Chapter Two
Accounting for Branches and Combined Financial Statements

1.1) Distinguishing Sales Agency, Branch, and Division

Sales Agency:
Sales agency is a term applied to a business unit that performs only a small portion of the functions associated branch. A sales agency usually carries samples of products but does not have an inventory of merchandise and usually lesser degree of autonomy.

Branch:
The term Branch is used to describe a business unit located at some distance from the Home Office. Branches are economic and accounting entities. However, branches are not separate legal entities. Branches may carry merchandise obtained from Home Office, make sales, approve customers' credit, and make collections from its customers.

Division:
Division is a business segment or a business enterprise which generally has more autonomy than a branch. Division may be as separate company or may not be a separate company. If the division is not a separate company, the accounting procedures are the same as Branch. If the division is a separate company (subsidiary company), the financial accounting requires consolidation, which will be discussed in later topics.

Differences between Sales Agency, Branch and Division			
Characteristics	**Sales Agency**	**Branch**	**Division**
Degree of Autonomy	Low	Moderate	High
Accounting Entity	No	Yes	Yes
Legal Entity	No	No	Possible
Economic Entity	No	No	Possible

2.2 Accounting System for Sales Agency
The term sales agency sometimes is applied to a business unit that performs only a small portion of the functions traditionally associated with a branch.

For example, a sales agency usually carries samples of products but does not have an inventory of merchandise. Orders are taken from customers and transmitted to the Home Office, which approves the customers' credit and ships the merchandise directly to customers. The agency's accounts receivable are maintained at the Home Office, which also performs the collection function. An imprest cash fund generally is maintained at the sales agency for the payment of operating expenses. A sales agency that does not carry an inventory of merchandise, maintain receivables, or make collections has no need for a complete set of accounting records. All what needed is a record of sales to customers and a summary of cash payments supported by vouchers.

If the Home Office wants to measure the profitability of each sales agency separately, it will establish in the general ledger separate revenue and expense accounts in the name of the agency, for example, ***Sales: Sales Agency; Rent Expense: Sales Agency***. The cost of goods sold by each agency also must be measured. When perpetual inventory system is used, shipments to customers by sales agency, for example, are debited to Cost of Goods Sold: Sales Agency account and credited to Inventories account.

When the periodic inventory system is used, a shipment of goods sold by an agency may be recorded by a debit to Cost of Goods Sold: Sales Agency and a credit to Shipments to Agencies. This journal entry is recorded only at the end of an accounting period if a memorandum record is maintained during the period listing the cost of goods shipped to fill sales orders received from agencies. At the end of the period the Shipments to Agencies ledger account is offset against the total of beginning inventories and purchases to measure the cost of goods available for sale for the Home Office in its own operations.

Office furniture or other assets located at a sales agency may be carried in a separate ledger account by the Home Office, or control over such assets may be achieved by use of a subsidiary ledger with a complete record for each asset showing cost, location, and any other relevant information.

Summary of Sales Agency:

- Sales agency is sometimes applied to a business unit that performs only a small portion of the functions of associated branch.
- A sales agency usually carries samples of products but does not have an inventory of merchandise
- Orders are taken from customers and transmitted to the Home Office
- The Home Office approves the customers' credit and ships the merchandise directly to customers. The sales agency's receivable are maintained by the Home Office
- The Home Office also performs collection function

- An imprest cash fund generally is maintained at sales agency for the payment of operating expenses.
- A sales agency that does not carry an inventory of merchandise, maintain receivables, or make collections has no need for a complete set of accounting.

***Illustration 2.1*:** Journal Entries made by Home Office to Record Sales Agency's Transaction. The sales agency is named Lakeview Agency

Home Office:

To record merchandise shipped to sales agency for use as samples

Inventory of Samples: Lakeview Agency	1,500	
Inventories		1,500

To establish Imprest cash fund for sales agency

Imprest Cash Fund: Lakeview Agency	1,000	
Cash		1,000

To record sales made by sales agency

Trade Account Receivables	50,000	
Sales: Lakeview Agency		50,000

To record cost of merchandise sold by sales agency

Cost of Goods Sold: Lakeview Agency	35,000	
Inventories		35,000

To replenish imprest cash fund which represents several checks sent to agent

Operating Expenses: Lakeview Agency	10,000	
Cash		10,000

To close revenue and expense accounts of sales agency

to a separate Income Summary Account

Sales: Lakeview Agency	50,000	
Cost of Goods Sold: Lakeview Agency		35,000
Operating Expenses: Lakeview Agency		10,000
Income Summary: Lakeview Agency		5,000

To close net income of sales agency to income summary ledger account

Income Summary: Lakeview Agency	5,000	
Income Summary		5,000

2.3) Accounting System for Branch and Division

As a business enterprise grows, it may establish one or more branches to market its products over a large territory. The term **Branch** is used to describe a business unit located at some distance from the **Home Office**. This unit carries merchandise obtained from the Home Office, makes sales, approves customers' credit, and makes collections from its customers. A branch may obtain merchandise solely from the Home Office, or a portion may be purchased from outside suppliers. The cash receipts of the branch often are deposited in a bank account belonging to Home Office; the branch expenses then are paid from an **imprest cash fund** or a bank account provided by the Home Office. As the imprest cash fund is depleted, the branch submits a list of cash payments supported by **vouchers** and receives a check for a transfer from the Home Office to replenish the fund.

The use of an imprest cash fund gives the Home Office considerable control over the cash transactions of the branch. However, it is common practice for a large branch to maintain its own bank accounts. The extent of autonomy and responsibility of a branch varies, even among different branches of the same business enterprise.

A segment of a business enterprise also may be operated as **division**, which generally has more autonomy than a branch. The accounting procedures for a division not organized as Separate Corporation (subsidiary company) are similar to those used for branches. When a business segment is operated as a separate corporation, consolidated financial statements generally are required.

Start-Up Costs of Opening New Branches

The establishment of a branch often requires the incurring of considerable costs before significant revenue may be generated. Operating losses in the first few months are likely. In the past, some business enterprises would capitalized and amortize such start-up costs on the grounds that such costs are necessary to successful operation at a new location. However, most enterprise recognized start-up costs in connection with the opening of a branch as expenses the accounting period in which the costs are incurred. The decision should be based on the principle that net income is measured by matching expired costs with realized revenue. Costs that benefit future accounting periods are deferred and allocated to those periods. Seldom is there complete certainty that a new branch will achieve a profitable level of operations in later years. In recognition of this fact, in 1998 the AICPA Accounting Standards Executive Committee issued Statement of Position 98-5 (SOP 98-5), "Reporting on the Costs of Start-Up Activities," which required expensing of all start-up costs, including those associated with organizing a new entity such as a branch or division.

