JAIIB/DBF ACCOUNTING & FINANCE FOR BANKERS (PAPER-2) CAPSULE PDF

1. MODULE-A
   BUSINESS MATHEMATICS AND FINANCE

2. MODULE-B
   Principles of Bookkeeping & Accountancy

3. MODULE-C
   Final Account

4. MODULE-D
   Banking Operation
JAIIB/DBF Accounting & Finance for Bankers (Paper 2) Capsule Notes-2.0

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2nd Note: If you will read capsule line by line, (available on ambitioubaba.com) and give the mock tests (available on test.ambitiousbaba.com) you will definitely crack the exam in the first attempt.

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<td><strong>Click here - Mock Link</strong></td>
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<td><strong>JAIIB/DBF Paper-3 (Legal and Regulatory Aspects of Banking) Online Mock Tests</strong></td>
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<td>Total- 1200+ Questions</td>
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Visit-test.ambitiousbaba.com

- Full length Mock 5- 600 Questions (Each Mock 120 Q)
- Memory based Mock

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(1500+ Questions)

Combo

Approx (4500 Questions) + Capsule PDF

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Module A- BUSINESS MATHEMATICS AND FINANCE

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Unit 1- Calculation of Interest and Annuities

Calculation of Interest and Annuities

Introduction:
People will earn money for their livelihood i.e. to spend on rent, food, clothing, education etc. along with this they need money to meet some extra expenditure like marriage in family, purchasing of vehicle, house or set up their own business and so on. Some people will manage with their own money, but most people have to borrow money for such contingencies.

Meaning of Interest:

- Interest can be defined as the price paid by a borrower for the use of a lender’s money.
  - It is compensation paid to the depositor.
  - In another words, it is excess of money paid or received on deposits or borrowings.
  - Interest is the price paid by a borrower for the use of a lender’s money. If you borrow (or lend) some money from (or to) a person for a particular period you would pay (or receive) more money than your initial borrowing (or lending).

Reasons for Charging Interest:

There are a variety of reasons for charging the interest, they are-

Time value of money:

- Time value of money means that the value of a unity of money is different in different time periods. The sum of money received in future is less valuable than it is today.
- In other words the worth of rupees received after some time will be less than a rupee received today.
Since a rupee received today has more value, rational investors would prefer current receipts to future receipts. If they postpone their receipts, they will certainly charge some money i.e. interest.

**Opportunity Cost:**
- The lender has a choice between using his money in different investments. If he chooses one, he forgoes the return from all others.
- In other words, lending incurs an opportunity cost due to the possible alternative uses of the lent money.

**Inflation:**
- Most economies generally exhibit inflation. Inflation is a fall in the purchasing power of money.
- Due to inflation, a given amount of money buys fewer goods in the future than it will now. The borrower needs to compensate the lender for this.

**Liquidity Preference:**
- People prefer to have their resources available in a form that can immediately be converted into cash rather than a form that takes time or involves expenditure to realize.

**Risk Factor:**
- There is always a risk that the borrower will go bankrupt or otherwise default on the loan.
- Risk is one determinable factor in fixing rate of interest.
- A lender generally charges more interest rate (risk premium) for taking more risk.

**Types of Interest**

**Interest can be of two types:**
- Simple Interest
- Compound Interest

**Simple Interest:**
SI is interest earned on only the original amount, called Principal, lent over a period of time at a certain rate.

Formula for SI = \( \frac{PRT}{100} \),
For ex: Rs.1000 deposited for one year at the rate of 8% p.a. interest will be Rs.8.

Compound Interest

CI is interest earned on any previous interests earned as well as on the Principal lent. It is Interest on interest.

Formula: \( CI = P(1+i)^n - P \)
\( A = P(1+i)^n \)
For ex: Rs. 1000 deposited for in year at the rate of 8% CI p.a. interest will be Rs.80

Compound Interest conversion:

<table>
<thead>
<tr>
<th>Conversion period</th>
<th>Description</th>
<th>No. of conversion</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Day</td>
<td>Compounded daily</td>
<td>365</td>
</tr>
<tr>
<td>1 Month</td>
<td>Compounded Monthly</td>
<td>12</td>
</tr>
<tr>
<td>3 Month</td>
<td>Compounded Quarterly</td>
<td>4</td>
</tr>
<tr>
<td>6 Month</td>
<td>Compounded Semiannually</td>
<td>6</td>
</tr>
<tr>
<td>12 Month</td>
<td>Compounded yearly</td>
<td>1</td>
</tr>
</tbody>
</table>

**Compound Vs Simple Interest:**

<table>
<thead>
<tr>
<th>Basis</th>
<th>Simple Interest</th>
<th>Compound Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Calculation</td>
<td>Easy to understand simple to calculate</td>
<td>Difficult to calculate</td>
</tr>
<tr>
<td>Constancy</td>
<td>Principal money remains same for all the years</td>
<td>Principal varies</td>
</tr>
<tr>
<td>Suitability</td>
<td>Suitable for short term deposits</td>
<td>Suitable for long term deposits</td>
</tr>
<tr>
<td>Formula</td>
<td>SI = ( \frac{PRT}{100} )</td>
<td>CI = ( P(1+i)^n - P )</td>
</tr>
<tr>
<td>Accrual</td>
<td>Interest will not accrue to the principal</td>
<td>Interest accrues every time to principal</td>
</tr>
</tbody>
</table>

**Types of Interest for Bank Deposits:**
<table>
<thead>
<tr>
<th>Type of Deposit</th>
<th>Type of Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Saving Account</td>
<td>Simple</td>
</tr>
<tr>
<td>Current Account</td>
<td>No Interest</td>
</tr>
<tr>
<td>Fixed Deposit</td>
<td>Simple</td>
</tr>
<tr>
<td>Reinvestment</td>
<td>Compound</td>
</tr>
<tr>
<td>Recurring Deposit</td>
<td>Compound</td>
</tr>
</tbody>
</table>

**Effective Rate of Return:**

- If interest is compounded more than once a year the effective interest rate for a year exceeds the per annum interest rate, then \( \text{ERR} > \text{NR} \)
- When compounding is done annually- \( \text{ERR} = \text{NR} = (1+i)n - 1 \)
- **For Ex:** The effective rate of return for 10% CI p. a, when compounded semi-annually, quarterly and monthly Will be-
  - Half yearly= \((1+.05)2 - 1 = 10.25\%\)
  - Quarterly= \((1+.025)4 - 1 = 10.38\%\)
  - Monthly= \((1+.0083)12 - 1 = 10.47\%\)

**Daily Product Method**

**Introduction:**

Finance is the life blood of trade, commerce and industry. Now-a-days, banking sector acts as the backbone of modern business. Development of any country mainly depends upon the banking system. With a bank people can open saving account, current account, fixed deposit account and recurring deposit account.

**Meaning of Saving Account: (SA)**

- A deposit account held at a bank or other financial institution that provides principal security and a modest interest rate.
- Savings account funds are considered one of the most liquid investments outside of demand accounts and cash.
RBI Guidelines on Saving Account

Savings bank account interest calculation by banks in India as per the new RBI guidelines is based on daily products, i.e. the balances outstanding as at the end of the day. The old method which banks used to calculate interest on savings interest was based on minimum balance kept in the a/c from 10th of any month and last working day of that month. But as per the revised RBI guidelines; the old method was changed (with effect from 01st April 2010). RBI deregulated the interest calculated on savings account which permitted banks to set their own rate of interest on the savings bank account.

New Vs Old method of Interest calculation on SB
Let’s understand the savings interest calculation (New Vs. Old) with an example. We’ll assume a/c statements as given in below are in INR.

<table>
<thead>
<tr>
<th>Date</th>
<th>Particular</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
<th>No. of Days (B)</th>
<th>Product (A*B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-1-2013</td>
<td>By Op Balance</td>
<td>300000</td>
<td></td>
<td>300000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12-1-2013</td>
<td>To down payment</td>
<td>50000</td>
<td></td>
<td>250000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>20-1-2013</td>
<td>By Cheque(000456)</td>
<td></td>
<td>80000</td>
<td>330000</td>
<td>8</td>
<td>2640000</td>
</tr>
<tr>
<td>28-1-2013</td>
<td>To ABC Co,</td>
<td>90000</td>
<td></td>
<td>240000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Calculating Interest as per the OLD method:

Following formula was applicable till 31st March 2010:

\[
\text{Savings Interest (Old Method)} = \text{Minimum balance between 10th and last working day of that month} \times \text{Rate of Interest} \times \frac{1}{\text{No. of Months in a Year}}
\]

So old rate of interest you’d received = 240000*4*1/12*100 = 800 INR

Calculating Interest as per the NEW Method:
Applicable From 01 Apr 2010 as per the RBI guidelines:

<table>
<thead>
<tr>
<th>Date</th>
<th>Particular</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
<th>No. of Days (B)</th>
<th>Product (A*B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-1-2013</td>
<td>By Op Balance</td>
<td>300000</td>
<td></td>
<td>300000</td>
<td>11</td>
<td>3300000</td>
</tr>
<tr>
<td>12-1-2013</td>
<td>To down payment</td>
<td>50000</td>
<td></td>
<td>250000</td>
<td>8</td>
<td>2000000</td>
</tr>
<tr>
<td>20-1-2013</td>
<td>By Cheque(000456)</td>
<td></td>
<td>80000</td>
<td>330000</td>
<td>8</td>
<td>2640000</td>
</tr>
</tbody>
</table>
Savings Interest (New Method):

(Total Products*Rate of Interest/ 365)
So, the interest you’ll receive = 89, 00,000*0.04/365 = **975.34 INR**
The new guideline has bought happiness to the account holder since he’ll see more balance in the account at the end of the month.

**EQUATED MONTHLY INSTALLMENT**

**Meaning of EMI (Equated Monthly Installment)**

An Equated Monthly Installment (EMI) is "A fixed payment amount made by a borrower to a lender at a specified date. Equated monthly installments are used to pay off both interest and principal each month, so that over a specified number of years, the loan is paid off in full." common types of loans, such as real estate mortgages, the borrower makes fixed periodic payments can be paid with the help of EMI. EMIs differ from variable payment plans, in which the borrower is able to pay higher payment amounts at his or her discretion. In EMI plans, borrowers are usually only allowed one fixed payment amount each month.

**Factors to be known about EMI:**

- The repayment of a loan is done by paying an EMI to the bank. The EMI depends on three factors: loan amount, interest rate and the duration of the loan.
- The EMI is decided when the loan is sanctioned and remains constant throughout the period of the loan, provided there is no change in any of the factors on the basis of which it is calculated.
- The EMI has an interest and a principal portion. Through the principal, the borrower repays the loan each month. Through the interest, he pays the bank the interest due on the outstanding loan amount.
- The EMIs are structured in such a way that the interest portion forms a major part of the payment that is made in the initial years. In the later years, the principal component becomes high.
- The EMI can change in the case of an alteration in interest rates or if there is a prepayment. It is also possible to keep the EMI constant and increase or decrease the tenure of the loan to reflect the changes in interest rates or loan prepayment.

**Formula for EMI Calculation:**

<table>
<thead>
<tr>
<th>Date</th>
<th>To ABC Co,</th>
<th>Amount</th>
<th>Rate of Interest</th>
<th>Duration</th>
<th>Total Products</th>
</tr>
</thead>
<tbody>
<tr>
<td>28-1-2013</td>
<td>90000</td>
<td>240000</td>
<td>4</td>
<td>31</td>
<td>890000</td>
</tr>
</tbody>
</table>

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Following is formula used to determine the EMI.

\[ E = P \times \frac{r \times (1+r)^n}{(1+r)^n - 1} \]

Where,
\( E \) = Installment Amount
\( P \) = Principal Loan Amount
\( R \) = Rate of Interest; for EMI, Rate of Interest has to be divided by 12
\( N \) = Number of installments

Let us understand calculation of EMI with following example-

For Ex: Mr. Goyal has taken personal loan of Rs. 100000 for 12 months at CI of 10% p.a. Calculate the EMI that has to be paid by him = Rs. 8885.19

**Fixed and Floating Interest Rates**

*There are two different modes of Interest. They are-*

- Fixed Rates
- Floating Rates also called as variable rates.

**What is Fixed Interest Rate?**

People who opt for Fixed Interest Rate mean that they have to repay the home loan is **fixed and equal instalments as per the loan tenure.** The advantage of fixed interest rate is that it would not change even if there are fluctuations or changes in the Indian financial market conditions or trends. Fixed Interest rate becomes the first preference when the financial market is down. Consumers take the opportunity by blocking or fixing the interest rate as per their preference. In simple terms, if you think that financial market will not drop down below a certain point or foresee a rise in the interest rates, then choosing fixed interest rate shall be the best option to avail.

**What is Floating Interest Rate?**

Interest rate which is volatile and keeps on changing as per market scenario is termed as **Floating Interest Rate.** This type of interest rate depends on the base rate offered by several lenders, so whenever the base rate changes, the interest rate gets automatically revised. As compared to fixed interest rate, floating rates are comparatively
cheaper. Fixed interest rates are 1%-2.5% higher than the floating interest rate. The increase and decrease in the floating interest rate is temporary, as it varies as per the market trends. As home loan is a long-term association with the lender, sometimes it becomes difficult to plan for the financials.

**Comparison between Fixed and Floating Interest Rate**

<table>
<thead>
<tr>
<th>Fixed Interest Rate</th>
<th>Floating Interest Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Higher Interest Rate</td>
<td>Lower Interest Rate</td>
</tr>
<tr>
<td>Not affected by financial market conditions</td>
<td>Affected by changes in the financial market</td>
</tr>
<tr>
<td>Fixed EMIs</td>
<td>EMIs change as per interest rate or MCLR</td>
</tr>
<tr>
<td>Budget planning possible</td>
<td>Difficult to budget or manage financials</td>
</tr>
<tr>
<td>Sense of security</td>
<td>Generates savings</td>
</tr>
<tr>
<td>Suitable for short/medium term (3-10 years)</td>
<td>Suitable for long term (20-30 years)</td>
</tr>
<tr>
<td>Lesser risk</td>
<td>Higher risk</td>
</tr>
</tbody>
</table>

**Front-End and Back-End Interest Rates**

**What Is the Front-End Ratio?**

The front-end ratio, also known as the mortgage-to-income ratio, is a ratio that indicates what portion of an individual's income is allocated to mortgage payments. The front-end ratio is calculated by dividing an individual’s anticipated monthly mortgage payment by his/her monthly gross income. The mortgage payment generally consists of principal, interest, taxes, and mortgage insurance (PITI). Lenders use the front-end ratio in conjunction with the back-end ratio to determine how much to lend.

**What Is the Back-End Ratio?**

The back-end ratio, also known as the debt-to-income ratio, is a ratio that indicates what portion of a person's monthly income goes toward paying debts. Total monthly debt includes expenses, such as mortgage payments (principal, interest, taxes, and insurance), credit card payments, child support, and other loan payments.

**Annuities**

**What are Annuities?**

At some point in your life, you may have had to make a series of fixed payments over a period of time—such as rent or car payments—or have received a series of payments over a period of time, such as bond coupons. These are called annuities.
Ordinary Annuity: Payment are required at the end of each period. For an illustration, straight bonds usually make coupon payments at the end of every six months until the bond’s maturity date.

Annuity Due: Payments are required at the beginning of each period. Rent is an illustration of annuity due. You are usually required to pay rent when you first move in at the beginning of the month, and then on the first of each month thereafter.

Since the present and future value calculations for ordinary annuities and annuities due are slightly different, we will first discuss the present and

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**Unit 2- Calculation of YTM**

**Meaning of Debt**

Debt means a sum of money due by one party to another. Most business need a mix of debt and equity to run their operations. This is called the capital structure of that firm/company.

Debts can arise through bank borrowings, fixed deposits, bonds or other instruments. Where the amount is fixed and specific, and does not depend upon any future valuation to settle it.

**Bonds**

Debt Capital Consists of mainly bonds and debentures.

**What are Bonds?**

Bonds are issued by organizations generally for a period of more than one year to raise money by borrowing.

Organizations in order to raise capital issue bond to investors which is nothing but a financial contract, where the organization promises to pay the principal amount and interest (in the form of coupons) to the holder of the bond after a certain date. (Also called maturity date). Some Bonds do not pay interest to the investors, however it is mandatory for the issuers to pay the principal amount to the investors.

**Why Investment is Important?**

Every individual needs to put some part of his income into something which would benefit him in the long run. Investment is essential as unavoidable circumstances can arise anytime and anywhere. One needs to invest money into something which would guarantee maximum returns with minimum risks in future. Money saved now will help you overcome tough times in the best possible way.
Characteristics of a Bond

- **Face value**: Also known as, the par value and stated on the face of the bond. It represents the amount borrowed by the firm, which it promises to repay after a specified period.

- **Coupon rate**: A bond carries a specific rate of interest, which is also called as the coupon rate.

- **Market value**: A bond may be traded on a stock exchange. Market value is the price at which the bond is usually bought or sold in the market. Market value may be different from the par value or the redemption value.

- **Redemption Value**: The value, which the bondholders gets on maturity. Is called the redemption value, A bond is generally issued at a discount (less than par value) and redeemed at par.

- **Maturity date**: Maturity date refers to the final date for the payment of any financial product when the principal along with the interest needs to be paid to the investor by the issuer.

Types of Bonds

*Following are the types of bonds:*

**Fixed Rate Bonds**

In Fixed Rate Bonds, the interest remains fixed throughout the tenure of the bond. Owing to a constant interest rate, fixed rate bonds are resistant to changes and fluctuations in the market.

**Floating Rate Bonds**

Floating rate bonds have a fluctuating interest rate (coupons) as per the current market reference rate.

**Zero Interest Rate Bonds**

Zero Interest Rate Bonds do not pay any regular interest to the investors. In such types of bonds, issuers only pay the principal amount to the bond holders.

**Inflation Linked Bonds**

Bonds linked to inflation are called inflation linked bonds. The interest rate of Inflation linked bonds is generally lower than fixed rate bonds.

**Perpetual Bonds**

Bonds with no maturity dates are called perpetual bonds. Holders of perpetual bonds enjoy interest throughout.
Subordinated Bonds

Bonds which are given less priority as compared to other bonds of the company in cases of a close down are called subordinated bonds. In cases of liquidation, subordinated bonds are given less importance as compared to senior bonds which are paid first.

Bearer Bonds

Bearer Bonds do not carry the name of the bond holder and anyone who possesses the bond certificate can claim the amount. If the bond certificate gets stolen or misplaced by the bond holder, anyone else with the paper can claim the bond amount.

Covered bond

Covered bond are backed by cash flows from mortgages or public sector assets. Contrary to asset-backed securities the assets for such bonds remain on the issuers balance sheet.

A Government Band

A government band, also called Treasury bond, is issued by a national government and is not exposed to default risk.

Optionality In Bonds

Occasionally a bond may contain an embedded option; that is, it grants option-like features to the holder or the issuer:

- **Callability**: Some bonds give the issuer the right to repay the bond before the maturity date on the call dates. This is call option. These bonds are referred to as callable bonds. Most callable bonds allow the issuer to repay the bond at par. With some bonds, the issuer has to pay a premium, the so-called call premium.

- **Putability**: Some Bonds give the holder the right to force the issuer to repay the bond before the maturity date on the put dates. This is put option. These are referred to as retractable or putable bonds.

Valuation of Bonds

A security/Bond can be regarded simply as an asset that pay a series of dividends or interests over a period. Therefore, the value of any security can be defined as the present value of these future cash streams, i.e, the intrinsic value of an assets is equal to the present value of the benefits associated with it. It is quite clear that the holder of a bond receives a fixed annual interest payment for a certain value (equal to par value) at the time of maturity. Therefore the intrinsic value of the present value of a bond is
Vo= intrinsic value of the bond  
I= Annual interest payable on the bond  
F= Redeemable value of the bond  
n= Maturity period of the bond  
k_d= Cost of capital  

Note: Solving the problems related to bond valuation, usually Present value Interest Factor of Annuity pertaining to the applicable interest rate are provided. PVIF represents the discount value of one Rupee for the period concerned and interest rate while PVIFA represents the present value of an ordinary annuity for the period concerned and interest rate. Example- PVIF (10%, 6) means present value of one Rupee to be received after 6 periods at the interest rate of 10% period. PVIFA (10%,6) means present value of an ordinary annuity one Rupee per period for 6 period at the interest rate of 10% per period.  

Example:  
A bond, whose par value is Rs 1000, bears a coupon rate of 12% and has a maturity period of 3 years. The required rate of return on the bond is 10%. What is the value of this bond?  

Solution-  
Annual interest payable= 1000* 12%=120  
Principle repayment at the end of 3 years= Rs 1000  
The value of the bond  
120(PVIFA 10%, 3yrs) + 1000 (PVIF 10%, 3 yrs)  
=120(2.487)+1000(0.751)  
=298.44+ 751  
=1049.44  

**Bond Value with Semi- Annual Interest**  
If the Bond carries a semi-annual, as the amount of the half-yearly interest can be reinvested, the value of such bonds would be more the value of bonds with an annual interest payment. Hence, by multiplying the numbers of years to maturity by two and
dividing the (i) annual interest payment, (ii) discount rate by two we can modify bond valuation formula as follows:

\[ V_0 = \sum_{t=1}^{2n} \frac{I/2}{(1 + kd/2)^t} + \frac{F}{(1 + kd/2)^n} \]

Example:

A bond, whose par value is Rs 1000 bears a coupon rate of 12% payable semiannually and has a maturity period of 3 years. The required rate of return on bonds is 10%. What is the value of this bond?

Solution-

Semi-annual interest payable = 1000 * 12% / 2 = 60

Principal repayment at the end or 3 years = 1000

The value of the bond

= 60(PVIFA 10%/2, 6dps) + 1000(PVIF 10%/2, 6pds)

= 60 (5.0746) + 1000 (0.746)

= 304.48 + 746

= 1050.48

Current Yield on Bond

Current yield represents the prevailing interest rate that a bond or fixed income security is delivering to its owners.

The formula for current yield is defined as follows:

\[ CY = \frac{\text{Annual interest payment}}{\text{Current Bond Price}} \]

For example, let's assume a particular bond is trading at par, or 100 cents on the dollar, and that it pays a coupon rate of 3%. In this case, the bond’s current yield will also be 3% (as shown below).

\[ CY = \frac{3}{100} = 3.00\% \]
However, let’s now assume that the same bond is trading at a discount to its par value. For the sake of example, let’s say investors can now purchase the bond for just 95 cents on the dollar. In this case, even though the bond will still be paying a 3% coupon, its current yield will actually be slightly higher (as shown below):

\[
\text{CY} = \frac{3}{95} = 3.16\%
\]

As another example, let’s say the bond is trading at a premium to its face value -- 110 cents on the dollar. In this case, even though the bond will still be paying a 3% coupon, its current yield will actually be quite a bit lower (as shown below):

\[
\text{CY} = \frac{3}{110} = 2.73\%
\]

Use our Yield to Call (YTC) Calculator to measure your annual return if you hold a particular bond until its first call date.

Use our Yield to Maturity (YTM) Calculator to measure your annual return if you plan to hold a particular bond until maturity.

**Yield-To- Maturity of Bond**

It is the rate of return earned by an investor, who purchases a bond and holds it until the maturity. The YTM is the discount rate, which equals the present value of promised cash flows to the current market price/ Purchase price.

**Example:**

Consider a Rs 1000 par value bond, whose current market price is Rs 850/-. The bond carries a coupon rate of 8% and has the maturity period of 9 yrs. What would be the rate of return that an investor earns if he purchase the bond and holds until maturity?

**Solution:**

If \( kd \) is the yield to maturity then,

\[
850 = 80 \times (PVIFA_{kd\%}, 9\ yrs)+1000 \times (PVIF_{kd\, 9yrs})
\]

To calculate the value of \( kd \), we have to try several values:

\[
=80 \times (PVIFA_{12\%, 9}) + 1000 \times (PVIF_{12\%\, 9})
=80 \times 5.328 + 1000 \times 0.361
=426.24 + 361 = 787.24
\]

Since, the above value is less than 850, we have to try with value less than 12%. Let us try with \( kd = 10\% \)

\[
=80 \times (PVIFA_{10\%, 9}) + 1000 \times (PVIF_{10\%\, 9})
=80 \times 5.759 + 1000 \times 0.424
\]
=884.72

Form the above it is clear that kd lies between 10% and 12%. We have to use linear interpolation in the range of 10% and 12%. Using it, we find that kd is equal to the following:

\[kd = 10\% + (12\% - 10\%) \times \frac{884.72 - 850}{884.72 - 787.24}\]

\[= 10\% + 2\% \times \frac{34.72}{97.48}\]

\[= 10.71\%\]

Therefore, the yield to maturity is 10.71%

**Duration of Bond**

**WHAT IS THE DURATION OF A BOND?**

The duration of a bond expresses the sensitivity of the bond price to changes in the interest rate. In other words, the bond duration measures the movement in the price of the bond for every 1% change in the interest rate.

The unit of bond duration is expressed in years. Also, the price of the bond and the interest rates are inversely related. Therefore, if a bond has a duration of 5 years, it signifies that for every 1% increase in the interest rate, the price of the bond will fall by 5% and vice-versa. The greater is the bond duration, the greater will be the amplification in the movement of bond price for every single unit of change of the interest rates.

**There is a simple way of computing the desired duration period:**

1. Determine the cash flows from holding the bond.
2. Determine the present value of these cash flows by discounting the flows with discount rate. (YTM)
3. Multiply each of the present values by respective numbers of years left before the present value is received.
4. Sum these products up and divide by the present value to get the duration of the bond.

**Properties of Duration**

- Duration is less than the term to maturity
- Bond’s duration will be equal to its term to maturity if and only if it is a zero coupon bond
• The duration of perpetual bond is equal to \((1+r)/r\), where \(r\) = current yield of the bond’
• Longer a coupon paying bond’s term to maturity, the greater the difference between its term to maturity and duration.
• Duration and YTM are inversely related.
• Larger the coupon rate, smaller the duration of a bond
• An increase in the frequency of coupon payments decrease the duration, while a decrease in frequency of coupons increases it.
Duration of a bond declines as the bond approaches maturity.

**Bond Price Volatility**

The sensitivity of the bond price to changes in the interest rates is called “Bond Volatility”. Bond prices and YTM are inversely related. Therefore, instantaneous changes in market yields cause prices to changes in the opposite direction. The extent of change in the bond prince for a change in YTM measures the interest rate risk of a bond. The interest rate risk is a function of the interest rate elasticity. Interest rate elasticity (IE) can be defined as:

\[
IE = \frac{\text{Percentage change in price for bond in period } t}{\text{Percentage change in yield to maturity for bond}}
\]

Interest rate elasticity is always a negative number, due to the inverse relationship between YTM and bond prices.

Bond price elasticity can also be computed with the help of following mathematical formula:

\[
IE = \frac{D \times \text{YTM}}{1+\text{YTM}}
\]

The above equation suggests that the duration and interest rate elasticity of a bond are directly related. Anything that causes the duration of a bond to increase will also increase the bond’s interest rate elasticity.

---

**Unit 3- Capital Budgeting**

**Capital Budgeting**

Capital budgeting is a process of evaluating investments and huge expenses in order to obtain the best returns on investment.
An organization is often faced with the challenges of selecting between two projects/investments or the buy vs replace decision. Ideally, an organization would like to invest in all profitable projects but due to the limitation on the availability of capital an organization has to choose between different projects/investments.

