

Unit-II: Consignment

1. Introduction and Meaning

To consign means to send. In Accounting, the term “**consignment account**” relates to accounts dealing with a situation where one person (or firm) sends goods to another person (or firm) on the basis that the goods will be sold *on behalf of and at the risk of the former*. The following should be noted carefully:

- (i) The party **which sends the goods (consignor)** is called principal.
- (ii) The party **to whom goods are sent (consignee)** is called agent.
- (iii) The ownership of the goods, i.e., the property in the goods, remains with the consignor or the principal – the agent does not become their owner even though they are in his possession. On sale, of course, the buyer will become the owner.
- (iv) The principal does not send an invoice to the agent. He sends only a proforma invoice, a statement that looks like an invoice but is really not one. The object of the proforma invoice is only to convey information to the agent regarding particulars of the goods sent.
- (v) Usually, the agent recovers from the principal all expenses incurred by him on the consignment. This however can be changed by agreement between the two parties.
- (vi) It is also usual for the agent to give an advance to the principal in the form of cash or a bill of exchange. It is adjusted against the sale proceeds of the goods.
- (vii) For his work the agent receives a commission, calculated on the basis of gross sale. For ordinary commission the agent is not responsible for any bad debt that may arise. If the agent is to be made responsible for bad debts, he is to be paid a commission called **del-credere commission**. It is calculated on total sales, not merely on credit sales until and unless agreed.
- (viii) Periodically, the agent sends to the principal a statement called Account Sales. It sets out the sales made by the agent, the expenses incurred on behalf of the principal, the commission earned by the agent and the balance due to the principal.
- (ix) Firms usually like to ascertain the profit or loss on each consignment or consignments to each agent.

Consignment Account relates to accounts dealing with such business where one person sends goods to another person on the basis that such goods will be sold on behalf of and at the risk of the former.

2. DISTINCTION BETWEEN CONSIGNMENT AND SALE

<i>S.No.</i>	<i>Consignment</i>	<i>Sale</i>
1.	Ownership of the goods rests with the consignor till the time they are sold by the consignee, no matter the goods are transferred to the consignee.	The ownership of the goods transfers with the transfer of goods from the seller to the buyer.
2.	The consignee can return the unsold goods to the consignor.	Goods sold are the property of the buyer and can be returned only if the seller agrees.
3.	Consignor bears the loss of goods held with the consignee.	It is the buyer who will bear the loss if any, after the delivery of goods.
4.	The relationship between the consignor and the consignee is that of a principal and agent.	The relationship between the seller and the buyer is that of a creditor and a debtor.
5.	Expenses done by the consignee to receive the goods and to keep it safely is borne by the consignor.	Expenses incurred by the buyer are to be borne by the buyer itself after the delivery of goods.

3. ACCOUNTING FOR CONSIGNMENT TRANSACTIONS AND EVENTS IN THE BOOKS OF THE CONSIGNOR

For ascertaining profit or loss on any transaction (or series of transactions) there is one golden rule; open an account for the transaction (or series of transactions) and

- (i) put down the cost of goods and other expenses incurred or to be incurred on the debit side; and
- (ii) enter the sale proceeds as also the cost of goods remaining unsold on the right hand or the credit side.
- (iii) The difference between the total of the two sides will reveal profit or loss. There is profit if the credit side is more.

4. VALUATION OF INVENTORIES

The principle is that inventories should be valued at cost or net realisable value whichever is lower, the same principle as is practised for preparing final accounts. In the case of consignment, cost means not only the cost of the goods as such to the consignor but also all expenses incurred till the goods reach the premises of the consignee. Such expenses include packaging, freight, cartage, insurance in transit, octroi, etc. But expenses incurred after the goods have reached the consignee's godown (such as godown rent, insurance of godown, delivery charges) are not treated as part of the cost of purchase for valuing inventories on hand. That is why in the case given above, inventories has been valued ignoring godown rent and insurance.

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(Sometimes an examination problem states only that the consignor's expenses amounted to such and such amount and that consignee spent so much. If details are not available for valuing inventories the expenses incurred by the consignor should be treated as part of cost while those incurred by the consignee should be ignored).