Accounting System for a Branch and Home Office

The accounting system of one business enterprise having branches may provide for a complete set of accounting records at each branch; policies of another such enterprise may keep all accounting records in the Home Office. For example, branches of drug and grocery chain stores submit daily reports and business documents to the ***Home Office***, which enters all transactions by branches in computerized accounting records kept in a central location. The Home Office may not even conduct operations of its own; it may serve only as an ***accounting and control*** center for the branches.

A branch may maintain a complete set of accounting records consisting of journals, ledgers, and a chart of accounts similar to those of an independent business enterprise. Financial statements are prepared by the branch accountant and forwarded to the Home Office. The number and types of ledger accounts, the internal control structure, the form and content of the financial statements, and the accounting policies generally are prescribed by the Home Office.

This section focuses on a branch operation that maintains a complete set of accounting records. Transactions recorded by a branch should include all controllable expenses and revenue for which the branch manager is responsible. If the branch manager has responsibility over all branch assets, liabilities, revenue, and expenses, the branch accounting records should reflect this responsibility. Expenses such as depreciation often are not subject to control by a branch manager; therefore, both the branch plant assets and the related depreciation ledger accounts generally are maintained by the Home Office.

2.3.1 Reciprocal Ledger Accounts

The accounting records maintained by a branch include a **Home Office** ledger account.

- Home Office account is credited for all merchandise, cash, or other assets provided by the Home Office;
- Home Office account is debited for all cash, merchandise, or other assets sent by the branch to the Home Office or to other branches.

The Home Office account is a quasi-ownership equity account that shows the net investment by the Home Office in the branch. At the end of an accounting period when the branch closes it accounting records, the Income Summery account is closed to the Home Office account. A net income increases the credit balance of the Home Office account; a net loss decreases this balance.

In the Home Office accounting records, a **reciprocal ledger account** with a title such as **Investment in Branch** is maintained.

- Investment in Branch is a non-current asset account, which is debited for cash, merchandise, and services provided to the branch by the Home Office, and for net income reported by the branch.
- Investment in Branch is credited for cash or other assets received from the branch, and for net losses reported by the branch.

Thus, the **Investment in Branch** account reflects the **equity method of accounting**. A separate investment account generally is maintained by the Home Office for each branch. If there is only one branch, the account title is likely to be Investment in Branch; if there are numerous branches, each account title includes a name or number to identify each branch.

2.3.2 Expenses Incurred by Home Office and Allocated to Branches

Some business enterprises follow a policy of notifying each branch of expenses incurred by the **Home Office** on the branch's behalf. **Plant assets** located at a branch generally are carried in the Home Office accounting records. If a plant asset is acquired by the **Home Office** for the branch, the journal entry for the acquisition is a debit to an appropriate asset account such as Equipment: Branch and a credit to Cash or an appropriate liability account. If the branch acquires a plant asset, it debits the Home Office ledger account and credits Cash or an appropriate liability account. The Home Office debits an asset account such as Equipment: Branch and credits Investment in Branch.

The Home Office also usually acquires insurance, pays property and other taxes, and arranges for advertising that benefits all branches. Clearly, such expenses as depreciation, property taxes, insurance, and advertising must be considered in determining the profitability of a branch. A policy decision must be made as to whether these expense data are to be retained at the Home

Office or are to be reported to the branches so that the income statement prepared for each branch will give a complete picture of its operations. An expense incurred by the Home Office and allocated to a branch is recorded by the Home Office by *a debit to* ***Investment in Branch*** *and a Credit to an appropriate expense ledger account; the branch debits an expense account and credits Home Office.*

If the Home Office does not make sales, but functions only as an accounting and control center, most or all of its expenses may be allocated to the branches. To facilitate comparison of the operating results of the various branches, the Home Office may charge each branch *interest on the capital invested in that branch.* Such interest expense recognized by the branches would be offset by interest revenue recognized by the Home Office and would not be displayed in the **combined** income statement of the business enterprise as a whole.

2.3.3 Alternative Methods of Billing Merchandise Shipments to Branches

Three alternative methods area available to the Home Office for billing merchandise shipped to its branches. The shipments may be billed:

1. At Home Office cost,
2. At a percentage above Home Office cost, or
3. At the branch's retail selling price

The shipment of merchandise to a branch does not constitute a **sale**, because ownership of the merchandise does not change.

1. Billing shipments to a branch at Home Office cost

This is the simplest procedure and is widely used. It avoids the complication of unrealized gross profit in inventories and permits the financial statements of branches to give a meaningful picture of operations. However, billing merchandise to branches at Home Office cost attributes all gross profits of the enterprise to the branches, even though some of the merchandise may be manufactured by the Home Office. Under these circumstances, Home Office cost may be the most realistic basis for billing shipment to branches.

2. Billing shipments at a percentage above Home Office cost (such as 110% of cost)

This may be intended to allocate a reasonable gross profit to the Home Office. When merchandise is billed to a branch at a price above Home Office cost, ***the net income reported by the branch is understated and the ending inventories are over-stated for the enterprise as a whole.*** Adjustments must be made by the Home Office to eliminate the excess of billed prices over cost (***intracompany profits***) in the preparation of combined financial statements for the Home Office and the branch.

3. Billing shipments to a branch at branch retail selling prices

This may be based on a desire to strengthen internal control over inventories. The inventories ledger account of the branch shows the merchandise received and sold at retail selling prices. Consequently, the account will show the ending inventories that should be on hand at retail prices. The Home Office record of shipments to a branch, when considered along with sales reported by the branch, provides a perpetual inventory stated at selling prices. If the physical inventories taken periodically at the branch do not agree with the amounts thus computed, an error or theft may be indicated and should be investigated promptly.

2.3.4 Separate Financial Statements for Branch and for Home Office

A separate income statement and balance sheet should be prepared for a branch so management of the enterprise may review the operating results and financial position of the branch. The branch's income statement has no usual features if merchandise is billed to the branch at Home Office cost. However, if merchandise is billed to the branch at branch retail selling prices, the branch's income statement will show a net loss approximating the amount of operating expenses. The only unusual aspect of the balance sheet for a branch is use of the Home Office ledger account in lieu of the ownership equity accounts for a separate business enterprise. The separate financial statements prepared for a branch may be revised at the Home Office to include expenses incurred by the Home Office allocable to the branch and to show the results of branch operations after elimination of any intracompany profits on merchandise shipments.

