**Principal of Accounting**

**Unit-2**

**Accounting of Non Trading Institutions**

Some of the organizations or institutions are constituted to provide valuable services to the society with the objective not to earn profit. These organizations normally offer the services such as education, medical, social clubs, charitable trusts, trade unions, etc.

However, we can summarize these organizations in the following three types of categories:

* Clubs, associations, or society’s works for the welfare of their members.
* Charitable institutions like hospitals, students’ hostels, and other educational institutions providing education to poor children as well as illiterate young and old groups.
* Professional firms of lawyers, chartered accountants, architects, doctors, solicitors, etc.

**Non Trading Account**

Maintenance of proper books of accounts is necessary to safeguard the money of its members and general public from any kind of misuse or misappropriations. It is important to know the total receipts, total payments, and also to know financial status of an institution. Hence, the account opened and maintained for and by the organizations discussed above is known as Non-trading account.

Normally, registration of members, minute book, cash receipt journal, cash payment journal, etc. are main record which is maintained by these organizations/ institutions in their non-trading accounts. At the end of an accounting period, these institutions prepares its final accounts, which include the following:

* Receipt and Payment Account
* Income and Expenditure Account
* Balance Sheet

**Receipt and Payment Account**

It is a real account. Basic rule of double entries is followed to prepare this account. It is prepared from a cash book at the end of the accounting period. Every transaction regarding the cash transactions is recorded in the Cash Book in a chronological order. We may say that the Receipt and Payment account is a summary of cash payment and cash receipts during the current year.

For example, if rent and salary paid on monthly basis all over the accounting period, and donation or subscription received during the current year recorded in a cash book date wise, but at the end of the accounting period, the Receipt and Payment account will contain total amount of rent paid, salary paid, subscription received and donation received. All cash receipt will be recorded on the debit side and all cash payment will be recorded on the credit side.

**Income and Expenditure Account**

Income and expenditure account is a nominal account and as an equivalent to Profit and Loss account.

The essential features of an income and expenditure account are as follows −

* Expenses and losses are recorded in the debit side of it and all incomes and gains are recorded on the credit side.
* Capital income and expenditure are excluded and revenue income and expenses are included in it.
* It is based on a mercantile system of accounting, therefore, the income and expenses related to preceding years or subsequent years are excluded while preparing the income and expenditure account.
* The credit balance of an income and expenditure account shows surplus. Further, excess of income over the expenditure and the debit balance of it show deficit i.e. excess of the expenditure over income.
* Only nominal accounts are considered in preparation of this account.

**Balance Sheet**

The date on which a balance sheet is prepared, particulars of all the assets and liabilities are recorded in the same manner as we do in any other profit making firms. Its capital fund is made up of surplus income over expenditure and other incomes capitalized in the given period of time. Sometimes, two balance sheets need to be prepared.

* At the beginning of the accounting year to know the opening capital fund and
* At the end of the financial year to know the financial position of the organization.

Conversion of Receipt and Payment Account into Income and Expenditure Account

Following are the steps required to convert receipt and payment account into income & expenditure account:

* Opening balance and closing balance of a receipt and payment account representing opening cash in hand, opening cash at bank, closing cash in hand, and closing cash at bank need to be ignored.
* Items of capital receipts and capital payment will be excluded while preparing an income and expenditure account.
* Revenue items of an income and expenditure will be considered only at the time of preparation of an income & expenditure account from the receipt and payment account.
* All adjustment regarding the outstanding expenses, prepaid expenses, provision for bad debts, provision for depreciation, income received in advance, and income receivable will be done.
* An income and expenditure relating to preceding year or subsequent year will be ignored, and the items only related to the current year will be considered.

**Items Peculiar to Non-Trading Concern**

There are certain peculiar items in the case of non-trading concerns, which require a special treatment:

**Donations**

Non-trading concerns may receive donations time to time. The treatment of donation depends upon nature of donation.