If the expected selling price of inventories on hand is lower than the cost, the value put on the inventories should be expected net selling price only, i.e. expected selling price less delivery expenses, etc.

5. GOODS INVOICED ABOVE COST

Sometimes the proforma invoice is made out at a value higher than the cost and entries in the books of the consignor are made out on that basis – even the inventories remaining unsold will initially be valued on the basis of the invoice price. It must be remembered, however, that the profit or loss can be ascertained *only* if sale proceeds (plus) inventories on hand, valued on cost basis, is compared with the cost of the goods concerned together with expenses. Hence, if entries are first made on invoice basis, the effect of the loading (i.e., amount added to arrive at the invoice price) must be removed by *additional entries*.

6. ABNORMAL LOSS

If any accidental or unnecessary loss occurs, the proper thing to do is to find out the cost of the goods thus lost and then to credit the Consignment Account and debit the Profit and Loss Account – this will enable the consignor to know what profit would have been earned had the loss not taken place. Suppose 1,000 sewing machines costing ` 250 each are sent on consignment basis and ` 10,000 are spent on freight etc. 20 machines are damaged beyond repair. The amount of loss will be:

$$\begin{array}{r} \text{Cost} = 20 \times 250 \qquad \qquad \qquad \text{` 5,000} \\ \text{Expenses} = 2 \times \frac{10,000}{1,000} \qquad \qquad \qquad \underline{\text{` 200}} \\ \qquad \qquad \qquad \qquad \qquad \qquad \qquad \qquad \qquad \underline{\text{` 5,200}} \end{array}$$

This amount should be credited to the Consignment Account and debited to the P&L A/c. If any amount, say, ` 4,000 is received from the insurers, then debit to the P&L A/c will be only ` 1,200. But the credit to the Consignment Account will still be ` 5,200. ` 4,000 will have been debited to the Bank Account.

Students will have noted that abnormal loss is valued just like inventories in hand.

Students should be careful while valuing goods lost in transit and goods lost in consignee's godown. Both are abnormal loss but in case of former consignee's non-recurring expenses are not to be included whereas it is to be included in case of latter.

7. NORMAL LOSS

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If some loss is essential and unavoidable, it would be spread over the entire consignment while valuing inventories. The total cost plus expenses incurred should be divided by the quantity available after the normal loss to ascertain the cost per unit. Suppose 1,000 kg of apples are consigned to a wholesaler, the cost being ₹ 3 per kg, plus ₹ 400 of freight. It is concluded that a loss of 15% is unavoidable. The cost per kg will be ₹ 3,400 ÷ 850 or ₹ 4. If the inventories is 100 kg its value will be ₹ 400.

8. COMMISSION

Commission is the remuneration paid by the consignor to the consignee for the services rendered to the former for selling the consigned goods. Three types of commission can be provided by the consignor to the consignee, as per the agreement, either simultaneously or in isolation. They are:

- **ORDINARY COMMISSION**

The term commission simply denotes ordinary commission. It is based on fixed percentage of the gross sales proceeds made by the consignee. It is given by the consignor regardless of whether the consignee is making credit sales or not. This type of commission does not give any protection to the consignor from bad debts and is provided on total sales.

- **DEL-CREDERE COMMISSION**

To increase the sale and to encourage the consignee to make credit sales, the consignor provides an additional commission generally known as del-credere commission. This additional commission when provided to the consignee gives a protection to the consignor against bad debts. In other words, after providing the del-credere commission, bad debts is no more the loss of the consignor. It is calculated on total sales unless there is any agreement between the consignor and the consignee to provide it on credit sales only.

- **OVER-RIDING COMMISSION**

It is an extra commission allowed by the consignor to the consignee to promote sales at higher price than specified or to encourage the consignee to put hard work in introducing new product in the market. Depending on the agreement it is calculated on total sales or on the difference between actual sales and sales at invoice price or any specified price.