Separate financial statements also may be prepared for the Home Office so that management will be able to appraise the results of its operations and its financial position. However, it is important to emphasize that separate financial statements of the Home Office and of the branch are prepared **for internal use only;** they do not meet the needs of investors or other external users of financial statements.

2.3.5 Combined Financial Statements for Home Office and Branch

A balance sheet for distribution to creditors, stockholders, and government agencies must show the financial position of a business enterprise having branches as a **single entity.** A convenient starting point in the preparation of a combined balance sheet consists of the adjusted trial balances of the ***Home Office*** *and* ***the Branch***.

❖ The assets and liabilities of the branch are substituted for the Investment in Branch ledger account included in the Home Office trial balance. Similar

accounts are combined to produce a single total amount for cash, trade accounts receivable, and other assets and liabilities of the enterprise as a whole.

❖ In the preparation of a combined balance sheet, **reciprocal ledger accounts** are eliminated because they have no significance when the branch and Home Office report as a single entity.

- The balance of the Home Office account is offset against the balance of the Investment in Branch account; also,
- Any receivables and payables between the Home Office and the branch (or between two branches) are eliminated.

The operating results of the enterprise (the Home Office and all branches) are shown by an income statement in which the revenue and expenses of the branches are combined with corresponding revenue and expenses for the Home Office. Any intracompany profits or losses are eliminated.

2.4) Illustrative Transactions and Financial Statements for the Branch and HO

Illustration* 2.2**: Assume **JIMMA TRADING Company** bills merchandise to **AGARO Branch at Home Office cost** and that **AGARO Branch** maintains complete accounting records and prepares financial statements. *Both the Home Office and the branch use the perpetual inventory system.** Equipment used at the branch is carried in the Home Office accounting records. Certain expenses, such as advertising and insurance, incurred by the Home Office on behalf of the branch, are billed to the branch. Transactions and events during the first year (2005) of operations of AGARO Branch are summarized below (start-up costs are disregarded):

1. Cash of Br 1,000 was forwarded by the Home Office to AGARO Branch.
2. Merchandise with a Home Office cost of Br 60,000 was shipped by the Home Office to AGARO Branch.
3. Equipment was acquired by AGARO Branch for Br 500, to be carried in the Home Office accounting records. (Other plant assets for AGARO Branch generally are acquired by the Home Office.)
4. Credit sales by AGARO Branch amounted to Br 80,000; the branch's cost of the merchandise sold was Br 45,000.
5. Collections of trade accounts receivable by AGARO Branch amounted to Br 62,000.
6. Payments for operating expenses by AGARO Branch totaled Br 20,000.
7. Cash of Br 37,500 was remitted by AGARO Branch to the Home Office.
8. Operating expenses incurred by the Home Office and charged to AGARO Branch totaled Br 3,000.

These transactions and events are recorded by the Home Office and by AGARO Branch as follows (explanations for the journal entries are omitted):

Typical Home Office and Branch Transactions and Events under Perpetual Inventory System	
Home Office Accounting Records Journal Entries	**AGARO Branch Accounting Records Journal Entries**
1.	
2.	
3.	
4.	
5.	
6.	
7.	
8.	

If a branch obtains merchandise from outsiders as well as from the Home Office, the merchandise acquired from the Home Office may be recorded in a separate Inventory account from Home Office ledger account. In the Home Office accounting records, the **Investment in AGARO Branch** ledger account has a debit balance of Br 26,000 before the accounting records are closed and the branch net income of Br 12,000 (Br 80,000 – Br 45,000 – Br 20,000 – Br 3,000 = Br 12,000) is transferred to the Investment in AGARO Branch ledger account, as illustrated below:

Investment in AGARO Branch Account				
Date	Explanation	Debit	Credit	Balance
2005	Cash sent to branch.....	1,000		1,000 Dr
	Merchandise billed to branch at Home Office cost.....	60,000		61,000 Dr
	Equipment acquired by branch, account by HO.....		500	60,500 Dr
	Cash received from branch.....		37,500	23,000 Dr
	Operating expenses billed to branch.....	3,000		26,000 Dr

In the accounting records of **AGARO Branch**, the **Home Office ledger account** has a credit balance of Br 26,000 (before the accounting records are closed and the net income of Br 12,000 is transferred to the Home Office account), as shown bellow:

Home Office Account				
Date	Explanation	Debit	Credit	Balance
2005	Cash received from the office……		1,000	1,000 Cr
	Merchandise received from Home Office……		60,000	61,000 Cr
	Equipment Acquired……	500		60,500 Cr
	Cash Sent to Home Office……	37,500		23,000 Cr
	Operating expenses billed by Home Office……		3,000	26,000 Cr

2.5) Working Paper for Combined Financial Statements

A working paper for combined financial statements has three purposes:

1. To combine ledger account balances for like revenue, expenses, assets, and liabilities,
2. To eliminate any intracompany profits or losses, and
3. To eliminate the reciprocal accounts

Assume that the perpetual inventories of Br 15,000 (Br 60,000 – Br 45,000 = Br 15,000) at the end of 2005 for AGARO Branch had been verified by a physical count. The working paper for **JIMMA TRADING Company** is based on the transactions and events shown in the above illustration and additional assumed data for the Home Office trial balance. All the routine year-end adjusting entries are assumed to have been made, and the working paper is begun with the adjusted trial balances of the Home Office and AGARO Branch. Income taxes are disregarded in this illustration.

Note that the Br 26,000 debit balance of the Investment in AGARO Branch ledger account and the Br 26,000 credit balance of the Home Office account are the balances **before the respective accounting records are closed,** that is, before the Br 12,000 net income of AGARO Branch is entered in these two reciprocal accounts. In the Eliminations column, elimination (a) offsets the balance of the Investment in AGARO Branch account against the balance of the Home Office account. ***This elimination appears in the working paper only;*** it is not entered in the accounting records of either the Home Office or

AGARO Branch because the sole purpose of the working paper is to facilitate the preparation of combined financial statements.

2.5.1 Illustration on Combined Financial Statements

The following working paper provides the information for the combined financial statements (excluding a statement of cash flows) of **JIMMA TRADING Company** below.

