ALL THE VERY BEST FOR YOUR EXAMS

SHORT NOTES FOR
JAIIB
ACCOUNTING & FINANCE FOR BANKERS

Though we had taken enough care to go through the notes provided here, we shall not be responsible for any loss or damage, resulting from any action taken on the basis of the contents. Creation of these short notes is the efforts of so many persons. First of all we thank all of them for their valuable contribution. We request everyone to go through the Macmillan book and update yourself with the latest information through RBI website and other authenticated sources. In case you find any incorrect/doubtful information, kindly update us also (along with the source link/reference for the correct information).

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JAIIB / DBF – GENERAL INFORMATION

- **Consists of 3 papers :**
    1. Principles & Practices of Banking
    2. Accounting & Finance for Bankers
    3. Legal & Regulatory Aspects of Banking.
- Only existing employees of banks can appear for JAIIB Exam.
- People other than Bank Employees can appear for Diploma in Banking and Finance Exam. If Passed, JAIIB Examination certificate will be issued after joining the bank.
- Syllabus & exam pattern for both JAIIB and DBF exams are mostly same.
- Both JAIIB and DBF exams are conducted in on-line mode only.
- The examination will be conducted normally twice a year in May / June and November / December on Sundays.
- The duration of the examination will be of 2 hours.

- **Examination Pattern** : Each Paper will contain approx. 120 objective type MCQs, carrying 100 marks including questions based on case studies. The Institute may, however, vary the number of questions to be asked for a subject. There is no negative marking for wrong answers.

- **Passing Criteria** - Minimum 150 in total and minimum 45 in each subject in any single attempt (not required to be the 1st attempt) is considered as pass. Else 50 in each subject. Passed subject gets carried forward to 4 continuous attempts (whether you appear for the exam or not) from the 1st attempt. If not passed in 4 continuous attempts, you need to appear in all 3 papers.
    - **First Class :** 60% or more marks in aggregate and pass in all the subjects in the FIRST PHYSICAL ATTEMPT.
    - **First Class with Distinction :** 70% or more marks in aggregate and 60% or more marks in each subject in the FIRST PHYSICAL ATTEMPT.
    - Candidates who have been granted exemption in the subject/s will be given **"Pass Class"** only.

- **Cut-off Date of Guidelines /Important Developments for Examinations** - The Institute has a practice of asking some questions in each exam about the recent developments/ guidelines issued by the regulator(s) in order to test if the candidates keep themselves abreast of the current developments. But, there could be changes in the developments / guidelines from the date the question papers are prepared and the dates of the actual examinations. In order to address these issues effectively, it has been decided that:

- In respect of the exams to be conducted by the Institute for the Period from February 2018 to July 2018, instructions/guidelines issued by the regulator(s) and important developments in banking and finance up to 31st December, 2017 will only be considered for the purpose of inclusion in the question papers.
- (ii)In respect of the exams to be conducted by the Institute for the period from August 2018 to January 2019, instructions/guidelines issued by the regulator(s) and important developments in banking and finance up to 30th June, 2018 will only be considered for the purpose of inclusion in the question papers.

- **Exam Fees**

JAIIB
First attempt fee - 2,400*
Second attempt fee - 1,000*
Third attempt fee - 1,000*
Fourth attempt fee - 1,000*

DBF
First attempt fee - 3,200*
Second attempt fee - 1,000*
Third attempt fee - 1,000*
Fourth attempt fee - 1,000*

CAIIB
First attempt fee - 2,700*
Second attempt fee - 1,000*
Third attempt fee - 1,000*
Fourth attempt fee - 1,000*

* Plus convenience charges and Taxes as applicable

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SYLLABUS

The details of the prescribed syllabus which is indicative are furnished below. However, keeping in view the professional nature of examinations, all matters falling within the realm of the subject concerned will have to be studied by the candidate as questions can be asked on all relevant matters under the subject. Candidates should particularly prepare themselves for answering questions that may be asked on the latest developments taking place under the various subject/s although those topics may not have been specifically included in the syllabus. Any alterations made will be notified from time to time. Further, questions based on current developments in banking and finance may be asked.

Candidates are advised to refer to financial news papers / periodicals more particularly "IIBF VISION" and "BANK QUEST" published by IIBF.

MODULE A – BUSINESS MATHEMATICS AND FINANCE

Calculation of Interest and Annuities

Calculation of Simple Interest & Compound Interest; Calculation of Equated Monthly Instalments; Fixed and Floating Interest Rates; Calculation of Annuities; Interest Calculation using Products / Balances; Amortisation of a Debt; Sinking Funds

Calculation of YTM

Debt- Definition, Meaning & Salient Features; Loans; Introduction to Bonds; Terms associated with Bonds; Cost of Debt Capital; Bond value with semi-annual Interest; Current Yield on Bond; Calculation of Yield-to- Maturity of Bond; Theorems for Bond Value; Duration of Bond; Properties of Duration; Bond Price Volatility

Capital Budgeting

Present Value and Discounting; Discounted Technique for Investment Appraisal; Internal Rate of Return (IRR); Method of Investment Appraisal; NPV and IRR compared; Investment Opportunities with Capital Rationing; Investment Decision making under condition of uncertainty; Expected NPV Rule; Risk Adjusted Discount Rate Approach for NPV Determination; Sensitivity Analysis for NPV Determination; Decision Tree Analysis for NPV Estimation; Payback Methods; ARR.

Depreciation and its Accounting

Depreciation, its types and methods; Comparing Depreciation Methods

Foreign Exchange Arithmetic

Fundamentals of Foreign Exchange; Forex Markets; Direct and Indirect Quote; Some Basic Exchange Rate Arithmetic – Cross Rate, Chain Rule, Value date, etc.; Forward Exchange Rates – Forward Points; Arbitrage; Calculating Forward Points; Premium / discount; etc.

MODULE B – PRINCIPLES OF BOOKKEEPING & ACCOUNTANCY **Definition, Scope and Accounting Standards**

Nature and Purpose of Accounting; Historical Perspectives; Origins of Accounting Principles; Accounting Standards in India and its Definition and Scope; Generally Accepted Accounting Principles of USA (US GAAP); Transfer Pricing; Overview of IFRS; Difference between GAAP & IFRS.

Basic Accountancy Procedures

Concepts of Accountancy; Going Concern Entity; Double Entry System; Principle of Conservatism; Revenue Recognition and Realisation; Accrual and Cash Basis.

Maintenance of Cash / Subsidiary Books and Ledger

Record Keeping Basics; Account Categories; Debit and Credit Concepts; Accounting and Columnar Accounting Mechanics; Journals; Ledgers; subsidiary books; etc.

Bank Reconciliation Statement

Need for Bank Reconciliation; Causes of Differences; Preparation of Bank Reconciliation Statement; How to prepare a Bank Reconciliation Statement when Extracts of Cash Book and Pass Book are given; Adjusting the Cash Book Balance; Advantages of Bank Reconciliation Statement.

Trial Balance, Rectification of Errors and Adjusting & Closing Entries

Meaning of a Trial Balance; Features and Purpose of a Trial Balance; Types of Trial Balance and Preparation of a Trial Balance; Disagreement of a Trial Balance; Classification of Errors; Location of Errors; Rectification of Errors; Suspense Account and Rectification; Rectification of Errors when Books are closed; Adjusting and Closing Entries.

Capital and Revenue Expenditure

Expenditure; Distinction between Capital and Revenue Expenditure; Deferred Revenue Expenditure; Receipts; General Illustrations.

Bills of Exchange

Types of Instruments of Credit; Term and Due Date of a Bill; Certain Important Terms; Accounting Entries to be Passed; Accommodation Bill etc.

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MODULE C – FINAL ACCOUNTS

Balance Sheet Equation

Balance Sheet Equation; Computation of Balance Sheet Equation.

Preparation of Final Accounts

Preparation of Trading A/C; Profit and Loss A/C; Profit&Loss Appropriation A/C; Balance sheets

Ratio Analysis

Meaning of Accounting Ratios; Classification of Ratios; Uses of Accounting Ratios; Limitations of Accounting Ratios; Calculation and interpretation of various Ratios; Different Users and their Use of Ratios.

Final Accounts of Banking Companies

Definition and Functions of a Bank; Requirements of Banking Companies as to Accounts and Audit; Significant Features of Accounting Systems of Banks; Principal Books of Accounts; Preparation and Presentation of Financial Statements of Banks; CMA Format; Accounting Treatment of Specific Items; Preparation of Profit and Loss Account; Comments on Profit and Loss Account; Important Items of Balance Sheet; Disclosure Requirements of Banks; Additional Disclosures prescribed by RBI; Disclosures required under BASEL norms.