9. RETURN OF GOODS FROM THE CONSIGNEE

Consigned goods can be returned by the consignee because of many reasons like poor quality or not upto the specimen or destroyed in transit etc. In such a situation, the question arises is the valuation of returned goods. Consigned goods returned by the consignee to the consignor are valued at the price at which it was consigned to the consignee. Expenses incurred by the consignee to send those goods back to the consignor are not taken into consideration while valuing it because only those expenses are included in the cost of goods which help to bring the goods into present location and condition i.e. the saleable condition.

10. ACCOUNT SALES

An account sale is the periodical summary statement sent by the consignee to the consignor. It contains details regarding –

- (a) sales made,
- (b) expenses incurred on behalf of the consignor,
- (c) commission earned,
- (d) unsold inventories left with the consignee,
- (e) advance payment or security deposited with the consignor and the extent to which it has been adjusted,
- (f) balance payment due or remitted.

It is a summary statement and is different from Sales Account.

11. ACCOUNTING BOOKS OF THE CONSIGNEE

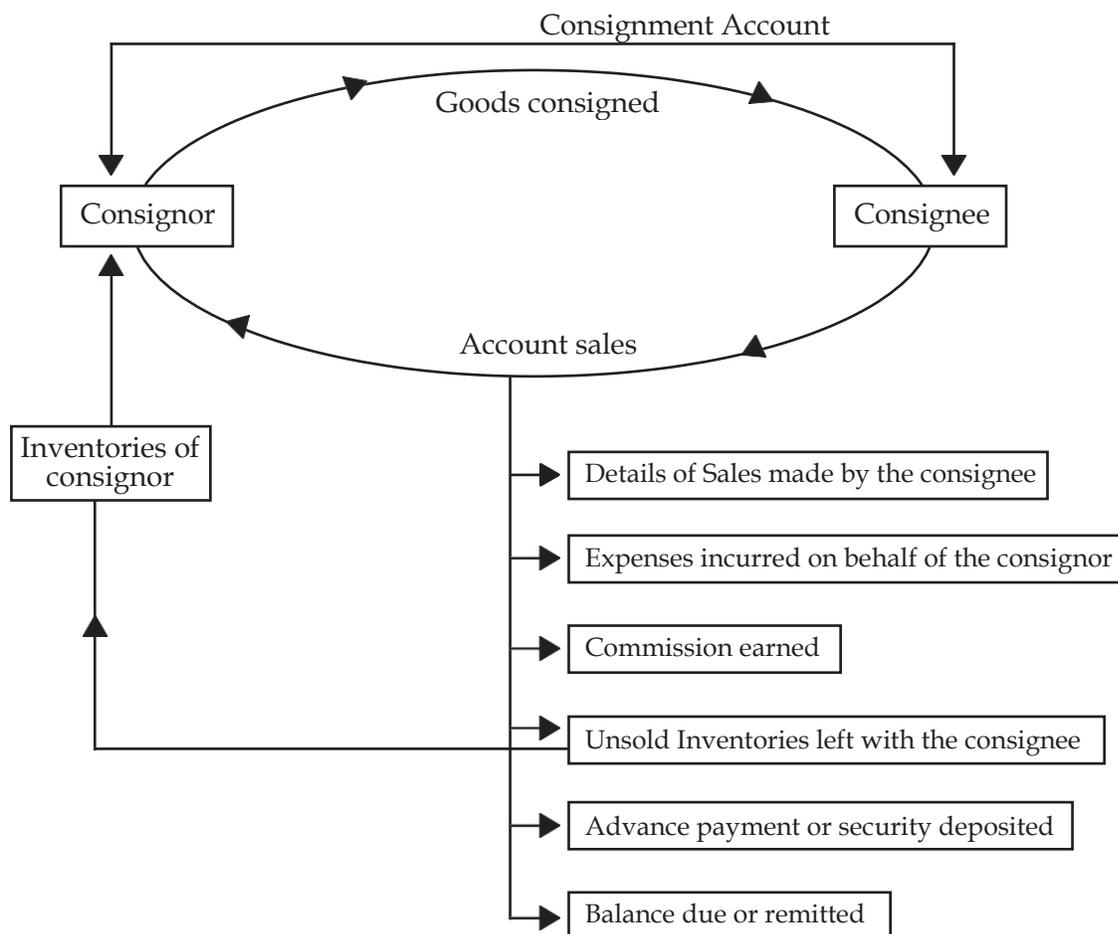
The consignee is not concerned when goods are consigned to him or when the consignor incurs expenses. He is concerned only when he sends an advance to the consignor, makes a sale, incurs expenses on the consignment and earns his commission. He debits or credits the consignor for all these as the case may be.