JIMMA TRADING COMPANY WORKING PAPER FOR COMBINED FINANCIAL STATEMENTS OF HO AND AGARO BRANCH FOR YEAR ENDED DECEMBER 31, 2005 (PERPETUAL INVENTORY SYSTEM: BILLINGS AT COST)				
	Adjusted Trial Balance			
	Home Office	**Branch**	**Elimination**	**Combined**
	Dr (Cr)	Dr (Cr)	Dr (Cr)	Dr (Cr)
Income Statement				
Sales.....	(400,000)	(80,000)		(480,000)
Cost of Goods Sold.....	235,000	45,000		280,000
Operating Expenses.....	90,000	23,000		113,000
Net Income.....	75,000	12,000		87,000
Totals.....	-0-	-0-	-0-	-0-
Statement of Retained Earnings				
Retained Earnings, Jan.1,	(70,000)			(70,000)

2005.....				
Net Income from above.....	(75,000)	(12,000)		(87,000)
Dividends Declared.....	40,000			40,000
Retained Earnings, Dec.31,2005.....				(117,000)
Totals.....				-0-
Balance Sheet				
Cash.....	25,000	5,000		30,000
Trade Accounts Receivables.....	39,000	18,000		57,000
Inventories.....	45,000	15,000		60,000
Investment in AGARO Branch.....	26,000		***(a)*** (26,000)	
Equipment.....	150,000			150,000
Accumulated Depreciation..	(10,000)			(10,000)
Trade Accounts Payable.....	(20,000)			(20,000)
Home Office.....		(26,000)	***(a)*** 26,000	
Common Stock, Br 10 par...	(150,000)			(150,000)
Retained Earnings from above.....				(117,000)
Totals.....	-0-	-0-	-0-	-0-

(a) To eliminate reciprocal ledger account balances

Combined Income Statement

JIMMA TRADING COMPANY Combined Income Statement For Year Ended December 31, 2005	
Sales.....	Br 480,000
Cost of goods sold.....	280,000
Gross margin on sale.....	Br 200,000
Operating expenses.....	113,000
Net income.....	Br 87,000
Basic earnings per share of common stock.....	Br 5.80

Statement of Retained Earnings

JIMMA TRADING COMPANY Statement of Retained Earnings For Year Ended December 31, 2005	
Retained earnings, beginning of year.....	Br

	70,000
Add: Net income.....	87,000
Subtotal.....	Br 157,000
Less: Dividends (Br 2.67 per share).....	40,000
Retained earnings, end of year.....	Br117,000

Balance Sheet

JIMMA TRADING COMPANY **Balance Sheet** **December 31, 2005**	
Assets:	
Cash.....	Br 30,000
Trade accounts receivable (net).....	57,000
Inventories.....	60,000
Equipment Br150,000	
Less: Accumulated depreciation..... 10,000	140,000
Total assets.....	**Br 287,000**
Liabilities & Stockholders' Equity:	
Liabilities	
Trade accounts payable	Br 20,000
Stockholders' equity	
Common Stock, Br 10 par, 15,000 shares authorized, issued, and outstanding..... Br150,000	
Retained earnings..... 117,000	267,000
Total liabilities & stockholders' equity.....	**Br 287,000**

2.5.2 Home Office Adjusting and Closing Entries and Branch Closing Entries

The Home Office's equity-method adjusting and closing entries for branch operating results and the branch's closing entries on December 31, 2005, are shown below (explanations for the entries are omitted):

Home Office Accounting Records Adjusting and Closing Entries			**AGARO Branch Accounting Records Closing Entries**		
None			Sales.....	80,000	
			Cost of Goods sold....		45,000
			Operating Expenses.....		23,000
			Income Summary.....		12,000
Investment in AGARO Branch.....	12,000		Income Summary.....	12,000	
Income: AGARO Branch.....		12,000	Home Office.....		12,000
Income: AGARO Branch.....	12,000		**None**		
Income Summary.....		12,000			

2.6) Billing of Merchandise to Branches at Prices above Home Office Cost

The Home Offices of some business enterprises bill merchandise shipped to branches at Home Office cost plus a markup percentage (or alternatively at branch retail selling prices). Because both these methods involve similar modifications of accounting procedures, a single example illustrates the key points involved, using the illustration for **JIMMA TRADING** Company one changed assumption: the Home Office bill merchandise shipped to AGARO Branch at a markup of **50% above Home Office cost**, or 33 1/3 % of billed price.

Under this assumption, the journal entries for the first year's events and transactions by the Home Office and AGARO Branch are the same as those presented on the journal entries for shipments of merchandise from the Home Office to AGARO Branch. These shipments (Br 60,000 Cost + 50% markup on cost = Br 90,000) are recorded under the perpetual inventory system as follows:

Home Office Accounting Records Journal Entries			**AGARO Branch Accounting Records Journal Entries**		
Investment in AGARO Branch.....	90,000.		Inventories.....	90,000	
Inventories.....		60,000	Home Office.....		90,000
AFOVI.....		30,000			

0	

In the accounting records of the Home Office, the Investment in AGARO Branch ledger account below now has a debit balance of Br 56,000 before the accounting records are closed and the branch net income or loss is entered in the Investment in AGARO Branch account. This account is Br 30,000 larger than the Br 26,000 balance in the prior illustration. The increase represents the 50% markup over cost (Br 60,000) of the merchandise shipped to the AGARO Branch.

Investment in AGARO Branch a/c				
Date	Explanation	Debit	Credit	Balance
2005	Cash sent to branch.....	1,000		1,000 Dr
	Merchandise billed to branch at 50% over cost.....	90,000		91,000 Dr
	Equipment acquired by branch, carried in HO.....		500	90,500 Dr
	Cash received from branch.....		37,500	53,000 Dr
	Operating expenses billed to branch.....	3,000		56,000 Dr

In the accounting records of AGARO Branch, ***the Home Office ledger account*** now has a credit balance of $56,000; before the accounting records are closed and the branch net income or loss is entered in the Home Office account, as illustrated below:

Home Office a/c				
Date	Explanation	Debit	Credit	Balance
2005	Cash received from the office.....		1,000	1,000 Cr
	Merchandise received from Home Office.....		90,000	91,000 Cr
	Equipment Acquired	500		90,500 Cr
	Cash Sent to Home Office.....	37,500		53,000 Cr
	Operating expenses billed by Home Office.....		3,000	56,000 Cr

AGARO Branch recorded the merchandise received from the Home Office at billed prices of Br 90,000; the Home Office recorded the shipment by credits

of Br 60,000 to Inventories and Br 30,000 to Allowance for Overvaluation of Inventories (AFOVI): AGARO Branch. Use of the allowance account enables the Home Office to maintain a record of the cost of merchandise shipped to AGARO Branch as well as the amount of the **unrealized gross profit** on the shipments.