Company Accounts I & II

Definition and Types of Companies; Distinction between Partnership and Limited Liability Company; Classes of Share Capital; Issue of Shares; General Illustrations Non-voting Shares; Form of Balance Sheet; Legal Requirements for Assets; Legal Requirements for Liabilities; Legal Requirements for Profit & Loss A/c; Preparation of Final Accounts

Accounting in a Computerized Environment

Meaning, Features of and Terms used in Computerized Accounting; Difference between Computerized and Manual Accounting; Advantages and Disadvantages of Computerized Accounting; Functions performed by Computerized Accounting Softwares available in the Market; Computerization – Scope and Experiences in Banking; The Core Banking Components; Information Security; Internet and World Wide Web – Influences on Banking

MODULE D – BANKING OPERATIONS

Banking Operations & Accounting Functions

Preparation of Vouchers, cash receipt and payment entries, clearing inward and outward entries, transfer debit and credit entries, what is KYC and what are the different documents to satisfy KYC, verify KYC and authenticity of documents, operational aspects in regard to opening of all types of accounts, scrutiny of loan applications / documents, allowing drawals and accounting entries involved at various stages, operational aspects of CBS environment etc., Back office operations in banks, handling of unreconciled entries in banks

Accounting & Finance for Bankers

Module- A

Simple Interest

'Simple' interest or **'flat rate'** interest is the amount of interest paid each year in a fixed percentage of the amount borrowed or lent at the start.

Formula for calculating simple interest :
Interest = Principal x Rate x Time (PRT), where:

'Interest' is the total amount of interest paid
'Principal' is the amount lent or borrowed
'Rate' is the percentage of the principal charged as interest each year.
'Time' is the time in years of the loan.

Example :

Principal: 'P' = Rs. 50,000, Interest rate: 'R' = 10% = 0.10, Repayment time: T = 3 years. Find the amount of interest paid.

Interest = PRT
= 50,000x0.10x3
= Rs. 15,000/-

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Compound Interest

Compound interest is paid on the original principal and accumulated part of interest.

Formula for calculating compound interest :

P = A(1 +r/n)^nt, where

P = the principal
A = the amount deposited
r = the rate (expressed as fraction, e.g. 6 per cent = 0.06)
n = number of times per year that interest is compounded
t = number of years invested

Frequently compounding of Interest. If the interest is compounded :
Annually = P (1 + r)
Quarterly = P (1 + r/4)^4
Monthly = P (1 + r/12)^12

Example :

The compound interest on Rs. 30,000 at 7% per annum is Rs. 4347. The period (in years) is:
Amount = Rs. (30000 + 4347) = Rs. 34347.
Let the time be *n* years. Then

30000(1+7/100)^n = 34347
(107/100)^n = 34347/30000
(107/100)^n = 11449/10000
(107/100)^n = (107/100)^2
***n* = 2 years.**

The Rule of 72: Allows you to determine the number of years before your money doubles whether in debt or investment. Divide the number 72 by the percentage rate.

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EQUATED MONTHLY INSTALMENTS (EMIs)

Equated Monthly Installment (EMI) refers to the monthly payment a borrower makes on his loan. Though it is a combination of interest payment and principal repayment, the total monthly amount is calculated in such a way that it remains constant all through the repayment tenure. In Equated Monthly Installments (EMIs), the principal and the interest thereon is repaid through equal monthly installment over the fixed tenure of the loan. The benefit of an EMI for borrowers is that they know precisely how much money they will need to pay toward their loan each month, making the personal budgeting process easier.

Formula :

E = P×r×(1 + r)n/((1 + r)n - 1)
E is EMI
where P is Principle Loan Amount
r is rate of interest calculated in monthly basis it should be = Rate of Annual interest/12/100
if its 10% annual ,then its 10/12/100=0.00833
n is tenure in number of months

Example :

For 100000 at 10% annual interest for a period of 12 months, it comes to :
100000*0.00833*(1 + 0.00833)12/((1 + 0.00833)12 - 1) = 8792

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Present Value

Present value describes how much a future sum of money is worth today. Three most influential components of present value are : time, expected rate of return, and the size of the future cash flow. The concept of *present value* is one of the most fundamental and pervasive in the world of finance. It is the basis for stock pricing, bond pricing, financial modeling, banking, insurance, pension fund valuation. It accounts for the fact that money we receive today can be invested today to earn a return. In other words, present value accounts for the time value of money.

The formula for present value is:
PV = CF/(1+r)n

Where:
CF = cash flow in future period
r = the periodic rate of return or interest (also called the discount rate or the required rate of return)
n = number of periods

Example :

Assume that you would like to put money in an account today to make sure your child has enough money in 10 years to buy a car. If you would like to give your child 10,00,000 in 10 years, and you know you can get 5% interest per year from a savings account during that time, how much should you put in the account now?

PV = 10,00,000/ (1 + .05)10 = 6,13,913/-

Thus, 6,13,913 will be worth 10,00,000 in 10 years if you can earn 5% each year. In other words, the present value of 10,00,000 in this scenario is 6,13,913.

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Future Value

The value of an asset or cash at a specified date in the future that is equivalent in value to a specified sum today. It refers to a method of calculating how much the present value (PV) of an asset or cash will be worth at a specific time in the future. There are two ways to calculate FV:

1) For an asset with simple annual interest: = Original Investment x (1+(interest rate*number of years))

2) For an asset with interest compounded annually: = Original Investment x ((1+interest rate)^number of years)

- Depending on the rate of interest, the amount you receive in future(A), will be more than the amount(P) available now.
- $A=P(1+r)^T$,when the compounding is yearly.
- Therefore,FV=Present Amount*$(1+r)^T$. We call $(1+r)^T$ compounding factor.
- E.g.,if rate of intt is 10%p.a., r=0.10. Therefore, compounding factor is 1.10 for 1 year, $(1.10)^2$ =1.21 for 2 years and so on.
- In above example,FV of Rs 100 , after 2 years will be, 100*$(1.10)^2$ =100*1.21=Rs 121. Similarly,FV of Rs 100, after 5 years, will be100*$(1.10)^5$

Example:

1) 10,000 invested for 5 years with simple annual interest of 10% would have a future value of

FV = 10000(1+(0.10*5))
= 10000(1+0.50)
= 10000*1.5
= 15000

2) 10,000 invested for 5 years at 10%, compounded annually has a future value of :
FV = 10000(1+0.10)^5)
= 10000(1.10)^5
= 10000*1.61051
= 16105.10

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Annuities

Annuities are essentially a series of fixed payments required from you or paid to you at a specified frequency over the course of a fixed time period. The most common payment frequencies are yearly, semi-annually (twice a year), quarterly and monthly. There are two basic types of annuities: ordinary annuities and annuities due.

Ordinary Annuity: Payments are required at the end of each period. For example, straight bonds usually pay coupon payments at the end of every six months until the bond's maturity date.

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Annuity Due: Payments are required at the beginning of each period. Rent is an example 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.

- E.g. Payment of Rs 1000 every year by LIC for next 20 years . Also, a Recurring deposit with bank for Rs 100 for 5 years.
- 2 types of Annuities. Ordinary Annuity; payment is at the end of the period. Annuity Due; payment is at the beginning of each period.

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Present Value and Future Value of an Annuity

- For calculating PV of Annuity, PV of each payment is calculated and added. E.g. if Rs 100 is paid at the end of each year for 10 years, we calculate PV of each of these 10 payments of Rs 100 separately and add these 10 values.
- Similarly, for calculating FV of Annuity, FV of each payment is calculated and added. E.g. if Rs 100 is paid at the end of each year for 10 years, we calculate fv of each of these 10 payments of Rs 100 separately and add these 10 values.

The present value an annuity is the sum of the periodic payments each discounted at the given rate of interest to reflect the time value of money.

PV of an Ordinary Annuity = R (1 − (1 + i)^-n)/i

PV of an Annuity Due = R (1 − (1 + i)^-n)/i × (1 + i)

Where,
i is the interest rate per compounding period;
n are the number of compounding periods; and
R is the fixed periodic payment.

In the formulae, given, we have to correctly arrive at r, i.e.the interest rate. E.g.the given intt rate is 12%p.a.If the payment is received yearly, r will be equal to 12/100=0.12.But if payment is received monthly, it will be 12/100*12=0.01.For quarterly payment, it will be 0.03 and for half yearly payment, it will be 0.06

Example :

1. Calculate the present value on Jan 1, 2015 of an annuity of 5,000 paid at the end of each month of the calendar year 2015. The annual interest rate is 12%.

Solution

We have,
Periodic Payment R = 5,000
Number of Periods n = 12
Interest Rate i = 12%/12 = 1%
Present Value

PV = 5000 × (1-(1+1%)^(-12))/1%
= 5000 × (1-1.01^-12)/1%
= 5000 × (1-0.88745)/1%
= 5000 × 0.11255/1%
= 5000 × 11.255
= 56,275.40

2. A certain amount was invested on Jan 1, 2015 such that it generated a periodic payment of 10,000 at the beginning of each month of the calendar year 2015. The interest rate on the investment was 13.2%. Calculate the original investment and the interest earned.