**Capital budgeting as a concept affects our daily lives. Let's look at an example-**

Your mobile phone has stopped working! Now, you have two choices: Either buy a new one or get the same mobile repaired. Here, you may conclude that the costs of repairing the mobile increases the life of the phone. However, there could be a possibility that the cost to buy a new cell phone would be lesser than its repair costs. So, you decide to replace your cell phone and you proceed to look at different phones that fit your budget!

**Future Value**

Money has a time value, i.e. a given sum of money has greater value if it is received earlier as it can be profitability invested. To illustrate, consider an investor, who is evaluating an investment opportunity that requires an immediate outlay is Rs 100000 that will generate income in subsequent years. In deciding whether to go ahead with the investment, the investor will be concerned with how much income generation will be there in future. A rational investor will be unwilling to undertake the investment if he knows that he will receive less than what he can earn as interest.

Thus, if the project has the life of one year, P is the immediate outlay and r is the rate of interest, his return should be more than the sum F, where

\[ F = P(1+r) = (100000)(1+.10) = 1,10000 \] (current rate of interest r=10%)

And if the project has the life of 2 yrs and the return is only at the end of 2 yrs his return should be more than the sum F, where

\[ F = P(1+r)^2 = 100000(1+.10)^2 = 121000 \]

Clearly, if the investor has choose the project, he has to compare the yield on the investment to the yield from project’s cash flow, i.e. if the project has the life of two years then his return should be more 1,21,000.

Future value of Rs 100000 in year 20= 1,00,000(1+0.10)^20=6,72,750

**Present Value and Discounting**

The Present value of a sum of money to be received in the future is calculated by dividing the future sum by \((1+r)^n\) as follows:

**Present Value** = \( P=M/(1+r)^n \)

The use of present time as a common reference point rather than some future point of time is particularly useful when comparing projects of different lengths of life. For Example, if
two projects are to be compared, one that has an expected life of five years and the other having an expected life of nine year, it is easier to convert the cash flows to their preset value than to a future value.

**Discounted cash flow Techniques for Investment Appraisal**

This chapter sets out two main discounting techniques of investment appraisal namely the net present value (NPV) method and the internal rate of return (IRR) methods. Two main assumptions that are made in discussing the two techniques, are as follows:

- That the sums of moneys, resulting from an investment, that accrue in future, are know with certainty.
- That there is no inflation.

**Net present value**

NPV method involves comparing the present value of the future cash flows of an investment opportunity with the cash outlay that is required to finance the opportunity. In this ways, we determine whether the investment opportunity provides a surplus, when the cash flows are measured in present value terms. The stages involved in using the NPV method are as follows:

- Estimate all future net cash flows (revenue minus cost) associated with an investment opportunity.
- Convert these net cash flow figures to their present value equivalents by discounting at the appropriate discount rate;
- Add all the present value figures of future cash flows;
- Subtract from this value, the initial cost of investment.

\[
NPV = C_0 + \frac{C_1}{1 + r} + \frac{C_2}{(1 + r)^2} + \ldots + \frac{C_T}{(1 + r)^T}
\]

- \(C_0\) = Initial Investment
- \(C\) = Cash Flow
- \(r\) = Discount Rate
- \(T\) = Time

Net Present Value (NPV) is a formula used to determine the present value of an investment by the discounted sum of all cash flows received from the project. The formula for the discounted sum of all cash flows can be rewritten as
When a company or investor takes on a project or investment, it is important to calculate an estimate of how profitable the project or investment will be. In the formula, the \(-C_0\) is the initial investment, which is a negative cash flow showing that money is going out as opposed to coming in. Considering that the money going out is subtracted from the discounted sum of cash flows coming in, the net present value would need to be positive in order to be considered a valuable investment.

**How is NPV calculated?**

NPV tells you whether a certain project will generate cash flows according to your expectations or not. Using an assumed rate of return and investment horizon, it brings to light any adjustments required in your current investment to achieve a positive return.

NPV can be calculated by using the following formula:

\[
NPV = \sum_{i=1}^{n} \frac{Cash\ Flow_i}{(1+r)^i} - \text{Initial Investment}
\]

Where

- \(C_n\) = difference of cash flows
- \(r\) = discount rate
- \(n\) = time in years

You need to follow selection criteria with regards to the usage of NPV. Calculation of NPV will result in three possible outcomes:

**Positive NPV:** In this situation, the present value of cash inflows is greater than the present value of cash outflows. This is an ideal situation for investment

**Negative NPV:** In this situation, the present value of cash inflows is less than the present value of cash outflows. This is not an ideal situation and any project with this NPV should not be accepted.
Zero NPV: In this situation, the present value of cash inflows equals the present value of cash outflows. You may or may not accept the project.

**Internal Rate of Return (IRR)**

The internal rate of return (IRR) is a discounting cash flow technique which gives a rate of return earned by a project. The internal rate of return is the discounting rate where the total of initial cash outlay and discounted cash inflows are equal to zero. In other words, it is the discounting rate at which the net present value (NPV) is equal to zero.

**How is the Internal Rate of Return computed?**

For the computation of the internal rate of return, we use the same formula as NPV. To derive the IRR, an analyst has to rely on trial and error method and cannot use analytical methods. With automation, various software (like Microsoft Excel) is also available to calculate IRR. In Excel, there is a financial function that uses cash flows at regular intervals for calculation.

\[
\text{IRR} = \frac{(\text{Cash flows})}{(1+r)^i} - \text{Initial Investment}
\]

Where:
- Cash flows = Cash flows in the time period
- \( r \) = Discount rate
- \( i \) = Time period

The rate at which the cost of investment and the present value of future cash flows match will be considered as the ideal rate of return. A project that can achieve this is a profitable project. In other words, at this rate the cash outflows and the present value of inflows are equal, making the project attractive.

**How is IRR used for capital budgeting?**

- If the same costs apply for different projects, then the project with the highest IRR will be selected. If an organization needs to choose between multiple investment options wherein the cost of investment remains constant, then IRR will be used to rank the projects and select the most profitable one. Ideally, the IRR higher than the cost of capital is selected.
In real life scenarios, since the investment in any project will be huge and will have a long-term effect, an organization uses a combination of various techniques of capital budgeting like NPV, IRR and payback period to select the best project.

Illustration

Let us say a company has an option to replace its machinery. The cost and return are as follows:

Initial investment = Rs.5,00,000
Incremental increase per year = Rs.2,00,000
Replacement value = Rs.45,270
Life of asset = 3 years

If we assume IRR to be 13%, the computation will be as follows.

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash flows</th>
<th>Discounted cash flows</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>-500000</td>
<td>(500000) (5,00,000 * 1)</td>
</tr>
<tr>
<td>1</td>
<td>200000</td>
<td>176991</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(2,00,000 * [1/1.13])</td>
</tr>
<tr>
<td>2</td>
<td>200000</td>
<td>156229 (2,00,000 * [1/1.13]^2)</td>
</tr>
<tr>
<td>3</td>
<td>200000</td>
<td>138610</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(2,00,000 * [1/1.13]^3)</td>
</tr>
<tr>
<td>4</td>
<td>45270</td>
<td>27765(45,270 * [1/1.13]^4)</td>
</tr>
</tbody>
</table>

The total of the column Discounted Cash Flows approximately sums up to zero making the NPV equal to Zero. Hence, this discounted rate is the best rate.

As can be seen from the above, using the rate of 13%, the cash flows, both positive and negative become minimum. Hence, it is the best rate of return on investment.

The cost of capital of the company is 10%. Since the IRR is higher than the cost of capital, the project can be selected.
If the company has another opportunity to invest the money in a project that gives a 12% return, the company will still go in for the machinery replacement since it gives the highest IRR.

**NPV and IRR Compared**

NPV and IRR methods have the advantage that they take into account the time value of money and thus, they are viewed as being superior to the non-discounting technique.

In addition, these two techniques have the advantage that they focus on cash flows rather than on accounting profits.

Given that both the NPV and IRR are characterised by these advantages, it may be thought that either is equally acceptable, in terms of proving decision advice, which will help to meet the goals of the organization. However, while the two techniques are clearly similar, they do not always guarantee to provide the same investment decision advice. We therefore, need to make a comparison of the two techniques to understand which one is superior. This is particularly important because, as we will see, is more reliable. The preference of decision makers for the IRR results from the fact that the business people are more used to thinking in terms of rates of return. However, in some situations, the use of the IRR approach may lead to inappropriate investment decision guidance.

**Investment Opportunities with capital Rationing**

In situations, Where the funds for investment are rationed, it will not be possible to undertake all investment opportunities that have a positive NPV or for which the IRR is greater than the cost of capital. Even where the projects are not mutually exclusive, capital rationing raise problems for both the NPV method and the IRR method.

**Risk Adjusted Discount Rate Approach for NPV Determination**

This approach to investment decision making process is an attempt to deal with the problem caused by an absence of certainty in relation to the cash flows in a manner that takes account of the risk attitudes of those people on whose behalf the decision is being made. When faced with a situation of risk, investors who are averse risk will require a higher rate of return to compensate them for taking on that risk. The higher the level of risk, the greater must be the rate of return. The risk –adjusted rate of return approach puts this simple concept into practice. *This method involves the following steps:*

- The decision makers should determine the rate of return that would be required for taking on investment with zero risk.
• Then add on to this rate of return, a risk premium, to take account of the risk factor of the investment under consideration.
• Rate of return, when calculated this way, is used as the discount rate in the NPV calculation.

**Non- Discounted Cash Flow Techniques**

**Payback period method:**

As the name suggests, this method refers to the period in which the proposal will generate cash to recover the initial investment made. It purely emphasizes on the cash inflows, economic life of the project and the investment made in the project, with no consideration to time value of money. Through this method selection of a proposal is based on the earning capacity of the project. With simple calculations, selection or rejection of the project can be done, with results that will help gauge the risks involved. However, as the method is based on thumb rule, it does not consider the importance of time value of money and so the relevant dimensions of profitability.

**Payback period = Cash outlay (investment) / Annual cash inflow**

**Accounting rate of return method (ARR):**

This method helps to overcome the disadvantages of the payback period method. The rate of return is expressed as a percentage of the earnings of the investment in a particular project. It works on the criteria that any project having ARR higher than the minimum rate established by the management will be considered and those below the predetermined rate are rejected.

This method takes into account the entire economic life of a project providing a better means of comparison. It also ensures compensation of expected profitability of projects through the concept of net earnings. However, this method also ignores time value of money and doesn't consider the length of life of the projects. Also it is not consistent with the firm's objective of maximizing the market value of shares.

**ARR= Average profit after tax/Average Investment**

**IMPORTANCE OF CAPITAL BUDGETING**

**Long term investments involve risks:** Capital expenditures are long term investments which involve more financial risks. That is why proper planning through capital budgeting is needed.

**Huge investments and irreversible ones:** As the investments are huge but the funds are limited, proper planning through capital expenditure is a pre-requisite. Also, the capital investment decisions are irreversible in nature, i.e. once a permanent asset is purchased its disposal shall incur losses.
Long run in the business: Capital budgeting reduces the costs as well as brings changes in the profitability of the company. It helps avoid over or under investments. Proper planning and analysis of the projects helps in the long run.

SIGNIFICANCE OF CAPITAL BUDGETING

- Capital budgeting is an essential tool in financial management
- Capital budgeting provides a wide scope for financial managers to evaluate different projects in terms of their viability to be taken up for investments
- It helps in exposing the risk and uncertainty of different projects
- It helps in keeping a check on over or under investments
- The management is provided with an effective control on cost of capital expenditure projects
- Ultimately the fate of a business is decided on how optimally the available resources are used

Unit 4 - Depreciation and its Accounting

Depreciation
Depreciation is a charge to profit and loss account for the fall in value of an asset during each year of its use.

- Depreciation is a part of the opening cost.
- It is a reduction in the value of the asset.
- The decrease in the value of an asset is due to its use, caused by wear and tear, or by other reasons.
- The decrease in the value of an asset is gradual and continuous.

**Causes of Depreciation**

- Wear and tear due to actual use
- Obsolescence
- Accidents
- Fall in market price
- Efflux of time

**Need for Depreciation**

- To know the correct profit
- To show correct financial position
- To make provision for replacement of asset

**Factors of Depreciation**

For calculating depreciation, the basic factors are:

- The cost of the asset;
- The estimated resident or scrap value at the end of its life;
- The estimated number of year of its commercial life.

**Methods of Depreciation**

The following are the various methods for providing depreciation:

- Fixed percentage on original cost or fixed instalment or straight line method.
- Fixed percentage on diminishing balance or reducing instalment methods or written down value method.
- Sum of years digits method.
**Accounting Entries**

*The accounting entries to be made on account of providing depreciation are:*

Depreciation account – Dr. 3000

To asset account - 3000

The depreciation account goes to the debit of profit and loss account and the asset appears at its reduced value in the balance sheet. An alternative entry is:

Depreciation account – Dr. 3000

To provision for depreciation Account- Dr. 3000

In this case, depreciation account goes to the debit of profit and loss account. The value of assets continue to be the same for every year in the balance sheet and the provision for depreciation is deducted from the value of asset and net value of asset is shown in the balance sheet. In other words, the provision for depreciation may appear in the balance sheet.

---

**Straight line Method**

According to the Straight line method, the cost of the asset is written off equally during its useful life. Therefore, an equal amount of depreciation is charged every year throughout the useful life of an asset. After the useful life of the asset, its value becomes nil or equal to its residual value. Thus, this method is also called Fixed Installment Method or Fixed percentage on original cost method.

When the amount of depreciation and the corresponding period are plotted on a graph it results in a straight line. Hence, it is known as the Straight line method (SLM).

This method is more suitable in case of leases and where the useful life and the residual value of the asset can be calculated accurately. However, where the repairs are low in the initial years and increase in subsequent years, this method will increase the charge on profit.

Also, while applying this method, the period of use of the asset should be considered. If an asset is used only for 3 months in a year then depreciation will be charged only for 3 months. However, for the Income Tax purposes, if an asset is used for more than 180 days full years’ depreciation will be charged.

---

**Advantages**

- It is the simplest method of calculating depreciation.
It is easy to understand, as there is no variation in the amount of depreciation charged from year to year.

**Disadvantages**

- The depreciation is equal for all the years, however, the expenditure on repairs and renewal goes on increasing as the asset gets older, resulting in higher amount charged to profit and loss account on account of depreciation and repairs in the subsequent years.

**Formula:**

**Amount of Depreciation** = \( \frac{(\text{Cost of Asset} - \text{Net Residual Value})}{\text{Useful Life}} \)

**The rate of Depreciation** = \( \frac{\text{Annual Depreciation} \times 100}{\text{Cost of Asset}} \)

**Journal Entries for Straight Line Method of Depreciation**

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Amount (Dr.)</th>
<th>Amount (Cr.)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Purchase of asset</strong></td>
<td>Dr. xx</td>
<td></td>
</tr>
<tr>
<td>1.</td>
<td><strong>Asset A/c</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>To Cash/ Bank/ Creditor’s A/c</strong></td>
<td>xx</td>
<td></td>
</tr>
<tr>
<td></td>
<td><em>(Being asset purchased)</em></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td><strong>Charge Depreciation</strong></td>
<td>Dr. xx</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Depreciation on Asset A/c</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>To Asset A/c</strong></td>
<td></td>
<td>xx</td>
</tr>
<tr>
<td></td>
<td><em>(Being depreciation charged on asset)</em></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td><strong>Transfer Depreciation</strong></td>
<td>Dr. xx</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Profit &amp; Loss A/c</strong></td>
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</tr>
<tr>
<td></td>
<td><strong>To Depreciation on Asset A/c</strong></td>
<td></td>
<td>xx</td>
</tr>
<tr>
<td></td>
<td><em>(Being depreciation on asset transferred to profit and loss)</em></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
**Example**

Q. Abhinav purchased a machine on 1 Apr 2015 for ₹400000. The useful life of the machine is 3 years and its estimated residual value is ₹40000. At the end of its useful life, the machine is sold for 50000. Prepare the necessary ledger accounts in the books of Abhianv for the year ending 31st December every year. Use SLM.

Ans: In the books of Abhinav

**Machinery A/c**

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Amount</th>
<th>Date</th>
<th>Particulars</th>
<th>Amount</th>
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</thead>
<tbody>
<tr>
<td>2015</td>
<td>1 Apr To Cash A/c</td>
<td>400000</td>
<td>31 Dec By Depreciation A/c</td>
<td>90000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>By balance c/d</td>
<td>31000</td>
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<tr>
<td></td>
<td></td>
<td>400000</td>
<td></td>
<td></td>
<td>400000</td>
</tr>
<tr>
<td>2016</td>
<td>1 Jan To balance b/d</td>
<td>31000</td>
<td>31 Dec By Depreciation A/c</td>
<td>120000</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>By balance c/d</td>
<td>190000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>310000</td>
<td></td>
<td></td>
<td>310000</td>
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</tbody>
</table>
### Depreciation A/c

<table>
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<tr>
<th>Date</th>
<th>Particulars</th>
<th>Amount</th>
<th>Date</th>
<th>Particulars</th>
<th>Amount</th>
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<tr>
<td>31 Dec</td>
<td>To Machinery A/c</td>
<td>90000</td>
<td>31 Dec</td>
<td>By Profit &amp; Loss A/c</td>
<td>90000</td>
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<tr>
<td></td>
<td>90000</td>
<td></td>
<td></td>
<td>90000</td>
<td></td>
</tr>
<tr>
<td>2016</td>
<td></td>
<td></td>
<td>2016</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
**Working Notes:**

Calculation of amount of depreciation

\[
\text{Depreciation} = \frac{\text{(Cost of Asset} - \text{Net Residual Value})}{\text{Useful life}}
\]

\[
= \frac{400000 - 40000}{3} = 120000 \text{ p.a.}
\]

**Diminishing Balance Method or Written-down Value Method**

According to the Diminishing Balance Method, depreciation is charged at a fixed percentage on the book value of the asset. As the book value reduces every year, it is also known as the Reducing Balance Method or Written-down Value Method.

Since the book value reduces every year, hence the amount of depreciation also reduces every year. Under this method, the value of the asset never reduces to zero.
When the amount of depreciation charged under this method and the corresponding period are plotted on a graph it results in a line moving downwards.

This method is based on the assumption that in the earlier years the cost of repairs to the assets is low and hence more amount of depreciation should be charged. Also, in the later years, the cost of repairs will increase and therefore less amount of depreciation shall be provided. Hence, this method results in an equal burden on the profit every year during the life of the asset.

**Amount of depreciation=Book Value× Rate of Depreciation/100**

**Advantage**

- This method is recognised under the Income-Tax Act and the Companies Act.
- The total expenditure on repairs and renewal and depreciation on asset are equal in all year, as in the initial years the depreciation will be more and less and in later years the expenditure on repairs will be high and depreciation less, through both may not exactly compensate the decrease/increase in the other.

**Disadvantage**

- The asset can never be reduced to zero value on the books
- Difficult to understand, as there is variation in the depreciation charged from year to year.

**Journal entry for Diminishing Balance Method of Depreciation**

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Amount (Dr.)</th>
<th>Amount (Cr.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Purchase of asset</td>
<td>Asset A/c</td>
<td>Dr. xx</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Cash / Bank / Creditor’s A/c</td>
<td></td>
<td>xx</td>
</tr>
<tr>
<td></td>
<td>(Being asset purchased)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Charge Depreciation</td>
<td>Depreciation on Asset A/c</td>
<td>Dr. xx</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Asset A/c</td>
<td></td>
<td>xx</td>
</tr>
</tbody>
</table>
### Example on Diminishing Balance method

Q. M/s. Srivastav and sons purchased a machine on 1 Apr 2015 for ₹400000 from ABC & Co. and paid ₹100000 on its installation. The useful life of the machine is 3 years and its estimated residual value is ₹40000. On 31st March 2018, M/s. Srivastav and sons sell the machinery for ₹250000.

Charge depreciation as per the W.D.V. method @10% p. a. Prepare the necessary ledger accounts in the books of Anil for the year ending 31st December every year.

**Ans:** In the books of M/s. Srivastav and sons

**Machinery A/c**

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Amount</th>
<th>Date</th>
<th>Particulars</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td></td>
<td></td>
<td>2015</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Apr</td>
<td>To ABC &amp; Co. A/c</td>
<td>400000</td>
<td>31 Dec</td>
<td>By Depreciation A/c</td>
<td>37500</td>
</tr>
<tr>
<td></td>
<td>To Cash A/c (installation exp.)</td>
<td>100000</td>
<td>31 Dec</td>
<td>By balance c/d</td>
<td>462500</td>
</tr>
<tr>
<td>Year</td>
<td>To balance b/d</td>
<td>Depreciation A/c</td>
<td>Balance c/d</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>2016</td>
<td>500000</td>
<td>462500</td>
<td>416250</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>416250</td>
<td>416250</td>
<td>374625</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td>374625</td>
<td>9366</td>
<td>250000</td>
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<td></td>
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</table>

**Depreciation A/c**
<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Amount</th>
<th>Date</th>
<th>Particulars</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>To Machinery A/c</td>
<td>37500</td>
<td>31 Dec</td>
<td>By Profit &amp; Loss A/c</td>
<td>37500</td>
</tr>
<tr>
<td>2016</td>
<td>To Machinery A/c</td>
<td>46250</td>
<td>31 Dec</td>
<td>By Profit &amp; Loss A/c</td>
<td>46250</td>
</tr>
<tr>
<td>2017</td>
<td>To Machinery A/c</td>
<td>41625</td>
<td>31 Dec</td>
<td>By Profit &amp; Loss A/c</td>
<td>41625</td>
</tr>
<tr>
<td>2018</td>
<td>To Machinery A/c</td>
<td>9366</td>
<td>31 Dec</td>
<td>By Profit &amp; Loss A/c</td>
<td>9366</td>
</tr>
</tbody>
</table>

**Working Notes:**

**Calculation of amount of depreciation**

Amount of depreciation = Book Value × Rate of Depreciation / 100

- 2015: Depreciation = 500000 × 10/100 × 9/12 = 37500
- 2016: Depreciation = 462500 × 10/100 = 46250
- 2017: Depreciation = 416250 × 10/100 = 41625
2018: Depreciation = \( 374625 \times \frac{10}{100} \times \frac{3}{12} = 9366 \)

*Calculation of loss on sale of machinery*

Loss = Book Value on 1 Jan 2018 – depreciation for 3 months – cash received

\[ = 374625 - 9366 - 250000 = 115259 \]

**JAIIB Online Mock test with Explanation**

<table>
<thead>
<tr>
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</table>

**Telegram Group:** ![Click Here](Mock Link)
Foreign Exchange

Foreign Exchange is the trading of one currency for another. For example, one can swap the U.S. dollar for the Indian Rupees. Foreign exchange transactions can take place on the foreign exchange market, also known as the Forex Market.

Fundamentals of Foreign Exchange

There are three fundamental aspects of this general mechanism of foreign exchange.

- Almost every country has its own currency (legal tender, distinctive unit of account) and the useful possession of the currency, can normally be had only in that country, in which it passes.
- The exchange from one currency for another is, mostly, put through by the banks by means of bookkeeping entries carried out in the two centres concerned.
- Almost all exchanges of one currency for another are affected with the help of credit instruments.

Indian Forex Market

The exchange rate movements in the Indian forex market do not necessarily follow the international trend, particularly in the short run. The main reason for this is the restriction on the free flow of capital into or out of the country. Prior to the method ‘Liberalised Exchange Rate Management System’ (LERMS) the Reserve Bank fixed the buying and selling rates and the market would remain within the ceiling and the floor, thus fixed by the Reserve Bank. However, at present, the forces of demand and supply in the local Interbank market derive the Exchange rate.

Direct and Indirect Quote

The quote is direct when the price of one unit of foreign currency is expressed in terms of the domestic currency.

The quote is indirect when the price of one unit of domestic currency is expressed in terms of Foreign currency.
Since the US dollar (USD) is the most dominant currency, usually, the exchange rates are expressed against the US dollar. However, the exchange rates can also be quoted against other countries’ currencies, which is called as cross currency.

Now, a lower exchange rate in a direct quote implies that the domestic currency is appreciating in value. Whereas, a lower exchange rate in an indirect quote indicates that the domestic currency is depreciating in value as it is worth a smaller amount of foreign currency.

**Some Basic Exchange Rate Arithmetic**

**Cross Rate**

If a person wants to remit Euros from India, and as a banker, and for argument sake, rupees/ Euros are not normally quoted and therefore, what we have to do is first buy dollars against the rupees and the same dollars will be disposed off overseas to acquire the Euros.

If a rate in Mumbai market are US 1 Dollar- Rs 60.8450/545 and rates in London market are US 1 Dollar=Euros 0.7587 we will get US 1 dollar for Rs 60.8545 and for one Us dollar we will get Euro 0.7587, thus we can form a sort of chain rule as under;

How many Rs. = 1 Euro

If 0.7587 Euro = US 1 dollar

Therefore, 1 Euro = Rs. 60.8545/0.7587

Or 1 Euro = Rs. 80.21

If an export customer has a bill for 100000 pound, the bank has purchase the Pound from him and give an equivalent amount in rupees to the customer. Presuming the inter-bank market quotations for spot delivery are as follows:

US 1 dollar = Rs 60.8450/545

The London market is quoting cable (STG/ DLR) as

1 pound = US 1.9720/40 Dollar

The bank has to sell pound in the London market at US 1.9720, ie. The market’s buying rate for Pound 1. The US dollars so obtained have to be disposed off in the local inter-bank market at US 1 dollar = Rs 60.8450 (market’s buying rate) for US dollar.

By chain rule, we get:
Pound 1 = 1.9720 * 60.8450
= Rs 119.9863

**Chain Rule**

Calculation of the cross rate is based on common sense approach. However, it can be reduced to a rule known as the chain rule with similar steps.

**Value Date**

The value date is a date on which the exchange of currencies actually takes place. Based on this concept, we have the following types of exchange rates.

- **Cash/ready:** it is the rate when an exchange of currencies takes place on the date of the deal.
- **TOM:** When the exchange of currencies takes place on the place on the next working day, i.e., tomorrow it is called the TOM rate.
- **Forward Rate:** If the exchange of currencies takes place after period of spot date, it is called the forward rate. Forward rates generally are expressed by indicating a premium/ discount for the forward period.
- **Premium:** When a currency is costlier in forward or say, for a future value date, it is said to be at a premium. In the case of the direct method of quotations, the premium is added to both the selling and buying rate.
- **Discount:** If currency is cheaper in the forward of for a future value date, it is said to be at a discount. In the case of a direct quotation, the discount is (deducted) subtracted from both the rates, i.e., buying and selling rates.

**Forward Exchange Rates**

The forward exchange rate (also referred to as forward rate or forward price) is the exchange rate at which a bank agrees to exchange one currency for another at a future date when it enters into a forward contract with an investor.

**Forward Rate**

The Exchange rate for settlement on a date beyond the spot is naturally different and the same is called the forward rate.

**Forward rate has two components:**

- Spot Rate
- Forward point reflecting the interest rate differentials adjustment for different settlement dates.
. (i) **Forward Point**

Let us suppose that spot rate of US$/Euro is

Spot     Euro 1= US$ 1.3180

The exchange rate three months forward is

3 months     Euro 1= US $1.3330

The difference of 150 points referred to is the forward point

**The following factors determine the forward point:**

- Supply and demand for the currency for the settlement date. If there are more buyers for a particular date then sellers, the forward point will be different from the situation if there were more sellers than buyers for that particular settlement date.
- Market view, i.e. expectations, about the future and developments likely to take place in interest rates and foreign exchange.
- The interest rate differential between the countries. For the period in question, whose currencies are being exchanged.

