B.COM II SEMESTER

FINANCIAL ACCOUNTING II

THEORY NOTES

# BILLS OF EXCHANGE

## Meaning of a Bill of Exchange

A Bill of Exchange is a written, unconditional order made by one person (the drawer) directing another person (the drawee) to pay a certain sum of money to a third person (the payee) or to the bearer of the instrument.

It is commonly used in credit transactions to ensure legal proof of debt and definite payment on a due date.

A bill of exchange helps in settling business transactions by providing security of payment, evidence of credit sales, and legal enforceability.

## PARTS / PARTIES OF A BILL OF EXCHANGE

1. Drawer

- The person who prepares and signs the bill.
- Usually the seller or creditor.
- He orders the drawee to pay the amount.

2. Drawee

- The person on whom the bill is drawn.
- Usually the buyer or debtor.
- He accepts the bill, promising to pay on the due date.

3. Payee

- The person who will receive the money.
- Can be the drawer himself or a third party.

4. Endorser

- If the payee transfers the bill to someone else, he becomes an endorser.

5. Endorsee

- The person to whom the bill is transferred.

6. Holder

- The person legally in possession of the bill and entitled to receive payment.

FEATURES / CHARACTERISTICS OF A BILL OF EXCHANGE

1. Written Document

- A bill of exchange must be in writing.
- Oral orders are not valid under the Negotiable Instruments Act.

2. Contains an Unconditional Order

- The bill must contain a clear and unconditional order to pay.
- Payment should not depend on any event or condition.

3. Three Parties Involved

- Drawer, Drawee, and Payee must be clearly stated.
- Sometimes drawer and payee may be the same person.

4. Signed by the Drawer

- The bill must be signed by the drawer to make it legally valid.
- Without signature, it has no legal effect.

5. Amount Must Be Certain

- The amount to be paid must be fixed, definite, and clearly mentioned.
- No ambiguity is allowed.

6. Payable in Money Only

- The bill should order payment in money only, not goods or services.

7. Time and Place of Payment

- A bill may be payable on demand, after a certain period, or on a fixed date.
- The place of payment is often mentioned for clarity.

8. Acceptance by Drawee

- For the bill to be complete, the drawee must accept the bill by signing on it.
- Once accepted, the drawee becomes the acceptor and is responsible for payment.

9. Negotiable Instrument

- A bill of exchange is freely transferable through endorsement and delivery.
- The holder in due course gets a good title.

10. Stamping

- Bills payable after a certain period must be duly stamped according to law.
- A stamp gives it legal validity.

11. Legal Evidence of Debt

- A bill acts as proof of credit transaction between the buyer and seller.
- It is acceptable in court if disputes arise.

12. Provides Security of Payment

- Both parties have certainty of payment on the due date.
- It reduces the risk of bad debts.

ADVANTAGES OF A BILL OF EXCHANGE

1. Helpful in Credit Sales

- Sellers can sell goods on credit and still have proof of payment.

2. Ensures Definite Payment Date

- Payment date is predetermined, aiding financial planning.

3. Can Be Discounted

- Bills can be sold to a bank before maturity to get immediate cash.

4. Useful for Legal Evidence

- Protects both buyer and seller legally.

5. Facilitates Easy Transferability

- Bills can be endorsed to others for settling business transactions

| Basis | Bill of Exchange (B/E) | Promissory Note (P/N) |
|---|---|---|
| **Definition** | A written order from one person (drawer) directing another (drawee) to pay a certain sum to a third person or bearer. | A written promise made by one person (maker) to pay a certain sum to another person or bearer. |
| **Parties Involved** | Three parties: Drawer, Drawee, Payee. | Two parties: Maker and Payee. |
| **Nature** | It is an **order** to pay. | It is a **promise** to pay. |

| Basis | Bill of Exchange (B/E) | Promissory Note (P/N) |
|---|---|---|
| **Acceptance** | Must be **accepted** by the drawee before payment. | No acceptance is required. |
| **Liability** | Drawer is primarily liable; drawee becomes liable after acceptance. | Maker is primarily liable. |
| **Usage** | Commonly used in trade transactions. | Used for loans, advances, or debt settlements. |
| **Transferability** | Can be **endorsed** to another party. | Can also be **endorsed**, but simpler in nature. |
| **Legal Framework** | Governed by the **Negotiable Instruments Act, 1881**. | Governed by the **Negotiable Instruments Act, 1881**. |
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JOINT VENTURE

Meaning of Joint Venture

A Joint Venture (JV) is a business arrangement in which two or more parties come together for a specific project or purpose.