Solution

Periodic Payment R = 10,000
Number of Periods n = 12
Interest Rate i = 13.2%/12 = 1.1%
Original Investment = PV of annuity due on Jan 1, 2015
= 10,000 × (1-(1+1.1%)^(-12))/1.1% × (1+1.1%)
= 10,000 × (1-1.011^-12)/0.011 × 1.011
= 10,000 × (1-0.876973)/0.011 × 1.011
= 10,000 × 0.123027/0.011 × 1.011
= 10,000 × 11.184289 × 1.011
= 1,13,073.20
Interest Earned = 10,000 × 12 – 1,13,073.20
= 1,20,000 – 1,13,073.20
= 6926.80

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Sinking fund

- Concept same as that of Annuity
- Suppose, you need a fixed amount(A) after, say, 5 years. You deposit an amount(C)every year with a bank. This becomes A after 5 years and can be used for repaying a debt or any other purpose. As the rate of intt and the FV is known, we can calculate C.

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Understanding Formula for EMI, Annuities

- Let us take case of a home loan of Rs 1lac at 12%p.a. ,repayable in 180 installments (here p=1,00,000and r=12/100*12=.01)
- In the 1st month, bank will charge interest equal to p*r=Rs 1000 and so, the outstanding amount will become Rs 1,01,000.
- What happens if the EMI is fixed at p*r, which is Rs 1000?This EMI will meet only the interest applied and so the principal will remain unchanged at Rs 1,00,000.This process will continue and the loan will remain outstanding for ever. Therefore, EMI has to be slightly more than p*r so that some amount can go towards reducing the principal amount
- If EMI has to be more than p*r, we should multiply p*r by a fig which is more than 1.
- This fig is $(1+r)^n$ / $(1+r)^n$ -1.You will observe that denominator in less than numerator by 1 only. E.g., if numerator is 4.3210, the denominator will be 3.3210 .So, this fig is always more than 1.
- As you know, $(1+r)^n$ is an important fig in business maths, and if the above concept is clear, you will never have difficulty in remembering EMI formula
- Once you are comfortable with EMI formula, you can derive yourself the formula for PV and FV of Annuities.
- Home loan is like an ordinary annuity in which payment takes place at the end of each month for an amount equal to EMI, and p is like the present value of annuity. Therefore, in a question, if periodic payment ,n and r are given, you can calculate PV. FV is calculated by multiplying PV by $(1+r)^n$.
- In case of annuity due, the payments are at the beginning of the period and not at the end as is the case with ordinary annuity. Therefore, both PV and FV will be more than what is arrived in case of ordinary annuity. The multiplying factor is (1+r)

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Bond Value

Debt

DEBT means a sum of money due by certain and expresses agreement. In a less technical sense, it means a claim for money. Loans from banks or financial institutions are one of the popular forms of debt.

Bonds

Debt capital consists of mainly bonds and debentures. The holder of debt capital does not receive a share of ownership of the company when they provide funds to the firm. Rather, when a company first issues debt capital, the providers of debt capital purchase a debenture, which involves lending money to the firm. In return for loaning this money, bond holders have a right to certain guaranteed payments during the life of the bond.

- A Bond is a form of debt raised by the issuer of the bond.
- Issuer of the bonds pays interest to the purchaser for using his money.
- Terms associated with bonds: Face value, Coupon rate, Maturity, Redemption value, Market value.
- Face value and redemption value may be different but these are fixed and known.
- Market value of the bond may be different form the face value and keeps changing.

For example : a company issued a bond of a face value of Rs. 100 carrying a coupon rate of 10 per cent for ten years. This entitles the bondholder to receive Rs. 10 (10 per cent of Rs. 100) for ten years as interest. At the end of tenth year, the bondholder is also entitled to receive back the invested amount of Rs. 100. Irrespective of the level of profits or losses, which company makes during that period of ten years, the bondholder is entitled to receive the coupon interest during that period.

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Terms Associated with Bonds

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.

Maturity: A bond is issued for a specified period. It is to be repaid on maturity.

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

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.

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Bond Value

- The purchaser of the bonds gets regular interest payments as also the redemption amount on maturity.

- The interest on bond (also called coupon rate) is fixed at the time of its issue. But interest rate in the market keeps changing, and, therefore, market price of bond also changes.
- The market price or intrinsic value of a bond is different from the face value if the coupon rate is different from the market interest rate at that particular time.
- Market value is equal to PV of all the coupon receipts and redemption value discounted at the prevailing market rate.

A bond, whose par value is Rs. 1,000, bears a coupon rate of 12 per cent and has a maturity period of 3 years. The required rate of return on the bond is 10 per cent. What is the value of this bond?

Solution

Annual interest payable = 1,000 * 12% = 120
Principal repayment at the end of 3 years = Rs. 1,000
The value of the bond
= 120 (PVIFA 10%, 3 yrs) + Rs. 1,000 (PVIF 10%, 3 yrs)
= 120 (2.487)+1,000 (0.751)
= 298.44 + 751
= Rs. 1,049.44

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

Solution

Semi-annual interest payable = 1,000 x 12 per cent/2= 60
Principal repayment at the end of 3 years = Rs. 1,000

The value of the bond
= 60 (PVIFA 10%/2, 6 pds) + Rs. 1,000 (PVIF 10%/2, 6 pds) =
60 (5.0746) + 1,000 (0.746) = 304.48 + 746 = 1,050.48

The face value of the bond is Rs. 1,000, coupon rate is 11 per cent, years to maturity is seven years. The required rate of return is 13 per cent, and then the present value of the bond is

110 x PVIFA (13 per cent, 7) + 1,000 (PVIF 13 per cent, 7)
110(4.423)+1,000 (0.425) = 911.53

One year from now, when the maturity period will be six years, the present value of the bond will be

110 x PVIFA (13 per cent, 6) + 1,000 (PVIF 13 per cent, 6)
110 (3.998) + 1,000 (0.480) = 919.78

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Similarly, when maturity period is 5, 4, 3, 2, 1 the Bond value will become 929.87, 940.14, 952.71, 966.48, 982.35, respectively.

YTM

CURRENT YIELD ON BOND

It measures the rate of return earned on a bond, if it is purchased at its current market price and if the coupon interest is received.

Current yield = Coupon interest/current market price

If a bond of face value Rs. 1,000, carrying a coupon interest rate of 8 per cent, is quoted in the market at Rs. 800, then the
Current yield of the bond is = 8 per cent * 1,000/800 = 10 per cent

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.

- Current yield =coupon interest/current market price.
- E.g. if face value of a bond is Rs 50, coupon rate is 8% pa, and market price is Rs 40, then the current yield=4/40=0.1 or 10%
- Yield to Maturity(YTM) is that discount rate at which all future cash flows equal the present market value.

Numerical problems on YTM

Consider a Rs. 1,000 par value bond, whose current market price is Rs. 850/-. The bond carries a coupon rate of 8 per cent and has the maturity period of nine years. What would be the rate of return that an investor earns if he purchases the bond and holds until maturity?

Solution

If kd is the yield to maturity then,
850 = 80 (PVIFA kd per cent, 9 yrs) + 1,000 (PVIF kd, 9 yrs)

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

= 80 (PVIFA 12 per cent, 9) + 1,000 (PVIF 12 per cent, 9)
= 80x 5.328+ 1,000 x (0.361)
= 426.24 + 361 =787.24

Since, the above value is less than 850, we have to try with value less than 12 per cent. Let us try with

kd =10 per cent
= 80 (PVIFA 10 per cent, 9) + 1,000 (PVIF 10 per cent, 9) = 80
x 5.759 + 1.000 * 0.424 = 884.72

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

(884.72-850) / (884.72-787.24)
34.72 / 97.48 = 10%.+
.71=10.71%
Therefore, the yield to maturity is 10.71%

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For two bonds X and Y having face value of Rs. 1.000, coupon rate of 10 per cent each, years to maturity is three and six years respectively.

Market value of bond X at YTM of 10 per cent is
100 PVIFA (10 per cent, 3) + 1.000 PVIF (10 per cent, 3) = 1,000

Market Value of Bond Y at YTM of 10 per cent is
100 PVIFA (10 per cent, 6) + 1,000 PVIF (10 per cent, 6) = 1,000

Now market value of bond X at YTM of 11 per cent is
100 PVIFA (11 per cent, 3) + 1,000 PVIF (11 per cent, 3) = 975

And Market Value of Bond Y at YTM of 11 per cent is
100 PVIFA (11 per cent, 6) + 1,000 PVIF (11 per cent, 6) = 958

Change in price for X on increasing YTM by 1 per cent is (1,000 - 975)/l,000 = 2.5 per cent
Change in price for Y on increasing YTM by 1 per cent is (1,000 - 958)/1,000 = 4.2 per cent

Thus, longer-term bond is more sensitive to interest rate change than short-term bond.