**Calculating forward points**

We can approximate forward points for a given forward period with the help of the following information:

Spot exchange rate= 15000

Interest rate differential= 3% per annum

Forward period= 90 days

No. of days in a year (360 or 365)= 365 days

**The formula is as**

\[ \text{Spot rate} \times \text{Interest rate differential} \times \text{Forward period}/100 \times \text{No. of days in the year} \]

\[ 1500 \times 3 \times 90/100 \times 360 = 0.01125 \]

Forward differential, is also known as the “Swap Rate”. Three months forward rate for a US$/ Euro can be calculated by adjusting spot rate with the forward differential.

**Interest differential from forward points:**
The formula for calculating the interest rate differential from the forward point is as under:

**Interest rate differential** = \(\text{Forward points \times No. of days in the year \times 100/Spot rate \times Forward period}\)

Continuing the above example, we have

\[=0.01125 \times 360 \times 100/1.50 \times 90=3\% \text{ annum}\]

**Forward differential formula** = \(\text{Spot rate} - \text{Forward rate}\)

(ii) **Arbitrage**

Arbitrage is an operation by which one can make risk free profits by undertaking offsetting transactions. Arbitrage can be in interest rates, i.e. borrow in one centre and lend in another at a higher rate. Arbitrage can occur in exchange rates also. However, with the present day efficient communication system, arbitrage opportunities are very rare.

In the above example forward rate, i.e Euro 1= US dollar 1.5436, would perfectly offset the interest rate differential and can be calculated as follows:

Principal + interest of US dollar investment = US $ 159
Principal + interest of Euro loan = Euro 103
Therefore, Euro 103
Or Euro 1 = US$ 159/103 = US$ 1.5436
## JAIIB Online Mock test with Explanation

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## Module B- Principles of Bookkeeping & Accountancy

### Index

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</table>
Unit 1 - Definition, Scope and Accounting Standards

Accounting

Accounting often is called the language of business. The basic function of any language is to serve as a means of communication. In this context, the purpose of accounting is to communicate or report the results of business operations and the financial health of the organization.

Features of Accounting

- Accounting is an art of recording, classifying and summarising business transactions: it not only records the business transaction but also records them in an orderly manner. It also classifies business transactions according to their nature, before recording them in the books of account.

- Accounting also summarises the data, recorded in books of account, and presents them in a systematic way, in the form of:
  1. Trial Balance
  2. Profit and loss account and
  3. Balance sheet

- Accounting records the transactions it terms of money: Accounting records business transactions by expressing them in term of money. This makes the
recorded data more meaningful. Events that cannot be expressed in money terms, are not recorded in the books of account.

- Accounting records only the transactions of a financial Character
- Accounting also interprets the financial data

**Purpose and Objectives of Accounting**

- To Keep a systematic record
- To Ascertain the result of the operations
- To ascertain the financial position of the business
- To facilitate rational decision-making
- To satisfy the requirements of law (*Companies Act, Societies Act, Public Trust Act etc and also compulsory under the Sales Tax Act and Income Tax Act*)

**Types of Accounting:**

- Financial Accounting
- Cost Accounting
- Management Accounting
- Social Responsibility Accounting
- Human Resource Accounting
- Inflation Accounting

**Accounting Standards in India and Its Definition and Scope**

The Institute of Chartered Accountants of India (ICAI), recognising the need to harmonise the diverse accounting policies and practices, constituted an ‘**Accounting Standards Board** (ASB) on 21st April, 1977. The main function of the ASB is to formulate accounting standards so that the council of ICAI may mandate such standards.

- ASB shall determine the broad areas in which accounting standards need to be formulated and the priority about the selection thereof.

- In the preparation of the accounting standards, the ASB will be assisted by study groups constituted to consider specific subjects. It will also hold a dialogue with the representatives of the government, public and private sector industries and other organisations, for ascertaining their views.
Based in the above, an exposure draft of the proposed standard will be prepared and issued to its members for comments and the public at large.

After taking into consideration the comments received, the exposure draft will be finalised by the ASB for submission to the council of ICAI.

A mandatory accounting standard, if not followed, requires the auditors, who are members of ICAI, to qualify their audit reports, failing which they will be guilty of professional misconduct. Both the SEBI and Companies Act 2013 require auditors to qualify the audit reports that do not conform to mandatory accounting standards. **Section 134(5) of the Companies Act 2013** also casts a responsibility on the board of directors to comply with mandatory accounting standards.

**Under the Section 129(5) of the Companies Act 2013**, where the financial statements do not comply with the accounting standards, such companies shall disclose the following:

- The deviation from the accounting standards
- The reasons for such a deviation
- The Financial effects, of any arising out of such a deviation.

**Accountancy Standards**

*The Institute of Chartered Accountants of India (ICAI) has so far issued twenty-nine standards:*

- (AS 1) Disclosure of Accounting Policies
- (AS 2) Valuation of Inventories
- (AS 3) Cash Flow Statements
- (AS 4) Contingencies and Events Occurring after the Balance Sheet Date
- (AS 5) Net Profit or Loss for the period, Prior Period and Extraordinary Items and Changes in less Accounting Policies
- (AS 6) Depreciation Accounting
- (AS 7) Accounting for Construction Contracts
- (AS 8) Accounting for Research and Development (deleted w.e.f. 1/4/2003)
- (AS 9) Revenue Recognition
- (AS 10) Accounting for Fixed Assets
- (AS 11) Accounting for the Effects of Changes in Foreign Exchange Rates
- (AS 12) Accounting for Government Grants
Apart from these, there are 3 not mandatory Accounting Standards:

• (AS 30) Financial Instruments; Recognition and Measurement
• (AS 31) Financial Instruments; Presentation
• (AS 32) Financial Instruments; Disclosures

**Generally Accepted Accounting Principles of USA (US GAAP)**

Generally accepted accounting principles, or GAAP, are a set of rules that encompass the details, complexities, and legalities of business and corporate accounting. The Financial Accounting Standards Board (FASB) uses GAAP as the foundation for its comprehensive set of approved accounting methods and practices.
U.S. law requires businesses that release financial statements to the public and companies that are publicly traded on stock exchanges and indices to follow GAAP guidelines, which incorporate 10 key concepts:

- **Principle of regularity**: GAAP-compliant accountants strictly adhere to established rules and regulations.
- **Principle of consistency**: Consistent standards are applied throughout the financial reporting process.
- **Principle of sincerity**: GAAP-compliant accountants are committed to accuracy and impartiality.
- **Principle of permanence of methods**: Consistent procedures are used in the preparation of all financial reports.
- **Principle of non-compensation**: All aspects of an organization’s performance, whether positive or negative, are fully reported with no prospect of debt compensation.
- **Principle of prudence**: Speculation does not influence the reporting of financial data.
- **Principle of continuity**: Asset valuations assume the organization’s operations will continue.
- **Principle of periodicity**: Reporting of revenues is divided by standard accounting time periods, such as fiscal quarters or fiscal years.
- **Principle of materiality**: Financial reports fully disclose the organization’s monetary situation.
- **Principle of utmost good faith**: All involved parties are assumed to be acting honestly.

GAAP compliance makes the financial reporting process transparent and standardizes assumptions, terminology, definitions, and methods. External parties can easily compare financial statements issued by GAAP-compliant entities and safely assume consistency, which allows for quick and accurate cross-company comparisons.

Because GAAP standards deliver transparency and continuity, they enable investors and stakeholders to make sound, evidence-based decisions. The consistency of GAAP compliance also allows companies to more easily evaluate strategic business options.

**These three rules are:**

**Basic accounting principles and guidelines**: These 10 guidelines separate an organization’s transactions from the personal transactions of its owners, standardize currency units used in reports, and explicitly disclose the time periods covered by specific
Reports. They also draw on established best practices governing cost, disclosure, going concern, matching, revenue recognition, professional judgment, and conservatism.

Rules and standards issued by the FASB and its predecessor, the Accounting Principles Board (APB): The FASB issues an officially endorsed, regularly updated compendium of principles known as the FASB Accounting Standards Codification. The compendium includes standards based on the best practices previously established by the APB. These organizations are rooted in historic regulations governing financial reporting, which were implemented by the federal government following the 1929 stock market crash that triggered the Great Depression.

Generally accepted industry practices: There is no universal GAAP model followed by all organizations across every industry. Rather, particular businesses follow industry-specific best practices designed to reflect the nuances and complexities of different areas of business. For example, banks operate using a different set of accounting and financial reporting methods than those used by retail businesses.

International Financial Reporting Standard (IFRS)

The International Financial Reporting Standards (IFRS) are accounting standards that are issued by the International Accounting Standards Board (IASB) with the objective of providing a common accounting language to increase transparency in the presentation of financial information.

What is IASB?

The International Accounting Standards Board (IASB), is an independent body formed in 2001 with the sole responsibility of establishing the International Financial Reporting Standards (IFRS). It succeeded the International Accounting Standards Committee (IASC), which was earlier given the responsibility of establishing the international accounting standards. IASB is based in London. It has also provided the ‘Conceptual Framework for Financial Reporting’ issued in September 2010 which provides a conceptual understanding and the basis of the accounting practices under IFRS.

The Principal Objective of the IFRS Foundation are:

To Develop a single set of high quality, understandable, enforceable and globally accepted International Financial Reporting Standards (IFRSs) through its standard-setting body, the International Accounting Standard Board (IASB);

To promote the use and rigorous applications of those standard;

To take account of the financial reporting needs of emerging economics and small and medium-sized entities (SMEs); and
To promote and facilitate adoption of IFRSs, being the standards and interpretations issued by the IASB, through the convergence of national accounting standards and IFRSs.

**List of International Financial Reporting Standards (IFRS)**

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<td>IFRS 2</td>
<td>Share-based Payment</td>
</tr>
<tr>
<td>IFRS 3</td>
<td>Business Combinations</td>
</tr>
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<td>IFRS 4</td>
<td>Insurance Contracts</td>
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<td>IFRS 5</td>
<td>Non-current Assets Held for Sale and Discontinue Operations</td>
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<td>Exploration and Evaluation of Mineral Resources</td>
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<td>IFRS 7</td>
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<td>Consolidated Financial Statements</td>
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<td>Disclosure of Interests in Other Entities</td>
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<td>Regulatory Deferral Accounts</td>
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<td>IFRS 15</td>
<td>Revenue from Contracts with Customers</td>
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<td>IFRS 16</td>
<td>Leases</td>
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<td>IFRS 17</td>
<td>Insurance Contracts</td>
</tr>
<tr>
<td>IAS 1</td>
<td>Presentation of Financial Statements</td>
</tr>
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<td>IAS 2</td>
<td>Inventories</td>
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<td>IAS 7</td>
<td>Statement of Cash Flows</td>
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<td>IAS 8</td>
<td>Accounting Policies, Changes in Accounting Estimates and Errors</td>
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<td>Events after the Reporting Period</td>
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<tr>
<td>IAS 11</td>
<td>Construction Contracts</td>
</tr>
<tr>
<td>IAS 12</td>
<td>Income Taxes</td>
</tr>
</tbody>
</table>
IAS 16- Property, Plant, and Equipment
IAS 17- Leases
IAS 18- Revenue
IAS 19- Employee Benefits
IAS 20- Accounting for Government Grants and Disclosure of Government Assistance
IAS 21- The Effects of Changes in Foreign Exchange Rates
IAS 23- Borrowing Costs
IAS 24- Related Party Disclosures
IAS 26- Accounting and Reporting by Retirement Benefit Plans
IAS 27- Separate Financial Statements
IAS 28- Investments in Associates and Joint Ventures
IAS 29- Financial Reporting in Hyperinflationary Economies
IAS 32- Financial Instruments: Presentation
IAS 33- Earnings per Share
IAS 34- Interim Financial Reporting
IAS 36- Impairment of Assets
IAS 37- Provisions, Contingent Liabilities, and Contingent Assets
IAS 38- Intangible Assets
IAS 39- Financial Instruments: Recognition and Measurement
IAS 40- Investment Property
IAS 41- Agriculture

**Differences between US GAAP and IFRS**
Transfer Pricing

Transfer pricing is the method used to sell a product from one subsidiary to another within a company. This approach is used when the subsidiaries of a parent company are measured as separate profit centers. Transfer pricing impacts the purchasing behavior of the subsidiaries, and may have income tax implications for the company as a whole. Here are the key issues:

- Revenue basis
- Preferred customers
- Preferred suppliers
Traditional Methods

- **Market rate transfer price.** The simplest and most elegant transfer price is to use the market price. By doing so, the upstream subsidiary can sell either internally or externally and earn the same profit with either option. It can also earn the highest possible profit, rather than being subject to the odd profit vagaries that can occur under mandated pricing schemes.

- **Adjusted market rate transfer price.** If it is not possible to use the market pricing technique just noted, then consider using the general concept, but incorporating some adjustments to the price. For example, you can reduce the market price to account for the presumed absence of bad debts, since corporate management will likely intervene and force a payment if there is a risk of non-payment.

- **Negotiated transfer pricing.** It may be necessary to negotiate a transfer price between subsidiaries, without using any market price as a baseline. This situation arises when there is no discernible market price because the market is very small or the goods are highly customized. This results in prices that are based on the relative negotiating skills of the parties.

- **Contribution margin transfer pricing.** If there is no market price at all from which to derive a transfer price, then an alternative is to create a price based on a component’s contribution margin.

- **Resale Price Methods:** The Resale Price (RP) while similar to the Cost plus method, is found by working backwards from the transactions taking place at the next stage in the supply chain and is determined by subtracting an appropriate gross mark-up from the sale price, to an unrelated third party, with the appropriate gross margin being determined by examining the conditions, under which, the goods or services are sold and comparing the said transaction to other third party Transactions.

- **Cost-plus transfer pricing.** If there is no market price at all on which to base a transfer price, you could consider using a system that creates a transfer price based on the cost of the components being transferred. The best way to do this is to add a margin onto the cost, where you compile the standard cost of a
component, add a standard profit margin, and use the result as the transfer price.

- **Cost-based transfer pricing.** Have each subsidiary transfer its products to other subsidiaries at cost, after which successive subsidiaries add their costs to the product. This means that the final subsidiary that sells the completed goods to a third party will recognize the entire profit associated with the product.

### Unit 2- Basic Accountancy Procedures

**Concepts of Accountancy**

Accounting of often called the language of business through which a business house normally communicates with the outside world. In order to make this language intelligible and commonly understand by all, it is necessary that it is based on certain uniform scientifically laid down standards. These standards are termed as accounting principles.

**Concepts**

*There following are the main accounting concepts*

**Cost Concepts:** Every business transactions is recorded in the books of accounts at cost price, e.g, the machinery is recorded in the books by that amount which is paid to the supplier plus the expenses of bringing and installing the machinery which are necessary to put it in working order.

**Applications**

- Fixed assets are kept at the cost of purchase and not their market value.
- Every transaction is recorded with the present value and not any future value.
- Unrealised gains are ignored.
- An item, that has no cost, is not taken in books

**Money measurement concept:** Every transaction that is recorded in books of accounts must be measured in terms of money. All the transactions are converted into a common form, which is money. Example, quarterly production, sales, wages, etc, all are converted in terms of money.

**Applications**

- Health of a proprietor or manager is not taken into the books although it may have a great impact on the overall business.
• We do not include any inflation or deflation in the value of any asset.

**Business entity Concept:** This concept separates the entity of the proprietor from the business transactions. The capital contributed by the owner is a liability for the business because business, which is an artificial person, is different from owner.

**Applications**

• Any money withdrawn by the proprietor is treated separately as drawings.
• Profit is a liability while loss is an asset.

**Realisation concept:** This concept tells us when is the revenue treated as realized or earned. It is treated as realized or earned on that date when the property in the goods pass to the buyer and he becomes legally liable to pay.

**Applications**

• No future income is considered.
• Goods sold on approval will not be included in sales but taken at cost only.
• The rules of revenue recognition determines that the earning process should be either complete or near completion.

**Historical records Concept:** In accounts, The historical cost principle states that businesses must record and account for most assets and liabilities at their purchase or acquisition price. In other words, businesses have to record an asset on their balance sheet for the amount paid for the asset.

**Going concern concept:** This concept indicates that the business is a going concern and the transactions are recorded accordingly. If an expense is incurred and its utility is consumed during the year, then it is treated as an expense, otherwise it is recorded as an asset.

**Applications**

• The fixed assets are valued at cost and not at market value.
• Current assets are valued at cost or the market value whichever is less.
• Depreciation is provided based on the total number of years of life of asset. Balances of one year are carried forward to the next year.
• Reserves and provisions are created for any future liability.

**Matching concept:** This concept explains that we have to match the income of a certain period with expenses of that period only. The term matching refers to the close relationship that exists between certain expired cost and revenues realized as a result of
incurred those costs. The justification of the matching concept arises from accounting period concept.

Applications

- All adjustments regarding prepaid expenses, outstanding expenses are made in the final accounts.
- Deferred revenue expenditure concept arises due to this.

Accounting period concept: An accounting period is the span of time covered by a set of financial statements. This period defines the time range over which business transactions are accumulated into financial statements, and is needed by investors so that they can compare the results of successive time periods.

Main Conventions of Accounting

Accounting of full disclosure: Entries are made in such a way, that they provide honestly all information relating to the activities of the business. The records should not conceal anything from outsider. Secret reserves should not be maintained as per this convention.

Convention of materially: All material information, must be recorded. What is material depends upon the value of the item involved and circumstances of individual case of business. Exp: Paisa is not recorded.

Convention of conservatism: While recording transactions, all possible losses must be taken into consideration, while all anticipated profits should be ignored. This is also called the principle of prudence.

Convention of consistency: If a method is selected for recording purposes, it must be regularly followed in the future also. Whenever it is necessary to change, the impact of such change must be given separately.

Going Concern Entity

The going concern concept of accounting implies that the business entity will continue its operations in the future and will not liquidate or be forced to discontinue operations due to any reason. A company is a going concern if no evidence is available to believe that it will or will have to cease its operations in foreseeable future.

An example of the application of going concern concept of accounting is the computation of depreciation on the basis of expected economic life of fixed assets rather than their current market value. Companies assume that their business will continue for an indefinite period of time and the assets will be used in the business until fully depreciated. Another example of the going concern assumption is the prepayment and accrual of expenses. Companies prepay and accrue expenses because they believe that they will continue operations in future.
System of Keeping Recording

Single entry system: A single entry system records each accounting transaction with a single entry to the accounting records, rather than the vastly more widespread double entry system. The single entry system is centered on the results of a business that are reported in the income statement.

Double entry system: The double-entry system of accounting or bookkeeping means that for every business transaction, amounts must be recorded in a minimum of two accounts. The double-entry system also requires that for all transactions, the amounts entered as debits must be equal to the amounts entered as credits.

Principles of Double Entry system

The following are main principles of double entry system:

- For every transaction, two parties must be interested
- Every business transaction has two aspects, one of receiving the benefit and the other of giving it. In simple words, “Double entry” system means “every debit has a corresponding credit”.
- Both the aspects, are recorded in the books of account.
- The two-fold effect of a business transaction is recorded by debiting one account and crediting the other account at the same time.

Principle of Conservatism

The conservatism principle is the general concept of recognizing expenses and liabilities as soon as possible when there is uncertainty about the outcome, but to only recognize revenues and assets when they are assured of being received. Thus, when given a choice between several outcomes where the probabilities of occurrence are equally likely, you should recognize the transaction resulting in the lower amount of profit, or at least the deferral of a profit. Similarly, if a choice of outcomes with similar probabilities of occurrence will impact the value of an asset, recognize the transaction resulting in a lower recorded asset valuation.

Under the conservatism principle, if there is uncertainty about incurring a loss, you should tend toward recording the loss. Conversely, if there is uncertainty about recording a gain, you should not record the gain.

The conservatism principle can also be applied to recognizing estimates. For example, if the collections staff believes that a cluster of receivables will have a 2% bad debt percentage because of historical trend lines, but the sales staff is leaning towards a higher 5% figure because of a sudden drop in industry sales, use the 5% figure when creating an allowance for doubtful accounts, unless there is strong evidence to the contrary.
Accrual Concept

The accrual concept makes a distinction the receipt of cash and right to receive, it and the payment of cash and the legal obligation to pay it. In actual business operations, the obligation to pay and the actual movement of cash may not coincide. The accrual recognises this distinction. In connection with the sale of goods, revenue may be received.

- Before the right to receive arise, or
- After the right to receive has been created.

Unit 3 - Maintenance of Cash/ Subsidiary Books and Ledger

Record Keeping Basics

Journal
The form of a journal contains a column Ledger folio. Journal records each transaction. However, if anyone wants to find out transactions affecting a personal account or an expense account, he will have to turn over pages of journal, add all debits and credits and then find out the balance of a particular account.

**Cash Book**

The Book that keeps records of all cash transactions, i.e. cash receipts and cash payments is called a cash book. Its ruling is like a ledge account and is divided into two sides, viz, debit and credit. All receipts are recorded on the debit side whereas all payment are recorded on the credit side. Since it serves the function of cash account, there is no need for opening cash account in the ledger.

**Accounting cycle includes the following:**

**Recording:** In the first instance, all transactions should be recorded in the journal or the subsidiary books as and when they take place.

**Classifying:** All entries in the journal or subsidiary books are posted to the appropriate ledger account to find out at a glance the total effect of all such transactions in a particular account.

**Summarising:** The last stage is to prepare the trial balance and final accounts with view to ascertain the profit or loss made during a particular period and the financial position of the business on a particular date.

**Ledger**

The Ledger is the principal book of accounts where similar transactions relating to a particular person or property or revenue or expense are recorded. In other words, it is a set of accounts. It contains all accounts of the business enterprise whether real, nominal or personal. **The main function** of a ledger is to classify or sort out all the items appearing in the journal or the other subsidiary books under their appropriate accounts, so that at the end of the accounting period each account will contain the entire information of all the transactions relating to it in a summarized or condensed form.

**Relationship Between ‘Journal’ and ‘Ledger’**

<table>
<thead>
<tr>
<th>BASIS FOR COMPARISON</th>
<th>JOURNAL</th>
<th>LEDGER</th>
</tr>
</thead>
<tbody>
<tr>
<td>Meaning</td>
<td>The book in which all the transactions are recorded, as and when they arise is known as Journal.</td>
<td>The book which enables to transfer all the transactions into separate accounts is known as Ledger.</td>
</tr>
</tbody>
</table>
### Journalise the following transactions and post them in their respective ledger accounts.

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td></td>
<td></td>
</tr>
<tr>
<td>May 2</td>
<td>Paid interest to Loan</td>
<td>4,000</td>
</tr>
<tr>
<td>May 3</td>
<td>Ramesh who owed Rs.3,000 has become insolvent. He pays 50 paise in rupee in full settlement.</td>
<td></td>
</tr>
<tr>
<td>May 4</td>
<td>A cheque received from Ranjan deposited into bank was returned dishonored.</td>
<td>6,300</td>
</tr>
<tr>
<td>May 5</td>
<td>Wood used for making office furniture.</td>
<td>5,000</td>
</tr>
<tr>
<td>May 21</td>
<td>Due from Rama are bad debts.</td>
<td>600</td>
</tr>
<tr>
<td>May 25</td>
<td>Purchased building and issued cheque.</td>
<td>4,300</td>
</tr>
</tbody>
</table>
### Journal Entry

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>L.F.</th>
<th>Dr. Rs.</th>
<th>Cr. Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>Interest to Loan A/c</td>
<td></td>
<td>4,000</td>
<td></td>
</tr>
<tr>
<td>May 2</td>
<td>To Cash A/c</td>
<td></td>
<td></td>
<td>4,000</td>
</tr>
<tr>
<td></td>
<td>(Being interest payment made on loan)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>May 3</td>
<td>Cash A/c</td>
<td></td>
<td>1,500</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bad Debts A/c</td>
<td></td>
<td></td>
<td>1,500</td>
</tr>
<tr>
<td></td>
<td>To Ramesh A/c</td>
<td></td>
<td></td>
<td>3,000</td>
</tr>
<tr>
<td></td>
<td>(Being 50 paise in rupee received from Ramesh out of the debt of Rs.3,000 in full settlement)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>May 4</td>
<td>Ranjan A/c</td>
<td></td>
<td>6,300</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Bank A/c</td>
<td></td>
<td></td>
<td>6,300</td>
</tr>
<tr>
<td></td>
<td>(Being the cheque deposited into bank dishonoured)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>May 5</td>
<td>Furniture A/c</td>
<td></td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Purchases A/c</td>
<td></td>
<td></td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>(Being the wood used in making office furniture)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>May 21</td>
<td>Bad Debts A/c</td>
<td></td>
<td>600</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Rama A/c</td>
<td></td>
<td></td>
<td>600</td>
</tr>
<tr>
<td></td>
<td>(Being the bad debts written off)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>May 25</td>
<td>Building A/c</td>
<td></td>
<td>4,300</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Bank A/c</td>
<td></td>
<td></td>
<td>4,300</td>
</tr>
<tr>
<td></td>
<td>(Being the goods purchased and payment made through cheque)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Account Categories

**Classification of Accounts:** Accounts are broadly classified into two classes:

- Personal Accounts and
- Impersonal Accounts

**The Letter is further sub-divided into:**

- Real Accounts
- Nominal Accounts

**Personal Accounts**

These accounts show the transactions with customers, suppliers, moneylenders, banks and the owner.

*Personal accounts can take the following forms:*

- **Natural Personal accounts**: The term natural person means persons who are the creation of God. For example, proprietor’s account, supplier’s account, receiver’s account (Abhinav a/c, Alpa A/c).

- **Artificial personal accounts**: These accounts include the accounts of corporate bodies or institutions that are recognised as persons in business dealings. Example: firm’s a/c, club a/c.

- **Representative personal account**: These are accounts that represent a certain person or group of person. Example: Salary outstanding, Rent prepaid etc.

*Following list indicates, some more of the usual accounts coming under each category: (Personal accounts)*

- Bank (an artificial Person)
- Tata Iron & Steel Co. (a Company)
- Alpa (an Individual)
- Capital (Abhinav –owner)
- Bank loan (an artificial person)
- Rent outstanding (representative personal account)

**Impersonal Accounts**

**Real Accounts**

*Real accounts may be of the following types:*

- **Tangible real accounts**: These are accounts of such things that are tangible, i.e, which can be seen, touched, physically. Example: Land, building, cash etc.

- **Intangible real accounts**: These account represent such things that cannot be touched. Example: Trademarks, Patent right etc.
There following list indicates, some more of the usual accounts coming under each category: (Real accounts)

- Plant and machinery
- Investment
- Land and building
- Stock in hand
- Bill receivable
- Trademarks
- Cash

Nominal Accounts

Nominal accounts are opened in the books to explain the nature of the transactions. Example: Salary is paid to the employees, rent is paid to the property owner etc.

There following list indicates, some more of the usual accounts coming under each category: (Nominal accounts)

- Interest
- Salaries
- Rent
- Carriage
- Commission received
- Insurance
- Discount received
- Wages
- Credit and Debit Concepp

Accounting and columnar accounting mechanics

Cash book may be defined as the record of transactions concerning cash receipts and cash payments. In other words, in cash book, all transactions (i.e receipts and payment of cash) are recorded as soon as they take place. Cash book is in the form of an account and actually it serves the purpose of a 'Cash Account'.

_Cash book thus serves the purpose of a book of original entry as well as that of a ledger account. A cash book has the following features:_
Only cash transactions are recorded in the cash book.

- It performs the functions of both, the journal and the ledger, at the same time.
- All cash receipts are recorded in the debit side and all cash payments are recorded in the credit side.
- It records only one aspect of transaction i.e., cash.
- All cash transactions are recorded chronologically in the cash book.

