Inter- and Intra- Company with Multiple Balancing Segments.

It seems to be difficult to enter, balance and eliminate inter- and intra- company transactions when there are multiple balancing segments in a chart of accounts. It need not be so.

Contents

Scope

This document is limited to a discussion of balancing inter and intra companies in software ledgers that support multiple balancing segments, such as Oracle's General Ledger Cloud Service.

Terminology

Let's look at the terminology and make some distinctions.

Inter-Company & Ownership

Inter-company is a phrase used by the FASB and IFRS to refer to updates of legal ownership between legal entities under common ownership or control. The words mean "between companies".

- Legal Entities are companies and other legally defined entities like government agencies who have been granted property rights and the right to enter into contracts (rights to hold title, that is, to own, and rights to buy and to sell) by their charter legislation, as opposed to management entities that have not been granted property or contracting rights. In addition to property rights, legal entities can have other rights, but generally do not have the same rights as citizens or residents.
- Legal entities, and only legal entities, can own cash, receivables, inventory, investments, other legal entities, and other assets, and are obliged to meet their debts. Legal entities' trades are all about "ownership" – LEs either acquire or relinquish ownership in their transactions.
- Because they have these property rights, legal entities really own, buy, and sell things and collect and disburse cash. Management entities, who have not been granted property rights by the government, don't own anything, and technically cannot buy or sell anything, although they do arrange and are responsible for the transactions and their content.
- When legal entities transfer legally owned property to other legal entities in the same group of companies, that and only that is "inter-company" in terms of "technical accounting". Inter-company is all about updating "legal ownership".
- Occasionally, one LE will act as an agent for another, selling or buying things it doesn't own, or sell through a legally recognized branch. These are special cases.

Intra-Company & Responsibility

Intra-company is a phrase used to discuss updates of management responsibility. Management individuals are classified by management organizations and are responsible and accountable for successfully creating transactions that increase the ownership of the legal entities. They "own" the transactions in the sense of being responsible for them, but not in the legal sense.

The words intra-company mean "within a company". An intra-company update implies that one team of employees in the company that owns an item has been made responsible for the item, rather than another team.

Inter and Intra together

Every update of ownership within a group carries a change in responsibility. The managers employed by the selling legal entity are no longer responsible for the item sold, and managers in the buying legal entity are assigned responsibility. This is true even when the managers in both organizations report to the same worldwide organization. The responsibility also often changes on a wider basis on a transfer of ownership. A sale of inventory from a manufacturing company to a sales subsidiary will involve a shift of responsibility from "manufacturing" to "marketing", for example.

Balancing Segment

A chart of accounts (list of accounts in a General Ledger) is a way of tagging transactions so that they can be classified by owner, responsibility, function, nature and other attributes. Detailed transactions are aggregated by these tags. The different tag types are called segments, and each segment has a list of values, one value for each "tag" in that segment. Company codes are a fine example of tags.

A balancing segment is a segment where the debits and credits always equal each other within a given value (BSV). Software makes this happen by creating a due-to and due-from entry within each value when the user writes an entry that crosses values.

Example

Say you transferred $1,000 from one company to another in a software ledger that served both.

You wrote an entry that credited company 100, cash for $1000, and debited company 200, cash for the same amount. Your software would add two lines to the journal, as shown in red, so that both companies had a complete set of debits and credits and therefore balanced:

Company	Natural Account	Debit	Credit
BSV	Nature	$	$
100	Cash		1,000
100	Due from Co. 200	1,000	
200	Due to Co. 100		1,000
200	Cash	1,000	

As the company codes in the illustration are company (LE) Codes, this example is a basic inter-company entry, updating ownership. Were they not company codes but division codes, it would instead be a basic intra-company entry, updating responsibility.

Balancing segments are used where you need to track equity and a complete balance sheet and income statement.

- Legal entities are often required by their charter law to file reports with company authorities and must keep a balanced book of record tracking their ownership. Even those that aren't required to file standalone reports tend to keep a balanced book so the that the overall group can measure its wealth and the change in its equity.
- Certain management entities and equity sensitive businesses, including those driving incentive compensation, like to measure the equity for which a management team was responsible.

EBS Deployment

Oracle EBS accommodates one balancing segment and many regular segments. EBS does not support multiple balancing segments.

The recommended deployment is to use the balancing segment for ownership by legal entities and regular segments for management responsibility. When people need the management responsibility to balance, they would either:

1. Use a regular segment and, manually or by using allocations, enter macro level balancing entries like the red lines above, or
2. Overload the balancing segment by using "smart numbers" that concatenated company codes and values from the implicit management segment, and by exploding the resulting trial balances to calculate and derive the legal and ownership balances.

The Cloud Service

The Oracle General Ledger Cloud Service addressed this issue by providing multiple balancing segments. There is one primary balancing segment, and there are two secondary balancing segments. The primary balancing segment can be echoed in the Intercompany Segment.