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Consider a bond having a face value of Rs. 1,000 with a coupon rate of 10 per cent and maturity period of five years. Let the YTM be 10 per cent. Market price of the bond will be equal to Rs. 1,000.

A 1 per cent increase in YTM to 11 per cent changes price to Rs. 963.04 (100 PVIFA 11 per cent, 5 + 1000 PBV1F 11 per cent, 5), a decrease of 3.7 per cent.

A decrease of 1 per cent YTM to 9 per cent changes the price to Rs. 1,039 (100 PVIFA 9 per cent, 5 + 1,000 PVIF 9 per cent, 5) an increase of 3.9 per cent.

Thus, an increase in bond's yield caused a price decrease that is smaller than the price increase caused by an equal size decrease in yield.

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A bond of face value of Rs. 1,000 par value X bond with a coupon rate of 12 per cent maturity period of six years and YTM of 10 per cent. The market value of the bond will be Rs. 1,087.

Consider another identical bond Y but with differing YTM of 20 per cent. The market value of this bond will be Rs. 734.

If the YTM increase by 20 per cent, i.e. YTM of bond X rises to 12 per cent (10 x 1.2) and bond Y rises to 24 per cent (i.e., 20 x 1.2) then the market value of both bonds will change to:

Bond ABC: 120 PVIFA (12 per cent, 6) + 1,000 PVIF (12 per cent. 6) = Rs. 1,000
Bond XYZ: 120 PVIFA (24 per cent, 6) + 1,000 PVIF (24 per cent, 6) = 638

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Market value of ABC bond with a lower YTM decreased by 8 per cent whereas in case of XYZ bond with an higher YTM the decrease is 13 per cent.

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Theorems for Bond Valuation

- When the required Rate of Return is equal to the coupon rate, the value of the Bond is equal to its par value.
- When the required rate of return (Kd) is greater than the coupon rate, the value of the bond is less than its par value.
- When the required rate of return is less than the coupon rate, the value of the bond is greater than its par value etc.,
- Effect of change in market interest rate
- Effect of maturity period
- Bond price is inversely related to YTM
- Interest rate elasticity= %age change in price/%age change in YTM .This is always negative as both move in opposite direction.

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Capital Budgeting Techniques

- Used to choose between various projects.
- A capital project involves capital outflow(investment) and capital inflows(net profit) over the life of the project.
- PV of all cash inflows will be +ve and PV of all cash outflows will be negative.PV will depend on the discount rate(cost of capital)
- Summation of all the PVs of cash inflows and outflows is called Net Present Value(NPV)
- IRR is that discount rate at which NPV of a project is zero.
- Other method used for capital budgeting is pay back period method.

Decision Making – to acquire or not to acquire the capital goods.

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Depreciation Accounting

Depreciation is a method of allocating the cost of a tangible asset over its useful life. Businesses depreciate long-term assets for both tax and accounting purposes. It is a decrease in an asset's value caused by unfavorable market conditions. a decrease in an asset's value, may be caused by a number of other factors as well such as unfavorable market conditions, etc. Machinery, equipment, currency are some examples of assets that are likely to depreciate over a specific period of time.

Depreciation – Different Methods

- Straight line method;(cost-residual value)/ estimated useful life
- Written Down Value method or declining balance method : %age is fixed
- Accelerated Depreciation
- Sum of years' digits method; Example, if an asset is to be depreciated over five years, add digits 5,4,3,2,1 .The total is 15.For the 1st year depreciation is 5/15,for 2nd year,4/15 , and so on

Need for depreciation

- To know correct profit
- Show correct financial position
- Make provision for replacement of assets

Factors of depreciation

- Cost of asset
- Residual value
- Life of an asset

AS-6 deals with Depreciation Accounting

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Module- B

Unit – 6 : Definition, Scope and Accounting Standards

Accounting is often called the language of business. Book-keeping and Accounting not one and the same – Book-keeping means recording the business Transactions. Accountancy means compilation of accounts in such a way that one is in a position to know the state of affairs of the business.

- Accounting is language of business.
- Communicate the result of business operations and its other aspects.

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- Accounting is an art of recording classifying and summarizing in a significant manner and in terms of money transactions and events which are in part at least of financial character and interpreting the results thereof.

Definition & scope of book-keeping

- Book keeping is merely recording the business transactions in books and ledgers
- Accountancy is wider concept: compilation of accounts in such a way that one is in a position to understand state of affairs of business.
- Users of financial statements are income tax department, S.T. department, shareholders, investors, banks and FIs and so on.
- It is in the interest of all that financial statements reflect true and fair view of state of affiairs of a business entity.

Accountancy involves:

- Systematic classification of business transactions in terms of money and financial character.
- Summarizing : trial balance and b/s
- Interpreting the financial transactions.

Financial Statements:

- Manufacturing Accounting.
- Trading Account
- Profit & Loss Account
- Balance Sheet
- Funds Flow (Changes in Financial Position)
- Cash Flow Statement

Purpose of accountancy

- To keep a systematic record
- To ascertain the results of operations
- To ascertain financial position of business.
- To facilitate rational decision making
- To satisfy requirement of law and useful in many respects.

Basic objective of Accountancy- to provide information to various users.

Income Tax Authorities
Sales Tax Authorities
Share holders
Investors
Business Associates
Directors
Banks for lending purpose

Purpose:

- To know the Profit & Loss
- To know the Financial position & Liabilities position
- To interpret the Financial Position

Objectives:

- To keep a systematic record
- To ascertain the results of the operations
- To ascertain the financial position of business
- To facilitate rational decision-making
- To satisfy the requirements of law

Advantages:

- For Economic Decisions
- To provide information to Investors
- To compare the financial position

Types of Accounting:

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

Concepts of Accountancy

Cost Concept:

- Business transactions are recorded in books at cost price.
- Fixed assets are kept at cost of purchase and not at their market price.
- Every transaction is recorded with present value and not any future value.
- Unrealized gains are ignored.
- Cost of an asset that has long but limited life is systematically reduced by a process called depreciation. But such depreciation has no relation to market value of asset.

Money Measurement Concept:

- Every transaction is measured in terms of money. Viz production/sales/wages etc all converted to money.
- Inflation or deflation not included in value of any asset.

Business Entity Concept

- This concept separates the entity of proprietor from the business transaction.
- Capital contributed by the owner is liability for business because business is different from owner.

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- Any money withdrawn by prop. Is drawings.
- Profit is liability and loss is an asset.
- All entries are kept from the point of view of business and not from owner.
- An enterprise is economic unit separate from owner.

Realisation Concept

- This concept tells us when revenue is treated as realised or earned. It is treated as realized on the date when property in goods passes to buyer and he becomes legally liable to pay.
- No future income is considered.
- Goods sold on approval will be included in sales but on cost only.

Going Concern Concept

- Business is a going concern and transactions are recorded accordingly.
- If an expense is incurred and utility is consumed during the year, then it is treated as an expense otherwise it is recorded as an asset.
- Reserves and provisions are created for any future liability.
- Deferred revenue expenditure is written off over number of years.
- Why loss is shown under assets side ?

Dual Aspect Concept

- Every transaction has double effect.
- Accounting equation: assets= cap+ liability.

Accounting Period Concept

- Business will run through long period. Hence accounts of each period is recorded.
- Results of operations can be known precisely only after business ceases to operate and entire assets are sold and entire liabilities paid.
- But one is interested in knowing periodically operating results of business say yearly or half yearly or quarterly.
- Hence all the expenses or income during this accounting period has to be taken into consideration irrespective of whether they are realised in cash or paid in cash.

Accounting for full disclosure

- Disclosure of material facts.(material and immaterial fact is matter of judgment)
- Contingent liability
- Market value of investments.

Convention or Principles of Conservatism

- All possible losses to be taken into consideration and anticipated profits to be ignored.
- Creation of provision for doubtful debts.
- Value of stock
- Convention of consistency: method of depreciation.

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Double Entry System

- Scientific system:
- Every transaction has two aspects.
- Crux of accountancy is to find out which two accounts are effected and which is to be debited and which is to be credited.

Journal

- Journal records each and every record.
- But to find out a transaction effecting a person, expenses account or asset one has to turnover all pages of journal .
- Hence transactions are posted from journal to particular pages of ledger.
- Hence journal contain a column L.F

Cash Book

- Cash book keeps records of all cash transactions i.e cash receipts and cash payments. All receipts are recorded on right side and all payments on left side.
- Cash book is book of original entry.