**Types of Cash book**

**Simple (Single column) cash book:** This cash book will only record cash transactions. The cash coming in (receipts) will be on the left and the cash payments will be on the right. And since we will record all cash transactions here there is no need for a cash ledger account.

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>L.F.</th>
<th>Receipt No.</th>
<th>Amount</th>
<th>Date</th>
<th>Particulars</th>
<th>L.F.</th>
<th>Vr. No.</th>
<th>Amount</th>
</tr>
</thead>
</table>

**Date:** The date on which cash is received or paid is entered in this column.

**Particulars:** The name of the account in respect of which the amount is received or paid is shown.

**LF (Ledger folio):** The column shows page number of the ledger where the entry has been posted.

**Two Column Cash Books**

Here instead of one column, we have an additional column for discounts. So along with the cash transactions, we will also record the discounts in the same cash book. So both discounts received and the discount that is given is recorded here. If any organization is in a general practice of giving or receiving discounts this is the preferable option.

Discount is a nominal account – so the discount is given (loss) is on the debit side and discount received (profit) is on the credit side. At the end of the period, we balance both columns and transfer the closing balances.

**Prepare a two column cash book from the following entries**

Cash in Hand – 15000

Received from ABC – 4800; Discount – 200

Goods bought for cash 1500
Cash paid to LMN – 2400; Discount – 100

### Cash Book

<table>
<thead>
<tr>
<th>Sr No</th>
<th>Particulars</th>
<th>Cash</th>
<th>Discount</th>
<th>Sr No</th>
<th>Particulars</th>
<th>Cash</th>
<th>Discount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>To Bal b/d</td>
<td>15000</td>
<td></td>
<td>1</td>
<td>By Goods Purchase A/c</td>
<td>1500</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>To ABC A/c</td>
<td>4800</td>
<td>200</td>
<td>2</td>
<td>LMN A/c</td>
<td>24000</td>
<td>1000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>By Bal c/d</td>
<td>5700</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>19800</td>
<td>200</td>
<td></td>
<td></td>
<td>25500</td>
<td>1000</td>
</tr>
<tr>
<td></td>
<td>To Bal b/d</td>
<td>5700</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Three Column Cash Books

This cash book has the cash, the discount and additionally the bank columns in it. Since the development of banking most firms, these days prefer to deal in cheques or other such bills of exchange. And so having a bank column in your cash book makes things concise and simpler to understand.

So when you receive a cheque and you deposit it in the bank the same day you make the entry in the bank column (the debit side in this case). But say you send the cheque later (not the same day) then this will be a contra entry. A contra entry is transactions that happen between a cash account and a bank account. Ultimately your Cash & Bank balance remains the same, the money just moves around.

### Petty Cash Book

In a firm, there are usually cash transactions happening in all the departments. These we will record in one of the above formats of cash books. But there are many cash transactions happening for very small amounts. Sometimes there are dozens of such transactions that occur in just one day. These are known as petty transactions. Examples are expenses for postage, stationery, traveling, food bills, etc.
So since the number of such transactions tends to be very high we maintain a separate cash book for them – the petty cash book. Such a cash book is maintained by the petty cashier (who in most cases also handles the petty cash).

**Two types of petty cash book:**

- Simple petty cash Book
- Columnar Petty cash Book

**Journalising**

**Journalising refers to recording business transactions systematically and in a summarised form in the journal.** It means a process of entering the twofold effects of transactions in the form of debt and credit in the journal.

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>L.F</th>
<th>Debit Amount</th>
<th>Credit Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>(ii)</td>
<td>(iii)</td>
<td>(iv)</td>
<td>(v)</td>
</tr>
</tbody>
</table>

**Date:** In the first column the date of the transaction is entered, the year is most probably written on the top of the column than to repeat it every day.

**Particulars:** Here the accounting entry is written in a summarised form of debit and credit. The names of the accounts involved in the transaction are written in the journal entry.

On the first line, the account is debited, the word “Dr.” is written at the right end of the same line of account debited.

On the second line, the account credited is written with a prefix “To” after leaving a little space towards the start.

Immediately below the entry, a small explanation of the transaction called ‘narration’ is written. The narration begins with the word "Being”.

**Ledger Folio No. (L.F.):** In this column, the page number of the Ledger in which the journal entry is posted, is recorded. This also helps is easy cross verification and reference in the future.

**Debit Amount:** The amounts to be debited to the accounts concerned or involved are written.

**Credit Amount:** The amounts to be credited to the accounts concerned or involved are written.

**Rules for Journalising Transactions: (Golden rules of Accountancy)**
Personal Account: It relates to persons (natural or legal) with whom a business keeps dealings.

**Rule:** Debit the receiver and Credit the giver.

E.g. Goods worth Rs. 5000/- sold to Alpa. Here, because Alpa is the receiver of goods so it is to be debited.

Real Account: It relates to property or goods which may come or go from the business.

**Rule:** Debit what comes in and Credit what goes out.

E.g. Goods worth Rs. 7000/- sold on cash. Here, cash a/c is to be debited because cash flows out.

Nominal Account: It relates to business expenses, losses, incomes, and gains.

**Rule:** Debit all the expenses or losses and Credit all the incomes, gains or profits.

E.g. Paid Rs. 2000/- as commission to the agent. Here, commission a/c is debited because it is a business expense.

Solved Example for You

**Question:** Journalise the following transactions in the Journal of Mr. Abhinav for the year 2018

- January 1 – Paid rent Rs. 4000/-
- January 2 – Sold goods to Harsh for Rs. 10,000/-

**Answer:**

**In the Journal of Mr. Abhinav**

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Debit Amount</th>
<th>Credit Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>Rent A/c .......................... Dr.</td>
<td>4000</td>
<td>4000</td>
</tr>
<tr>
<td>01/01</td>
<td>To Cash A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being rent paid)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Unit 4 - Bank Reconciliation Statement

**Recording Transactions in cash Book**

Record the following transactions in a bank column cash book for December 2019:

<table>
<thead>
<tr>
<th>Date</th>
<th>Transaction Description</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>01</td>
<td>Started business with cash</td>
<td>80,000</td>
</tr>
<tr>
<td>04</td>
<td>Deposited in bank</td>
<td>50,000</td>
</tr>
<tr>
<td>Date</td>
<td>Receipts</td>
<td>L.F.</td>
</tr>
<tr>
<td>--------</td>
<td>--------------</td>
<td>------</td>
</tr>
<tr>
<td>01 Dec</td>
<td>Capital</td>
<td></td>
</tr>
<tr>
<td>04 Dec</td>
<td>Cash</td>
<td>C</td>
</tr>
<tr>
<td>10 Dec</td>
<td>Abhinav</td>
<td></td>
</tr>
<tr>
<td>30 Dec</td>
<td>Bank</td>
<td>C</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>83,000</td>
<td>50,000</td>
<td>83,000</td>
</tr>
</tbody>
</table>

**Cash Book and Passbook**

<table>
<thead>
<tr>
<th>BASIS FOR COMPARISON</th>
<th>CASH BOOK</th>
<th>PASSBOOK</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
**Meaning**

| A book that keeps a record of cash transactions is known as cash book. | A book issued by the bank to the account holder that records the deposits and withdrawals is known as passbook. |

**Prepared by**

| Firms | Bank |

**Side affected**

| Receipts will be shown in the debit side while payments are entered in credit side. | Deposits will be shown in credit side while withdrawals are shown in debit side. |

**Preparation**

| Discretionary | Compulsory |

**Recording of cheque deposited for collection**

| Date of deposit | Date on which the amount is actually collected from the debtor's bank |

**Recording of cheque issued to the creditor**

| Date of issue. | When the amount is paid by the bank to the creditor. |

**What do the balances reflect?**

| Debit balance shows cash at bank while the credit balance shows overdraft. | Debit balance shows overdraft while the credit balance shows cash at bank. |

**Understanding Reconciliation**

The Bank statement is received periodically, say every month. We check it for clerical and if any errors are found, we obtain a revised statement containing no errors. **The balance is this statement gives us a firm starting point to proceed for:**

- Finding out entries which do not require change in cashbook (these entries are present in the cashbook but not in the bank statement). These entries give us the ‘Adjusted bank balance’.
- Finding out clerical mistake in our cashbook and rectifying them.
- Finding out entries which require change in our cashbook (these entries are present in the statement but not in the cashbook).

**Preparing Reconciliation Statement**

Based on these 3 steps, we can prepare a statement called “Bank Reconciliation”. It is pertinent to note that step 1 gives the adjusted bank balance which is a national figure and not the actual balance in the account with in bank while step 2 and 3 result in actually changing the balance in the cashbook by correction of errors and posting of missing entries.
This cash book balance should be equal to the adjusted bank balance as arrived in step 1. This is balance which goes to the trial balance and balance sheet.

Bank Reconciliation Statement as in__________

<table>
<thead>
<tr>
<th>Description</th>
<th>Adjustment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Closing balance in bank statement</td>
<td>Rs..................</td>
</tr>
<tr>
<td>Adjustments to the balance in the bank statement</td>
<td></td>
</tr>
<tr>
<td>(a) Add: cheque deposited but not yet credited</td>
<td>Rs ..................</td>
</tr>
<tr>
<td>(b) Subtract: Cheque issued but not presented to the bank for payment</td>
<td></td>
</tr>
<tr>
<td>Adjusted balance in the bank statement</td>
<td>Rs .................. A</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>Adjustment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance as per cashbook</td>
<td>Rs..................</td>
</tr>
<tr>
<td>Adjustment made to cashbook</td>
<td></td>
</tr>
<tr>
<td>(a) Add or subtract: clerical errors</td>
<td>Rs ..................</td>
</tr>
<tr>
<td>(b) Add: Credit entries shown in the bank statement but not appearing in cash book</td>
<td>Rs ..................</td>
</tr>
<tr>
<td>(c) Subtract: Debit entries shown in the bank statement but not appearing in cashbook</td>
<td>Rs ..................</td>
</tr>
<tr>
<td>Adjusted (corrected) cashbook balance</td>
<td>Rs .................. B</td>
</tr>
</tbody>
</table>

**Need for Preparing a Bank Reconciliation Statement**

- Accuracy
- Check on the Entries
- Rectifying Incorrect Entries
- Updated Cash Book
- Detection of Delays
- Check on the Dishonest Behavior of Employees

**Example:**
The cash book of Mr Abhinav shows Rs 8364 as the balance at the bank as on 31 December 2018, but you find this does not agree with the balance as per the bank pass book, which shows a balance of Rs 15534.

**On scrutiny, you find the following discrepancies:**

- On 1<sup>st</sup> December, the payment side of the cash book was undercast by Rs 100
- A cheque of Rs 131 issued on 25<sup>th</sup> December, was not taken in the bank column.
- One deposit of Rs 150 was recorded in the cash book as if there is no bank column therein.
- On 18<sup>th</sup> December, the debit balance of Rs 1526 as on the previous day, was brought forward as credit balance.
- Of the total cheque, amounting to Rs 11,514 drawn in the last week of December, cheques aggregating to Rs 7815 were encashed in December.
- Dividend of Rs 250, collected by bank and, subscription of Rs 100, paid by it, were not recorded in the cash book
- One out-going cheque of Rs 350 was recorded twice in the cash book.

**Rough working: Correction of cash book for errors**

<table>
<thead>
<tr>
<th>Item</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deposit entry (shown in cash column)</td>
<td>150</td>
<td></td>
</tr>
<tr>
<td>Wrong carry forward of balance</td>
<td>3052</td>
<td></td>
</tr>
<tr>
<td>Outgoing cheque recorded twice</td>
<td>350</td>
<td></td>
</tr>
<tr>
<td>Under casting payment side</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td>Cheque issued</td>
<td></td>
<td>131</td>
</tr>
<tr>
<td>Total</td>
<td>3552</td>
<td>231</td>
</tr>
</tbody>
</table>

**The bank reconciliation statement will be as under:**
Closing balance in bank statement
Adjustments to the balance in the bank statement
(a) Add: cheque deposited but not yet credited
(b) Subtract: Cheque issued but not presented to the bank for payment

Adjusted balance in the bank statement

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Closing balance</td>
<td>Rs 15534</td>
</tr>
<tr>
<td>Adjustments to the</td>
<td></td>
</tr>
<tr>
<td>balance in the bank</td>
<td></td>
</tr>
<tr>
<td>statement</td>
<td></td>
</tr>
<tr>
<td>(a) Add: cheque</td>
<td></td>
</tr>
<tr>
<td>deposited but not yet</td>
<td></td>
</tr>
<tr>
<td>credited</td>
<td></td>
</tr>
<tr>
<td>(b) Subtract: Cheque</td>
<td></td>
</tr>
<tr>
<td>issued but not</td>
<td></td>
</tr>
<tr>
<td>presented to the</td>
<td></td>
</tr>
<tr>
<td>bank for payment</td>
<td>Rs 3699</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted balance in</td>
<td>Rs 11835</td>
</tr>
<tr>
<td>the bank statement</td>
<td>A</td>
</tr>
</tbody>
</table>

Balance as per cashbook
Adjustment made to cashbook
(a) Add or subtract: clerical errors
(b) Add: Credit entries shown in the bank statement but not appearing in cash book
(c) Subtract: Debit entries shown in the bank statement but not appearing in cash book

Adjusted (corrected) cashbook balance

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance as per</td>
<td>Rs 8364</td>
</tr>
<tr>
<td>cashbook</td>
<td></td>
</tr>
<tr>
<td>Adjustment made to</td>
<td></td>
</tr>
<tr>
<td>cashbook</td>
<td></td>
</tr>
<tr>
<td>(a) Add or subtract:</td>
<td></td>
</tr>
<tr>
<td>clerical errors</td>
<td>Rs. 3321</td>
</tr>
<tr>
<td>(b) Add: Credit entries</td>
<td></td>
</tr>
<tr>
<td>shown in the bank</td>
<td>Rs. 250</td>
</tr>
<tr>
<td>statement but not</td>
<td></td>
</tr>
<tr>
<td>appearing in cash book</td>
<td></td>
</tr>
<tr>
<td>(c) Subtract: Debit</td>
<td></td>
</tr>
<tr>
<td>entries shown in the</td>
<td>Rs. -100</td>
</tr>
<tr>
<td>bank statement but not</td>
<td></td>
</tr>
<tr>
<td>appearing in cash book</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted (corrected)</td>
<td>Rs. 11835 B</td>
</tr>
<tr>
<td>cashbook balance</td>
<td></td>
</tr>
</tbody>
</table>

How to prepare a Bank Reconciliation statement when extracts of cash Book and Pass Book are given

When the cash book and pass book abstracts are given, the following points should be noted.

- Find out the period for which both the abstracts are given
- When the period for which both the abstracts are given is common, i.e. the cash book abstract relates to January and the pass book abstract is also given for January, take into account only uncommon entries.
• When the period for which both the abstracts are given is uncommon, i.e, the cash book relates to January but the pass book relates to February, take into account only common entries.
• Where the period is same, uncommon entries will appear in the reconciliation statement.
• When the period is different, common entries will appear in the reconciliation statement.

**Adjusting The Cash Book Balance**

We have learnt that certain entries appear in the pass book first and then by comparing the pass book with the cashbook, these missing entries are incorporated in the cash book. The trader must know the correct bank balance at any time so that he can issue cheques only to the extent of the available bank balance. Therefore, preparing a bank reconciliation statement, the accountant makes the necessary corrections in the cash book and adjusts the cash book balance.

*The items, which can usually be adjusted in the cash book are:*

• Payment made by bank as per standing instructions.
• Bank charges, interest on bank overdraft debited by the bank.
• Collection of interest in securities and dividend on shares by bank.
• Debits for the dishonor of cheques in the pass book.
• Direct deposits made by customers of the trader.
• Errors committed in the cash book.

**Advantages of Bank Reconciliation Statement**

Following are the advantage of preparing the bank reconciliation statement:

• It helps the management to check the accuracy of the entries made in the cash book.
• It helps to detect errors and to take timely action for the correction of balances.
• It is a very important control technique for the management.
• It shows the correct bank balance at any particular time
• It reveals frauds committed by the staff handling cash and cheques and thus, helps the management to have effective control.

**Unit 5- Trial Balance, Rectification of Errors and Adjusting & Closing Entries**

**Trial Balance**
Multiple entries in various accounts will make a Ledger. Taking all the ledger balances and presenting them in a single worksheet as on a particular date is Trial Balance.

To understand a trial balance, we must first understand the following:

- **Double entry system** – Recording two entries for a single transaction that is equal and opposite in nature
- **Journal** – All transactions recorded in double entry system of bookkeeping
- **Ledger** – Summary of all journals of a similar nature.

**Features and Purpose of a Trial Balance**

- It is a list of debit and credit balance drawn from ledger.
- It includes cash and Bank balance.
- Its main purpose is to establish arithmetical accuracy of transactions recorded in the books of account.
- It is usually prepared at the end of the year but it can also be prepared any time, as and when required, e.g. monthly, quarterly or half yearly.
- It enables the trader to know amounts receivable from customers and amounts payable to suppliers.
- It facilities preparation of final accounts.

**Types of Trial Balance and Preparation of Trial Balance**

There are two types of Trial balance:

- Gross Trial Balance
- Net Trial Balance

**Gross Trial Balance**

*It is Prepared in the following stages:*

- Take totals of debit and credit columns of each ledger account.
- Take totals of receipts and payments of cashbook showing separately cash, bank and discount columns.
- Write names of all accounts as per the ledger and cash, bank and discount accounts as per cash book onto a statement.
- Enter the debit and credit totals against each item.
- Finally take total of debit and credit columns.

**Example:**
On 31\textsuperscript{st} March 2014, the totals of debit and credit sides of various ledger accounts and receipts and payments sides of cash and bank columns of cash book of Mr. Abhinav are as under:

<table>
<thead>
<tr>
<th>Name of the account</th>
<th>Total of debit side (Rs.)</th>
<th>Total of credit side (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abhinav Capital</td>
<td>10,000</td>
<td>1,35,000</td>
</tr>
<tr>
<td>Drawings</td>
<td>25,000</td>
<td>-</td>
</tr>
<tr>
<td>Stock on 31\textsuperscript{st} March, 1996</td>
<td>15,000</td>
<td>-</td>
</tr>
<tr>
<td>Purchases</td>
<td>1,90,000</td>
<td>4,000</td>
</tr>
<tr>
<td>Purchases Returns</td>
<td>18,000</td>
<td></td>
</tr>
<tr>
<td>Sales</td>
<td>6,000</td>
<td>2,45,000</td>
</tr>
<tr>
<td>Sales Returns</td>
<td>13,000</td>
<td>--</td>
</tr>
<tr>
<td>Expenses</td>
<td>12,000</td>
<td>-</td>
</tr>
<tr>
<td>Customers</td>
<td>3,05,000</td>
<td>2,50,000</td>
</tr>
<tr>
<td>Suppliers</td>
<td>2,00,000</td>
<td>2,35,000</td>
</tr>
<tr>
<td>Car</td>
<td>1,00,000</td>
<td>-</td>
</tr>
<tr>
<td>Dena Bank</td>
<td>2,81,000</td>
<td>2,75,000</td>
</tr>
<tr>
<td>Cash</td>
<td>43,000</td>
<td>38,000</td>
</tr>
</tbody>
</table>

Solution

**Gross Trial Balance as on 31\textsuperscript{st} March 2014**

<table>
<thead>
<tr>
<th>Name of the Account</th>
<th>L.F</th>
<th>Debit (Rs.)</th>
<th>Credit (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abhinav Capital</td>
<td>10000</td>
<td>1,35,000</td>
<td></td>
</tr>
<tr>
<td>Drawings</td>
<td>25000</td>
<td>--</td>
<td></td>
</tr>
<tr>
<td>Stock on 31\textsuperscript{st} March, 2013</td>
<td>15000</td>
<td>--</td>
<td></td>
</tr>
<tr>
<td>Purchases</td>
<td>190000</td>
<td>4000</td>
<td></td>
</tr>
<tr>
<td>Purchases Returns</td>
<td>--</td>
<td>18000</td>
<td></td>
</tr>
</tbody>
</table>
Net Trial Balance

Under this trial Balance, net balance of each amount are drawn and shown in trial balance. If debit total of an account is more, it will show debit balance and of credit total of an account is more, it will show a credit balance.

Net Trial Balance as on 31st March 2014

<table>
<thead>
<tr>
<th>Name of the Account</th>
<th>L.F</th>
<th>Debit (Rs.)</th>
<th>Credit (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abhinav Capital</td>
<td></td>
<td>1,25,000</td>
<td></td>
</tr>
<tr>
<td>Drawings</td>
<td></td>
<td>25000</td>
<td>--</td>
</tr>
<tr>
<td>Stock on 31st March, 2013</td>
<td></td>
<td>15000</td>
<td>--</td>
</tr>
<tr>
<td>Purchases</td>
<td></td>
<td>186000</td>
<td></td>
</tr>
<tr>
<td>Purchases Returns</td>
<td></td>
<td>--</td>
<td>18000</td>
</tr>
<tr>
<td>Sales</td>
<td></td>
<td></td>
<td>2,39,000</td>
</tr>
<tr>
<td>Sales Returns</td>
<td></td>
<td>13000</td>
<td>--</td>
</tr>
<tr>
<td>Expenses</td>
<td></td>
<td>12000</td>
<td>--</td>
</tr>
<tr>
<td>Customers</td>
<td></td>
<td>55000</td>
<td>--</td>
</tr>
<tr>
<td>Suppliers</td>
<td></td>
<td></td>
<td>35,000</td>
</tr>
<tr>
<td>Car</td>
<td></td>
<td>1,00,000</td>
<td>--</td>
</tr>
</tbody>
</table>
Disagreement of a Trial Balance

Disagreement of a trial balance may be caused by the wrong totaling or balancing of ledger accounts. While totaling the figure of subsidiary books there may arise some errors that will cause disagreement of trial balance. Omission to post a ledger balance also causes the disagreement of a trial balance.

Classification of Errors

Errors can be broadly divided into two type:

- Clerical Errors
- Principle Errors

Clerical Errors

- Errors of Omission,
- Errors of Commission, and
- Compensating errors.

Errors of Omission

The Errors of Omission will occur when a transaction is not recorded in the books of accounts or omitted by mistake. The Errors of Omission two types.

- Partial
- Complete

The partial errors may happen in relation to any subsidiary books. This is the result of when a transaction is entered in the subsidiary book but not posted to the ledger. For example, cash paid to the suppliers has been entered in the payment side of the cash book but it will not be entered in the debit side of the suppliers account.

The complete omission may happen the transaction is completely omitted from the books of accounts. For example, an accountant fails to enter a specific invoice from the sales day book.

Errors of Commission

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Dena Bank</td>
<td>6000</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>5000</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>4,17,000</td>
<td>4,17,000</td>
</tr>
</tbody>
</table>
When a transaction is entered in the books of accounts in wrongly, this may be entered as partially or incorrectly. This kind of errors are known as Errors of Commission. The Errors of Commission may happens because of ignorance or negligence of the accountant. This may be of different types, the main reasons are Errors relating to subsidiary books and Errors relating to ledger. Following are some of the examples:

- Posting of correct amount but on the wrong side
- Posting of a wrong amount but on the correct side
- Posting of a wrong amount amount on wrong side of an account

Compensating Errors

Compensating Errors are those errors which compensates themselves in the net results of the business. This means, if there are over debit in one account which will be compensated by the over credit in some account in the same extent of the business. Like that, if there is a wrong debit in one account which will be neutralized by some wrong credit in the same extent of the business.

Errors of Principles

This kind of errors are occurs when the entries are made against the principle of accounting. These Errors are made because of the following reasons:-

- Errors happens due to the inability to make a distinction between the revenue and capital items.
- Errors happens due to the inability to make a difference between the business expenses and personal expenses.
- Errors happens because of the inability to make a distinction between the productive expense and nonproductive expenses.

Rectification of Errors

One-sided Errors

These errors affect only one account. Thus, these are one-sided errors. We can rectify these errors by giving an explanatory note in the account or by passing a journal entry with the help of Suspense A/c. When we detect an error before posting to the ledger, we can correct it by simply crossing the wrong amount, writing the correct amount above it and initializing it. Similarly, we can also correct an error in the ledger account.

Errors of casting, errors of carrying forward the balances, errors of balancing the accounts, errors of posting the wrong amount in the correct account, error of posting in the correct
account on the wrong side, omitting to show an account in the trial balance, posting in wrong side with wrong amount are the examples of errors affecting the Trial Balance.

**Two-sided Errors**

These errors affect two or more accounts simultaneously. Thus, these are two-sided errors. We can rectify these by passing a journal entry giving the correct debit and credit to the accounts. In order to rectify an error, we need to cancel the effect of wrong debit or credit by reversing it and restore the effect of correct debit or credit.

When there is short debit or excess credit in an account we need to debit the concerned account. Whereas, when there is short credit or excess debit in an account we need to credit the concerned account.

Complete omission to record an entry in the journal or the subsidiary books, incorrect recording of transactions in the books, complete omission of posting and errors of principle are the examples of these errors.

**Suspense Account**

When the trial balance does not tally due to the one-sided errors in the books, an accountant puts the difference between the debit and credit side of the trial balance on the shorter side as the Suspense A/c. As and when we locate and rectify the errors, the balance in the Suspense A/c reduces and consequently becomes zero. Thus, we cannot categorize the Suspense A/c. It is a temporary account and can have debit or credit balance depending upon the situation.

*While using the Suspense A/c to rectify the one-sided errors, the accountant needs to follow the following steps:*

- Identification of the account with the error.
- Ascertainment of the excess debit or credit or short debit or credit in the above account.
- In case of short debit or excess credit in an account, we need to debit the concerned account. Whereas, in case of short credit or excess debit in an account we need to credit the concerned account.
- Pass the necessary journal entry by debiting or crediting the Suspense A/c.

**Example**

Q: Trial Balance of M/s Srivastav Enterprises did not agree. It puts the difference to the Suspense A/c. Rectify the following errors and prepare the Suspense A/c to ascertain the original difference in the trial balance.

Amount paid for the installation of the machinery ₹10000 was posted to the Repairs and maintenance A/c.
Total of Purchases book ₹50000 was not posted to the ledger.
Goods returned to John ₹3000 were recorded in Sales Book.
Salary paid to Ram ₹6000 was debited to his personal account.
Depreciation written-off on furniture ₹500 was not posted to the furniture account.

**Ans: In the books of M/s Srivastav Enterprises**

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Amount (Dr.)</th>
<th>Amount (Cr.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Machinery A/c</td>
<td>Dr. 10000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Repairs and Maintenance A/c</td>
<td></td>
<td>10000</td>
</tr>
<tr>
<td></td>
<td>(Being rectification of the wrong journal entry in the Repairs and maintenance A/c)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>Purchases A/c</td>
<td>Dr. 50000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Suspense A/c</td>
<td></td>
<td>50000</td>
</tr>
<tr>
<td></td>
<td>(Being rectification of the omission to post the total of purchases book in the ledger)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>Sales A/c</td>
<td>Dr. 3000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Purchases Return A/c</td>
<td></td>
<td>3000</td>
</tr>
<tr>
<td></td>
<td>(Being rectification of wrong recording of the purchases return in the sales book)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>Salary A/c</td>
<td>Dr. 6000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Ram’s A/c</td>
<td></td>
<td>6000</td>
</tr>
</tbody>
</table>
Adjusting and Closing Entries

Adjusting Entries

Final Account are the accounts which are prepared at the end of the trading year. These accounts show the final results of the business carried out. Final accounts are prepared to find out profit earned or loss sustained by a concern.