* **Specific Donation:** Some donation may be received for any specific purpose, for example, for the construction of a room or building and then donation is termed as specific donation. The amount of such donation cannot be used for any other purpose. It should be shown on liabilities side of the Balance-sheet and used only for the same purpose it is meant for.
* **General Donation:** When a donation is received for a common purpose is termed as General Donation. If the amount of donation is small, it will be treated as recurring income and will be recorded in the credit side of income & expenditure account.

Donation of the big amount should be fairly treated as capital receipts and will be shown in the liabilities side of the Balance sheet. However, donation is of a small amount or a big amount may depend upon the size of a concern and amount.

**Legacy**

Sometimes, as per the will of a person, an amount received is called as legacy. It is as good as donation. It is of a non-recurring nature, therefore should be treated as a capital receipt, and hence will be appeared in the liabilities side of a Balance sheet. However, it may also be treated as an income and may be taken to income & expenditure account.

**Entrance Fees**

A club or society usually charge admission fees or entrance fees for the membership. In case of club etc., admission fees or entrance fees usually charged as capital receipts, but in case of a hospital or educational institution, it is treated as a recurring income.

**Life Membership Fees**

The life membership fees may be taken from the members of institution only once in their lifetimes. On the basis of lifetime membership, members may enjoy certain benefits. Amount received as the Life Membership might be transferred to the “Life Membership Fees Account” of the institution and can be dealt in the accounts by any of the following methods −

* May be taken as liabilities side of a Balance sheet as Life Membership Fees.”
* Normal subscriptions of the members may be transferred from the Life Membership Fees account to the subscription account as an income and the balance may be carried forward to the following years.
* On the basis of average life of a member, the amount may be transferred to the income and expenditure account annually and rest will be carried forward towards the following years.

**Sale of Scrap or Old Newspapers**

Without any dispute, it will be treated as recurring income and will appear in the credit side of an income and expenditure account.

**Subscription**

Subscription is the major source of an income for the non-trading concerns. Subscriptions are received from the members of a club or institution. A receipt and payment account records all the actual subscription received during the current year and an income & expenditure account shows the subscriptions, which relates to the current accounting period. Therefore, some adjustments require to calculate the subscription of the current year.

**Special Funds**

Some special funds are created by the respective institutions for specific purpose. For example, a prize fund may be created to give the best player of the year award. Any income relating to those funds should be added to the funds and deficit, if any may be charged from the income & expenditure account.

**Joint Venture Accounts**

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An association of two or more persons or we may say temporary partnership combined for the carrying out a specific business, and divide profit or loss thereof in agreed ratio is called a **Joint Venture**. Concerned parties to joint venture are known as co-venturers. The liabilities of co-venturers are limited to their profit sharing ratio or as per agreed terms:

Suppose ‘A’ and ‘B’ undertake the job to develop a park for a consideration of Rs. 10,000/- Lacs. Since they come together for a work on a specific project, it will termed as joint venture and each of them (A and B) will be called as a co-venturer. Further, this venture will automatically terminate once the project is completed.

**Major Features and Characteristics of Joint Venture**

Following are the major features of a joint venture:

* There is an agreement between two or more persons.
* Joint venture is made for the specific execution of a business plan/project.
* It is a temporary partnership without the use of a firm name.
* Agreement for joint ventures is automatically dissolved as soon as specific project is over.
* Profit & Share are shared on the same terms and conditions agreed upon. However, in the absence of any agreement, profit & share will be divided equally.

**Partnership and Joint Venture**

There are following differences between partnership and joint venture −

* Partnership always carried on with firm’s name, but for the joint venture, no such firm’s name is required.
* The persons who run the business on partnership are called as partners and the persons who agreed to take the project as joint venture are called as co-venturers.
* Normally, a partnership is constituted for a long period (including various projects), whereas joint venture is formed to complete a specific job/project.
* Partnership is governed under the Partnership Act, 1932, whereas there is no enactment of such kind for the joint ventures. However, as a matter of fact in law, a joint venture is treated as a partnership.
* There is no limit specified for the numbers of co-venturers, but the number of partners is limited to 10 under banking business and 20 for any other trade or business.
* Liability of a partner is unlimited and may extent of his business and personal estate, whereas under joint venture, liabilities of co-venturers are limited to the particular assignment or project agreed upon.