It is strongly recommended that you use the primary balancing segment to track legal ownership through the legal owner, the legal entity – that is, GAAP or IFRS recognition of ownership – and use the other segments for management purposes.

Folk are often intimidated by the idea of the secondary balancing segments, particularly those who have been accustomed to the EBS approach. They are concerned that they will generate a great number of transactions. People are also concerned as to how to balance and eliminate responsibility accounting balances.

How To Make It Work

While relatively new to Oracle – the feature was introduced some ten years ago – it is not at all new in business. There is a long tradition of revising management responsibility at the same time as you update legal ownership and GAAP recognition.

The Ideas Behind This Approach

Although you don't manage by legal entity, you do own by legal entity.
Although you do manage by management entity, you don't own by management entity.

So, let's distinguish between (a) the legal ownership transaction as the formal sale and purchase that it is, and (b) the responsibility update as a de-assignment and re-assignment to potentially, but not always, new managers.

This perspective worked before computers did, and it worked on mainframes, on mid-sized computers, on client server, on Unix & Linux boxes, and it will in the cloud.

The Approach

The approach is (a) to acknowledge the stripping of responsibilities from the providing LE's staff before making the sale, then (b) to make the sale and buy, without any responsibility transfer, and (c) finally, to have the second LE, once it has acquired ownership, assign the appropriate responsibility to its staff. This series of actions can be largely automated.

1. Before selling (de-recognizing an LE's ownership) a service or a product (the content) to a sister company, clear the management attribution associated with the content from it.
2. Execute the sale – transfer ownership to the recipient LE, recording an inter-company receivable.
3. At the acquiring company, record the buy, that is, the recognition of the new ownership of the content, and record a liability to the selling company.
4. Attribute management responsibility to the content as appropriate for the buying company.

The Advantages

1. Intercompany activity is separated from intra-company activity and is limited to true updates of legal ownership.
    a. This facilitates LE derivation during the close, improving close speed.
    b. It dramatically reduces the number of cross-book transactions, also improving close speed.
    c. Inter-company reconciliation is simplified, speeding the close by reducing the volume of work done during the close.
    d. Inter-company elimination is simplified, also speeding the close.
2. Intra-company activity is confined to individual Legal Entities. The selling company eliminates its own internal intra-company, and the buying company does likewise. There are no intra-company account balances on the legal entities' consolidated trial balances.
    a. Intra-company reconciliation is executed by the LE controller, not the consolidation controller, that is, where the knowledge is, thus speeding the close.
    b. It is not assumed that the selling company will understand the bookkeeping requirements of the buying company, reducing the risk of error.
    c. The process can be largely automated, also reducing risk of error:
        i. At the selling company, by availing of the standard balancing segment features (described earlier)
        ii. At the buying company, by using Sub-Ledger Accounting (SLA) as configured and implemented in Accounts Payable, along with the GL & SLA balancing feature.

A Little Detail

Before selling goods or services to a sister company, you can strip the accounting attributes tagged in the secondary balancing segments by intra-company updating them to common values that mean "no value". There are different ways to do this, depending on how you designed your chart of accounts, and the processes involved.

One Example Technique

- The Group defines a value in each secondary segment that means "for intra-company use", for example, 999, or blank, or 000. Let's call it the common segment value. One might consider it to mean "Corporate", but it really means "none" or "nobody".
- Each LE includes that value in their available list of values. Its use is limited to "intra-company".
- As part of the sale or sale preparation, the selling company transfer the goods or services to that common intra-company balancing segment value in each secondary balancing segment, using the common "Not-a-real receivable or payable"" account.
    - In the common intra-company account at the selling company, the transfer-in from the original account (e.g., inventory) is offset by the transfer-out to the intercompany account, nets to zero, and is reported as a zero-balance account.
    - The inter-company transaction then carries the common value to the buying company.
    - The buying company posts the acquisition of the goods and services to the values they need to use in the secondary balancing segments.
        - The balancing feature again works to create a zero-value internal account.

- The Group either
    - Ignores the common balancing segments value in analysis or reporting
    - Exploits it for some reason.

Automation

The possibility of automation in these cases can be a function of the process involved. The initial entry removing the local attributes at the source can be handled by the standard SLA (XLA) & GL balancing feature, and never includes any profit mark-up issues, as it within the legal entity.

The second entry from the Intra-account to the Inter-account must be addressed by the functionality one is using to generate the intercompany transaction.

At the receiver company, the entry from the intercompany account to the intra company account can be set-up using the intercompany functionality, and the management attribution can be handled by SLA's balancing feature.

Example

Our friends at Vision Farms operate a farm in Upstate New York, incorporated as New York Farms LLC, and managed by the Upstate Farmer team. A high-quality farm, its products are branded as Vision Organic.