At the end of the accounting year, all ledger accounts are balanced and then trial balance is prepared. Form the trial balance, final accounts, i.e. trading, profit and loss account and balance sheet are drawn. While preparing trading and profit and loss account, all expenses and incomes for the full period are to be taken into consideration. If expenses have been incurred but not paid or income is due but not received, necessary entries are required to be passed to show the correct picture of the business. These entries are called "Adjusting Entries".

<table>
<thead>
<tr>
<th>Date</th>
<th>particulars</th>
<th>amount</th>
<th>Date</th>
<th>particulars</th>
<th>amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.</td>
<td>To Furniture A/c</td>
<td>500</td>
<td>2.</td>
<td>By Purchases A/c</td>
<td>50000</td>
</tr>
<tr>
<td></td>
<td>Difference as per Trial balance</td>
<td>49500</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>50000</td>
<td></td>
<td></td>
<td>50000</td>
</tr>
</tbody>
</table>

Suspense A/c

(Difference as per Trial balance)

Being rectification of wrong debit to the personal account of an employee

<table>
<thead>
<tr>
<th>Date</th>
<th>particulars</th>
<th>amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.</td>
<td>To Furniture A/c</td>
<td>500</td>
</tr>
<tr>
<td></td>
<td></td>
<td>50000</td>
</tr>
</tbody>
</table>

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Closing Entries

At the end of cash year, all accounts of expenses and incomes must be closed. The balance of these accounts are transferred to trading account and profit and loss account. The entries passed to transfer these balances are called “Closing entries”.

Unit 6- Capital and Revenue Expenditure

Expenditure

Expenditure means spending on something. This can be a payment is cash or can also be the exchange of some valuable item in exchange for goods or services. It is the process of causing a liability by a commodity. Receipts and invoices keep the records of expenditures. An expense is a word very similar to expenditure but expense shows the deduction in the value of the asset while expenditure simply denotes the obtaining of assets. Two types of expenditures are present on the basis of time durations, That is

- Capital expenditures
- Revenue expenditures

Capital Expenditures

These are expenditures for high-value items that holds longer duration requirements. Capital expenditures are long-term expenditures. In other words, when the expenses are made for a particular asset but they do not get completely consumed in the specific time. Due to this the earning capacity increases, and in the meanwhile, the price of the assets decreases. Example: Cash money spent on business purposes, purchasing of plants and machinery items etc.

Revenue Expenditures

In contrast to the capital expenditure, revenue expenditures are not the high-value items, instead, they are the routine expenditures that takes place in the normal business. In other words, this kind of expenditure maintains fixed assets.

Unlike capital expenditure, earnings do not increase but stay maintained in revenue expenditure. The assets get consumed in an accounting year and no future benefits are available.

Capital VS Expenditure

<table>
<thead>
<tr>
<th>Capital Expenditure</th>
<th>Revenue Expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount spent of usually large.</td>
<td>Amount spent is relatively small.</td>
</tr>
</tbody>
</table>
The purpose is to improve or enhance business or productive or earning capacity | The Benefit is short duration
---|---
The benefit of long duration | The benefit is short duration
It is non-recurring | It is recurring
It is shown in balance sheet | It is shown in profit and loss account.
Not matched with capital receipts | Matched with revenue receipts

**Receipts**

**Capital Receipts**

Capital Receipts are from issue of Equity/ Preference share/ Capital Instruments or from sale of Disposal of fixed Assets/Long Term investment or from Grants received from Government for Building of Capital Assets. Capital receipts are not routed through Profit & Loss account. However profit/loss, if any, arising from such transactions is recorded in the P & L account.

**Revenue Receipts**

Revenue Receipts are from day to day operation of the company or receipts where is no further obligation on the entry to perform certain actions. Revenue Receipts are routed through Profit and loss account.

**Unit 7- Bills of Exchange**

**Types of Instruments of Credit**

In a business, credit transactions play very important role. For manufacturing goods, manufacturer purchases raw materials, the majority of which will be on credit.

Credit may also be granted by a moneylender, a banker or financial institution. Credit is, generally, provided by obtaining, a written document called ‘Instrument of Credit’. The serves as a proof of existence of credit.

- Bills of Exchange
- Promissory Notes
**Bills of Exchange**

- **Drawer**: A person who draws the bill.
- **Drawee**: A person on whom the bill is drawn
- **Payee**: A person who is going to receive money.

**Features of Bills of Exchange**

- A bill of exchange an instrument in writing.
- It is drawn and signed by the maker i.e. drawer of the bill.
- Contains an unconditional order to a person i.e. drawee.
- The specified amount is payable to the person whose name is mentioned in the bill or to his order or to the bearer.
- It specifies the date by which amount should be paid. (Section 5 of Negotiable Instrument Act).
- Payment of the bill must be in the legal currency of the country.
- It must be properly stamped.
- It must bear a revenue stamp.

**Bills of Exchange Example**

Mr. Abhinav srivastav draws a bill on Ms. Alpa jha for 3 months for ₹ 50,000, payable to Mr. Niraj kumar or his order on 15th April 2019.

Mr. Abhinav srivastav has ordered Ms. Alpa jha to pay ₹ 50,000 to Mr. Niraj kumar. If the order is acceptable to Ms. Alpa jha, he will write across the bill as follows:

Accepted
Ms. Alpa jha
Sector 56, Noida, UP
17th April 2019

When the drawee writes such acceptance on the bill, it becomes a bill of exchange. In the above example Mr. Abhinav srivastav is the drawer of the bill, Ms. Alpa jha is the acceptor and Mr. Niraj kumar is the payee. Ms. Alpa jha will pay the amount to Mr. Niraj kumar.

**Promissory Notes**
A written undertaking by the buyer to make a payment on a specified date can take the form of a bill of exchange or a promissory note. We have seen earlier that a bill of exchange is drawn by the creditor and accepted by the debtor. A promissory notes, on the other hand, is written by the debtor (buyer) promising the creditor (seller) to pay a specified sum after a specified period. Thus, it can be defined as:

**Features of Promissory Notes**

- An instrument in writing
- Containing an unconditional undertaking
- Signed by the maker to pay a certain sum of money
- To or to the order of a certain person or the bearer of the instrument (section 4 of the Negotiable instrument Act)

In a case of Promissory notes, there are two parties:

- **Maker:** A person who makes the note and promises to make the payment.
- **Payee:** A person who is to receive money.

Or

- **The holder:** A holder is basically the person who holds the notes. He may be either the payee or some other person.

**Essential Elements of a Promissory Note**

- Written notes
- Express undertaking
- Unconditional promise
- Specific amount
- Legal tender

Example:
**Difference between Bills of Exchange and Promissory Note**

<table>
<thead>
<tr>
<th>Bills of Exchange</th>
<th>Promissory Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>It is an unconditional order to pay</td>
<td>It is an unconditional promise to pay.</td>
</tr>
<tr>
<td>It is made by a creditor.</td>
<td>It is made by a debtor.</td>
</tr>
<tr>
<td>Acceptance by debtor is necessary</td>
<td>No acceptance is required</td>
</tr>
<tr>
<td>On dishonor of a bill, it is usually noted by the notary Public.</td>
<td>Nothing is not necessary.</td>
</tr>
</tbody>
</table>

**Cheque**

**Essential Features of cheque**

- A cheque must have to fulfill all the essential elements of a bill of exchange.
- It must be payable to bearer or to order but in either case, it must be payable on demand.
- The banker named pays it when it is presented for payment.
- The signature must tally with the specimen sign of the drawer kept in the bank.
- A cheque must be dated.
• A cheque drawn with a future is valid but the same is payable on or after such specified period.

**Difference between Bills of Exchange and Cheque**

<table>
<thead>
<tr>
<th>Bills of Exchange</th>
<th>Cheque</th>
</tr>
</thead>
<tbody>
<tr>
<td>A bill of exchange can be drawn upon any person including a bank.</td>
<td>A cheque can be drawn only upon a bank.</td>
</tr>
<tr>
<td>A bill of exchange requires acceptance.</td>
<td>A cheque does not require any acceptance</td>
</tr>
<tr>
<td>The acceptor of a bill of exchange is allowed three days of grace after the date maturity of the bill.</td>
<td>A cheque is always payable on demand</td>
</tr>
<tr>
<td>Notice of dishonor is necessary</td>
<td>Notice does not require any stamp.</td>
</tr>
<tr>
<td>A bill of exchange must be stamped</td>
<td>A cheque does not require any stamp.</td>
</tr>
</tbody>
</table>

**Accommodation Bill**

Accommodation Bills are drawn and accepted with no consideration passed or received. The Bill, which is drawn just to oblige a friend, who is in need of money, of course without any trading activities, with sole intention of raising funds required for ready cash is known as Accommodation Bill.

The accommodating party, i.e., the drawee accepts the Bill drawn by the accommodated party (drawer). That is the Drawer of the accommodation bill can be called accommodated party and drawee can be called accommodating party. After the Bill is accepted, the drawer discounts it with a bank and obtains the cash.

Before the due date of the Bill, Drawer provides funds to the Acceptor, who honours the Bill. Since the acceptance is given without consideration and to help the accommodated party to raise the funds, the accommodated party has to discharge the Bill by himself or provide funds to accommodating party.

Thus, there is always a mutual understanding between the parties and hence, these bills are called Accommodation Bills.

Example:
Mr. A accepted a bill for Rs 20,000 drawn by B to enable the latter to raise funds at three months on 1st October 2004. The bill was duly discounted by B at their Bank at 6% per annum. On the due date B remitted the amount to the acceptor and the Bill was duly met. Pass journal entries in the books of both the parties.

**SOLUTION**

<table>
<thead>
<tr>
<th>Date</th>
<th>Bills Receivable Account</th>
<th>A's Journal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oct. 1</td>
<td>Dr 20,000</td>
<td>Rs 20,000</td>
</tr>
<tr>
<td></td>
<td>To A Account</td>
<td>To Bills Payable Account</td>
</tr>
<tr>
<td></td>
<td>(Being Bill drawn on A for 3 months)</td>
<td>(Being acceptance of Bill drawn by B)</td>
</tr>
<tr>
<td>Oct. 2</td>
<td>Dr 19,700</td>
<td>NO ENTRY</td>
</tr>
<tr>
<td></td>
<td>Discount on Bills Account</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Dr 300</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Bills Receivable</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being Bill discounted at 6% p.a)</td>
<td></td>
</tr>
<tr>
<td>Jan. 4</td>
<td>Dr 20,000</td>
<td>Rs 20,000</td>
</tr>
<tr>
<td></td>
<td>To Cash Account</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being amount paid to A to meet the Bill on the due date)</td>
<td></td>
</tr>
</tbody>
</table>

Discount: 20,000 x 6/100 x 3/12 = Rs 300

**Bill Books**

Two types of Bill Books

- Bills Receivable Book
- Bills Payable Book

**Bills Receivable Book**

Bills receivable book is a book where all the bills, which are received, are recorded and posted directly to the credit of respective customer’s account from there. The total amount of bills so received during the period, either at the end of the week or month, is to be posted to, in one lump sum, to the debit of the bills receivable account. **The usual form of bills receivable book, with imaginary figures is shown below.**

<table>
<thead>
<tr>
<th>No.</th>
<th>Date of Receipt</th>
<th>From whom</th>
<th>Accept or</th>
<th>Date of bill</th>
<th>Term</th>
<th>Date due</th>
<th>Where payable</th>
<th>Amount</th>
<th>L. F</th>
<th>How Disposed off</th>
<th>Remarks</th>
</tr>
</thead>
</table>
**Bills Payable Book**

This is a book where all particulars relating to the bills accepted are recorded and posted from there, directly to the debit of the respective creditor’s account. The total amount of the bills so accepted during the period, either at end of the week or month, is to be posted in one lump sum to the credit of bills payable account. *The usual form of ‘Bill payable book’ with imaginary figures,*

<table>
<thead>
<tr>
<th>No.</th>
<th>Date of Receipt</th>
<th>Drawn by</th>
<th>Payee</th>
<th>Date of Bill</th>
<th>Term</th>
<th>Date due</th>
<th>Where payable</th>
<th>Amount</th>
<th>L. F</th>
<th>How Dispose off</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1/1/20</td>
<td>A</td>
<td>A</td>
<td>1/1/20</td>
<td>1mon ht</td>
<td>1/1/20</td>
<td>Delhi</td>
<td>4000</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

**Important Terms**

**Honouring of Bill:** When the drawee pays the amount of the bill on due date, the bill is said to be ‘Honoured Bills’.

**Dishonour of Bill:** When the drawee pays the amount of the bill on due date, the bill is said to be ‘Honoured Bills’.

**Discounting of Bills:** The drawer may discount the bill with the bank before the due date. The bank charges discounting charges from the drawer at a certain rate. Thus, at the time of discounting the bank deposits the net amount after charging such amount of discount in the account of the holder of the bill.

\[ \text{Discount} = \frac{\text{Amount of bill} \times \text{Rate of interest or discount}}{100} \times \frac{\text{Remaining period to maturity}}{12} \]

**Endorsement of bills:** Transfer of bill to same other person by the holder.

**Retirement of bills:** When a drawee pays the bill before its due date. It is called retirement of bill.

**Renewal of bill:** Renewal of bill of exchange is an act of cancellation of old bill before its maturity in return of a new bill, including interest, for an extended period. It is done by drawer on request of drawee.

**Accommodation of bill:** An accommodation bill is a bill of exchange signed for by a person (the accommodation party) acting as a guarantor. The accommodation party is liable for
the bill should the acceptor fail to pay at maturity. Accommodation bills are sometimes also referred to as windbills or windmills.

**Notary Public:** A notary public of the common law is a public officer constituted by law to serve the public in non-contentious matters usually concerned with estates, deeds, powers-of-attorney, and foreign and international business.

**Rebate:** When a bill is paid by drawee before due date, same allowance is given to him. This allowance is called ‘Rebate’.

### JAIIB Online Mock test with Explanation

<table>
<thead>
<tr>
<th>JAIIB/DBF Paper</th>
<th>Mock Link</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>JAIIB/DBF Paper-I (Principle and Practices of Banking) Online Mock Tests</strong></td>
<td>• <strong>Unit wise Mock</strong>- 450 questions</td>
</tr>
<tr>
<td></td>
<td>• <strong>Module Wise Mock</strong>- 250 Questions</td>
</tr>
<tr>
<td></td>
<td>• <strong>Full length Mock 5-</strong> 600 Questions (Each Mock 120 Q)</td>
</tr>
<tr>
<td></td>
<td>• <strong>Memory based Mock</strong></td>
</tr>
<tr>
<td></td>
<td>• <strong>Case Study Mock</strong></td>
</tr>
<tr>
<td></td>
<td><strong>Click here -Mock Link</strong></td>
</tr>
<tr>
<td></td>
<td><strong>Total- 1500+ Questions</strong></td>
</tr>
<tr>
<td><strong>Visit-test.ambitiousbaba.com</strong></td>
<td></td>
</tr>
</tbody>
</table>

<p>| JAIIB/DBF Paper-II (Accounting &amp; Financial for Bankers) Online Mock Tests | • <strong>Unit wise Mock</strong>- 250+Questions |
|                                                                         | • <strong>Module Wise Mock</strong>- 200 Questions    |
| <strong>Visit-test.ambitiousbaba.com</strong>                                      |                                               |</p>
<table>
<thead>
<tr>
<th>Test Series</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Full length Mock 5</strong></td>
<td>600 Questions (Each Mock 120 Q)</td>
</tr>
<tr>
<td><strong>Memory based Mock</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Case Study Mock</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Click Here- Mock Link</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1200+ Questions</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Test Series</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>JAIIB/DBF Paper-3 (Legal and Regulatory Aspects of Banking) Online Mock Tests</td>
<td></td>
</tr>
<tr>
<td>Visit-test.ambitiousbaba.com</td>
<td></td>
</tr>
<tr>
<td><strong>Unit wise Mock</strong></td>
<td>500+Questions</td>
</tr>
<tr>
<td><strong>Module Wise Mock</strong></td>
<td>200 Ques</td>
</tr>
<tr>
<td><strong>Full length Mock 5</strong></td>
<td>600 Questions (Each Mock 120 Q)</td>
</tr>
<tr>
<td><strong>Memory based Mock</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Click here- Mock Link</strong></td>
<td></td>
</tr>
<tr>
<td>(1500+ Questions)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Test Series</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Combo</td>
<td>Approx (4500Questions) + Capsule PDF</td>
</tr>
<tr>
<td>Visit-test.ambitiousbaba.com</td>
<td></td>
</tr>
<tr>
<td><strong>Click here-Mock Link</strong></td>
<td></td>
</tr>
</tbody>
</table>

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**JAIIB Paper 2- Accounting & Finance for Bankers**

**Module C- Final Account**

**Index**

<table>
<thead>
<tr>
<th>No. of Unit</th>
<th>Unit Name</th>
</tr>
</thead>
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</tr>
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<td>Company Accounts-1</td>
</tr>
<tr>
<td>Unit 6</td>
<td>Company Accounts-2</td>
</tr>
<tr>
<td>Unit 7</td>
<td>Accounting in Computerised Environment</td>
</tr>
</tbody>
</table>

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**Unit -1 Balance Sheet Equation**

**Balance Sheet Equation**

An Accounting Equation is also called the Balance Sheet Equation. We all know that we record all the business transactions using the Dual Aspect concept. This means that each debit has an equal credit and vice-versa.

- **Capital**: It means the amount which the owner of business has invested in the firm and can claim from the firm.
• **Liability**: It means the amount which the firm owes to outsiders. Long term liabilities are those liabilities which are payable after a long term. Current liabilities are those liabilities which are payable in near future (generally within one year).

• **Asset**: Assets are things of value owned. Fixed assets are those assets which are purchased for the purpose of operating the business but not for resale, e.g. Land, building, Plant and Machinery, etc. Current assets are those assets which are kept for short term for converting into cash or for resale, e.g. unsold goods, debtors, cash, bank balance, etc.

**Assets** = Liabilities + Capital (Owner’s Equity)

**Liabilities** = Assets - Capital or Capital = Assets – Liabilities

Example:

ABC starts the food truck. He puts ₹ 50,000 as a capital fund. He further loans ₹ 25,000 from a local credit vendor. Now, he has a total of ₹ 75,000, he then purchases a fully furnished truck for ₹ 45,000.

Below is the ABC balance sheet for December 2017.

<table>
<thead>
<tr>
<th>Balance Sheet</th>
<th>December 31, 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td><strong>Liabilities</strong></td>
</tr>
<tr>
<td>Cash</td>
<td>30,000</td>
</tr>
<tr>
<td>Food truck</td>
<td>45,000</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>75,000</strong></td>
</tr>
</tbody>
</table>

---

**Unit 2 - Preparation of Final Accounts**

**Preparation of Trial Balance**

The first step in the preparation of final accounts is the preparation of trial balance. So it is absolutely essential that we prepare the trial balance perfectly, so our final accounts do not contain any errors. Let us learn more about the methods and procedures of preparation of trial balance.

**Trial Balance**
A trial balance is a bookkeeping worksheet-like account that reflects all the credit and debit balances of all the ledger accounts. Once we prepare this statement, we can prepare the final accounts of the company on the basis of this trial balance.

One other important use of the trial balance is that it can determine the arithmetic accuracy of the accounts. So if both columns of the trial balance tally, we can be reasonably assured of the accuracy of the accounts. It does not ensure that the accounts are free of all errors but it can at least establish mathematical accuracy.

**Trial Balance (ABC Trading as at 30 June 2018)**

<table>
<thead>
<tr>
<th>General ledger A/C</th>
<th>Dr. Debit</th>
<th>Cr. Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash at bank</td>
<td>10000</td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td>40000</td>
<td></td>
</tr>
<tr>
<td>Vehicles</td>
<td>30000</td>
<td></td>
</tr>
<tr>
<td>Fixtures and Fitting</td>
<td>32000</td>
<td></td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>15000</td>
<td></td>
</tr>
<tr>
<td>Credit card Payment</td>
<td></td>
<td>12000</td>
</tr>
<tr>
<td>Account payable</td>
<td></td>
<td>15000</td>
</tr>
<tr>
<td>Bank Loan</td>
<td></td>
<td>50000</td>
</tr>
<tr>
<td>Sales</td>
<td></td>
<td>175,000</td>
</tr>
<tr>
<td>Purchases</td>
<td>60,000</td>
<td></td>
</tr>
<tr>
<td>Advertising</td>
<td>5000</td>
<td></td>
</tr>
<tr>
<td>Wages</td>
<td>65000</td>
<td></td>
</tr>
<tr>
<td>Rent</td>
<td>15000</td>
<td></td>
</tr>
<tr>
<td>Electricity</td>
<td>5000</td>
<td></td>
</tr>
<tr>
<td>Owner Capital</td>
<td></td>
<td>25000</td>
</tr>
<tr>
<td>Total</td>
<td>277,000</td>
<td>277,000</td>
</tr>
</tbody>
</table>

**Adjustment Entries**
An accountant or a bookkeeper makes adjustment entries either before preparation of trial balance or after preparation of trial balance.

Usually, adjustment entries are made after preparation of trial balance. In a case when he makes the adjustment entries after preparation of trial balance, he needs to treat each of the adjustment twice while preparing trading and profit and loss account and balance sheet.

In case adjustment entries made before preparation of trial balance, such adjustment appears in the trial balance. Also, such adjustments appear only once in the preparation of final accounts.

**Adjustment Entries Relating to Income and Expenditure**

*Some of the expenses may have been incurred but not paid:* For example- Salary for the month of March has been incurred during the month but will be paid in April. For this, adjusting entries, will be passed in the ledger by debit to charges (salary) account and credit to “Salary payable” account.

*Some of the expenses may have been paid in advance but not incurred:* If a payment has been made in advance i.e. it does not pertain to the accounting period in question, it is not treated as an expense, and the person who received the amount is treated as a debtor.

*Some income may have accrued but not received:* For example, interest accrued on a fixed deposit with the bank which will be paid by the bank on maturity along with the principal. For accounting the interest income, credit ‘Interest income’ account and debit ‘interest receivable’ account.

*Some incomes may have been received but not accrued:* If an income has been received but not accrued, it should not be accounted for. For example, advance payment of rent by a tenant. This should not be taken into account. Therefore, rent account should be debited and ‘Advance rent Received’ account should be debited.

**Preparation of Financial Statements from Trial Balance**

If we have recorded all the transactions, their arithmetical accuracy has been checked by the trial balance and the required adjusting entries have been made, we should be able to find out the results of the operations during the accounting period (day year) and also know the financial position of the business at the close the year.

This is done through preparing the Profit and loss account and the Balance sheet (Both these are called the financial statements).

**Entries Relating to Depreciation of Fixed Assets**

Before we can start preparing the financial statements, it is important to pass entries for depreciation to include it in the records as an expense.
Entries Relating to closing stocks

Every sales transaction results in reduction in available stocks and every purchase transaction increases the stocks available in the godown. However, the entries passed in the ledger, do not affect the stocks account:

Example-

Purchase of goods worth Rs 2000 results in the following postings in the ledger-

Dr. Purchase A/C Rs. 2000
Cr. Cash A/c Rs. 2000

Similarly, sales of goods for Rs. 500 result in the following posting in the ledger-

Dr. Cash A/c Rs. 500
Cr. Sales A/c Rs 500

As no entry is passed in the stocks account during the year, the balance in it remains the same as in the beginning of the year, i.e. the opening balance of the stock (this is a debit balance and is shown in the balance sheet of the last year as closing stock)

As we will see in our discussion in the P/L account, the Profit= sales- (purchases+ opening stock-closing stock+ expenses)

In the above formula, all items, except the closing stock, are available from the ledger. As the amount of the closing stock in not available from the ledger, we will have to actually verify the available stock at the close of the year and value it. This is called ‘Inventory Valuation’ and has its impact on the Profit of loss of the firm during that year.

Entries Relating to other items

Other adjustments pertain to provision for bad and doubtful debts, writing off part fictitious assets like preliminary expanses etc. provisioning for contingent events etc.

Preparation of Profit and loss account

Closing Entries

At the end of each accounting period, all the income and expenses accounts should be closed by transferring the balance to the P & L account. The entries passed for this purpose are called Closing Entries.

Example: If the salary account is showing the debit balance of Rs 300000 a credit entry ‘By transfer to P&L account will be posted in this account and debit entry will be posted to P & L account. Thus balance in the salary account will become Nill.
Trading Account

This is not a necessary step for preparation of the P & L account but many accountants prefer to prepare it. It forms part of the P & L account. A trading account takes into account only the direct costs associated with the materials in which the firm is dealing. The operating costs are not included. This means that we calculate the ‘Cost of Goods Sold’ and subtract it from the Revenue to arrive at what is called ‘Gross Profit’. It is important to note here that under ‘Cost of Goods Sold’, we calculate the cost of only those goods which are sold and not the cost of entire goods purchased. If we have only purchased the goods during a year and not sold anything, there will be no cost associated with selling of goods as the purchase resulted in only increasing the inventory (Closing stock).

Cost of Goods Sold = (purchases + opening stock) - closing stock + expenses

Preparation of Profit and Loss account

There are prescribed formats for preparing Profit and loss accounts for all the companies in India. Such form is either provided in the Companies Act 2013 or the Banking Regulation Act or some other Act for specific types of companies. However, for other business entities, there is no prescribed format. Traditionally, all the formats used put sales and other incomes on the credit side and all the expenses on the debit side and arrive at the profit figure. This is achieved by passing the closing entries in respect of all the earnings and expenses accounts in the General Ledger so that the balances in all the remaining accounts in the GL, form the balance sheet, discussed in the next paragraphs. A typical format of a P & L account may be as under if the practice of preparation a Trading account is followed:

Profit and Account of ........

For the year ending ......2019.....

To salary ........ By Gross profit carried over
From Trading a/c ................
To electricity charges ............ Gross Loss ................
To conveyance charges ............
To depreciation
To office charges ..............
To other charges ..............
To Taxes
Net Profit ..............
If the practice of preparing the Trading account is not followed, the format may look as under.

**Profit and loss Account of ...........
For the year ending ......2019......**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>To opening stock</td>
<td>.......</td>
</tr>
<tr>
<td>By sales</td>
<td>.......</td>
</tr>
<tr>
<td>To purchases</td>
<td>.......</td>
</tr>
<tr>
<td>Less returns</td>
<td>.......</td>
</tr>
<tr>
<td>By closing stock</td>
<td>.......</td>
</tr>
<tr>
<td>Less returns</td>
<td>.......</td>
</tr>
<tr>
<td>To carriage inwards</td>
<td>.......</td>
</tr>
<tr>
<td>Gross loss</td>
<td>.......</td>
</tr>
<tr>
<td>To cartage</td>
<td>.......</td>
</tr>
<tr>
<td>To dock charges</td>
<td>.......</td>
</tr>
<tr>
<td>To Wages</td>
<td>.......</td>
</tr>
<tr>
<td>To duty</td>
<td>.......</td>
</tr>
<tr>
<td>To Freight</td>
<td>.......</td>
</tr>
<tr>
<td>To clearing charges</td>
<td>.......</td>
</tr>
<tr>
<td>To salary</td>
<td>.......</td>
</tr>
<tr>
<td>To electricity</td>
<td>.......</td>
</tr>
<tr>
<td>To telephone charges</td>
<td>.......</td>
</tr>
<tr>
<td>To conveyance charges</td>
<td>.......</td>
</tr>
<tr>
<td>To office charges</td>
<td>.......</td>
</tr>
<tr>
<td>To other charges</td>
<td>.......</td>
</tr>
<tr>
<td>To taxes</td>
<td>.......</td>
</tr>
<tr>
<td>Net Profit</td>
<td>.......</td>
</tr>
</tbody>
</table>

**Profit and loss Appropriation account**

Net profit, as arrived at in the P&L A/c, is utilized by the company, for providing dividend, dividend distribution tax, adjustments to income tax and transfer to reserves etc. This is done through the profit and loss Appropriation account.