At the end of the accounting period, AGARO Branch reports its inventories (at billed prices) at Br 22,500. The cost of these inventories is Br 15,000 (Br 22,500/1.50 = Br 15,000). In the Home Office accounting records, the required balance of the Allowance for Overvaluation of Inventories: AGARO Branch ledger account is Br 7,500 (Br 22,500 – Br 15,000 = Br 7,500); thus, this account balance must be reduced from its present amount of Br 30,000 to Br 7,500. The reason for this reduction is that *the 50% markup of billed prices over cost has become realized gross profit to the Home Office with respect to the merchandise sold by the branch***.** Consequently, at the end of the year the Home Office reduces its allowance for overvaluation of the branch inventories to the Br 7,500 excess valuation contained in the ending inventories. The debit adjustment of Br 22,500 in the allowance account is offset by a credit to the Realized Gross Profit: AGARO Branch Sales account, because it represents additional gross profit of the Home Office resulting from sales by the branch.

Working Paper When Billings to Branches Are at Prices above Cost

When a Home Office bills merchandise shipments to branches at prices above Home Office cost, preparation of the working paper for combined financial statements is facilitated by any analysis of the flow of merchandise to a branch, such as the following for **AGARO Branch** of **JIMMA TRADING Company**:

JIMMA TRADING COMPANY
Flow of Merchandise for AGARO Branch
During 2005

	Billed Price	HO Cost	Markup (50% of Cost)
Beginning Inventories	-0-	-0-	-0-
Add: Shipments from Home Office	Br 90,000	Br 60,000	Br 30,000
Available for Sale	Br 90,000	Br 60,000	Br 30,000
Less: Ending Inventories	22,500	15,000	7,500
Cost of Goods Sold	Br 67,500	Br 45,000	Br 22,500

The foregoing analysis provides in the Markup column the information needed for the Eliminations column in the working paper for combined financial statements below:

JIMMA TRADING COMPANY AND AGARO BRANCH Working Paper for Combined Financial Statements For The Year Ended December 31, 2005 (Perpetual Inventory System and Billings Above Cost)				
	Adjusted Trial Balances			
	Home Office	**Branch**	**Elimination**	**Combined**
	Dr (Cr)	Dr (Cr)	Dr (Cr)	Dr (Cr)
Income Statement				
Sales.....	(400,000)	(80,000)		(480,000)
Cost of Goods Sold.....	235,000	67,500	***(a)*** (22,500)	280,000
Operating Expenses.....	90,000	23,000		113,000
Net Income (loss).....	75,000	(10,500)	***(b)*** 22,500	87,000
Totals.....	-0-	-0-	-0-	-0-
Statement of Retained Earnings				
Retained Earnings, Jan.1, 2005.....	(70,000)			(70,000)
Net Income from above.....	(75,000)	10,500	***(b)*** (22,500)	(87,000)
Dividends Declared.....	40,000			40,000
Retained Earnings, Dec.31,2005.....				(117,000)
Totals.....				-0-
Balance Sheet				
Cash.....	25,000	5,000		30,000
Trade Accounts Receivables	39,000	18,000		57,000
Inventories.....	45,000	22,500	***(a)*** (7,500)	60,000
AFOVI.....	(30,000)		***(a)*** 30,000	
Investment in AGARO Branch.....	56,000		***(c)*** (56,000)	
Equipment.....	150,000			150,000
Accumulated Depreciation.....	(10,000)			(10,000)

Trade Accounts Payable…….	(20,000)			(20,000)
Home Office…….		(56,000)	***(c)*** 56,000	
Common Stock, Br 10 par…….	(150,000)			(150,000)
Retained Earnings from above…….				(117,000)
Totals…….	-0-	-0-	-0-	-0-

Elimination Journal Entries:

a) To reduce ending inventories and cost of goods sold of branch to cost, and to eliminate unadjusted balance of Allowance of Overvaluation of Inventories: AGARO Branch ledger account.

AFOVI……	30,000	
Cost of Goods Sold…….		22,500
Inventory……		7,500

(b) To increase income of Home Office by portion of merchandise markup that was realized by branch sales.

Unrealized Gross Profit……	22,500	
Realized Income: AGARO Branch……		22,500

(c) To eliminate reciprocal ledger account balances

Home Office……	56,000	
Investment in AGARO Branch….		56,000

The working paper above differs from the working paper when merchandise shipped at Home Office cost by the inclusion of an elimination to restate the ending inventories of the branch to cost. Also, the income reported by the Home Office is adjusted by the Br 22,500 of merchandise markup that was realized as a result of sales by the branch. This amount in the Eliminations column appears only in the working paper. The amounts represent a mechanical step to aid the preparation of combined financial statements and are not entered in the accounting records of either the Home Office or the branch.

Combined Financial Statements

Because the amounts in the Combined column of the working paper are the same as in the working paper prepared when the merchandise shipments to the branch were billed at Home Office cost, **the combined financial statements are identical** to those illustrated when merchandise is shipped at Home Office cost.

Home Office Adjusting and Closing Entries and Branch Closing Entries

The adjusting and closing entries are different. The **December 31, 2005**, adjusting and closing entries of the Home Office are illustrated below assuming the merchandise is shipped 50% above Home Office cost:

Home Office Accounting Records Adjusting and Closing Entries			
1.	Income: AGARO Branch (loss).....	10,500	
	Investment in AGARO Branch.....		10,500
To record net loss reported by branch			
2.	AFOVI: AGARO Branch.....	22,500	
	Realized Gross Profit.....		22,500
To reduce allowance to amount by which ending inventories of branch exceed cost			
3.	Realized Gross Profit: AGARO Branch Sales.....	22,500	
	Income: AGARO Branch.....		10,500
	Income Summary.....		12,000
To close branch net loss and realized gross profit to Income Summary account			

After the forgoing journal entries have been posted, the ledger accounts in the Home Office general ledger used to record branch operations are as follows:

