of department

- Methods used to apportion expenses should be fair enough

- Possibility of improving the performance of least profitable or loss making department

- Effect upon other departments after closure of existing departments

- Non-financial factors such as brand image, relationship with customers and suppliers

- Loss of staff morale because of redundancies and closure need to be considered

- Must be borne in mind that not all expenses apportioned to a department will be avoided

- Better / alternate uses of the resources becoming available

Past Paper Questions

Q1. Joe Brown has a petrol station which has three departments, fuel, car wash and café. The following information is available for the year ended 31 December 2012.

	Fuel	Car wash	Cafe
	$	$	$
Revenue	735 600	30 650	61 300
Inventory at 1 January 2012	38 700	3 650	4 725
Purchases	454 320	7 240	9 620
Inventory at 31 December 2012	39 760	2 480	4 820
Direct wages	36 000	3 000	12 000
Non-current assets at cost	120 000	15 000	2 760
Accumulated depreciation	6 000	1 200	850

Additional information

Depreciation rate	10%	15%	15%
Depreciation method	Straight line	Reducing balance	Straight line
Floor area (square metres)	3 400	850	425

Other expenses for the year are:

	$
Rent of premises	46 288
Electricity	18 300
Administration charges	17 119
Other expenses	54 023

The expenses are split between the departments on the following basis:

Rent of premises in the ratio of floor area,
Electricity in the ratio 4:1:1 between fuel, car wash and café,
Administration charges in the ratio of wages,
Other expenses in the ratio of sales.

REQUIRED

(a) Prepare a departmental income statement for the year ended 31 December 2012.

(b) Joe is considering closing the car wash department due to its poor profitability. Advise Joe on the long term effects of this decision.

(c) Joe is looking for funds to improve the business. He is considering applying for either a bank loan or an overdraft. Explain **three** differences between a bank loan and an overdraft.

Q2. Alana owns and manages a shop with three separate departments selling food, clothing and toys. The following trial balance is available for the year ended 30 April 2012.

	$ 000	$ 000
Inventory at 1 May 2011:		
Food	10	
Clothing	12	
Toys	31	
Purchases and sales		
Food	67	250
Clothing	50	150
Toys	57	100
Sales staff wages	80	
Advertising	8	
Heat and light	30	
Insurance	5	
Fixtures and fittings at cost	120	
Provision for depreciation, fixtures and fittings		12
Property	200	
Trade receivables	95	
Bank	55	
Trade payables		40
Capital		268
	820	820

Additional information:

1 Inventory at 30 April 2012:

	$
Food	17 000
Clothing	12 000
Toys	43 000

2 The shop has 2 floors with the food department on the ground floor and both the clothing and toys departments taking up equal floor space on the floor above.

3 At 30 April 2012:
- an invoice for advertising amounting to $2000 remained unpaid;
- $6000 had been paid in advance for heating and lighting.

4 Expenses are apportioned between departments as follows:

Apportioned on the basis of sales income:
- sales staff wages; advertising.

Apportioned on the basis of floor area:
- heat and light; insurance; depreciation.

5 Straight line depreciation is charged on fixtures and fittings at 10% per annum.

REQUIRED

(a) Prepare, in columnar format, a departmental income statement for the year ended 30 April 2012.

(b) Explain how the preparation of a departmental income statement might assist Alana in managing the business.