Record keeping basis

- Recording: journalising as and when transaction takes place. Journal is book of original or first entry.
- Classifying: all entries in journal or subsidiary books are posted to ledger account (posting) to find out at a glance the total effect of all such transactions. Ledger is book of secondary entry.
- Summarising: last stage is to prepare the trial balance and final accounts with a view to ascertain the profit or loss during particular period.
- It is customary to use to and by while posting ledger.
- Balancing an account means equalizing two sides.
- If debit side of account exceed credit side, difference is put on credit side and it is said to have debit balance and vice versa..

Adjusting and closing entries

- While preparing trading and profit and loss account all expenses and income for the full period are to be taken into consideration. If expenses have been incurred but not paid during that period , liabilities for unpaid amount should be created before the accounts can be said to show the actual profit and loss. All expenses and income should properly be adjusted through accounting entries.
- Trial balance is prepared from the books of accounts of organization. Final accounts are the final process of accounting. Once the trial balance is prepared the books are half way closed.
- Now all adjusting entries passed at the time of preparing the final accounts have dual effect i.e both debit and credit.
- Hence all adjusting entries passed after Trial balance drawn will have two effects.
- One in either trading and profit and loss account and other in Balance sheet or one in trading account and other in Profit and loss account.

Some examples:

- Closing stock adjustment: Will be shown in asset side of balance sheet and will be shown in credit side of trading account.
- Goods lost by fire: Will be shown in credit side of trading account. Will be shown on debit side of profit and loss account.
- Outstanding expenses: Will be shown in debit side of profit and loss account. Will be shown in liabilities side of balance sheet.
- Prepaid expenses: Prepaid expenses shown in Asset side (Dr Pre paid expenses) and Credit P&L Expenditure as they do not pertain to current year.
- Depreciation: It is fall in value of asset due to use or passage of time. Depreciation Dr. To asset account

Accounting standards:

- Institute of chartered accountants of India recognising the need to harmonise the diverse accounting policies and practices constituted an accounting standards board in the year 1977.
- ASB formulate accounting standards so that council of ICAI may mandate such standards.

Day book and GLB posting in a bank

- The general ledger balance is virtually trial balance of the bank on a particular day. It reflect the balances of all accounts. While preparing balance sheet and profit and loss account of branch of bank the GLB balances are taken.
- Balance sheet of all branches together when consolidated becomes the balance sheet of bank.

Generally accepted accounting principles

- The common set of accounting principles, standards and procedures that companies use to compile their financial statements. GAAP are a combination of authoritative standards (set by policy boards) and simply the commonly accepted ways of recording and reporting accounting information.
- GAAP are imposed on companies so that investors have a minimum level of consistency in the financial statements they use when analyzing companies for investment purposes. GAAP cover such things as revenue recognition, balance sheet item classification. Companies are expected to follow GAAP rules when reporting their financial data via financial statements.

That said, keep in mind that GAAP is only a set of standards. What is important that its underlying objectives are followed in true perspective.

Some of the important Accounting Standards are :

- AS-1 - Disclosure of Accounting Policies
- AS-2 - Valuation of Inventories
- AS-3 - Cash Flow Statements
- AS-4 - Contingencies and events occurring after balance sheet
- AS- 5 - Changes in Accounting Policies
- AS-6 - Depreciation Accounting etc.

Unit - 7 : Basic Accountancy procedures

At the recording stage:

- Business entity concept
- Money measurement concept
- Objective evidence concept
- Historical record concept
- Cost concept
- Dual aspect concept

At the reporting:

- Going Concern concept
- Accounting period concept
- Matching concept
- Conservatism concept
- Full disclosure concept
- Materiality concept

Main conventions of Accounting

- Accounting of full disclosure
- Convention of Materiality
- Convention of Conservatism
- Convention of Consistency

Two systems of keeping records

- Single entry system
- Double entry system

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Unit - 8 : Maintenance of Cash/Subsidiary Books and Ledger

Journal / Subsidiary Books and Ledger

Recording keeping Basics

- Recording
- Classifying
- Summarizing

Classification of Accounts

- Personal Accounts
- Impersonal Accounts
  - Real Accounts
    - Tangible
    - Intangible
  - Nominal Accounts
    - Interest, Rent, Carriage, Commission, Insurance
    - Salaries, Discount and wages etc

Unit - 9 : Bank Reconciliation statement

Bank Reconciliation statement

- Bank reconciliation(B. R.) is based on the principle of double entry.
- Credit the giver and debit the receiver
- B. R. Shows causes of differences between cash book and pass book balance
- Debit balance as per cash book is credit balance as per pass book = positive balance
- Credit balance in cash book is debit balance in pass book = negative balance/overdraft

Causes of differences

- Cheque issued but not presented for payment
- Cheque deposited but not yet realized
- Bank charges
- Interest on saving bank
- Int. on overdraft
- Amount directly collected by bank
- Amount directly paid by bank on Std. Instructions
- Dishonor of a Cheque
- Direct payment into bank by customer
- errors

Unit - 10 : Trial balance, Rectification of Errors and Adjusting & Closing Entries

Trial balance

A Trial Balance is a list of accounts and their current balances at a given date. It is usually prepared on the last day of the accounting period and the list of account balances are arranged according to debit and credit balances.

Before preparing financial statements at the end of a period, the books must be balanced, i.e. to determine total debits equal total credits. This is determined by preparing a trial balance.

Debit balances are listed in one column and credit balances are listed in another. The two column totals should be equal. When this occurs, the ledger is said to be in balance.

Preparing a trial balance for a company serves to detect any mathematical errors that have occurred in the double-entry accounting system. Provided the total debts equal the total credits, the trial balance is considered to be balanced, and there should be no mathematical errors in the ledgers.

A trial balance is prepared for two reasons -

- To check the arithmetic accuracy, i.e. The debit totals and the credit totals should be equal if the double- entry system of book-keeping is followed.

- To write up the financial statements, i.e. Trading and Profit & Loss Accounts, and Balance Sheet.

Types of Errors

Keeping in view the nature of errors, all the errors can be classified into the following four categories:

- **Errors of Commission :** These are the errors which are committed due to wrong posting of transactions, wrong totalling or wrong balancing of the accounts, wrong casting of the subsidiary books, or wrong recording of amount in the books of original entry, etc. For example: Raj Hans Traders paid Rs. 25,000 to Preetpal Traders (a supplier of goods). This transaction was correctly recorded in the cashbook. But while posting to the ledger, Preetpal's account was debited with Rs. 2,500 only.
- **Errors of Omission :** The errors of omission may be committed at the time of recording the transaction in the books of original entry or while posting to the ledger. These can be of two types: (i) error of complete omission (ii) error of partial omission When a transaction is completely omitted from recording in the books of original record, it is an error of complete omission. For example, credit sales to Mohan Rs. 10,000, not entered in the sales book. When the recording of transaction is partly omitted from the books, it is an error of partial omission. If in the above example, credit sales had been duly recorded in the sales book but the posting from sales book to Mohan's account has not been made, it would be an error of partial omission.

- **Errors of Principle :** Accounting entries are recorded as per the generally accepted accounting principles. If any of these principles are violated or ignored, errors resulting from such violation are known as errors of principle. For example, amount spent on additions to the buildings should be treated as capital expenditure and must be debited to the asset account. Instead, if this amount is debited to maintenance and repairs account, it has been treated as a revenue expense.
- **Compensating Errors :** When two or more errors are committed in such a way that the net effect of these errors on the debits and credits of accounts is nil, such errors are called compensating errors. For example, if purchases book has been overcast by Rs. 10,000 resulting in excess debit of Rs. 10,000 in purchases account and sales returns book is undercast by Rs. 10,000 resulting in short debit to sales returns account is a case of two errors compensating each other's effect.

Rectification of Errors

Errors can be classified into two categories for the purpose of rectification of errors-

Rectification of Errors which do not Affect the Trial Balance

The following errors do not affect the equality of the Trial Balance totals:

Errors of Omission: A transaction is omitted completely from the books so that there is no debit and credit entry of the transaction, e.g. Drawings of Rs. 5000 cash by the proprietor was not recorded.

Errors of Commission: An entry is posted to the correct side of the ledger but to the wrong account, i.e. items have been posted to the wrong account of the same class, e.g. Payment of Rs. 1000 cash by a customer A. John was wrongly posted to the account of another customer, B. Johan.

Errors of Principle: An entry is made in the wrong class of account, i.e. when an expense is treated as an asset and vice versa, e.g. Repairs to building Rs. 4000 was debited to the Building Account.

Complete Reversal of Entries: An account that should be debited is credited and vice versa, e.g. A cheque Rs. 2000 received from Sunita was debited to the account of Sunita and credited to the Bank Account.