Investment in AGARO Branch a/c				
Date	Explanation	Debit	Credit	Balance
2005	Cash sent to branch.....	1,000		1,000 Dr
	Merchandise billed to branch at 50% markup over cost.....	90,000		91,000 Dr
	Equipment acquired by branch, carried in HO.....		500	90,500 Dr
	Cash received from branch.....	37,500		53,000 Dr
	Operating expenses billed to branch.....	3,000		56,000 Dr
	Net loss for 2005 reported by branch.....		10,500	45,500 Dr

End-of-Period Balance in Accounting Records of the Home Office

Allowance for Overvaluation of Inventories: AGARO Branch

Date	Explanation	Debit	Credit	Balance
2005	Markup on merchandise shipped to branch During 2005 (50% of cost).....		30,000	30,000 Cr
	Realization of 50% markup on merchandise Sold by branch during 2005.....	22,500		7,500 Cr

Realized Gross Profit: AGARO Branch Sales

Date	Explanation	Debit	Credit	Balance
2005	Realization of 50% markup on merchandise sold by branch during 2005.....		22,500	22,500 Cr
	Closing Entries.....	22,500		-0-

Income: AGARO Branch

Date	Explanation	Debit	Credit	Balance
2005	Net loss for 2005 reported by branch.....	10,500		10,500 Dr
	Closing Entries.....		10,500	-0-.

In the **separate** balance sheet for the Home Office, the Br 7,500 credit balance of the Allowance for Overvaluation of Inventories: AGARO Branch ledger account is deducted from the Br 45,500 debit balance of the Investment in AGARO Branch account, thus reducing the carrying amount of the investment account to a cost basis with respect to shipments of merchandise to the branch. In the **separate** income statement for the Home Office, the Br 22,500 realized gross profit on AGARO Branch sales may be displayed following gross margin on sales, Br 165,000 (Br 400,000 sales – Br 235,000 cost of goods sold = Br 165,000).

The closing entries for the branch at the end of 2005 are as follows:

AGARO Branch Accounting Records Closing Entries		
Sales.....	80,000	
Income Summary.....	10,500	
Cost of Goods Sold.....		67,500

		0
Operating Expenses.....		23,000
To close revenue and expense ledger accounts		
Home Office.....	10,500	
Income Summary.....		10,500
To close the net loss in the Income Summary account to the HO account.		

After these closing entries have been posted by the branch, the following Home Office ledger account in the accounting records of AGARO Branch has a credit balance of Br 45,500, the same as the debit balance of the Investment in AGARO Branch account in the accounting records of the Home Office:

Home Office				
Date	Explanation	Debit	Credit	Balance
2005	Cash received from the office.....		1,000	1,000 Cr
	Merchandise received from Home Office cost.....		90,000	91,000 Cr
	Equipment acquired.....	500		90,500 Cr
	Cash sent to Home Office.....	37,000		53,000 Cr
	Operating expenses billed to branch.....		3,000	56,000 Cr
	Net loss for 2005.....	10,500		45,500 Cr

2.7) Treatment of Beginning Inventories Priced above Cost

The working paper shows how the ending inventories and the related allowance for overvaluation of inventories were handled. However, because 2005 was the first year of operations for AGARO Branch, no beginning inventories were involved.

Perpetual Inventory System

Under the perpetual inventory system, no special problems arise when the beginning inventories of the branch include an element of unrealized gross profit.

Periodic Inventory System

To continue the illustration for **JIMMA TRADING Company** for a second year of operations (2006) to demonstrate the handling of beginning inventories carried by AGARO Branch at an amount above Home Office cost, assume that both the Home Office and AGARO Branch adopted the periodic inventory system in 2006. When the periodic inventory system is used, the Home Office credits **Shipments to Branch** (**an offset account to Purchases**) for the Home Office cost of merchandise shipped and **Allowance for Overvaluation of Inventories for the Markup** over Home Office cost. The branch debits **Shipments from Home Office** (*analogous to a Purchase account*) for the billed price of merchandise received.

The beginning inventories for year 2006 were carried by AGARO Branch at Br 22,500, or 150% of the cost of Br 15,000 (Br 15,000 @ 1.50 = Br 22,500). Assume that during 2006 the Home Office shipped merchandise to AGARO Branch that cost Br 80,000 and was billed at Br 120,000, and that AGARO Branch sold for Br 150,000 merchandise that was billed at Br 112,500. The journal entries to record the shipments and sales under the periodic inventory system are illustrated below:

Home Office Accounting Records Journal Entries			**AGARO Branch Accounting Records Journal Entries**		
Investment in AGARO Branch.....	120,000		Shipments from HO.....	120,000	
Shipment to AGARO Branch.....		80,000	Home Office.....		120,000
AFOVI: AGARO Branch.....		40,000			
None			Cash or Trade Accounts Rec.....	150,000	
			Sales.....		150,000

The inventories in a branch at the end of 2006 amounted to Br 30,000 at billed prices, representing cost of Br 20,000 plus a 50% markup on cost (Br 20,000 @ 1.5 = Br 30,000). The flow of merchandise for AGARO Branch during 2006 is summarized below:

JIMMA TRADING COMPANY **Flow of Merchandise for AGARO Branch** **During 2006**			
	Billed Price	HO Cost	Markup (50% of cost; 33.33% of Billed Price)
Beginning inventories.....	Br 22,500	Br 15,000	Br 7,500
Add: Shipments from	120,000	80,000	40,000

HO.....			
Available for sale.....	Br 142,500	95,000	Br 47,500
Less: Ending inventories.....	(30,000)	(20,000)	(10,000)
Cost of goods sold .....Br...	Br 112,500	Br 75,000	Br 37,500

The activities of the branch for 2006 and end-of-period adjusting and closing entries are reflected in the four Home Office ledger accounts below.