**Joint Venture and Consignment**

Major differences between joint venture and consignment may be summarized as −

* **Relationship**: The co-venturers of a Joint venture are the owners of a Joint venture, whereas relationship of a consignor and consignee is of owner and Agent.
* **Sharing of Profits**: There is no distribution of profit between a consignor and consignee, consignee only gets commission on sale made by him. On the other hand, the co-venturers of a joint venture share profits as per the agreed profit sharing ratio.
* **Ownership of Goods**: Ownership of the goods remains with the consignor. Consignor transfers only possession to the consignee, but every co-venturer of a joint venture is the co-owner of the goods/project.
* **Contribution of Funds**: Investment is done by the consignor only. On the other hand, funds are contributed by all co-ventures in a certain agreed proportion.
* **Continuity of Business:** In case of a joint venture, there is no continuity of the business once project is completed. On the other hand, if, everything goes smooth, consignment is a continuous process.

**Accounting Records**

To keep a record of the joint venture transactions, there are three following types of accounting methods:

* When one of the Venturers keeps Accounts,
* When Separate Books of Accounts are kept for the Joint Venture, and
* When Separate Books of Accounts are not kept for the Joint Venture.

Let’s discuss each of them separately:

**When one of the Ventures keeps Accounts**

If one of the co-venturers is appointed to manage the joint venture, he is awarded an extra commission or remuneration out of the profit for his services.

Journal Entries

|  |  |
| --- | --- |
| When share of investment received from other co-venturers | Cash/Bank A/cDr  To Co-venturers A/c |
| When goods are purchased | Joint Venture A/cDr  To Cash A/c (in case of cash purchase)  Or  To Creditors A/c (for credit purchase) |
| When expenses incurred | Joint Venture A/cDr  To Cash A/c |
| When goods are sold | Cash A/cDr  Or  Debtors A/cDr  To Joint Venture A/c |
| When commission allowed to working co-venturer | Joint Venture A/cDr  To Commission A/c |
| In case of Profit balance of joint venture, account will be transferred to profit & Loss (own share of working co-venturer) and other co-venture’s personal accounts | Joint Venture A/cDr  To Profit & Loss A/c  To Co-venturers personal A/c |
| In case of Loss | Profit & Loss A/cDr  To Joint Venture A/c |
| On settlement of accounts | All Co-venturer A/cDr  To Cash/Bank A/c |

**When Separate Books of Accounts are kept for the Joint Venture**

Under this method, all co-venturers contribute their share of investment and deposit their shares in a Joint Bank account — newly opened for the specific purpose of the Joint Venture. They may use this bank account to make any kind of payments and to deposit sale proceeds or any other kind of receipts.

In addition to Bank account, a Joint venture account is also opened in the books to keep records of all transactions routed through this account.

This category of accounts is a personal account of the each co-venturer. Thus following three accounts are opened −

* Joint Bank Account
* Joint Venture Account
* Personal account of co-venturers

**When Separate Books of Accounts are not kept for the Joint Venture**

It is of two types:

* When all venturers keep separate accounts
* Memorandum joint venture method

**When all Venturers keep Separate Accounts**:

* Separate Joint venture account and personal accounts of other co-venturers are opened under this method of accounting.
* Joint venture account is debited and bank account or creditor account is credited on the account of goods purchased or expensed.
* Joint venture account is credited and a bank account or debtor account is debited in case of either cash sale or credit sale.
* Each co-venturer debits joint venture account and credits personal accounts of other co-venturer on the account of either goods purchased or expensed by other co-venturers.
* Joint venture account is credited and personal account of others co-venturer account is debited in case of sale made by other co-venturers.
* Joint venture account is debited and commission account is credited if, commission is receivable, but if commission is receivable by other co-venturer, then the concerned co-venturer account will be credited instead of the commission account.
* If unsold stock is taken, then goods account will be debited by crediting Joint venture account. On the other hand, if unsold stock is taken by any other co-venturer, then personal account of the co-venturer will be debited.
* Balance in the joint venture accounts represents profit or loss and later that amount of profit or loss will be transferred to the personal accounts of co-venturers.