Compensating Errors: Errors (or error) on one side of the ledger are compensated by an error (or errors), e.g. The Purchases Account and Sales Account were both overcast by Rs. 1500.

Errors of Original Entry: The original figure may be incorrectly entered although the correct double-entry principle has been observed using this incorrect figure, e.g. Credit sales of Rs. 9650 to Ranjit was recorded in the Sales Account and Ranjit's account as Rs. 6950.

Rectification of Errors which Affect the Trial Balance

Errors which are revealed by the Trial Balance are those errors which cause the Trial Balance totals to be in disagreement.

Errors in Calculation: If there is any miscalculation of the Trial Balance totals or the net account balances, the Trial Balance will not balance, e.g. There was an error in the calculation of the cash balance, causing the Trial Balance totals not to balance too.

Errors in Omission of One Entry: Omission of either the debit or credit entry of a transaction will cause the totals of the Trial Balance not to agree, e.g. A cheque Rs. 5000 received for commission was debited to the Bank Account only.

Posting to the Wrong Side of An Account: Entry into the wrong side of an account will cause one side of the ledger to be more than the other, e.g. A cheque of Rs. 8000 paid to creditor, K. Raj was credited instead of debited to his account.

Errors in Amount: If the debit entry of a transaction differs in amount with the credit entry, the Trial Balance will not balance, e.g. Cash Rs. 9650 received from Anand was debited to the Cash Account as Rs. 9650 and credited to the account of Anand as Rs. 6950.

Summary

- An account has a debit balance when its debit total exceeds its credit total.
- An account has a credit balance when its credit total exceeds its debit total.
- Asset, expenses and drawings accounts have debit balances.
- Liability, capital and revenue accounts have credit balances.
- A Trial Balance is a list of debit and credit balances extracted from the accounts in the ledger at a particular date.
- The Trial Balance is prepared for the purpose of checking the arithmetical accuracy of the entries made in the ledger.
- The total debit balances will equal the total credit balances in the Trial Balance if the double-entry principles of recording have been strictly adhered to.
- Errors that effect the agreement of the Trial Balance totals are wrong calculation of balances, omission of either a debit or credit entry of a transaction, entry on the wrong side of an account, and errors in amount.
- Errors that do not affect the agreement of the Trial Balance totals are complete omission of entries of a transaction, errors of commission, errors in principle, compensating errors, and errors in original entry.
- Asset and liability accounts are balanced and their balances brought down to the next accounting period.

- Personal accounts record transactions with persons who have dealings with the business, e.g. debtors and creditors accounts.

Adjusting Entries

Some common adjustments are:

- Closing Stock
- Expenses due but not paid (Outstanding expenses)
- Expenses paid in advance (Prepaid expenses)
- Incomes due but not received (Accrued incomes)
- Incomes not due but received (Unearned incomes)
- Depreciation on assets
- Interest on Capital
- Interest on Drawings
- Interest on Loan
- Bad debts to be written off
- Provision for bad debts
- Provision for discount on Debtors
- Provision for discount on creditors
- Losses on account of accidents
- Commission payable on profit
- Goods used by the proprietor
- Goods distributed as Free Samples

Closing Entries

Closing consolidated journal entries are normally passed for

- Transfer of all manufacturing and purchase expense to the debit side of trading a/c
- Transfer of Purchases and Sales return to the debit side of Trading a/c
- Transfer of Sales and Purchases return to the credit side of Trading a/c
- Transfer of closing stock to the credit of trading account by an adjustment entry
- Transfer of Gross profit to the credit side of Profit & Loss a/c
- Transfer of Gross loss to the debit side of Profit & Loss a/c
- Transfer of all administrative, selling and financial expenses to the debit of P & L A/c
- Transfer of all operational and non-operational incomes to the credit of P & L A/c
- Transfer of Net profit to the credit of Capital a/c
- Transfer of net loss to the debit of Capital a/c

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Unit - 11 : Capital and Revenue Expenditure

A **capital expenditure** is an amount spent to acquire or improve a long-term asset such as equipment or buildings. Usually the cost is recorded in an account classified as Property, Plant and Equipment. The cost (except for the cost of land) will then be charged to depreciation expense over the useful life of the asset.

A **revenue expenditure** is an amount that is expensed immediately—thereby being matched with revenues of the current accounting period. Routine repairs are revenue expenditures because they are charged directly to an account such as Repairs and Maintenance Expense. Even significant repairs that do not extend the life of the asset or do not improve the asset (the repairs merely return the asset back to its previous condition) are revenue expenditures.

Difference between Capital and Revenue Expenditure

CAPITAL	REVENUE
Large amount	Relatively small
Improve or enhance earning capacity	Maintain asset
Long duration benefit	Short duration
Non- recurring	Recurring
Balance sheet item	Trading /P & L A/c item

Capital and Revenue Expenditure : Examples

1. Cost of replacement of defective parts of the machinery is ……
   a. Capital expenditure
   b. Revenue expenditure
   c. Deferred revenue expenditure
2. Loss of goods due to fire Rs.8000 is a revenue expenditure because……
   a. It is recurring
   b. Amount involved is small
   c. Loss is arising out of business operations
3. Preliminary expenses , discount allowed on issue of shares are the examples of
   a. Capital expenditure
   b. Deferred revenue expenditure
   c. Revenue expenditure
4. Expenditure incurred in acquiring the patents rights for the business is an example of ----
   a. Capital expenditure
   b. Deferred revenue expenditure
   c. Revenue expenditure

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Unit - 12 : Bills of Exchange

A written, unconditional order by one party (the drawer) to another (the drawee) to pay a certain sum, either immediately (a sight bill) or on a fixed date (a term bill), for payment of goods and/or services received. The drawee accepts the bill by signing it, thus converting it into a post-dated check and a binding contract. It is also called as "Draft".

Promissory Note

A financial instrument that contains a written promise by one party to pay another party a definite sum of money either on demand or at a specified future date. A promissory note typically contains all the terms pertaining to the indebtedness by the issuer or maker to the note's payee, such as the amount, interest rate, maturity date, date and place of issuance, and issuer's signature. Promissory notes that are unconditional and saleable become negotiable instruments that are extensively used in business transactions in numerous countries.

A promissory note is usually held by the payee. Once the debt has been discharged, it must be canceled by the payee and returned to the issuer.

Difference between Bill of Exchange and Promissory Note

Bill of Exchange	Promissory Note
Unconditional order	Unconditional promise
Made by creditor	Made by debtor
Acceptance by debtor must	No acceptance as such
Three parties to a bill	Two parties to a bill
On dishonor, noting is necessary by notary public	Noting is not necessary

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Unit - 13 : Balance Sheet Equation

Always the total claims (those of outsiders such as creditors and of the proprietors, i.e. net worth) will equal the total assets of the business.

We can express the same as:

Assets = Equities (total claims)
or Assets = Liabilities + Capital
or Liabilities = Assets - Capital
or Capital = Assets – Liabilities

Computation of Balance Sheet Equation
If there is any change in the amount of the assets or the liabilities, the owners' claim or the capital is bound to change correspondingly. If assets increase and liabilities do not, the capital will increase; a reduction in the amount of assets or an increase in the amount of liabilities will mean a reduction in the amount of capital.

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).

Assets: 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.

Revenue: It means the amount which, as a result of operations, is received by the business.

Expense: It is the amount spent in order to produce and sell the goods and services which produce the revenue.

Income: The difference between revenue and expense is called income (if revenue is more than expense).

Debtor: A person who owes money to the firm, mostly on account of credit sales of goods, is called a debtor.

Creditor: A person to whom money is owed by the firm is called a creditor.

Unit - 14 : Preparation of Final Accounts

Trial Balance

The Trial Balance is a statement of ledger account balances as on a particular instance.

The trial balance is prepared to check/ensure the arithmetical accuracy of accounting. Preparation of Trial Balance is not an act that forms a part of the activities involved in the regular accounting cycle. Final Accounting can be completed without the preparation of the Trial Balance also.

The trial balance is generally prepared at a time when all the ledger accounts are balanced like at the end of the accounting period. Theoretically, the trial balance can be prepared as and when needed. In this mechanised (computerised) accounting systems, trial balance is a statement that can be automatically derived as and when needed.

Adjustment Entries

There might be a number of accounting transactions which might not have been taken into consideration by the time the Trial Balance has been prepared. Some of the reasons for the presence of such transactions are

• Transactions which do not occur in the normal course of business

There are a number of transactions relating to the business which do not occur in the normal course of business. These transactions unless deliberately recorded do not get into the books of accounts.

Examples for such transactions

Stock taken away by the proprietor for personal use
Abnormal loss of stock

• Transactions which have to be recorded only towards the end

There are a number of transactions relating to the business which have to be recorded only at the end of the accounting period. If the trial balance has been prepared before all such transactions into consideration have been taken into consideration, then they stay unrecorded in the books of accounts.