New York Farms LLC transfer $1M worth of goods and services to another Vision company, Vision New York City Retail LLC, who operate stores in NYC and on Long Island, and is managed, of course, by the New York Grocery management team. These particular goods and services are destined for the Vision Convenience brand, sold through small stores at subway and LIR stations, where you can pick up fresh, healthy food on your way to and from the office in Manhattan. (City Retail view them as a Convenience Store sale, while New York Farms viewed then as an Organic sale.)

Vision tracks the ownership by LE in a primary balancing segment, their management teams in the first secondary balancing segment, and the brands in the second secondary balancing segment. The secondary balancing segments each have a 999 "common" value. Intra-company receivable & payables are all posted to a natural account called "Intra-charge". Inter-company business is charged to intercompany AR and AP accounts with the counter-party company code in an intercompany segment, for balancing & elimination.

Trial Balance Extract
debit | (credit)

		Balancing Segments:	Primary	First Secondary		Second Secondary		Primary	First Secondary		Second Secondary	
Activity	Natural Account	*Usage*	LE/Company	Management		Brand		LE/Company	Management		Brand	
		Tag Meaning	Owner: NY Farms LLC	Upstate Farmer	Corp	Vision Organic	Corp	Owner: NYC Retail LLC	NYC Grocery	Corp	Vision Convenience	Corp
		Value	14	175	999	315	999	25	482	999	523	999
	Content Opening Balance		1,000,000	1,000,000		1,000,000						
Strip original attributes	Tfr to Intra 14 account / 175-			(1,000,000)	1,000,000	(1,000,000)	1,000,000					
	Interim Balance		1,000,000	0	1,000,000	0	1,000,000					
Transfer to other LE	Tfr to 14-Intercompany-25		(1,000,000)		(1,000,000)		(1,000,000)					
	From #14: 25-intercompany-							1,000,000		1,000,000		1,000,000
	Interim Balance		0	0	0	0	0	1,000,000	0	1,000,000	0	1,000,000
Assign buying co's attributes	Tfr to Intra 25 Account / 482								1,000,000	(1,000,000)	1,000,000	(1,000,000)
	Final Balance		0	0	0	0	0	1,000,000	1,000,000	0	1,000,000	0

Figure 1 Ownership update with Responsibility Revision

This is an extended trial balance format. The columns represent the owners and managers. The horizontal lines include the T-accounts.

1. The illustration does not assign account numbers to natural accounts. Assuming a common chart of accounts, this text will use the following:
   Inventory-4500; IntraCo Balances-9999; interco receivables-3500; interco payables-8500
2. In the beginning, $1,000,000 is coded to 14-175-315-4500 (inventory owned by Co. 14, attributed to 175 and 315.)
3. Intra Company balancing credits it there and debits it to 14-999-999-9999 (Intra Balances)
4. Inter Company accounting credits it to 14-999-999-9999, balancing 9999, and…
5. Debits it the intercompany receivable 14-999-999-3500-25, 14's intercompany receivable from 25.
6. On their trial balance, company 14 reports no inventory, nothing in 175 or 315, and nothing in 999, 999 or in 9999, and an intercompany receivable in 14-999-999-3500-25
7. On receipt of the charge, Company 25 credits the intercompany payable 25-999-999-8500-14
8. And debits 25-999-999-9999, in the intra company "common" account
9. Intracompany credits the "common account" 25-999-999-9999, thereby balancing it, and debits whatever management team and natural account is appropriate: 25-482-523-xxxx (in this case 4500 for inventory.)
10. On their trial balance, company 25 reports owning inventory, attributed to 482 and 523, and nothing in 999, 999 or in 9999, and an intercompany payable in 25-999-999-8500-14
11. In consolidation, there are no balances in 14-175 or 14-315. There is no balance in 14-4500. There are no balances in 9999, or in 999 or 999.
12. 14 does show a receivable from a sister company in 14-999-999-3500-25.
13. 25 does show a payable to a sister company in 25-999-999-8500-14
14. These obviously (14-25 versus 25-14) match and eliminate.
15. 25's inventory in 25-3500 is on the Group balance sheet as owned through subsidiary company 25 and is attributed to the management teams 482 and 523.
16. The account 9999 has a zero balance on both trial balances and therefore on the group.
17. The management attributes 999 and 999 in both companies have zero currency values.

Ending Positions

	LE/Company (Ownership)		
LE Name:	NY Farms	NYC Retail	Group
LE Number/value	14	25	all
Content Owned	0	1,000,000	1,000,000
Inter-Company	(1,000,000)	1,000,000	0

	Management (Responsibility)		
Management Name	Upstate	NYC	Corp
Mgmt #/Value	175	482	999
Responsible for Content	0	1,000,000	0

	Brand (Classification)		
Brand Name	Organic	Convenience	Corp
Brand #/Value	315	523	999
Content Classified as	0	1,000,000	0

Figure 2 Net Position after inter-intra update

There are other approaches to managing ownership and responsibility accounting together. This one has been tested by time and practice, and very much reflects the underlying principles.

Thank you

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