12. ADVANCE BY THE CONSIGNEE VS SECURITY AGAINST THE CONSIGNMENT

Generally the consignor insist the consignee for some advance payment for the goods consigned at the time of delivery of goods. This advance payment is adjusted in full against the amount due by the consignee on account of the goods sold.

But if the advance money deposited by the consignee is in the form of security against the goods consigned then the full amount is not adjusted against the amount due by the consignee to the consignor on account of goods sold in case, there is any unsold inventories left with the consignee. In that case proportionate security in respect of unsold goods is carried forward till the time the respective goods held with the consignee are sold.

An overview of the consignment transaction between consignee and consignor can be depicted with the help of the following chart :



Journal Entries in the Books of Consignor:

1	For goods sent on consignment to consignee		
	Consignment A/c Dr.		
	To Goods Sent on Consignment Account		
2	For expenses incurred by consignor		
	Consignment A/c Dr.		
	To Cash / Bank A/c		
3	When a bill is drawn by the Consignor on Consignee and when Consignee accepts the bill		
	Bills Receivable A/c Dr.		
	To Consignee A/c		
4	When the Consignor discounted the bill with his banker		
	Bank A/c Dr.		
	Discount A/c Dr.		
	To Bills Receivable A/c		
5	For the expenses incurred by Consignee		
	Consignment A/c Dr.		
	To Consignee A/c		
6	For Commission payable to Consignee		
	Consignment A/c Dr.		
	To Consignee A/c		
7	For Sales effected by the Consignee		
	Consignee A/c Dr.		
	To Consignment A.c		
8	In the Consignment A/c, if the credit side is greater (Profit)		
	Consignment A/c Dr.		
	To Profit and Loss A/c		
9	In the Consignment A/c, if the debit side is greater (Loss)		
	Profit and Loss A.c Dr.		
	To Consignment A.c		

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10	In Consignee A/c, if the credit side is greater		
	Consignee A/c Dr.		
	To Cash / Bank A/c		
11	In Consignee A/c, if the debit side is greater		
	Cash / Bank A/c Dr.		
	To Consignee		
12	To close the Goods Sent on Consignment A/c		
	Goods Sent on Consignment A/c Dr.		
	To Trading Account		

Journal Entries in the Books of Consignee:

<u>1</u>	For Bills Payable accepted		
	Consignor A/c Dr.		
	To Bills Payable A/c		
<u>2</u>	For Sales effected on behalf of Consignor - Cash Sales		
	Cash / Bank A/c Dr.		
	To Consignor A/c		
<u>3</u>	For Sales effected on behalf of Consignor - Credit Sales		
	Debtors A/c Dr.		
	To Consignor A/c		
<u>4</u>	For expenses incurred on behalf of Consignor - if paid		
	Consignor A/c Dr.		
	To Cash / Bank A/c		
<u>5</u>	For expenses incurred on behalf of Consignor - if payable		
	Consignor A/c Dr.		
	To Creditors A/c		
<u>6</u>	For commission receivable		
	Consignor A/c Dr.		
	To Commission A/c		
	(and)		
	Commission A/c Dr.		
	Profit and Loss A/c		

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<u>7</u>	For Collections made from Debtors		
	Cash / Bank A/c Dr.		
	Debtors A/c		
<u>8</u>	When Bad debts occur - if delcredere commission is paid		
	Bad debts A/c Dr.		
	To Debtors A/c		
	P & L A/c (or) Commission A/c Dr.		
	To Bad Debts A/c		
<u>9</u>	When Bad debts occur - if delcredere commission is not paid		
	Consignor A/c Dr.		
	To Debtors A/c		
<u>10</u>	For final settlement to Consignor -		
	Consignor A/c Dr.		
	To Cash / Bank A/c		
	(or)		
	Cash / Bank A/c Dr.		
	To Consignor A/c		