Depreciation on Assets
Expenses - Outstanding/Prepaid
Incomes - Outstanding/Pre-received

• Transactions relating to Error Rectifications

The agreement of a Trial Balance is not a conclusive proof of absence of errors in accounting. Even in case where the trial balance agrees, there may still be errors existing in the books of accounts. These errors if identified subsequent to the preparation of the Trial Balance, need to be rectified which needs journal entries to be passed for rectification.

The transactions which have not yet been journalised, appended to the trial balance are what we call adjustments. Thus we can say that Adjustments are transactions relating to the business which have not been journalised by the end of the accounting period.

Since adjustments are also transactions relating to the business, we need to bring them into the accounting books by journalising them.

Accounting for the Transactions

Recording the transactions represented by adjustments normally would result in the existing balance in the affected ledger accounts to either increase or decrease.

» Transaction
Wages to the extent of Rs. 43,000 are incorrectly recorded as Salaries.
This represents an error of principle whereby an expenditure that was to be debited in a particular account has been debited to another account.

To bring the effect of this transaction into books, the journal entry to rectify this error has to be recorded.

Effect of the Transaction

The effect of the journal entry to be recorded in the above case can be analysed as

(−) From Salaries on the debit side of P/L a/c

The Salaries a/c which already has a debit balance is credited which will result in a decrease in the existing debit balance.

To bring the effect of this transaction, the amount involved in the transaction (Rs. 43,000) is deducted from the Salaries a/c balance (Rs. 1,53,000) shown on the debit side of the "Profit & Loss a/c".

(+) To Wages on the debit side of Trading a/c

The Wages a/c which already has a debit balance is debited resulting in an increase in the existing debit balance.

To bring the effect of this transaction, the amount involved in the transaction (Rs. 43,000) is added to the Wages a/c balance (Rs. 18,000) shown on the debit side of the "Trading a/c".

These are the adjustments to be made to bring the affect of the above transaction into the books of accounts.

Trading Account

Trading account is a part of final accounts prepared by a business firm which shows gross profitability of business activities during a particular period. In other words, trading account shows total sales, total purchases and all direct expenses relating to purchase and sales.

Trading account is prepared by manufacturing companies and trading companies only because the sales and purchases of goods are done in these types of business firms only.

Trading Account is like a statement which is divided in two parts i.e. Income part and Expenditure Part.

In income part, we show the following details:-

Sales of goods Less Sales Returns
Closing Stock of goods

In Expenditure part, we show the following accounts:-

Opening stock of goods
Purchases of goods Less Purchase Returns
All direct expenses relating to purchase, sale and manufacturing of goods like Cartage & Freight Expenses, Rent for godown or factory, Electricity and Power expenses, wages of workers and supervisors, Packing expenses etc.

Profit & Loss Account

Profit & Loss Account is part of final accounts, prepared by a business firm to know the net profit of the business activities during a particular period.

Profit and Loss Account is different from Trading Account because Trading account shows only the gross profit while profit and loss account shows net earnings of the business firm. In profit and loss account all indirect expenses and indirect incomes are shown.

Profit and Loss Account is prepared with the help of Trial Balance. Profit and Loss Account is just like Trading Account which is divided in two parts i.e. Income part and Expenditure Part.

In income part, we show the following accounts:-

Gross Profit brought forward.
Indirect Income i.e. interest received, commission received, rent received etc. In other words indirect income means which is not directly related to purchase or sales.

In Expenditure part, we show the following details:-

Gross Loss brought forward
All indirect Expenses i.e. any expenses which arr not related to purchase and sales.

Balance Sheet

Balance Sheet is part of Loss Account final accounts, prepared by a business firm to know its financial position on a particular date for a particular period. Balance sheet shows the total liabilities and total assets of a business firm on a particular date.

Balance Sheet can be prepared on monthly basis or quarterly basis or half yearly basis or yearly basis according to its requirement. For example all the companies registered with stock exchanges furnish monthly details relating to sale, profits, liabilities and assets of listed companies. Therefore these companies have to prepare the Trading account, Profit and Loss Account and balance sheet on monthly basis. But if we talk in general then it is prepared at the end of the financial year.

Balance Sheet is prepared with the help of Trial Balance. Balance sheet is divided in two parts i.e. Liabilities and Assets.

In Liabilities, we show the following details:-

Capital
Secured Loans
Unsecured Loans
Current Liabilities and Provisions
Profit and Loss Account (Balance of Profit)

In Assets, we show the following accounts:-

Fixed Assets
Investments
Current Assets, Loans and Advances
Miscellaneous Expenditure
Profit and Loss Account (Balance of losses)

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Unit - 15 : Ratio Analysis

- Accounting ratios are relationship expressed in mathematical terms between accounting figures which for meaningful purpose.
- Classification: P & L Ratios
- Balance Sheet Ratios
- Composite or Inter-Statement Ratios.

Functional Classification

- Profitability
- Turnover/Activity Ratios
  Financial/Solvency Ratios

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- Financial Ratios may be further classified as Short Term Ratios/Liquidity Ratios or Long Term/ Solvency Ratios

Return on Capital Employed

- EBIT * 100
  Capital Employed
  Earnings before Interest & Tax
- Op. Profit means profit from the Operations of the Company plus Int(Long term) & Tax
- Capital Employed = Share Capital+ Reserves & Surplus+ Long Term loans –(Non- business assets + Fictitious assets)
- Proper calculation gives us Return on Capital Employed

Earnings Per Share (EPS)

EPS = Net Profit after tax & Pref. Dividend
No. of Equity Shares

This shows whether equity Capital of Co. is properly used or not Company's capacity to pay Dividend.

EPS helps us at estimating Market Price of the Company

Price Earning (P/E Ratio)

Market Price of per Equity Share
EPS

Helps to decide whether to buy Share of a Company.

Gross Profit Ratio

Gross Profit* 100
Net Sales

It helps in Price decision & Profit from Op. before Charging all other expenses.

Net Profit Ratio

Net Operating Profit * 100
Net sales

Solvency Ratios

Long Term Solvency Ratios

- Fixed Assets Ratios : Fixed Assets
  Long Term Funds

- The ratio should not be more than one.
- If it is less than one then it indicates part of the Working Capital Financed through Long term Funds i.e. we may call Core Working Capital

Debt- Equity Ratio

- i) DE Ratio : $\frac{\text{Total Long Term Debt}}{\text{Total Long Term Funds}}$
- Ii) DE Ratio : $\frac{\text{Total Long Term Debt}}{\text{Shareholders Funds}}$
- Debt Service Coverage Ratio= $\frac{\text{Cash Profit available for debt service}}{\text{Interest+ Instalment}}$

Short Term Solvency Ratio

i) Current Ratio = $\frac{\text{Current Assets}}{\text{Current Liabilities}}$

Ideal ratio: 2

Acceptable to Bank 1.33

ii) Liquidity Ratio/Acid Test or Quick Ratio:

$\frac{\text{Liquid Assets}}{\text{Current Liability}}$

Turnover Ratios

Stock Turnover Ratio =

$\frac{\text{Cost of goods Sold during the year}}{\text{Average Inventory}}$

Debtors Turn over Ratios (Debtors Velocity) =

$\frac{\text{Credit Sales}}{\text{Average Accounts Receivable}}$

Debtors Collection Period =

$\frac{\text{Months or days in a year}}{\text{Debtors turnover}}$ or

$\frac{\text{Accounts receivable}}{\text{Average Monthly or daily Credit sales}}$

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Fixed Assets Turnover Ratio =

$$\frac{\text{Cost of Goods Sold}}{\text{Net Fixed Assets}}$$

Calculate the following ratios for YE March2014 & 2015

a) Return on Capital Employed
b) Current Ratio
c) Debt Equity Ratio
d) Fixed Assets Turnover Ratio
e) Inventory Turnover Ratio
f) Earning Per Share

Balance Sheets as at 31st March Rs. Lakhs

Liabilities	2013	2014	2015
Sh. Capital:Shares of Rs.10 each	800	1000	1000
Reserves & surplus	700	800	1000
Secured Term Loans	800	2000	2400
Cash Credits from bank	800	1000	1500
Sundry Creditors	1200	900	1100
	4300	5700	7000