Profit and loss Appropriation account is different from profit and loss account and is normally put before the net profit figure in the same statement. The net profit is transferred to the credit side of profit and loss appropriation account.
account shows only the net profit or net loss from operations of business while the profit and loss appropriation accounts shows all non-operational adjustment.

A typical format of this account is given below. The items included may vary from company to company.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
<th>Particulars</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>To transfer to reserves</td>
<td>............</td>
<td>By last year’s balance brought down</td>
<td>............</td>
</tr>
<tr>
<td>To debenture redemption reserve</td>
<td>............</td>
<td>By net profit of the year brought down</td>
<td>............</td>
</tr>
<tr>
<td>To additional income tax provision for earlier year</td>
<td>............</td>
<td>By excess income tax provision of earlier years</td>
<td>............</td>
</tr>
<tr>
<td>To interim dividend</td>
<td>............</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To dividend/Proposed dividend</td>
<td>............</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To surplus carried over to the balance sheet</td>
<td>............</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>............</td>
<td>Total</td>
<td>............</td>
</tr>
</tbody>
</table>

**Preparation of Balance Sheet**

Below are the steps mentioned to prepare a balance sheet.

**Compose a trial balance**- It is a regular report included in any accounting programme. If it is a manual mode, then create a trial balance by transferring every general ledger account’s ending balance to a spreadsheet.

**Arrange the trial balance**- It is important to arrange the initial trial balance to assure that the balance sheet similar to the relevant accounting structure. While using adjusting entries to adjust the trial balance all the entry should be completely recorded so the auditors can understand why it was made.

**Discard all expense and revenue accounts**- The trial balance includes expenses, revenue, losses, gains, liabilities, equity, and assets. Delete all from the trial balance except equity, liabilities, and assets. However, the deleted accounts are used to create an income statement.
Calculate the remaining accounts- In this stage, sum up all the trial balance account used to create a balance sheet. The typical line items used in the balance sheet are:

- Cash
- Accounts receivable
- Inventory
- Fixed assets
- Other assets
- Accounts payable
- Accrued liabilities
- Debt
- Other liabilities
- Common stock
- Retained earnings

Validate the balance sheet- The total for all assets recorded in the balance sheet should be similar to the liabilities and stockholders’ equity accounts.

Present in the required balance sheet format

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Amount</th>
<th>Asset</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital</td>
<td></td>
<td>Fixed Asset-land, Bldg</td>
<td></td>
</tr>
<tr>
<td>Loan Taken</td>
<td></td>
<td>Current Assets</td>
<td></td>
</tr>
<tr>
<td>Current Liabilities</td>
<td></td>
<td>Cash/Bank B/s</td>
<td></td>
</tr>
<tr>
<td>Outstanding Expenses</td>
<td></td>
<td>Accounts Receivable</td>
<td></td>
</tr>
<tr>
<td>Bank Overdraft</td>
<td></td>
<td>Bills Receivable</td>
<td></td>
</tr>
<tr>
<td>Account Payable</td>
<td></td>
<td>Inventories (stock)</td>
<td></td>
</tr>
<tr>
<td>(Creditors)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>XYZ</td>
<td></td>
<td>XYZ</td>
<td></td>
</tr>
</tbody>
</table>
Unit 3- Ratio Analysis: Advantages and Limitations of Ratio Analysis and Calculation

**Accounting Ratios**

Accounting ratio is the comparison of two or more financial data which are used for analyzing the financial statements of companies. It is an effective tool used by the shareholders, creditors and all kinds of stakeholders to understand the profitability, strength and financial status of companies.

**Classification of Ratios**

Accounting ratios can be classified on the following basis:

**Traditional Classification**

The traditional classification has been on the basis of the financial statements, to which the determinants of a ratio belong. On this basis, the ratios could be classified as:

- Profit and loss account ratios, i.e., ratios calculated on the basis of the profit and loss account only.
- Balance sheet ratios, i.e., ratios calculated on the basis of the figures of balance sheet only.
- Composite ratios or inter-statement ratios, i.e., ratios based on figures of profit and loss account as well as the balance sheet.

**Functional classification**

Traditional basis of classification, as given above, has been found to be too crude and unsuitable because, analysis of balance sheet and income statement cannot be done in isolation. They have to be studied together in order to determine the profitability and solvency of the business. According to the order that ratios serve as a tool for financial analysis, they are now classified as:

- Profitability ratios,
- Turnover or activity ratios, and
- Financial or solvency ratios

**Financial ratios two categories:**

- **Short term Solvency Ratios** are the ratios that disclose the financial position or solvency of the firm in the short period. Some accountants prefer to call them simply as ‘Liquidity Ratios’.
• **Long term Solvency Ratios** are the ratios that disclose the financial position or solvency of the firm in the long period. Some accountants prefer to call them simply as ‘Solvency Ratios’.

**Uses of Accounting Ratios**

• **Simply financial Statements**: Ratios simplify the comprehension of financial statement. Ratios tell the whole story of changes in the financial condition of the business.

• **Facilitate inter-firm comparison**: Ratios provide data for inter-firm comparison. Ratios highlight the factors associated with successful and unsuccessful firms. They also reveal strong firms and weak firm, overvalued and under-valued firms.

• **Facilitate intra-firm Comparison**: Ratios also make possible comparison of the performance of the different divisions of the firm. The ratios are helpful in deciding about their efficiency or otherwise in the past and likely performance in the future.

• **Help in planning**: Ratios help in planning and forecasting. Over a period of time, a firm or industry develops certain norms that may indicate future success or failure.

**Limitations of Accounting Ratios**

• The firm can make some year-end changes to their financial statements, to improve their ratios. Then the ratios end up being nothing but window dressing.

• Ratios ignore the price level changes due to inflation. Many ratios are calculated using historical costs, and they overlook the changes in price level between the periods. This does not reflect the correct financial situation.

• Accounting ratios completely ignore the qualitative aspects of the firm. They only take into consideration the monetary aspects (quantitative).

• There are no standard definitions of the ratios. So firms may be using different formulas for the ratios. One such example is Current Ratio, where some firms take into consideration all current liabilities but others ignore bank overdrafts from current liabilities while calculating current ratio.

• And finally, accounting ratios do not resolve any financial problems of the company. They are a means to the end, not the actual solution.

**Calculation and Interpretation of various Ratios**

**Profitability Ratios**

**Overall Profitability Ratio**
It is also called as the ‘**Return on Investment**’. It indicates the percentage of return on the total capital employed in the business. It is calculated on the basis of the **following formula**:

\[
\frac{\text{Operating Profit}}{\text{Capital Employed}} \times 100
\]

**Capital Employed**: Different meanings by different accountants.
- Sum total of all assets whether fixed or current.
- Sum total of fixed assets
- Sum total of long term funds employed in the business i.e, Share + Capital + Reserves and Surplus + Long term loans – (Non business assets + fictitious assets)

**Operating Profit**: Means profit before ‘Interest and Tax’. The term 'Interest' means interest means 'Interest on long term borrowings. Interest on short-term borrowings will be deducted for computing operating profit.

**Earnings per share (EPS)**

EPS tells about the earning per equity share. It can be computed as follows:

\[
\text{Earning per share} = \frac{\text{Net profit after tax and Pref. dividend}}{\text{Number of equity shares}}
\]

**Price Earning (P/E) Ratio**

The ratio indicates the number of times the earning per share is covered by its market price. This is calculated according to the following formula:

\[
\frac{\text{Market price per equity share}}{\text{Earning per share}}
\]

**Gross Profit Ratios**

The ratio expresses the relationship between the gross profit and the net sales.

\[
\frac{\text{Gross Profit}}{\text{Net Sales}} \times 100
\]

**Net Profit Ratio**

This ratio indicates net margin earned on a sale of Rs. 100. It is calculated as follows:

\[
\frac{\text{Net Operating Profit}}{\text{Net Sales}} \times 100
\]

**Solvency Ratios**
A company is considered to be solvent or financially sound if it is in a position to carry on its business smoothly and meet all obligations, both long-term as well as short-term, without strain. The following are the important ratios for measuring the long-term solvency of a firm.

**Long –term Solvency Ratios:** In order to determine the long term solvency of a business, the following ratios will be useful:

(i)**Fixed Asset Ratio:** The ratio is expressed as follows:

\[
\text{Fixed assets/ Long-term funds}
\]

- The ratio should not be more than 1. If it is less than 1, it shows that a part of the working capital has been financed through long-term funds. This is desirable to some extent because a part of working capital, termed as ‘Core Working capital’ is more or less of a fixed nature. The ideal ratio is 0.67.

- Fixed assets include ‘net fixed assets’ (i.e., original cost - depreciation to date) and trade investments including share in subsidiaries. Long term funds include share capital, reserves and long term loans.

(ii)**Debt Equity Ratio:** The debt-equity ratio is calculated to ascertain the soundness of the long-term financial policies of the company. It is also known as the ‘External- Internal’ equity ratio. It may be calculated as follows:

\[
\text{Debt-equity ratio} = \frac{\text{External equities}}{\text{Internal equities}}
\]

**Short term Solvency Ratios**

The following ratios will be useful for determining the short-term solvency of a business.

**Current Ratio:** This ratio is an indicator of the firm's commitment to meet its short-term liabilities.

\[
\frac{\text{Current Assets}}{\text{Current liabilities}}
\]

**Liquidity Ratio:** This ratio is also termed as ‘acid test ratio’ or ‘quick ratio’. This ratio is ascertained by comparing the liquid assets (i.e., assets which are immediately convertible into cash without much loss) to current liabilities. Prepaid expenses and stock are not taken as liquid assets. The ratio may be expressed as:

\[
\frac{\text{Liquid assets}}{\text{Current liabilities}}
\]

**Turnover Ratios**

**Stock turnover Ratio:** This ratio indicates whether the investment in inventories is efficiently used or not. It, therefore, explains whether investment in inventories is within proper limits or not.
Cost of goods sold during the year/ Average inventory

**Debtors' Turnover Ratio (Debtors Velocity):** Debtors are an important constituent of current assets and therefore, the quality of debtors, to a great extent, determines a firm's liquidity. Two ratios are used by financial analysis to judge this. They are:

(i) Debtors, turnover ratio, and

(ii) Debt collection period ratio.

**Debtor’s turnover ratio is calculated as under:**

Credit sales/ Average accounts receivable

**Debt collection period Ratio:** The ratio indicates the extent to which the debts have been collected in the time. It gives the average debt collection period. The ratio is very helpful to the lenders because it explains to them whether their borrowers are collecting money within a reasonable time. An increase in the period will result in greater blockage of funds in debtors. The ratio may be calculated by any of the following methods:

(i) Months (or days) in a year/ Debtors turnover

(ii) 

\[
\frac{\text{Months (or days) in a year}}{\text{Credit sales for the year}} \times \frac{1}{\text{Average accounts receivable}}
\]

(iii) Account receivable/ Average monthly or daily credit sales

**Different Users and Their Use of Ratios**

**(i) Accounting ratios used by a long-term creditor:**

(a) Fixed charges cover = Income before interest and tax/ Interest charges

(b) Debt service coverage ratio = Cash profit available for debt service/ Interest + Principal payment instalment

**(ii) Accounting ratios used by a bank granting a short-term loan:**

(a) Quick ratio = Quick assets/ Current liabilities

(b) Current ratio = Current assets/ Current liabilities

**(iii) Accounting ratios used by shareholders:**

(a) Earnings per share = Profit available for equity shareholders/ No. of equity shares

(b) Dividend yield ratio = Dividend per share/ Market price per share
Unit 4- Final Accounts of Banking Companies

Introduction

A banking company means and includes any company which carries on the business or which transacts business of banking in India. A banking company is generally governed by the provisions of the Companies Act, 2013 and specifically by the Banking Regulation Act. The Banking Regulation Act of 1949 came into force on 16th March, 1949 as a result of the long-felt need to regulate the banking business in India and protect the interests of number of depositors.

Functions of a Bank

Banking has been defined by Section 5 of the Banking Regulation Act and means: accepting of deposits of money from the public, for purpose of lending or investment and the deposit are repayable on demand or otherwise by cheque, draft, order etc.

Requirements of Banking Companies as to Accounts and Audit

Preparation of financial Statements and Accounting Data - Companies Act 2013, Section 29

- Form A- Balance sheet
- Form B- Profit & Loss Account
- The Govt. has notified that account of the banking companies shall be closed on 31st March every year as against 31st December earlier.

Signatures – Financial statements of banking companies incorporated in India should be signed by the manager or principal officer of the banking company- Companies Act 2013, Section 29

Audit (Section 30)

Submission of Accounts (Section 31 and 32): Three copies of the balance sheet and profit and loss account prepared under Section 29 together with auditor’s report under section 30 must be submitted to the RBI within 3 months from the end of the period to which they refer. However, it can be extended up to a further period of 3 months by RBI (Section 31).

Section 32 of the Act requires a banking company (but not other types of banks) to furnish 3 copies of its annual accounts and auditor’s report there on the Registrar of Companies at the same time when it furnished these documents to the RBI.
Publication of Accounts: Rule 15 of the Banking Regulating (Companies) Rules, 1949. Publication of accounts- within 6 months

**Features of Accounting Systems of Banks**

Bankers’ Book: According to Section 2 (3) of the Bankers’ Books Evidence Act, ‘Bankers Books’ included ledgers, day book, cash book, account books and all other books used in the ordinary business of a bank. Generally the following books are maintained by bank to keep up to date records of its customers.

Cash Book: All cash receipt and payments are recorded in the receiving cashier’s cash book and paying cashier’s cash book.

Ledger Book: Maintained Current Account Ledger, FD accounts Ledger, RD accounts Ledger, Loan Ledger etc.

Other Book: Clearing Register, Securities Register, Draft Register, Bills for collection Register, Safe deposit vault Register, Dishonored cheques Register

**Balance sheet-Form A**

- **Schedule 1**: Capital
- **Schedule 2**: Reserves & surplus
- **Schedule 3**: Deposits
- **Schedule 4**: Borrowings
- **Schedule 5**: Other Liabilities & Provisions
- **Schedule 6**: Cash & Bank Bal. RBI
- **Schedule 7**: Balances with Banks & Money at call and Short Notice
- **Schedule 8**: Investments
- **Schedule 9**: Advances
- **Schedule 10**: Fixed Assets
- **Schedule 11**: Other Assets
- **Schedule 12**: Contingent Liabilities
  - (i) Claims against bank not acknowledged as debts
  - (ii) Liability for partly paid shares
  - (iii) Liability on account of outstanding forward exchange contracts
  - (iv) Acceptances, endorsement & other obligations
  - (v) Other items for which bank is contingently liable.
**Profit & loss account-form B**

<table>
<thead>
<tr>
<th>Income</th>
<th>Schedule.13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Earned</td>
<td>Schedule.14</td>
</tr>
<tr>
<td>Other Income</td>
<td>Schedule.13</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expenditure</th>
<th>Schedule.15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Expended</td>
<td>Schedule.16</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>Schedule.16</td>
</tr>
<tr>
<td>Provision for contingencies</td>
<td>Schedule.16</td>
</tr>
</tbody>
</table>

**Profit /Loss**

<table>
<thead>
<tr>
<th>Appropriations</th>
<th>Schedule.17</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transfer to Reserves</td>
<td>Schedule.17</td>
</tr>
<tr>
<td>Proposed dividend</td>
<td>Schedule.17</td>
</tr>
<tr>
<td>Balance carried to Balance sheet</td>
<td>Schedule.17</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Significant Accounting Policies</th>
<th>Schedule.18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Notes forming part of Accounts</td>
<td>Schedule.18</td>
</tr>
</tbody>
</table>

**Other Income**

- Profit on exchange transactions
- Profit on sale of investments
- Profit on revaluation of investments
- Profit on sale of fixed assets
- Letting of locker (income from locker charges )
- Misc. income -Godown rent

**Important points**

- Govt. securities shown at book value and diff. between MV and BV is given in the notes
- If some fixed assets are w/o on revaluation of assets/reduction of capital every B/S after wards should. show the revised figure for next 5 yrs. With the date & amt. revised
- Other fixed assets includes vehicles, furniture and fixtures. Lockers and safe deposit vaults are included in furniture
- 20% to reserve fund before declaring dividend
- Gold is treated as investment
- Silver is treated as other assets
- Income from performing assets is recognized on accrual basis while in r/o non-performing assets it is on cash basis
- In r/o NPA, if income is already recognized, then make provision
ASSET CLASSIFICATION

Asset Classification

- Performing and
- non performing (remain out of order)

Income Recognition

- Performing - accrual basis
- Non performing - cash basis

Asset Classification

- Std-0.40% (revised from 0.25%)
- Sub-Std.-Unsecured – 25%, Secured - 15%
- Doubtful – Unsecured - 100%, Secured - upto 1year-25%, 1 to 3yrs-40%, more than 3 years - 100%
- Loss assets-100%

SLR & NON SLR DEPOSITS

<table>
<thead>
<tr>
<th>Held to maturity</th>
<th>Available for sale</th>
<th>Held for trading</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment should not exceed 25% of total investment</td>
<td>Freedom available</td>
<td>Freedom available</td>
</tr>
<tr>
<td>-no marked to market. Profit on sale treated as cap. Reserve</td>
<td>-Marked to market</td>
<td>Marked to market</td>
</tr>
<tr>
<td></td>
<td>-profit on sale of investment. taken to P&amp;L a/c</td>
<td>To be sold within 90 days</td>
</tr>
</tbody>
</table>

JAIIB Online Mock test with Explanation

<table>
<thead>
<tr>
<th>JAIIB/DBF Paper</th>
<th>Mock Link</th>
</tr>
</thead>
</table>
| JAIIB/DBF Paper-I (Principle and Practices of Banking) Online Mock Tests | • Unit wise Mock- 450questions  
• Module Wise Mock- 250 |
<table>
<thead>
<tr>
<th>Questions</th>
<th>Visit-test.ambitiousbaba.com</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Full length Mock 5- 600 Questions (Each Mock 120 Q)</td>
<td></td>
</tr>
<tr>
<td>• Memory based Mock</td>
<td></td>
</tr>
<tr>
<td>• Case Study Mock</td>
<td></td>
</tr>
<tr>
<td><strong>Click here -Mock Link</strong></td>
<td></td>
</tr>
<tr>
<td>Total- 1500+ Questions</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>JAIIB/DBF Paper-II (Accounting &amp; Financial for Bankers) Online Mock Tests</th>
<th>Visit-test.ambitiousbaba.com</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Unit wise Mock- 250+Questions</td>
<td></td>
</tr>
<tr>
<td>• Module Wise Mock- 200 Questions</td>
<td></td>
</tr>
<tr>
<td>• Full length Mock 5- 600 Questions(Each Mock 120 Q)</td>
<td></td>
</tr>
<tr>
<td>• Memory based Mock</td>
<td></td>
</tr>
<tr>
<td>• Case Study Mock</td>
<td></td>
</tr>
<tr>
<td><strong>Click Here- Mock Link</strong></td>
<td></td>
</tr>
<tr>
<td>Total- 1200+ Questions</td>
<td></td>
</tr>
</tbody>
</table>

| JAIIB/DBF Paper-3 (Legal and Regulatory                                  |                             |
| • Unit wise Mock- 500+Questions                                          |                             |
### Unit 5- Company Accounts-1

**Company**

A company is an association of persons who contribute money or money’s worth to a common stock and uses it for a common purpose. It is created by law and effected by law. It is a legal person just as much as much as an individual but with no physical existence.

**Section 20 of the Companies Act, 2013**, defines a company as A company incorporated under this act, or under any previous company law.

**Features of a Joint stock Company**

- Incorporated association
- Artificial person
• Perpetual succession
• Common seal
• Limited liability
• Separation of management from ownership
• Transferability of shares
• Separate legal status
• Large membership
• Minimum paid up capital: It is Rs 1 lakh Private LTD. Company and 5 lakhs for a Public LTD company.

**Types of companies**

<table>
<thead>
<tr>
<th>On the basis of incorporation</th>
<th>On the basis of ownership</th>
<th>On the basis of liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chartered company</td>
<td>Private company</td>
<td>Company limited by shares</td>
</tr>
<tr>
<td>Statutory company</td>
<td>Public company</td>
<td>Company Ltd. by guarantee</td>
</tr>
<tr>
<td>Registered company</td>
<td>Government company</td>
<td>Company with unlimited liability</td>
</tr>
<tr>
<td>Foreign company</td>
<td>Holding company</td>
<td></td>
</tr>
</tbody>
</table>

**Partnership Vs Limited Liability Partnership (LLP)**

<table>
<thead>
<tr>
<th>BASIS FOR COMPARISON</th>
<th>PARTNERSHIP</th>
<th>LIMITED LIABILITY PARTNERSHIP (LLP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Meaning</td>
<td>Partnership refers to an arrangement wherein two or more person agree to carry on a business and share profits &amp; losses mutually.</td>
<td>Limited Liability Partnership is a form of business operation which combines the features of a partnership and a body corporate.</td>
</tr>
<tr>
<td>Governed By</td>
<td>Indian Partnership Act, 1932</td>
<td>Limited Liability Partnership Act, 2008</td>
</tr>
<tr>
<td>Registration</td>
<td>Optional</td>
<td>Mandatory</td>
</tr>
<tr>
<td>----------------</td>
<td>----------</td>
<td>-----------</td>
</tr>
<tr>
<td>Charter document</td>
<td>Partnership deed</td>
<td>LLP Agreement</td>
</tr>
<tr>
<td>Liability</td>
<td>Unlimited</td>
<td>Limited to capital contribution, except in case of fraud.</td>
</tr>
<tr>
<td>Contractual capacity</td>
<td>It cannot enter into contract in its name.</td>
<td>It can sue and be sued in its name.</td>
</tr>
<tr>
<td>Legal Status</td>
<td>Partners are collectively known as firm, so there is no separate legal entity.</td>
<td>It has a separate legal status.</td>
</tr>
<tr>
<td>Name of firm</td>
<td>Any name</td>
<td>Name containing LLP as suffix</td>
</tr>
<tr>
<td>Maximum partners</td>
<td>100 partners</td>
<td>No limit</td>
</tr>
<tr>
<td>Property</td>
<td>Cannot be held in the name of firm.</td>
<td>Can be held in the name of the LLP.</td>
</tr>
<tr>
<td>Perpetual Succession</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Audit of accounts</td>
<td>Not mandatory</td>
<td>Mandatory, only if turnover and capital contribution overreaches 40 lakhs and 25 lakhs respectively.</td>
</tr>
<tr>
<td>Relationship</td>
<td>Partners are agents of firm and other partners as well.</td>
<td>Partners are agents of LLP only.</td>
</tr>
</tbody>
</table>

### Classes of Share Capital

*Share capital of a company limited by shares can be two kinds*

- Equity share
- Preference share

Equity share capital means that part of share capital which is not preference share capital. Preference shares can be further classified as under:

- Cumulative
• Redeemable
• Participating

*Share capital can be classified in a different way as to:*
  • Authorised capital
  • Issued capital
  • Subscribed Capital
  • Called up capital
  • Paid-up capital

### Issue of Shares

#### Issue of Share at Par

<table>
<thead>
<tr>
<th>Activity</th>
<th>Bank</th>
<th>Share application</th>
<th>Share capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit</td>
<td></td>
<td>Debited</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>..................</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Credited</td>
<td></td>
</tr>
</tbody>
</table>

#### Over subscription

<table>
<thead>
<tr>
<th>Activity</th>
<th>Bank</th>
<th>Share application</th>
<th>Share capital</th>
<th>Bank (refund)</th>
<th>Share allotment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit</td>
<td></td>
<td>Debited</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>..................</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Credited</td>
<td></td>
<td>Credited</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Credited</td>
<td></td>
<td>Credited</td>
<td></td>
</tr>
</tbody>
</table>

#### Share Allotment/Share Call

<table>
<thead>
<tr>
<th>Activity</th>
<th>Bank</th>
<th>Share allotment a/c</th>
<th>Share capital a/c</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit</td>
<td></td>
<td>Debited</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>..................</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Credited</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Activity</th>
<th>Bank</th>
<th>Share call a/c</th>
<th>Share capital a/c</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit</td>
<td></td>
<td>Debited</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>................</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Credited</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Activity</th>
<th>Bank</th>
<th>Share call a/c</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Credited</td>
</tr>
</tbody>
</table>

—
### Issue of shares at premium

<table>
<thead>
<tr>
<th>Description</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share application/allotment a/c</td>
<td>Debit</td>
<td>Credit</td>
</tr>
<tr>
<td>Share capital A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share premium A/c</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Issue of shares at discount

<table>
<thead>
<tr>
<th>Description</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share allotment A/c</td>
<td>Debit</td>
<td></td>
</tr>
<tr>
<td>Discount on issue of shares A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share capital A/c</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Forfeiture of shares

<table>
<thead>
<tr>
<th>Description</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital A/c</td>
<td>Debit</td>
<td>Credit</td>
</tr>
<tr>
<td>Call in arrears A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Forfeited shares A/c</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Re-issue of shares

<table>
<thead>
<tr>
<th>Description</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank A/c</td>
<td>Debit</td>
<td>Credit</td>
</tr>
<tr>
<td>Forfeited shares A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share capital A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital reserve A/c</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Issue of Bonus shares

<table>
<thead>
<tr>
<th>Description</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Redemption Reserve A/c</td>
<td>Debit</td>
<td></td>
</tr>
<tr>
<td>Share premium A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital reserve A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gen Reserve A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profit &amp; Loss A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bonus to shareholders A/c</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Non- Voting Shares

Section 43 of the Companies Act 2013, Provided that share capital of the company shall consist of the following:

- Equity shares with voting rights
- Equity shares with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed; and
- Preference share capital

The demand for non-voting equity shares has been made by several sections of the industry basically on the ground that they do exist in many other countries and also provide a measure to the management to tap a class of investors who are interested in higher dividend against absence of voting rights.

There are some conditions for issue of non-voting equity share follow:

- Issue of non-voting equity shares shall be authorized by the Articles of Association of the company and approved by the shareholders at their general body meeting by passing a special resolution.
- Special resolution must state the price at which the shares can be issued and higher rate of dividend which non-voting equity shares shall carry.
- Such shareholders are entitled to all rights and bonus shares but do not enjoy voting rights.
- Only 25% of the paid-up capital of the company can be issued as equity shares without voting rights.
- Only a public company limited by shares can issue non-voting equity shares.
- Non company will be permitted to convert shares with voting rights into shares without voting rights.

Unit 6- Company Accounts II

Form of Balance Sheet

As given in part 1 of Schedule III of the Companies Act, the prescribed form of Balance sheet is given:
Part 1- Balance sheet

Name of the Company ..........................