- It is temporary in nature.
- Each party contributes capital, resources, or expertise and shares profits or losses in an agreed ratio.
- Unlike partnerships, a joint venture does not create a permanent firm; it ends after the completion of the project.

Example: Two companies collaborate to build a real estate project or export goods jointly.

Characteristics / Features of Joint Venture

1. Temporary Partnership

- A joint venture exists only for a specific project or purpose.
- It automatically dissolves when the objective is achieved.

2. Separate Bank Account

- Usually, a joint bank account is opened for JV transactions.
- All receipts and payments related to the JV are recorded in this account.

3. Memorandum Joint Venture Account

- Accounts are maintained using a Memorandum Joint Venture Account (MJVA) in the books of each co-venturer.
- It is nominal in nature and does not affect the personal capital accounts.

4. No Separate Legal Entity

- A JV is not a separate legal entity.
- Each co-venturer is personally responsible for transactions in proportion to their agreement.

5. Profit and Loss Sharing

- Profit or loss is shared according to the agreement made before starting the venture.
- No profit-sharing without consent.

6. Individual Ownership of Assets

- Assets purchased or brought into the venture are jointly or individually owned, depending on the agreement.
- They are not merged into a single firm.

7. Control and Decision Making

- Each co-venturer retains some control over operations.
- Decisions are usually taken mutually or as per the agreement.

8. No Permanent Business Name

- A joint venture does not have a permanent firm name.
- It may operate under a project-specific name if required.

Accounting for Joint Venture

1. Separate Account Method:
   - All receipts and payments are recorded in a Memorandum Joint Venture Account.
   - Profit or loss is transferred to each co-venturer's account.
2. Books of Each Co-venturer:
   - Each co-venturer keeps a personal account of the venture in their books.
   - Entries include capital contribution, expenses, and share of profit/loss.
3. Joint Bank Account:
   - A joint bank account simplifies handling of transactions and prevents disputes.

Advantages of Joint Venture

1. Shared Risk: Losses are shared among co-venturers.
2. Pooling of Resources: Combines capital, skills, and expertise.
3. Ease of Management: Temporary nature allows flexibility.
4. No Legal Formalities: Unlike partnerships, no formal registration is needed.

Disadvantages of Joint Venture

1. Limited Duration: Exists only for a specific project.
2. Mutual Trust Required: Disputes may arise if co-venturers do not agree.
3. No Separate Identity: Cannot enter contracts in the name of the venture itself.
4. Profit Sharing Conflicts: Profit distribution may create conflicts if agreements are unclear.

CONSIGNMENT

Meaning of Consignment

Consignment is a business arrangement in which goods are sent by the owner (consignor) to an agent (consignee) to sell on behalf of the owner.

- The consignee does not buy the goods; they act as a selling agent.
- The consignor retains ownership of the goods until they are sold.
- Profit or loss is shared as per agreement.

Example: A manufacturer sends goods to a wholesaler in another city to sell them on his behalf.

Parties Involved in Consignment

1. Consignor

- The owner of the goods who sends them for sale.
- Receives payment after sale minus commission and expenses.

2. Consignee

- The agent who sells the goods on behalf of the consignor.
- Receives commission for selling the goods.

3. Customers

- Buyers who purchase the goods from the consignee.

Features / Characteristics of Consignment

1. Goods Are Sent for Sale, Not Purchase

- Consignee does not purchase the goods.
- Ownership remains with the consignor until sold.

2. Ownership Retained by Consignor

- Even though goods are physically with the consignee, legal ownership stays with the consignor.