- Investment in Branch Account

Investment in AGARO Branch Account				
Date	Explanation	Debit	Credit	Balance
2006	Balance, Dec. 31, 2005.....			45,500 Dr
	Merchandise billed to branch at markup of 50%.....	120,000		165,500 Dr
	Cash received from branch.....		113,000	52,500 Dr
	Operating expenses billed to branch.....	4,500		57,000 Dr
	Net income for 2006 reported by branch.....	10,000		67,000 Dr

- Allowance for Over Valuation of Inventories

Allowance for Overvaluation of Inventories: AGARO Branch				
Date	Explanation	Debit	Credit	Balance
2006	Balance, Dec. 31, 2005.....			7,500 Cr
	Markup on merchandise shipped to branch During 2006 (50% of cost).....		40,000	47,500 Cr
	Realization of 50% markup on merchandise Sold by branch during 2006.....	37,500		10,000 Cr

- Realized Gross Profit

Realized Gross Profit: AGARO Branch Sales				
Date	Explanation	Debit	Credit	Balance
2006	Realization of 50% markup on merchandise sold by branch during		37,50	37,500

	2005.....		0	Cr
	Closing Entries.....	37,500		-0-

- Investment Income

Investment Income: AGARO Branch				
Date	Explanation	Debit	Credit	Balance
2006	Net income for 200 reported by branch.....		10,000	10,000 Cr
	Closing Entries.....	10,000		-0-

In the accounting records of the Home Office at the end of 2006, the balance required in the Allowance for Overvaluation of Inventories: AGARO Branch ledger account it Br 10,000, that is, the billed price of Br 30,000 less cost of Br 20,000 for merchandise in the branch's ending inventories. Therefore, the allowance account balance is reduced from Br 47,500 to Br 10,000. This reduction of Br 37,500 represents the 50% markup on merchandise above cost that was realized by AGARO Branch during 2006 and is credited to the Realized Gross Profit: AGARO Branch Sales account.

Home Office a/c				
Date	Explanation	Debit	Credit	Balance
2005	Balance, Dec. 31, 2005.....			45,500 Cr
	Merchandise received from HO.....		120,000	165,500 Cr
	Cash sent to Home Office.....	113,000		52,500 Cr
	Operating expenses billed by HO.....		4,500	57,000 Cr
	Net income for 2006.....		10,000	67,000 Cr

The working paper for combined financial statements under the periodic inventory system, which reflects pre-adjusting and pre-closing balances for the reciprocal ledger accounts and the Allowance for Overvaluation of Inventories are as follows:

JIMMA TRADING COMPANY
Working Paper for Combined Financial Statements of Home Office and AGARO Branch
For Year Ended December 31, 2006
(Periodic Inventory System: Billings above Cost)

	Adjusted Trial Balance		Elimination	Combined
	Home Office	Branch		
	Dr (Cr)	Dr (Cr)	Dr (Cr)	Dr (Cr)
Income Statement				
Sales.....	(500,000)	(150,000)		(650,000)
Inventories, Dec.31, 2005…	45,000	22,500	***(b)*** (7,500)	60,000
Purchases.....	400,000			400,000
Shipments to AGARO Branch.....	(80,000)		***(a)*** 80,000	
Shipments from Home Office.....		120,000	***(a)*** (120,000)	
Inventories, Dec.31, 2006…	(70,000)	(30,000)	***(c)*** 10,000	(90,000)
Operating Expenses.....	120,000	27,500		147,500
Net Income (loss).....	85,000	10,000	***(d)*** 37,500	132,500

Totals.....	-0-	-0-	-0-	-0-
Statement of Retained Earnings				
Retained Earnings, Dec.31, 2005.....	(117,000)			(117,000)
Net Income from above.....	(85,000)	(10,000)	***(d)*** (37,500)	(132,500)
Dividends Declared.....	60,000			60,000
Retained Earnings, Dec.31,2005.....				(189,500)
Totals.....				-0-
Balance Sheet				
Cash.....	30,000	9,000		39,000
Trade Accounts Receivables(net)	64,000	28,000		92,000
Inventories (Dec.31, 2006).....	70,000	30,000	***(c)*** (10,000)	90,000
AFOVI: AGARO Branch.....	(47,500)		***(a)*** 40,000 ***(b)*** 7,500	
Investment in AGARO Branch.....	57,000		**(e)** (57,000)	
Equipment.....	158,000			158,000
Accumulated Depreciation..	(15,000)			(15,000)
Trade Accounts Payable.....	(24,500)			(24,500)
Home Office.....		(57,000)	***(e)*** 57,000	
Common Stock, Br 10 par...	(150,000)			(150,000)
Retained Earnings from above.....				(189,500)
Totals.....	-0-	-0-	-0-	-0-

(a) To eliminate reciprocal ledger accounts for merchandise shipments
(b) To reduce beginning inventories of branch to cost
(c) To reduce ending inventories of branch to cost
(d) To increase HO income of by portion of merchandise markup that was realized by branch sales
(e) To eliminate reciprocal ledger account balances

2.8) Reconciliation of Reciprocal Ledger Accounts

At the end of an accounting period, the balance of the Investment in Branch ledger account in the accounting records of the Home Office may not agree with the balance of the Home Office account in the accounting records of the branch because certain transactions may have been recorded by **one office** but not by **the other office.** The situation is comparable to that of reconciling

the ledger account for Cash in Bank with the balance in the Monthly Bank Statement. The lack of agreement between the reciprocal ledger account balances causes no difficulty during an accounting period, but at the end of each period the reciprocal account balances must be brought into agreement before combined financial statements are prepared.

Illustration 2.3:
As an illustration of the procedure for reconciling reciprocal ledger account balances at year-end, assume that the Home Office and branch accounting records of Mercy Company and its branch Arvin Branch contain the following data on December 31, 2003:

Accounting Records of Home Office

Investment in Arvin Branch				
Date	Explanation	Debit	Credit	Balance
2003				
Nov. 30	Balance (BBF).....			62,500 Dr
Dec. 10	Cash received from branch.....		20,000	42,500 Dr
27	Collection of branch trade accounts receivable.....		1,000	41,500 Dr
29	Merchandise shipped to branch.....	8,000		49,500 Dr

Accounting Records of Arvin Branch

Home Office Account				
Date	Explanation	Debit	Credit	Balance
2003				
Nov. 30	Balance (BBF).....			62,500 Cr
Dec. 10	Cash sent to Home Office.....	20,000		42,500 Cr
27	Acquired equipment	3,000		39,500 Cr
29	Collection of HO trade accounts receivable.....		2,000	41,500 Cr

There might be a number of reconciling items between Investment in Branch and Home Office accounts. These are: -

- Inventories may be in-transit
- Trade Accounts Receivables of Branch may be collected by Home Office
- Branches may acquire plant assets to be maintained by HO without the knowledge of HO

- Trade Accounts Receivables of the Home Office may be collected by the Branches

Comparison of the two reciprocal ledger accounts discloses four reconciling items, describing as follows:

1. A debit of Br 8,000 in the Investment in Arvin Branch ledger account without a related credit in the Home Office account.