Balance sheet as at ......................... (Rupees in ..............)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Note No.</th>
<th>Figure at the end of current reporting period</th>
<th>Figure at the end of previous reporting period</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
</tbody>
</table>
### Equity and Liabilities

(i) Shareholder’s funds
   (a) Share capital
   (b) Reserves and surplus
   (c) Money received against share warrants

(ii) Share application money pending allotment

(iii) Non-current liabilities
   (a) Long-term borrowings
   (b) Deferred tax liabilities (Net)
   (c) Other long term Liabilities
   (d) Long –term provisions

(iv) Current liabilities
   (a) Short term borrowings
   (b) Trade payables
   (c) Other current liabilities
   (d) Short term provisions

**Total**

### Assets

(i) Fixed assets
   (a) Tangible assets
   (b) Intangible assets
   (c) Capital work-in progress
   (d) Intangible assets under development

(ii) Non-current investments
<table>
<thead>
<tr>
<th>Current assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Current investments</td>
</tr>
<tr>
<td>(ii) Inventories</td>
</tr>
<tr>
<td>(iii) CASH and cash equivalents</td>
</tr>
<tr>
<td>(iv) Short-term loans and advances</td>
</tr>
<tr>
<td>(v) Other current assets</td>
</tr>
<tr>
<td>(iii) Deferred tax assets (net)</td>
</tr>
<tr>
<td>(iv) Long-term loans and advances</td>
</tr>
<tr>
<td>(v) Other non-current assets</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

|                                  |
|                                  |
|                                  |
**Part 2- Statement of Profit and Loss**

Name of the Company ..........................

Profit and loss statement for the year ended ............... (Rupees in.........)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Note No.</th>
<th>Figure at the end of current reporting period</th>
<th>Figure at the end of previous reporting period</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(i) Revenue from operations</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ii) Other income</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) Total Revenue (I + II)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iv) Expenses:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of materials consumed</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchases of stock-in-Trade</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Changes in inventories of finished goods</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Work-in-process and Stock-in-trade</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee benefits expense</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Finance costs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation and amortization expense</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Others Expenses</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total expenses</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(v) Profit before exceptional and extraordinary items and tax (III-IV)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(vi) Exceptional items</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(vii) Profit before extraordinary items and tax (V-VI)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(viii) Extraordinary items</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ix) Profit before tax (VII-VIII)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(x) Tax Expense:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(1) Current tax</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(2) Deferred tax</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(xi) Profit (loss) for the period from continuing operations (VII-VIII)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(xii) Profit/(loss) from discontinuing operations</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(xiii) Tax expense of discontinuing operations</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(xiv) Profit/(loss) from Discontinuing operations (after tax) (XII-XIII)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(xv) Profit (loss) for the period (XI+XIV)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(xvi) Earning per equity share:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(1) Basic</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(2) Diluted</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

## Unit 7- Accounting in Computerised Environment

### Computerised Accounting

An accounting system is one that performs the following functions:

- It captures business transactions in the form of accounting entries.
- The accounting entries are then used to prepare financial statements.
The financial statements are prepared based on accounting standards.
Various financial reports are prepared from the data available in the financial statements.

**Features of Computerized Accounting**

- Speed
- Accuracy
- Various informative reports can be generated
- Economy
- A Computerised system may be a single stand Along unit or a Multiple User, ie, LAN, WAN etc.

**Terms used in Computerized Accounting**

- Data
- Record
- Data file or file
- System

**Advantages of Computerized Accounting**

- Accurate, High speed and low cost or operation
- Availability of various reports from the same accounting data
- Error-free accounting
- Automatic completion of all records by feeding only one entry into the computer
- Multiple set of Printouts available

**Disadvantages of Computerized Accounting**

- Requirement of special Programme and Professional
- Qualified staff required for Operations
- Costly computer peripherals and stationery
- Regular back-up is required as Data may be lost for various reasons
• Computer viruses

**Functions performed by computerized accounting software available in the market**

• Tally versions such as 4, 4.5, 5, 5.4, 6.3, 7.2 and 8.2
• Ex, accounting software
• Bank 2000 for accounting needs for banks
• B@NKS-24-core banking solution
• MEFCOMP accounting software for professional
• Quick FA

**Core Banking Components**

Core Banking is delivered as a set of integrated core banking components that are then tailored to fit the institution’s individual business requirements. These components can be easily re-configured as business requirement change, protecting the organisation’s strategic investment and maintaining a unified business approach.

**Core Bank components include**

• Core Bank financial institution infrastructure
• Core Bank customer management and customer overview
• Core Bank Account Administration
• Core Bank Payments
• Core Bank Management Information

**Advantages of Core Banking**

• Makes the internal staff more competent.
• Minimises human intervention thereby limiting errors.
• Helps prevent frauds and thefts with real-time banking facilities.
• Reduces operational costs.
• Aids in studying changing customer demands.
• Facilitates decision making through reporting and analytics.
Information Security

Information Security is basically the practice of preventing unauthorized access, use, disclosure, disruption, modification, inspection, recording or destruction of information. Information can be physical or electrical one.

Information system Security

Information systems security provides essential information for managing the security of an organization where information technology is an important factor. It is mainly for all the staff, who are the first-line support, responsible for the daily, efficient operation of security policies, procedures, standards and practices. It cover

- Access control systems and methodologies
- Computer operations security
- E-mail and internet access
- Application and systems developments
- Cryptography
- Law, investigations and ethics
## JAIIB Online Mock test with Explanation

<table>
<thead>
<tr>
<th>JAIIB/DBF Paper</th>
<th>Mock</th>
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</table>
| JAIIB/DBF Paper-I (Principle and Practices of Banking) Online Mock Tests | • Unit wise Mock- 450 questions  
• Module Wise Mock- 250 Questions  
• Full length Mock 5- 600 Questions (Each Mock 120 Q)  
• Case Study Mock  
• Memory based Mock  
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• Full length Mock 5- 600 Questions (Each Mock 120 Q)  
• Case Study Mock  
• Memory based Mock  
**Total- 1200+ Questions** |
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• Module Wise Mock- 200 Questions  
• Full length Mock 5- 600 Questions (Each Mock 120 Q)  
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(1500+ Questions) |
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Banking as defined by Section 5 of the Banking Regulation Act means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft and order or otherwise.

In addition to banking business, a bank is permitted under Section 6 of the Banking Regulation Act, 1949 to engage in certain classes of business which are incidental to the business of Banking. Section 8 of the Act ibid prohibits a bank from buying, selling or dealing in goods except in connection with the realization of a security held by it or in
connection with the business of collection with the business of collection or negotiating bills of exchange.

**Some of the main functions of modern commercial banks are:**

- Accepting deposit
  1. Demand Deposits – withdrawable on demand
  2. Current Account
  3. Savings Deposits
  4. Term Deposits – Received for a fixed period
- Granting loans and advances
  1. Overdraft
  2. Cash Credit:
  3. Discounting of Bills
  4. Loans and Advances
- Dealing in securities, on its own account or on behalf of its customers.
- Opening letters of credit/ issuing guarantees.
- Dealing of foreign exchange.
- Remittances: Through demand drafts, RTGS, NEFT, etc.
- Locker Facility
- Traveller’s Cheques
- Letter of Credit
- Collection of Statistics
- Underwriting Securities
- Gift Cheques
- Acting as Referee
- Foreign Exchange Business
- Derivatives
- Prepaid payment instruments

**Para Banking Activities**

- Mutual Fund Business
- Money Market Mutual Funds
- Cheque Writing Facility for Investors of Mutual Funds/Money Market Mutual Funds
Primary Dealership Business
Underwriting Activities
Equipment Leasing, Hire Purchase Business and Factoring Services
Investment in Venture Capital Funds
Sponsors to Infrastructure Debt Funds
Insurance Business
Pension Fund Management
Referral Services
Trading on/Membership of SEBI approved Stock Exchanges
Portfolio Management Services

Outsourcing of Services by Banks

The 'Outsourcing' may be defined as a bank’s use of a third party (either an affiliated entity within a corporate group or an entity that is external to the corporate group) to perform activities on a continuing basis that would normally be undertaken by the bank itself, now or in the future. “Continuing basis” would include agreements for a limited period.

Scope of RBI Guidelines includes:

- Activities that should not be outsourced
- Bank’s role and regulatory and supervisory requirements
- Risk management practices for outsourced financial services
- Role of Board of directors and senior management
- Evaluation of risk
- Evaluation the capability of the services provider
- Outsourcing agreement
- Confidentiality and security
- Responsibility of DSA/DMA/Recovery agents
- Monitoring of Outsourced activities
- Redressal of grievances related to outsourced services
- Reporting of transactions to financial Intelligence Unit
- Off-shore outsourcing of financial services

Front office and Bank office in a Bank
The terms “Front office” and “Bank office” come from the building layout of early companies where the front office would contain the sales and other customer-facing staff and the bank office would be those manufacturing or developing the products or involved in administration but without being seen by customers.

**Banking operations Manual**

The Banking operation Manual is prepared with a view to provide a ready guide to the officers and staff of the Bank-in day to day banking operations. The manual is prepared based on the extant banking law practices and is an attempt to provide guidance to the front office functionaries in the Banking operations of the Bank.

A banking operations manual helps you get the very best out of each employee. It also helps to ensure that each one knows not only their duties but also the policies, products and how to do things the right way.

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**Unit 2-Operational Aspects of KYC/Customer Service**

**Know Your Customers (KYC) Norms**
RBI has issued instructions to all banks to implement certain procedural norms on KYC. Failure attracts levy of penalty and of penalty has been levied, the same is to be disclosed in the notes to accounts. It is, therefore, necessary that framework relating to “Know Your Customer’ and Anti-Money Laundering measures is formulated and put in place by very bank.

- Customer Acceptance Policy
- Customer Identification Procedures
- Monitoring of Transactions
- Risk management

**Note:** Reserve Bank of India has issued guidelines to banks under **Section 35A of the Banking Regulation Act, 1949 and Rule 7 of Prevention of Money-Laundering (Maintenance of Records of the Nature and Value of Transactions, the Procedure and Manner of Maintaining and Time for Furnishing Information and Verification and Maintenance of Records of the Identity of the Clients of the Banking Companies, Financial Institutions and Intermediaries) Rules, 2005.**

**Features to be verified and documents required to be obtained from customers**

<table>
<thead>
<tr>
<th>Features</th>
<th>Documents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts of individuals</td>
<td>(i) Passport (ii) PAN card (iii) Voter’s Identity Card (iv) Driving License (v) Job Card issued by NREGA duly signed by an officer of the State Govt (vi) The letter issued by the Unique Identification Authority of India (UIDAI) containing details of name, address and Aadhaar number (vii) Identity card (subject to the bank’s satisfaction) (viii) Letter from a recognized public authority or public servant verifying the identity and residence of the customer to the satisfaction of bank.</td>
</tr>
<tr>
<td>o Legal name and any other names used</td>
<td>(i) Telephone bill (ii) Bank account statement (iii) Letter from any recognized public authority (iv) Electricity bill (v) Ration card (vi) Letter from employer (subject to</td>
</tr>
<tr>
<td><strong>o Correct permanent address</strong></td>
<td>satisfaction of the bank) (any one document which provides customer information to the satisfaction of the bank will suffice)</td>
</tr>
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<td>-------------------------------------------------------------------------------------------------</td>
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<tr>
<td><strong>Accounts of companies</strong></td>
<td>(i) Certificate of incorporation and Memorandum &amp; Articles of Association (ii) Resolution of the Board of Directors to open an account and identification of those who have authority to operate the account (iii) Power of Attorney granted to its managers, officers or employees to transact business on its behalf (iv) Copy of PAN allotment letter (v) Copy of the telephone bill</td>
</tr>
<tr>
<td><strong>o Name of the company</strong></td>
<td></td>
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<tr>
<td><strong>o Principal place of business</strong></td>
<td></td>
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<tr>
<td><strong>o Mailing address of the company</strong></td>
<td></td>
</tr>
<tr>
<td><strong>o Telephone/Fax Number</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Accounts of partnership firms</strong></td>
<td>(i) Registration certificate, if registered (ii) Partnership deed (iii) Power of Attorney granted to a partner or an employee of the firm to transact business on its behalf (iv) Any officially valid document identifying the partners and the persons holding the Power of Attorney and their addresses (v) Telephone bill in the name of firm/partners</td>
</tr>
<tr>
<td><strong>o Legal name</strong></td>
<td></td>
</tr>
<tr>
<td><strong>o Address</strong></td>
<td></td>
</tr>
<tr>
<td><strong>o Names of all partners and their addresses</strong></td>
<td></td>
</tr>
<tr>
<td><strong>o Telephone numbers of the firm and partners</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Accounts of trusts &amp; foundations</strong></td>
<td>(i) Certificate of registration, if registered (ii) Power of Attorney granted to transact business on its behalf (iii) Any officially valid document to identify the trustees, settlors, beneficiaries and those holding Power of Attorney,</td>
</tr>
<tr>
<td><strong>o Names of trustees, settlors, beneficiaries and signatories</strong></td>
<td></td>
</tr>
<tr>
<td><strong>o Names and addresses of the founder, the</strong></td>
<td></td>
</tr>
<tr>
<td>managers/directors and the beneficiaries</td>
<td>founders/managers/directors and their addresses</td>
</tr>
<tr>
<td>-----------------------------------------</td>
<td>-----------------------------------------------</td>
</tr>
<tr>
<td>o Telephone/fax numbers</td>
<td>(iv) Resolution of the managing body of the foundation/association</td>
</tr>
<tr>
<td></td>
<td>(v) Telephone bill</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Accounts of Proprietorship Concerns</th>
<th>Proof of the name, address and activity of the concern</th>
<th>Registration certificate (in the case of a registered concern)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Certificate/licence issued by the Municipal authorities under Shop &amp; Establishment Act,</td>
<td>• Sales and income tax returns</td>
<td>• CST/VAT certificate</td>
</tr>
</tbody>
</table>
| • CST/VAT certificate               | • Certificate/registration document issued by Sales Tax/Service Tax/Professional Tax authorities | • Licence issued by the Registering authority like Certificate of Practice issued by Institute of Chartered Accountants of India, Institute of Cost Accountants of India, Institute of Company Secretaries of India, Indian Medical Council, Food and Drug Control Authorities, registration/licensing document issued in the name of the proprietary concern by the Central Government or State Government Authority/Department, etc. Banks may also
accept IEC (Importer Exporter Code) issued to the proprietary concern by the office of DGFT as an identity document for opening of the bank account. etc.

- The complete Income Tax return (not just the acknowledgement) in the name of the sole proprietor where the firm’s income is reflected, duly authenticated/acknowledged by the Income Tax Authorities.

- Utility bills such as electricity, water, and landline telephone bills in the name of the proprietary concern. Any two of the above documents would suffice. These documents should be in the name of the proprietary concern.

**Norms for Periodical Updation of KYC**

Bank would need to continue to carry out on-going due diligence with respect to the business relationship with every client and closely examine the transactions in order to ensure that they are consistent with their knowledge of the client, his business and risk profile and, wherever necessary, the source of funds.

Full KYC exercise will be required to be done at least every two years for high risk individuals and entities.

Full KYC exercise will be required to be done at least every 10yrs for low risk and at least every 8 yrs for medium risk individuals and entities.

Fresh photographs will be obtained from minor customer on becoming major.
Recent simplified KYC measures by RBI

(1) Single document for proof of identity and proof of address

Officially valid documents (OVDs) for KYC purpose include: Passport, driving licence, voters’ ID card, PAN card, Aadhaar letter issued by UIDAI and Job Card issued by NREGA signed by a State Government official.

To further ease the process, the information containing personal details like name, address, age, gender, etc., and photographs made available from UIDAI as a result of e-KYC process can also be treated as an ‘Officially Valid Document’.

(2) No separate proof of address is required for current address

Since migrant workers, transferred employees, etc., often face difficulties while submitting a proof of current address for opening a bank account, such customers can submit only one proof of address (either current or permanent) while opening a bank account or while undergoing periodic updation. If the current address is different from the address mentioned on the proof of address submitted by the customer, a simple declaration by her/him about her/his current address would be sufficient.

(3) No separate KYC documentation is required while transferring accounts from one branch to another of the same bank

Once KYC is done by one branch of the bank, it is valid for transfer of the account to any other branch of the same bank. The customer would be allowed to transfer her/his account from one branch to another branch without restrictions and on the basis of declaration of his/her local address for communication.

(4) Small Accounts

Those persons who do not have any of the ‘officially valid documents’ can open ‘small accounts’ with banks. A ‘small account’ can be opened on the basis of a self-attested photograph and putting her/his signature or thumb print in the presence of an official of the bank. These small accounts would be valid normally for a period of twelve months. Thereafter, such accounts would be allowed to continue for a further period of twelve more months, if the account holder provides a document showing that she/he has applied for any of the officially valid document, within twelve months of opening the small account.

(5) Relaxation regarding officially valid documents (OVDs) for low risk customers

If a person does not have any of the ‘officially valid documents’ mentioned above, but is categorised as ‘low risk’ by the banks, then she/he can open a bank account by submitting any one of the following documents:
• identity card with applicant's photograph issued by Central/State Government Departments, Statutory/Regulatory Authorities, Public Sector Undertakings, Scheduled Commercial Banks, and Public Financial Institutions;
• letter issued by a gazetted officer, with a duly attested photograph of the person.

(6) Periodic updation of KYC

Time intervals for periodic updation of KYC for existing low/medium and high risk customers have been increased from 5/2 yrs to 10/8/2 yrs, respectively.

(7) Other relaxations

• KYC verification of all the members of Self Help Groups (SHGs) is not required while opening the savings bank account of the SHG and KYC verification of only the officials of the SHGs would suffice. No separate KYC verification is needed at the time of credit linking the SHG.
• Foreign students have been allowed a time of one month for furnishing the proof of local address.
• In case a customer categorised as low risk is unable to submit the KYC documents due to genuine reasons, she/he may submit the documents to the bank within a period of six months from the date of opening account.

Operational Procedure to be followed by banks for e-KYC exercise

The e-KYC service of the UIDAI is be leveraged by banks through a secured network. Any bank willing to use the UIDAI e-KYC service is required to sign an agreement with the UIDAI. The process flow to be followed is as follows:

(1) Sign KYC User Agency (KUA) agreement with UIDAI to enable the bank to specifically access e-KYC service.

(2) Banks to deploy hardware and software for deployment of e-KYC service across various delivery channels. These should be Standardisation Testing and Quality Certification (STQC) Institute, Department of Electronics & Information Technology, Government of India certified biometric scanners at bank branches/ micro ATMs/ BC points as per UIDAI standards.

(3) Develop a software application to enable use of e-KYC across various Customer Service Points (CSP) (including bank branch, BCs etc.) as per UIDAI defined Application Programming Interface (API) protocols. For this purpose banks will have to develop their own software under the broad guidelines of UIDAI. Therefore, the software may differ from bank to bank.
(4) Define a procedure for obtaining customer authorization to UIDAI for sharing e-KYC data with the bank. This authorization can be in physical (by way of a written explicit consent authorising UIDAI to share his/her Aadhaar data with the bank/BC for the purpose of opening bank account) /electronic form as defined by UIDAI from time to time.

(5) Sample process flow would be as follows:

- Customer walks into CSP of a bank with his/her 12-digit Aadhaar number and explicit consent and requests to open a bank account with Aadhaar based e-KYC.
- Bank representative manning the CSP enters the number into bank’s e-KYC application software.
- The customer inputs his/her biometrics via a UIDAI compliant biometric reader (e.g. fingerprints on a biometric reader).
- The software application captures the Aadhaar number along with biometric data, encrypts this data and sends it to UIDAI’s Central Identities Data Repository (CIDR).
- The Aadhaar KYC service authenticates customer data. If the Aadhar number does not match with the biometrics, UIDAI server responds with an error with various reason codes depending on type of error (as defined by UIDAI).
- If the Aadhaar number matches with the biometrics, UIDAI responds with digitally signed and encrypted demographic information [Name, year/date of birth, Gender, Address, Phone and email (if available)] and photograph. This information is captured by bank’s e-KYC application and processed as needed.
- Bank’s servers auto populate the demographic data and photograph in relevant fields. It also records the full audit trail of e-KYC viz. source of information, digital signatures, reference number, original request generation number, machine ID for device used to generate the request, date and time stamp with full trail of message routing, UIDAI encryption date and time stamp, bank’s decryption date and time stamp, etc.
- The photograph and demographics of the customer can be seen on the screen of computer at bank branches or on a hand held device of BCs for reference.
- The customer can open bank account subject to satisfying other account opening requirements.

Customer Service in Banks

(i) Service at the counters

- Business hours/working hours
- Display of time norms
- Uninterrupted Service
• Guidance to Customers
• Provision of ramps at Automated Teller Machines (ATMs)/Branches

Non-voucher generating transactions

• Issue of pass books/statement of accounts
• Issue of cheque books
• Delivery of term deposit receipts/drafts
• Acceptance of share application forms
• Acceptance of clearing cheques
• Acceptance of bills for collection

Voucher generating transactions

• Issue of term deposit receipts
• Acceptance of cheques for locker rent due
• Issue of travellers cheques
• Issue of gift cheques
• Acceptance of individual cheques for transfer credit

(ii) Identity Badges
(iii) Complaint Box and Book
(iv) Advisory Services on deposit schemes
(v) Brochures/pamphlets for guidance of customers
(vi) Banking facilities to the visually challenged
(vii) Fair Practice code- Display of Bank/Service charges
(viii) Cheque Drop facility and the Facility for Acknowledgement of cheques
(ix) Infrastructure provision
(x) Customer education
(xi) Term Deposit Maturity Intimation in Advance

Banking Codes and Standards Board of India (BCSBI)

In November 2003, Reserve Bank of India (RBI) constituted the Committee on Procedures and Performance Audit of Public Services under the Chairmanship of Shri S.S. Tarapore (former Deputy Governor) to address the issues relating to availability of adequate banking services to the common person. The Committee recommended setting up of the Banking Codes and Standards Board of India (BCSBI). BCSBI was set up to ensure that the common
person as a consumer of financial services from the banking Industry is in no way at a disadvantageous position and really gets what he/she has been promised.

**The main objectives of the BCSBI are**

- To plan, evolve, prepare, develop, promote and publish comprehensive Codes and Standards for banks, for providing for fair treatment to their customers.
- To function as an independent and autonomous body to monitor, and to ensure that the Codes and Standards adopted by banks are adhered to, in letter and spirit, while delivering services to their customers.
- BCSBI monitors the implementation of the Codes through the following methods:
  - Obtains from member banks an Annual Statement of Compliance (ASC)
  - Visits branches to find out the status of ground-level implementation of Codes
  - Studies complaints received from customers and orders / awards issued by Banking Ombudsmen / Appellate Authority to find out whether there is any system-wide deficiency
  - Organizes an annual Conference with Principal Code Compliance Officers of the Member banks to discuss implementation issues.

**BCSBI also**

- Undertakes campaigns and initiatives to spread awareness of the Codes amongst customers and banks
- Provides faculty support to training establishments of banks
- Participates in on-location workshops held by / for member banks to increase coverage
- associates with customer awareness programmes conducted by Banking Ombudsmen
- provides credit counselling services in Mumbai
- publishes quarterly newsletter entitled ‘Customer Matters’, containing matters of interest to customers

**Unit 3- Operational Aspects of Accounting Entries**

**Transactions**

In the case of the latter, also called “Transfer transactions” one or both of the accounts concerned may be of the customers or the internal accounts of the bank.

**Types of Transactions**

*Transactions in a bank rate are of two types*
Vouchers

Both debit and credit operations on all accounts, either by customer or by the bank itself, are made by means of vouchers.

There are two kinds of vouchers

- Debit vouchers
- Credit Vouchers

Note: Which contains both debit and credit to different accounts. For the sake of convenience, the letter kind of vouchers may be called “Composite vouchers”.

The debit vouchers are, broadly the following:

- Cheques issued by the customers.
- Cheques/Pay orders issued by the bank
- Withdrawal forms received from the savings bank account holders.
- Drafts issued by other branches of the bank payable at the branch.
- Drafts issued by other banks on the branch, in terms of an approved arrangement between the two banks.
- Dividend/interest warrants issued by the bank’s customers and payable by the branch in terms of an approved arrangement.
- Travellers’ cheques issued by any branch of the bank which are presented to the branch for payment.
- Drafts/pay orders issued by the branch itself which are cancelled at the request of the customer and amount is refunded to him.
- Instruments like traveler’s cheques/gift cheques, etc, of other banks which are paid by the branch in term of an approved arrangement.
- Letter of authority signed by the customers, containing standing instructions.
- Debit vouchers prepared by the branch on its printed stationery which are authorized by a designated official of the bank and may also carry authority from the customers in some cases if the debit is to his account at the branch.
- In respect of realisation of collection instrument sent to other branches of the bank, a debit advice (which may be known by different names in different banks) prepared by the other branch may itself act as a debit voucher.
- Term deposit receipts presented for payment, renewal or premature closure.

The credit vouchers which are also of many kinds broadly encompass the following:

- Pay-in-slip filled by the customers (depositors as well as borrowers) for deposit of amounts in their accounts. Generally, the pay-in-slip are in a standard format.
adopted by the bank but there may be cases of a special kind of pay-in-slip in respect of some customers pursuant to a formal agreement between the bank and the customer.

- Applications for issue of term deposits, demand drafts, RTGS/NEFT, banker’s cheques, pay orders, gift cheques, traveller’s cheques and other similar instrument. Some of these applications may be made on behalf of the branch itself for the payments it has to make.

- Challans for deposits into the accounts of Central/State Government, e.g. on account of direct/indirect taxes or under schemes like public provident fund etc.

- Credit voucher prepared by the branch on its printed stationery which are authorized by an official of the bank. Normally, these vouchers are signed on behalf of the branch only but these may be some instance where the customer concerned also signs on the voucher as evidence that the transaction actually pertains to him. **Example are:** Deposit of locker charges (credit to an income account of the bank), deposit of money with the bank for purchase of non-judicial stamps required for execution of documents in favour of the bank etc.

- On payment of collection instruments from other branches of the bank, a credit advice (which may be known by different names in different banks) or a copy of the collection schedule received from the other branch may itself be treated as a credit voucher.
Implementation of Cheque Truncation system (CTS)

What is Cheque Truncation?

Truncation is the process of stopping the flow of the physical cheque issued by a drawer at some point by the presenting bank en-route to the paying bank branch. In its place an electronic image of the cheque is transmitted to the paying branch through the clearing house, along with relevant information like data on the MICR band, date of presentation, presenting bank, etc. Cheque truncation thus obviates the need to move the physical instruments across bank branches, other than in exceptional circumstances for clearing purposes. This effectively eliminates the associated cost of movement of the physical cheques, reduces the time required for their collection and brings elegance to the entire activity of cheque processing.

What is the status of CTS implementation in the country?

CTS has been implemented in New Delhi, Chennai and Mumbai with effect from February 1, 2008, September 24, 2011 and April 27, 2013 respectively. After migration of the entire cheque volume from MICR system to CTS, the traditional MICR-based cheque processing has been discontinued across the country.

What is the new approach to CTS implementation in the country?

The new approach envisioned as part of the national roll-out is the grid-based approach. Under this approach the entire cheque volume in the country which was earlier cleared through 66 MICR Cheque Processing locations is consolidated into the three grids in New Delhi, Chennai and Mumbai.

CTS-2010 standard

Accordingly, certain benchmarks towards achieving standardisation of cheques issued by banks across the country have been prescribed like – quality of paper, watermark, bank’s logo in invisible ink, void pantograph, etc., and standardisation of field placements on cheques. The benchmark prescriptions are collectively known as “CTS-2010 standard”.

RBI Guidelines on collection of Cheques

Local Cheques

- Local cheques are payable within the jurisdiction of the clearing house and will be presented through the clearing system prevailing at the centre. Credit arising out of local cheques shall be given to the customer’s account as indicated in the Cheque Collection Policy (CCP) of the concerned collecting bank.
Notwithstanding to the CCP of concerned collecting bank, ideally, in respect of local clearing, banks shall permit usage of the shadow credit afforded to the customers’ accounts immediately after closure of the relative return clearing on the next working day or maximum within an hour of commencement of business on the third working day from the day of presentation in clearing, subject to usual safeguards.