3. Commission to Consignee

- Consignee is paid a fixed percentage of sales as commission.

4. Risk and Profit

- The consignor bears the risk of loss unless the agreement states otherwise.
- Profit is earned by consignor after deducting expenses and commission.

5. Accounting Method

- Consignment is recorded in the books of consignor through a Consignment Account.
- Expenses incurred by consignee may also be debited to consignment account.

6. No Cash Sale Between Consignor and Consignee

- Goods are sent on credit terms, and payment is made after sale.

7. Valuation of Goods

- Consignment goods are usually sent at cost price plus agreed terms.
- Consignee may be authorized to sell at market price.

Consignment Account – Accounting Treatment

In the books of Consignor:

1. Goods sent to consignee – recorded at cost price.
2. Expenses incurred by consignor – added to consignment account.
3. Expenses incurred by consignee – added if borne by consignor.
4. Commission of consignee – deducted from sales proceeds.
5. Profit or Loss – transferred to consignor’s personal account.

Advantages of Consignment

1. Market Expansion: Manufacturer can sell goods in distant markets.
2. Risk Sharing: Consignee handles sales risk, consignor bears only loss of unsold goods.
3. No Need for Own Sales Network: Consignor can save distribution costs.
4. Encourages Agents: Consignees are motivated because they earn commission.

Disadvantages of Consignment

1. Risk of Loss: Unsold goods may be damaged or lost.
2. Delay in Cash Realization: Payment is received only after sale.
3. Dependence on Consignee: Sales depend on consignee's efficiency.
4. Accounting Complexity: Maintaining consignment accounts is slightly more complex.

TYPES OF COMMISSION IN CONSIGNMENT

In a consignment transaction, the consignee sells goods on behalf of the consignor. For this service, the consignee earns a commission, which may vary depending on the nature of the goods, sales, and agreement. The main types of commission are as follows:

1. Regular or Ordinary Commission

- Meaning: A fixed percentage of the sales price given to the consignee as payment for selling the goods.
- Example: If goods sold for ₹50,000 and the agreed commission is 5%, the consignee earns ₹2,500.
- Purpose: Rewards the consignee for performing the selling function.

2. Del-credere Commission

- Meaning: Extra commission paid to the consignee for guaranteeing payment by the buyer.
- Explanation:
  - The consignee assumes credit risk in case the customer defaults.
  - It is over and above the ordinary commission.
- Purpose: Provides incentive for consignees to collect payments diligently.

3. Overriding or Extra Commission

- Meaning: Additional commission paid for performing special duties beyond normal sales, such as:

- Advertising or marketing the goods
- Handling bulky or difficult-to-sell items
- Managing multiple consignments

• Purpose: Encourages consignees to go the extra mile in promoting or selling goods.

4. Commission on Expenses (Reimbursement Commission)

• Meaning: Sometimes consignees are reimbursed for certain expenses (like freight, packing, insurance) in addition to their commission.

• Explanation:

- It is not technically a commission but part of remuneration to cover costs incurred in selling.

• Purpose: Ensures the consignee is not burdened financially while handling goods.

5. Combination Commission

• Meaning: A combination of ordinary and del-credere commission.

• Explanation:

- Often, the consignee receives 5% ordinary commission + 2% del-credere commission.

• Purpose: Motivates the consignee for efficient sales and credit collection.

ACCOUNTS FROM INCOMPLETE RECORDS

Meaning

Accounts from Incomplete Records (also called Single Entry System) is a method of keeping accounting records where all transactions are not fully recorded in the books.

• Only partial information is available.

• Usually, cash transactions and some credit transactions are recorded, but full double-entry bookkeeping is not maintained.

• This system is common with small businesses or sole proprietors.

Explanation:

In this system, we often know the opening capital, cash received and paid, some assets and liabilities, but not the complete ledger accounts. To find profit or loss, we reconstruct the accounts using available information.

Features / Characteristics

1. Partial Records

- Only cash receipts, payments, or certain transactions are recorded.
- Many transactions like depreciation, drawings, or accruals may be ignored.