On December 29, the Home Office shipped merchandise costing Br 8,000 to the branch. The Home Office debits its reciprocal ledger account with the branch on the date merchandise is shipped, but the branch credits its reciprocal ledger account with the branch on the date merchandise is shipped, but the branch credits it reciprocal account with the Home Office when the merchandise is received a few days later. The required journey entry on December 31, 2003, in the **branch accounting records**, assuming use of the perpetual inventory system, appears below:

Inventories in Transit.....	8,000	
Home Office.....		8,000

To record shipment of merchandise in transit from Home Office

In taking a physical inventory on December 31, 2003, the branch must add to the inventories on hand the Br 8000 of merchandise in transit. When the merchandise is received in 2004, the branch debits Inventories and credits Inventories in Transit.

2. A credit of Br 1,000 in the Investment in Arvin Branch ledger account without a related debit in the Home Office account.

On December 27, trade accounts receivables of the branch were collected by the Home Office. The collection was recorded by the Home Office by a debit to Cash and a credit to Investment in Arvin Branch. No journal entry was made by Arvin Branch; therefore, the following journal entry is required **in the accounting records of Arvin Branch** on December 31, 2003:

Home Office.....	1,000	
Trade Accounts Receivable.....		1,000

To record collection of account receivable by Home Office

3. A debit of Br 3,000 in the Home Office ledger account without a related credit in the Investment in Arvin Branch account.

On December 28, the branch acquired equipment for Br 3,000. Because the equipment used by the branch is carried in the accounting records of the Home Office. The journal entry made by the branch was a debit to Home Office and a credit to Cash. No journal entry was made by the Home Office;

therefore, the following journal entry is required on December 31, 2003, *in the accounting records of the Home Office*:

Equipment: Arvin Branch.....	3,000	
Investment in Arvin Branch.....		3,000

To record equipment acquired by branch.

4. A credit of Br 2,000 in the Home Office ledger account without a related debit in the Investment in Arvin Branch account.

On December 30, trade accounts receivables of the Home Office were collected by Arvin Branch. The collection was recorded by Arvin Branch by a debit to Cash and a credit to Home Office. No journal entry was made by the Home Office; therefore, the following journal entry is required *in the accounting records of the Home Office* on December 31, 2003:

Investment in Arvin Branch.....	2,000	
Trade Accounts Receivable.....		2,000

To record collection of accounts receivable by Arvin Branch.

The effect of the foregoing end-of-period journal is to update the reciprocal ledger accounts, as shown by the following reconciliation:

MERCY COMPANY-HOME OFFICE AND ARVIN BRANCH
Reconciliation of Reciprocal Ledger Accounts
December 31, 2003

	Investment in Arvin Branch Account	**Home Office Account**
Balances before adjustments.....	Br 49,500 Dr	Br 41,500 Cr
Add: (1) Merchandise shipped to branch by HO.....		8,000
(4) HO trade A/Rec collected by Branch.....	2,000	
Less: (2) Branch A/Rec collected by HO.		(1,000)
(3) Equipment acquired by branch	(3,000)	
Adjusted balances.....	Br 48,500 Dr	Br 48,500 Cr

2.9) Transactions between Branches

Efficient operations may on occasion require that merchandise or other assets be transferred from one branch to another. Generally, a branch does not carry

a reciprocal ledger account with another branch but records the transfer in the Home Office ledger account. For example, if MODJO Branch ships merchandise to **ADAMA Branch**, **MODJO Branch** debits Home Office and credits Inventories (assuming that the perpetual inventory system is used). On receipt of the merchandise, **ADAMA Branch** debits Inventories and credits Home Office. The Home Office records the transfer between branches by a debit to Investment in **ADAMA** Branch and a credit to Investment in **MODJO** Branch.

The transfer of merchandise form one to another does not justify increasing the carrying amount of inventories by the freight costs incurred because of the indirect routing. The amount of freight costs properly included in inventories at a branch is limited to the cost of shipping the merchandise ***directly*** from the Home Office to its present location. **Excess freight costs** are recognized as expenses of the Home Office.

Illustration 2.4:
To illustrate the accounting **for excess freight** costs on inter-branch transfers of merchandise, assume the following for excess freight costs on interbranch transfers of merchandise, assume the following data. The **Home Office** shipped merchandise costing Br 6,000 to Dana Branch and paid freight costs of Br 400. Subsequently, the Home Office instructed Dana Branch to transfer this merchandise to Evan Branch. Freight costs of Br 300 were paid by Dana Branch to carry out this order. If the merchandise had been shipped directly from the Home Office to Evan Branch, the freight costs would have been Br 500. The journal entries required in the three sets of accounting records (assuming that the perpetual inventory system is used) as follows:

1. In the Accounting Records of Home Office:

Investment in Dana Branch.....	6,400	
Inventories.....		6,000
Cash.....		400

To record shipment of merchandise and payment of freight costs

Investment in Evan Branch.....	6,500	
Excess Freight Cost–Interbranch Transfer Expense.....	200	
Investment in Dana Branch.....		6,700

To record transfer of merchandise from Dana Branch to Evan Branch under instruction of Home Office

Interbranch freight of Br 300 paid by Dana Branch caused total freight costs on this merchandise to exceed direct shipment cost by Br 200 (Br 400 + Br 300 – Br 500 = Br 200).

2. In the Accounting Records of Dana Branch:

Inventories	6,000	
Freight-In	400	
Home Office		6,400

To record receipt of merchandise from Home Office with freight costs paid in advance by Home Office.

Home Office	6,700	
Inventories		6,000
Freight In		400
Cash		300

To record transfer of merchandise to Evan Branch under instruction of Home Office and payment of freight costs of Br 300.

3. In Accounting Records of Evan Branch:

Inventories	6,000	
Freight In	500	
Home Office		6,500

To record transfer of merchandise to Evan Branch under instruction of Home Office and Normal freight costs billed by Home Office.

Recognized excess freight costs on merchandise transferred from one branch to another as expenses of the Home Office is an example of the accounting principle that expense and losses should be given prompt recognition. The excess freight costs from such shipments generally result from inefficient planning of original shipments and should not be included in inventories.

In recognizing excess freight costs of interbranch transfer as expenses attributable to the Home Office, the assumption was that the Home Office makes the decisions directing all shipments. If branch managers are given authority to order transfers of merchandise between branches, the excess freight costs are recognized as expenses attributable to the branches whose managers authorized the transfers.