- Under grid-based Cheque Truncation System clearing, all cheques drawn on bank branches falling within in the grid jurisdiction are treated and cleared as local cheques. The grid clearing allows banks to present/ receive cheques to/ from multiple cities to a single clearing house through their service branches in the grid location.

- If there is any delay in credit, beyond the period specified above, customer is entitled to receive compensation at the rate specified in the CCP of the concerned collecting bank. In case, no rate is specified in the CCP for delay in realisation of local cheques, compensation at savings bank interest rate has to be paid for the corresponding period of delay.

Outstation Cheques

Maximum timeframe for collection of cheques drawn on state capitals/major cities/other locations are 7/10/14 days respectively.

If there is any delay in collection beyond this period, customer is entitled to receive compensation at the rate specified in the Cheque Collection Policy (CCP) of the concerned bank. In case the rate is not specified in the CCP, interest rate on Fixed Deposits for the corresponding maturity to be paid. Banks’ cheque collection policy also indicates the limit up to which outstation cheques are given immediate/instant credit.

What happens if cheques / instruments are lost in transit / in clearing process?

If cheques are lost in transit or in the clearing process or at the paying bank’s branch under physical instrument delivery clearing, the bank should immediately bring the same to the notice of the presenting customer (beneficiary)’s notice so that the customer can inform the drawer to record stop payment and can also take care that other cheques issued anticipating the credit arising out of the lost cheque are not dishonoured due to non-credit of the amount of the lost cheques / instruments.

It may however be noted that the probability of losing the physical instrument in the hands of paying bank is remote in the locations covered by CTS as clearing is undertaken on the basis of images. If the instrument is lost after lodging with the collecting bank but before
truncating the same for sending through image based clearing, the presenting bank should follow the procedure indicated above.

The customer is entitled to be reimbursed by banks for related expenses for obtaining duplicate instruments and also interest for reasonable delays in obtaining the same.

**Cash and Its Custody**

(1) General

The cash and small coin balances must be kept in the string room in the joint custody of the Head Cashier/cashier and authorized supervising official.

(2) Strong Room/ Safe

The strong room or Safe must be under the double lock of the cashier and the supervising official in charge of cash.

(3) Cash Balance of the Bank

The bulk of the cash balance should always be in the strong room/safe under joint custody. While the remainder (Cashier hand balance) which will be kept as low as conveniently possible, will be left with the Head Cashier/Cashier during the day for the day's transactions.

(4) Checking of Cash Balance

*Before taking notes and coins into "Joint Custody", the supervising official will:*

- Personally count all notes of denominations above Rs. 10.
- Count all other notes on the "clip system".
- Have all bags of coins weighed in his presence.
- Take and count few pieces and leave the reminder to be counted in his presence on the "clip system".
- Invariably check the entire Head Cashier’s/Cashier’s hand balance of loose notes.
- Assure that Head Cashier’s/Cashier’s hand balance are kept in the cash box and locked in his presence.

(5) Shortage or Excess in Cash

- Any shortage in the cash balance should be recovered on the same day from the Head Cashier/Cashier.
Failing recovery on the same day, the amount of shortage should be debited to Suspense Account taking the signatures of the members responsible under report to the Head Office.

Head Cashier/Cashier is responsible for any shortage either in Hand or Vault Balance.

Cashiers signed the Denomination Slips will be responsible for any shortage in book of notes.

Any excess in the Cash Balance must be credited to Sundry Creditors Account on the same day.

(6) Remittance of Cash

When remittances of currency notes are sent from one office to another, following instructions must be strictly complied with:

- Should not be allowed to be carried without and armed guard.
- Always entrusted to an authorised employee with experienced subordinate staff and armed guard.
- Night journeys and unusual halts at junctions should be avoided.
- Remittance box should always be conveyed in the van provided.
- The box should be securely chained and locked.
- A register should be maintained to record all cash remittances.

(7) Insurance

All cash remittance in transit are covered under the Blanket Insurance Policy obtained by the Bank.

(8) Custody of Keys:

Particulars of all Important keys, including those of the Head Cashier/ Cashier, must be entered in the Key Register. The Register Should show what originals and duplicates exists and where they are to be found and must be initialed by every incoming Manager.

(9) Security Measures

The security Measures as advised by the Head Office in respect of security guards deployed and use of alarm system etc.

Clearing Operations
Pre-requisites for sending cheques for clearing

- All the instruments presented through the clearing should bear the “Clearing” stamp with Bank and Branch and date.
- Bank crossing stamp with MICR code.
- Verify the name of the payee and on pay-in-slip which should be one and the same.
- Verify the amount on the cheque and on pay-in-slip which should be one and the same.
- Cheques with a/c payee crossing must be collected to the payee a/c only.
- Send the unpaid Return Cheques through the branch courier to reach the clearing branch before stipulated time.

Inward clearing cheques
Outward clearing cheques
High Value clearing
Electronic Clearing System (ECS)
Clearing House Account Reconciliation
Balancing of Clearing House Account

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Unit 5: Operational Aspects of Deposit Accounts

Features of Deposit Accounts

Current Account

This account is meant for Individual or Institutions having large number of transactions, mainly for meeting their day to day business and operational requirement for parking their operational fund balance.

- Current Accounts (C/As) under type of can be opened by individuals, partnership firms, private and public limited companies, HUFs, societies, trusts, clubs, associations, Govt Departments etc.
- A current account cannot be opened by:

1. Minors. However accounts of minors to be operated by the natural guardian may be opened.
2. Purdanashin Women
3. Illiterate persons
4. Blind Persons

- No interest is payable on credit balances in Current Accounts.
- The customers may receive the statements of account according to the frequency desired by them.
- Cheque books are issued to all Current Account holders and all withdrawals should be made only through issue of cheques.
• There is no restriction on the number of transactions in the account holder at any one time.
• All withdrawals by the current holder, including request for RTGS/NEFT/Draft, must be through cheques only.
• As per RBI directive, the applicant for Current Account should declare in the account opening form or separately that he/they is/are not enjoying any credit facility with any Bank and if he/they does/do enjoy any credit facility, he/they should declare full particulars thereof indicating the name of the Bank/branch concerned.

**Savings Accounts**

Savings Bank accounts are meant for individuals operating singly or jointly with other individuals. Sometimes such accounts are opened in the names of institutions which are specifically approved by the RBI for maintaining saving bank accounts with banks.

**Eligibility to open accounts:**

• Individual is single name.
• Two or more persons in joint names.
• Associations, club or similar other Non-trading institutions provided their by-law/rules are found acceptable and strictly adhered to. They must also be eligible as per the guidelines of RBI.
• Minor above 10 years can open and operate Saving bank account.
• A bank should not open more than one Saving bank account for the same person in his individual name.

**Saving Deposit account cannot be opened by banks in the name of:**

• Government Departments
• Bodies depending upon budgetary allocations for performance of their functions.
• Municipal corporations or Municipal committees
• Panchayat samitis
• State Housing Boards
• Water and Sewerage/ Drainage Boards
• State Text Book Publishing Corporations
• Societies
• Metropolitan Development Authority
• State/ District Level Housing Co-op Societies etc.

**Saving Deposit account cannot be apply by banks in the name of:**
• Khadi and Village Industries Boards.
• Societies registered under the Societies Registration Act, 1860 or any other corresponding law in force in State or a Union Territory.
• Companies governed by the Companies Act, 1956 which have been licensed by the Central Government under Section 25 of the said Act, or under the corresponding provision in the Indian Companies Act, 1913 and permitted, not to add to their names the words “Limited” or the words “Private Limited”.
• Agriculture Produce Industries Boards.

The main objective of saving account is to promote savings.

• There is no restriction on the number and amount of deposits. However, in India, mandatory PAN (Permanent Account Number) details are required to be furnished for doing cash transactions exceeding ₹50,000.
• Withdrawals are allowed subject to certain restrictions.
• The money can be withdrawn either by cheque or withdrawal slip of the respective bank.
• The rate of interest payable is very nominal on saving accounts. At present it is between 4% to 6% p.a in India.
• Saving account is of continuing nature. There is no maximum period of holding.
• A minimum amount has to be kept on saving account to keep it functioning.
• No loan facility is provided against saving account.
• Electronic clearing System (ECS) or E-Banking are available to pay electricity bill, telephone bill and other routine household expenses.
• Generally, equated monthly installments (EMI) for housing loan, personal loan, car loan, etc., are paid (routed) through saving bank account.

Unclaimed Deposits and Inoperative/ Dormant Accounts

• In view of the increase in the amount of unclaimed deposits with banks year after year and the inherent risk associated with such deposits, it is felt that banks should play a more pro-active role in finding the whereabouts of the account holders whose accounts have remained inoperative. Keeping these factors in view, Banks may follow the instructions detailed below while dealing with inoperative/dormant accounts:
• Further, the segregation of the inoperative accounts is from the point of view of reducing risk of frauds etc. However, the customer should not be inconvenienced in any way, just because his account has been rendered inoperative.
• Operation in such accounts may be allowed after due diligence as per risk category of the customer. Due diligence would mean ensuring genuineness of the transaction, verification of the signature and identity etc.
• There should not be any charge for activation of inoperative account.
Banks are also advised to ensure that the amounts lying in inoperative accounts ledger are properly audited by the internal auditors/statutory auditors of the bank.

Interest on savings bank accounts should be credited on regular basis whether the account is operative or not. If a Fixed Deposit Receipt matures and proceeds are unpaid, the amount left unclaimed with the bank will attract savings bank rate of interest.

Banks should carry out an annual review of accounts in which there are no operations for more than one year. The banks may approach the customers and inform them in writing that there has been no operation in their accounts and ascertain the reasons for the same.

If the letters are returned undelivered, they may immediately be put on enquiry to find out the whereabouts of customers or their legal heirs in case they are deceased.

In case the whereabouts of the customers are not traceable, banks should consider contacting the persons who had introduced the account holder. They could also consider contacting the employer/or any other person whose details are available with them. They could also consider contacting the account holder telephonically in case his telephone number / Cell number has been furnished to the bank. In case of Non Resident accounts, the bank may also contact the account holders through email and obtain their confirmation of the details of the account.

A savings as well as current account should be treated as inoperative/dormant if there are no transactions in the account for over a period of two years.

In case any reply is given by the account holder giving the reasons for not operating the account, banks should continue classifying the same as an operative account for one more year within which period the account holder may be requested to operate the account. However, in case the account holder still does not operate the same during the extended period, banks should classify the same as inoperative account after the expiry of the extended period.

For the purpose of classifying an account as 'inoperative' both the type of transactions i.e. debit as well as credit transactions induced at the instance of customers as well as third party should be considered. However, the service charges levied by the bank or interest credited by the bank should not be considered. Interest on Fixed Deposit account is credited in the Savings Bank accounts as per the mandate of the customer, the same could be treated as a customer induced transaction and the account should be treated as operative account as long as the interest on Fixed Deposit account is credited to the Savings Bank account.

Basic Savings Bank Deposit Account (BSBDA)

Basic Saving Bank Deposit account is made available by banks to facilitate financial inclusion of persons of lower economic standing and enable them to get access to banking
facilities. The earlier “No Frills” account have been converted to Basic Saving bank deposit account (BSBDA), under instructions from RBI.

- The BSBAD should be considered a normal banking service available to all.
- This account shall not have the requirement of any minimum balance.
- The services available in the account will include deposit and withdrawal of cash at bank branch as well as ATMs; receipt/credit of money through electronic payment channels or by means of deposit/collection of cheques drawn by Central/State Government agencies and departments;
- While there will be no limit on the number of deposits that can be made in a month, account holders will be allowed a maximum of four withdrawals in a month, including ATM withdrawals;
- Facility of ATM card or ATM-cum-Debit Card;
- The above facilities will be provided without any charges. Further, no charge will be levied for non-operation/activation of in-operative ‘Basic Savings Bank Deposit Account’.
- Banks would be free to evolve other requirements including pricing structure for additional value-added services beyond the stipulated basic minimum services on reasonable and transparent basis and applied in a non-discriminatory manner.
- The BSBDA would be subject to RBI instructions on Know Your Customer (KYC) / Anti-Money Laundering (AML) for opening of bank accounts issued from time to time.
- If such account is opened on the basis of simplified KYC norms, the account would additionally be treated as a ‘Small Account’ and would be subject to conditions stipulated for such accounts.
- Holders of BSBDA will not be eligible for opening any other savings bank deposit account in that bank. If a customer has any other existing savings bank deposit account in that bank, he/she will be required to close it within 30 days from the date of opening a BSBDA.

Operational Instructions in Joint Account

- **Joint Account Without Survivorship Clause:** This Account is to be operated jointly by all the Account holders. In the event of death of one of the account holders, operations in this account should be stopped and the balance in this account is payable to the survivors and the legal heirs of the deceased party.
- **Joint or Survivor with Survivorship:** This account is to be operated jointly by all the account holders. In the event of death of one of the account holders, the survivor/s can be allowed to continue to operate the account or the balance in the account can be paid to survivor/s.
- **Either or Survivor:** This is the most common type of joint account and is applicable between any two individuals. For example, if a husband and wife have a joint account with ‘either or survivor’ clause, either of them can operate the
account. In the case of the death of one of the depositors, the other can continue, and receives the final balance in the account along with all interests (as applicable at the time of closure). If there is a nominee for the account, the conditions will be the same and the nominee gets access to the funds on the death of both the account holders.

- **Anyone or Survivor**: This type of account holds true when more than two individuals start an account jointly. Here, any of the depositors can operate the account at any time. In case any of the depositors expire, the others can continue the account. If required, the final balance along with interest will be paid to any of the survivor/s as requested.

### Opening and Operating of Accounting Under Different Categories

#### How to open a minor savings account

- According to Indian Majority Act, a Minor is one who has not completed 18 years of age, but in the case of a Minor whose guardian is appointed by the court, the Minority status continue up to of 21 years.
- An account opening form needs to be filled with the minor as the first holder and parent/guardian as the joint holder.
- Birth certificate of the child needs to be submitted to verify the age of the minor as well as his relationship with the parent/guardian.
- Pan Card details of the parent/guardian are required. Also, the parent/guardian should have an account in the bank where they wish to open the minor’s account.
- A separate form needs to be filled by the parent/guardian with all the necessary details.
- Address proof for the minor (such as the minor’s name which reflects on the ration card) is mandatory.
- The signature of the parent/guardian is also registered for all future account transactions.
- Photographs of the parent/guardian should be attached to the account opening form. Some banks even require the minor’s photograph.

#### Accounts of illiterate persons:

Once again I will like to remind the bankers that the illiterate person is competent to contract like any other person. However, he may contest subsequently that his consent was obtained by misrepresentation and thereby try to avoid the contract. Therefore, banks should get the same witnessed to the effect that the terms and condition of the bank were explained to the illiterate person in his own language and he signed the form after understanding in their presence. Normally cheque book is not issued to illiterate depositor. However cheque book can be issued for making statutory payments post dated
cheques for repayment of installments of loan. In such cases, the cheques will be crossed account payee and thumb impression of the illiterate depositor will be verified on such cheques at the of issue of cheque book by competent authority of the bank.

**Accounts of Blind Persons:**

You need to remember that a blind person is fully competent to enter into a contract like any other person. However, due to his physical disability, there can be a situation where he contests subsequently that the facts were misrepresented to him and thereby try to avoid the contract. Therefore, signature or thumb impression of the blind person should be attested by an independent witness to the effect that all terms and conditions were properly explained to the blind person in his presence. Moreover, cash deposit and withdrawal by blind person should be handled by the officer of the bank. Cheque book can be issued only if the blind person can sign consistently.

**Accounts of Pardanashin ladies:**

*Let us first understand who is a Pardanashin lady?*

A pardanashin lady is one who remain in complete seclusion and does not transact with people other than members of her family. Though Pardanashin lady is legally competent to enter into a contract, she may be able to avoid it on the pretext of undue influence and the onus of proving of influence is on the bank. Therefore, bank should take extra care in this regards. Signature of pardanashin lady should be attested by her guardian if she is unmarried and by her husband if she is married. The signature may be attested by any other member of the family also. If she is illiterate she will not be issued cheque book and for every payment she will have to give the discharge in the presence of an independent witness. However, in case of literate Woman, cheque book will be issued and payment will be made on the basis of recorded signatures.

**Nomination**

*Salient features*

- Nomination facilitates faster and easier release of funds/articles without insistance on Succession Certificate/Probate of Will.
- Nomination facility is available to accountholders operating current accounts, savings bank accounts and all types of term deposit accounts, safe deposit lockers or safe custody of articles.
- Nomination facility is intended for individuals only.
- Nomination can be made in favour of one person only. It can be made in existing or new accounts and can be cancelled or changed subsequently by the depositors.
- Nomination cannot be made in accounts where deposits are held in a representative capacity e.g. trust accounts etc. and in accounts of partnership firms, H.U.F., companies, associations, clubs etc.
• In case of a joint account of individuals, nomination should be made by all depositors jointly.
• In case of minor’s account whether self operated or otherwise, nomination should be made by a person lawfully entitled to act on behalf of the minor.
• Nomination favouring the minor is permitted on the condition that the account holder, while making the nomination, appoints another individual, not being a minor, to receive the amount of the deposit on behalf of the nominee in the event of the death of the depositor during the minority of the nominee. Date of birth of minor be obtained and noted.
• A nomination will continue to be in force even on renewal of term deposit, unless specifically cancelled or changed.
• Name of existing nominee in respect of specific Term Deposit Receipt will not be added for subsequent deposit receipts. Separate nomination will be obtained for each deposit receipt.
• Nomination facility is available for savings bank accounts opened for credit of pension. However, Banking Companies (Nomination) Rules, 1985 are distinct from the Arrears of Pension (Nomination) Rules, 1983 and the nomination exercised by the pensioner under the latter rules for receipt of arrears of pension will not be valid for the purpose of deposit accounts held by the pensioners with banks, for which a separate nomination is necessary in terms of the Banking Companies (Nomination) Rules, 1985 in case a pensioner desires to avail of nomination facility.
• A non-resident can be nominated as a nominee in a resident account. In case of non-resident nominees, the amount entitled to him from the account(s)/deposit(s) of a deceased person, will be credited to his NRO account.
Unit 6 - Operational Aspects of Loan Accounts

Operational Terms/ Aspects Common in loan Functions

• Types of Borrowers
  1. An individual
  2. Sole Proprietary Firm
  3. Partnership firm and joint venture
  4. HUF
  5. Companies
  6. Statutory Corporations
  7. Trusts and Co-Op societies

• Funded and Non-Funded Credit Facilities
• Term Loans
• Demand Loans
• Bills Purchased
• Bills Discounted
• End use of funds
• Primary Securities
• Collateral Securities
• Personal Security of Guarantor
• Fixed Charges
• Floating Charges
• Margin
• Priority Sector

1. **Agricultural Financial**
2. **Finance to micro and small enterprises**
3. **Housing Finance** (loans upto 20 lakhs to individual, loans upto Rs 1 lakh for rural/semi urban and Rs. 2 lakhs for urban areas)
4. **Educational loans** (upto Rs 10 lacs for studies in India and Rs 20 lakhs for studies abroad)
5. **Export credit**
6. **Retail trade**

• Refinance
• Credit Risk Management
• Credit Exposure Norms
• Base Rate System of Interest on Advances
• Fixed/Floating Rate of Interest on Loans
• Penal Rate of Interest
• Security
• Documents of Title of Goods
• Banker’s General Lien
• Negative Lien
• Restrictions on Advances
• Rehabilitation and Recovery
• Fair Practices code: The guidelines issued by RBI on fair practices code for lending are required to be compulsorily followed by all banks in India. The operating staff should be aware of these guidelines. **These guidelines pertain to:**

1. **Application for loans and their processing**
2. **Loan appraisal and terms/conditions’**
3. **Disbursements of loans**
4. **Post disbursement supervision**
5. **General guidelines relating to discrimination based on sex, caste and religion, harassment in recovery, transfer/ takeover of account etc.**

**Operational Process of Loans in the Banks**
• Receipt of Loan Application
• Assessment of viability and credit worthiness
• Sanction
• Disbursement
• Monitoring and supervision
• Inspections
• Review of the conduct of the account
• Renewal of advances
• Methods of Assessment of loans

Assessment of working CMA formats

Under the Credit Monitoring Arrangement (CMA), banks have been permitted for sanctioning credit proposals (of large borrowers) after detailed analysis of the past performance. There is another requirement for the Banks. They need to submit the large credit proposals to the Reserve Bank of India for post-sanction scrutiny. These proposals involve working capital limits of Rupees 500 lakhs (5 crores) and above and/or term loan in excess of Rupees 200 lakhs (2 crores).

CMA covers the following statements

- Particulars of current & proposed limits
- Operating statement
- Analysis of Balance sheet
- Comparative statement of Current Asset & Current liabilities
- Calculation of Maximum Permissible Bank Finance (MPBF)
- Fund flow statement

Operating Manual for Loans and Advances

The operations Manual of a bank is intended to provide guidelines to the operating staff on the above mentioned areas and any other areas considered relevant by the bank. The operational guidelines regarding loans and advances, contained in a bank's operational manual, are based primarily on-

- Principles of credit
- Bank’s loan policy
- Regulatory and legal framework

Samples Operating instructions

Advance against Goods and Warehouse Receipts
- Documentation
- Margin
- Valuation
- Marketability
- Go down Board
- Insurance
- Godowns in a Pledge Account
- Pledging of Stocks
- Storage of goods pledged in the godowns where goods not pledged are also stored
- Delivery of stocks pledged
- Submission of stock statements in Hypothecation accounts
- Goods hypothecated in the godowns where goods not hypothecated are also lying
- Staff accountability
- Charges for inspection of Godowns/Assets/Securities etc.
- Godown charges
- Selective credit control
- Advances against warehouse receipts

**Operational aspects of few common loan products**

**Gold Loans**

- Must be covered under policy framed by Bank’s Board
- Prohibited from granting any advance against bullion/primary gold
- End use of the funds to be ensured
- Ownership of the ornaments to be ensured
- Valuation of gold ornaments to be done
- Prefer hallmarked jewellery
- Purpose of loan can be for both Agriculture and non-agriculture purposes
- Loan to Value (LTV) to be maintained (Max. 75% of value of gold ornaments)
- Maximum amount of loan should be within board approved limit
- Record of security
- Custody of ornaments
- Repayment should not be more than 12 months (other than agriculture)
- Return of ornaments on repayment
- Delivery to third parties
- Default
- Insurance
- Verification

**Educational Loans**

- Service area norms
Eligibility criteria
Student eligibility
Expenses considered for loan
Quantum of finance
Margin: No margin may be insisted upon Rs 4 lakhs. However, for loan of higher amounts, the margin requirement may be 5% for inland studies and 15% for studies abroad.
Security: No security must be insisted upon for loans upto Rs 4 lakhs.
Documentation
Sanction
Disbursement
Repayment
Follow up
Processing charges
Capability certificate

Home Loans

• Valuation of property
• Eligibility
• Loan to Vale (LTV) ratio:

1. Upto Rs 20 lakhs; 90%
2. Above Rs 20 lakhs and Upto Rs 75 lakhs; 80%
3. Above Rs 75 lakhs; 75%

• Interest rate
• Security
• Insurance
• Disbursal – for purchase of constructed property/built up property
• Disbursal – for building construction
• Repayment
• No Foreclosure charges/Prepayment penalty for floating rate individual borrowers

Vehicle Loans

• Purpose of Auto Loan – New/used Car, MUVs, SUVs, Two wheelers
• Eligibility
• Documents required to be submitted
• Loan Tenure: Maximum 84 months
• Loan to Vale (LTV) ratio:
1. **Upto Rs 10 lakhs**: Maximum Permissible LTV ratio is 85% of “on road Price” of the car
2. **Above Rs 10 lakhs**: Maximum permissible LTV ratio is 80% of “on road price” of the car

- Interest rate – Fixed/Floating
- Calculation of interest
- Penal interest
- Bounced cheque/ECS or SI dishonor
- Intimation of change in base rate
- Repayment
- Security
- Insurance
- Prepayment penalty is waived
- Inspection
- Fees and charges
- Disbursement

**Others Point**

- **KYC**: All loans should be sanctioned only after completion of KYC verification by the branch.
- **CIBIL Disclosure**: The Borrowers should agree and give consent for disclosure by the Bank of all or any

  1. Information and data relating to the Borrowers
  2. Information or data relating to any credit facility availed or to be availed by the borrowers and default, if any, committed by the borrowers in discharge or his/their such obligation as the Bank may deem appropriate and necessary, to disclose and furnish to Credit Information Bureau (India) Ltd. (CIBIL), and other agency authorized in this behalf by RBI.

- **Default**: Default is failure to meet the legal obligations of a loan, for example when a home buyer fails to make a mortgage payment, or when a corporation or government fails to pay a bond which has reached maturity.
- **Time taken for disposal of application**: The loan applications with complete information and required documents should be disposed by the branch within the

**Unit 7- Operational Aspects of CBS Environment**

**Core Banking Solution**
Core Banking Solution (CBS) is networking of bank branches, which allows customers to manage their accounts, and use various banking facilities from any part of the world. In simple term, there is no need to visit your own branch to do banking transactions. You can do it from any location, any time.

**Function of CBS**

- Opening new Account
- Recording of transactions
- Passbook maintenance
- Interest calculations on loans and deposits,
- Processing cash deposits and withdrawals,
- Processing cash deposits and cheques,
- Maintaining records of all the transactions,
- Customer relationship management activities
- Managing customer accounts

**Customers find core banking advantageous since**

The entire range of banking products including savings, deposit accounts etc are available from any location

- Accessibility through multiple channels, including mobile banking and web
- Accurate, timely and actionable information about customer relations
- Single view between bank and customers
- Redefining the concept of ‘anywhere, anytime’ banking.

**Need for CBS**

- To enhance efficiency and effectiveness
- To increase customer satisfaction and convenience
- To enhance bank’s competitiveness
- To simplify processes for the staff
- To make available more time for branch staff to focus on sales and marketing
To meet the compliance requirements
To meet the intense competition
To meet the demands of customers who have become more demanding and less loyal.

**Unit 8- Back Office Operations/Handling of Unreconciled Entries in Banks**

**Back Office**

Back office carry out various functions to support the front office activities. In Specialised functions like Treasury operations and Forex, the bank offices perform the mainstream role of directly supporting the trading room or front office by controlling confirmations and settlement transactions.

- **Book keeping and accounting** – Transaction processing, maintenance of General Ledger and other book of accounts, balancing of branch accounts, reconciliation of entries and sub-systems, preparation of financial statements.
- **Deposits** – Calculation and posting of interest, service charges, remainders for renewals of term deposits, nature of operation of account-single/joint etc.
- **Loans** – processing end-to-end loan originations, calculation of EMI, calculation and posting of interest, penal interest, processing fee, commission, charges, risk management
- **Regulatory compliance** – Identifying KYC gaps, customer grievance redressal system etc.
- **e-Banking** – handling transactions through internet, mobile banking or ATMs, card based payments etc.
- **Other functions** – Clearing, collection, remittances etc.

**Reconciliation functions in Banks**

- Reconciliation of accounts for payments involving intermediaries
- Reconciliation of accounts for with correspondent banks
- Reconciliation of bank accounts with RBI and other banks and institutions
- Reconciliation of Inter branch entries
- Reconciliation of Inter branch entries and sub-systems
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<td>Total- 1200+ Questions</td>
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(1500+ Questions) |
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