2. Absence of Double Entry

- Unlike the traditional system, every transaction is not recorded twice (once as debit and once as credit).
- This makes it incomplete for financial analysis.

3. Capital and Drawings

- Capital and drawings may not be recorded systematically.
- Reconstructing capital is often required to calculate profit or loss.

4. Profit Determination

- Profit or loss is not directly available.
- Must be determined using Statement of Affairs Method or Conversion Method.

5. Simple and Economical

- Requires less time and effort.
- Suitable for small traders or businesses with limited transactions.

Methods of Preparing Accounts from Incomplete Records

1. Statement of Affairs Method

- Steps:

1. Prepare a Statement of Affairs at the beginning and end of the period.
2. Calculate Capital: Assets – Liabilities.
3. Compare opening and closing capital to determine profit or loss:

- Explanation: Useful when only the capital and personal accounts are known.

2. Conversion Method

- Steps:

1. Convert single-entry records into double-entry format.
2. Prepare ledger accounts for assets, liabilities, capital, revenue, and expenses.
3. Prepare Trial Balance, Trading Account, and Profit & Loss Account.

- Explanation: This method is more detailed and produces financial statements like in double-entry system.

Advantages

1. Simplicity: Easy to maintain for small businesses.
2. Low Cost: Requires less accounting expertise.
3. Quick Recording: Saves time as not all transactions are recorded.
4. Useful for Profit Calculation: Profit or loss can still be determined using Statement of Affairs.

Disadvantages

1. Incomplete Information: Not all transactions are recorded; accuracy is limited.
2. Difficult for Analysis: Cannot prepare detailed accounts like double-entry bookkeeping.
3. No Control: Hard to detect frauds, errors, or omissions.
4. Limited Use: Not suitable for large or complex businesses.

# ACCOUNTS FOR NON-TRADING CONCERNS

## Meaning

Non-trading concerns are organizations that do not aim to earn profits.

- Their main objective is social service, welfare, or charitable activities.
- Examples: Schools, Hospitals, Charitable Trusts, Clubs, and Churches.
- Even though they do not trade for profit, they maintain accounts to track receipts, payments, and funds.

## Features / Characteristics

1. No Profit Motive

- Primary aim is service, welfare, or social objectives.
- Profit or surplus is not the main goal.

2. Receipts and Payments Basis

- Accounts are maintained for funds received and spent, not for income and expenditure.
- Helps to track cash inflows and outflows.

3. Capital

- Initial funds are called Capital or Fund rather than investment for profit.
- Funds may come from donations, subscriptions, grants, or membership fees.

4. Surplus or Deficit

- Excess of receipts over payments is called Surplus.
- Deficit occurs if payments exceed receipts.
- Surplus is retained for future activities, not distributed as profit.

5. Fund-Based Accounting

- Non-trading concerns use fund-based accounting, recording opening and closing funds.
- Helps in proper utilization of resources.

Accounting Methods

1. Receipts and Payments Account

- A simple cash book showing all cash and bank transactions.
- Does not record accruals or outstanding items.
- Similar to Cash Book in trading concerns but focused on funds.
- Net Result: Difference between total receipts and total payments = Surplus or Deficit.

2. Income and Expenditure Account

- Similar to Profit & Loss Account in trading concerns.
- Adjusts for outstanding, prepaid, or accrued items.
- Shows actual surplus or deficit for the period.
- Net Result: Total income – total expenditure = Surplus/Deficit.

3. Balance Sheet

- Shows assets, liabilities, and accumulated fund of the concern.
- Helps management and donors understand financial position.

Advantages of Accounting in Non-Trading Concerns

1. Helps in tracking funds and their proper utilization.
2. Facilitates preparation of financial statements for donors and authorities.
3. Provides transparency and accountability.
4. Assists in budgeting and planning future activities.

Disadvantages

1. Does not measure profit, so business performance is not analyzed.
2. Complexities arise with prepaid, outstanding, and fund allocation.
3. Requires careful recording to avoid mismanagement of donations