**Note**: Above transactions are possible only when all the co-venturers exchange information’s on regular basis.

**Memorandum Joint Venture Method**

Important features of memorandum method are given as hereunder:

* Only one personal account is opened by each co-venturer in his book named Joint Venture account with…………… (Name of other co-venturer). Same process will be followed by other co-venturer in his books of accounts.
* Only one personal account will be opened by each co-venturer irrespective of the fact, how many other co-venturers are exists. For example, there is a joint venture of 4 person A,B,C, & D; now, A in his books will open only one personal account named as ***Joint venture with B,C, & D account***.
* Each party will record only those transactions in his book, which are done by him; the transactions done by other co-venturers will be ignored.
* In addition to above said personal account, a combined account named as “memorandum joint venture account” will also be opened.
* Memorandum account is merely a combined account of personal accounts opened by each co-venturer. Debit side of personal account will be transferred to the memorandum account and the credit side of personal account will be transferred to the credit side of memorandum account.
* Transactions done by co-venturers among themselves including cash received or paid by one co-venturer to other will be ignored at the time of preparation of a memorandum account.
* Balance of memorandum joint venture account will represent profit or loss of the particular business. Further, the profit or loss will be transferred to the individual co-venturer account in their profit sharing ratio.

**Consignment Account**

**Consignment** occurs when goods are sent by their owner (the consignor) to an agent (the consignee), who undertakes to sell the goods. The consignor continues to own the goods until they are sold, so the goods appear as inventory in the accounting records of the consignor, not the consignee.

**Consignment Accounting – Initial Transfer of Goods**

When the consignor sends goods to the consignee, there is no need to create an accounting entry related to the physical movement of goods. It is usually sufficient to record the change in location within the inventory record keeping system of the consignor. In addition, the consignor should consider the following maintenance activities:

Periodically send a statement to the consignee, stating the inventory that should be on the consignee’s premises. The consignee can use this statement to conduct a periodic reconciliation of the actual amount on hand to the consignor’s records.

Request from the consignee a statement of on-hand inventory at the end of each accounting period when the consignor is conducting a physical inventory count. The consignor incorporates this information into its inventory records to arrive at a fully valued ending inventory balance.

It may also be useful to occasionally conduct an audit of the inventory reported by the consignee.

From the consignee’s perspective, there is no need to record the consigned inventory, since it is owned by the consignor. It may be useful to keep a separate record of all consigned inventory, for reconciliation and insurance purposes.

**Consignment Accounting – Sale of Goods by Consignee**

When the consignee eventually sells the consigned goods, it pays the consignor a prearranged sale amount. The consignor records this prearranged amount with a debit to cash and a credit to sales. It also purges the related amount of inventory from its records with a debit to cost of goods sold and a credit to inventory. A profit or loss on the sale transaction will arise from these two entries.

Depending upon the arrangement with the consignee, the consignor may pay a commission to the consignee for making the sale. If so, this is a debit to commission expense and a credit to accounts payable.

From the consignee’s perspective, a sale transaction triggers a payment to the consignor for the consigned goods that were sold. There will also be a sale transaction to record the sale of goods to the third party, which is a debit to cash or accounts receivable and a credit to sales.

Consignment is a system where one person sends the goods to another so that the latter can sell those goods on behalf of the person who sends it in the first place. Risk related to goods will be on the part of the consignor.

**Parties in Consignment Account**

There are two parties in a consignment.

1. The person sending the goods is the consignor
2. The person receiving the goods is the consignee