Balance Sheets as at 31st March Rs. Lakhs

Liabilities	2013	2014	2015
Fixed Assets: Gross Block	2800	3000	4000
Less : Dep	920	1400	2000
Net Block	1880	1600	2000
Current Assets: Stock	1520	2400	2800
Debtors	480	500	900
Other Current Assets	420	1200	1300
	2420	4100	5000
Total Assets	4300	5700	7000

$$\frac{\text{EBIT}}{\text{Capital Employed}} * 100$$

EBIT=Earnings before Interest & Tax

Ret. On Cap. Emp= Total Cap. Employed for March,2013 is Rs. 2300+Rs. 3800 for Mar,2014.So Av. Cap. Employed is Rs.6100 /2= 3050 lakhs. EBIT is Rs.1020. So ROCE $\frac{1020}{3050}$*100= 33.34%

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ROCE for March,2015

Total Cap. Employed for March,2014 is Rs. 3800+Rs. 4400 for Mar,2015.So Av. Cap. Employed is Rs.8200 /2= 4100 lakhs. EBIT is Rs.1800. So ROCE is $\frac{1800}{4100}$*100= 43.90%

Current Ratio = $\frac{\text{Current Assets}}{\text{Current Liabilities}}$

2014	2015
$\frac{4100}{1900}$ =2.16	$\frac{5000}{2600}$ =1.92

Debt Equity Ratio = $\frac{\text{Total Long Term Debt}}{\text{Total Long Term Funds}}$

2014	2015
$\frac{2000}{1800}$ = 1.11	$\frac{2400}{2000}$ = 1.2

Fixed Assets Turnover Ratio =

$\frac{\text{Cost of goods Sold during the year}}{\text{Average Net Fixed Assets}}$

We may take sales when Cost of goods figures are not available

$\frac{4800}{1740}$ =2.76 $\frac{7200}{1800}$ =4

Average Fixed Assets for March,2009 = 1880+1600=3480/2=1740

Average Fixed Assets for March,2010 = 1600+2000=3600/2=1800

Stock Turnover Ratio =

$\frac{\text{Cost of goods Sold during the year}}{\text{Average Inventory}}$

We may take sales when Cost of goods figures are not available

Sales / Av Inv.	$\frac{4800}{490}$ =9.8	$\frac{7200}{700}$ = 10.29

EPS = $\frac{\text{Net Profit after tax \& Pref. Dividend}}{\text{No. of Equity Shares}}$

Net Profit after Tax for 2009 = Rs.300 Lakhs = Rs.3 =EPS

While no. of Eq. shares are 100 Lakhs

Net Profit after Tax for 2010 = Rs.600 Lakhs = Rs. 6 =EPS
While no. of Eq. shares are 100 Lakhs

Unit - 16 : Final Accounts of Banking Companies

Requirements –Accounts & audit

- Third Schedule annexed to BRA
- Form A- Balance sheet
- Form B- Profit & Loss Account
- Audit
- Submission of accounts- RBI- within 3 months
- Publication of accounts- within 6 months
- Auditor-prior approval of RBI for appt/removal

Balance sheet-Form A

Capital & Liabilities	**Assets**
1.Capital	6.Cash & Bank Bal. RBI
2. Reserves & surplus	7.Balances with Banks & Money at call and SN
3.Deposits	8.Investments
4.Borrowings	9Advances
5 Other Liabilities & Provisions	10.Fixed Assets
	11.Other Assets

Demand deposits

- Credit balances in OD and CC
- Deposits payable at call

- Overdue deposits
- In-operative current accounts
- Matured time deposits
- Matured cash certificates
- Matured certificate of deposits

Contingent liabilities

Schedule-12

- Claims against bank not acknowledged as debts
- Liability for partly paid shares
- Liability on account of outstanding forward exchange contracts
- Acceptances ,endorsement & other obligations
- Other items for which bank is contingently liable.

PROFIT & LOSS ACCOUNT-FORM B

Income Interest Earned Other Income	Schedule.13 Schedule.14
Expenditure Interest Expended Operating Expenses Provision for contingencies	Schedule.15 Schedule.16
Profit /Loss	
Appropriations	
Significant Accounting Policies	Schedule.17
Notes forming part of Accounts	Schedule.18

Other Income

- Profit on exchange transactions
- Profit on sale of investments

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

Just go through these 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 ETC

- 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

Held to maturity	Available for sale	Held for trading
Investment should not exceed	Freedom available	Freedom available

25% of total investment		
-no marked to market. Profit on sale treated as cap. Reserve	-Marked to market -profit on sale of investment.taken to P&L a/c	Marked to market To be sold within 90 days

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Unit – 17 & 18 : Company Accounts

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

Types of companies

On the basis of incorporation	On the basis of ownership	On the basis of liability
Chartered company	Private company	Co.limited by shares
Statutory company	Public company	Co. Ltd. by guarantee
Registered company	Government company	Co. with unlimited liability
Foreign company	Holding company	

SHARE CAPITAL

- EQUITY
- PREFERENCE
  - CUMULATIVE

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- REDEEMABLE
- PARTICIPATING

- AUTHORISED CAPITAL
- ISSUED CAPITAL
- SUBSCRIBED CAPITAL
- CALLED CAPITAL
- PAID UP CAPITAL

ISSUE OF SHARE AT PAR

-BANK - SHARE APPLICATION	Debited -	- credited
SHARE APPLICATION SHARE CAPITAL	Debited -	- Credited
Over subscription -share application -share capital -bank (refund) -share allotment	Debited - - -	- Credited Credited Credited

SHARE ALLOTMENT/SHARE CALL

Share allotment a/c Share capital a/c	Debited -	- Credited
Bank a/c Share allotment a/c	Debited -	- Credited
Share call a/c Share capital a/c	Debited -	- Credited
Bank a/c Share call a/c	Debited -	- Credited
Calls in arrears a/c Share allotment a/c Share call a/c	Debited - -	- Credited Credited

Issue of shares at premium

Share application/ allotment a/c Share capital A/c Share premium A/c	Debited - -	- Credited Credited

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Issue of shares at discount

Share allotment A/c Discount on issue of shares A/c Share capital A/c	Debited Debited -	- - Credited

Forfeiture of shares

Share capital A/c Call in arrears A/c Forfeited shares A/c	Debited - -	- Credited Credited

Re-issue of shares

Bank A/c Forfeited shares A/c Share capital A/c Capital reserve A/c	Debited Debited - -	- - Credited Credited

Issue of Bonus shares

Cap. Red. Reserve A/c Share premium A/c Capital reserve A/c Gen Reserve A/c Profit & Loss A/c Bonus to shareholders A/c	Debited Debited Debited Debited Debited -	- - - - - credited
Bonus to shareholders A/c Equity share capital A/c	Debited	- credited

Balance sheet equation

LIABILITIES		ASSETS	
Capital	300.00	Fixed assets	700.00
Reserves	200.00	Current assets	300.00
Term Loans	300.00		
Current Liabilities	300.00		
Total	1000.00	Total	1000.00

Balance sheet equation

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Assets	=	Liabilities	
Assets	=	Liabilities (+)	Capital
Liabilities	=	Assets (-)	Capital
Capital	=	Assets (-)	Liabilities

Assets = Liabilities

Assets = Capital + Liabilities

Assets =Net worth + Liabilities

Net worth = Capital + Reserves& Surplus

Net worth = Assets Less Liabilities

<u>B/s Equation Example</u>

If the net worth of the business is Rs.1100,fixed assets are Rs. 600, current assets Rs.400, nvestments Rs.300, current liabilities Rs. Nil, what is the amount of claim to outsiders?

a. Rs. 1300l
b. Rs. 500
c. Rs.200
d. Rs. Nil

Ans – c

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Unit - 19 : Accounting in Computarised Environment

Nowadays, many organisations perform their accounting work on computers ignoring the manual method of bookkeeping. Modern accounts are more like computer-keeping rather than bookkeeping.

It is an accounting system is one that performs the following functions:

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

A computer accounting system runs based on a set of instructions called the software programmes developed by a person who is a computer software professional and he is called the programmer. The instructions of the programmer are in a computer language in the form of computer programme(s) and are called the computer software. Accounting software may be written in any of the computer languages such as COBOL, Foxpro, etc., or on an operating platform such as Windows, UNIX, etc.

Digital computers are the kind of computers used in computerised accounting.

The main features of computerised accounting are:

1. Speed
2. Accuracy
3. Various Informative Reports can be Generated
4. Economy
5. A Computerised System may be a Single Stand Alone Unit or a Multiple User, i.e. LAN, WAN, etc.

Differences between manual and computerised systems

1. Data Stored in Computer are not visible and thus, the Trail of Events is Difficult to Establish
2. Accounting Data can be manipulated to Generate Various other Reports/Statements

The advantages of computerised accounting system are:

1. Accurate, High Speed and Low Cost of Operation
2. Availability of Various Reports from the Same Accounting Data
3. Error-free Accounting
4. Automatic Completion of all Records by Feeding Only One Entry into the Computer
5. Multiple Set of Printouts Available

The disadvantages of computerised accounting are:

1. Requirement of Special Programme and Professional
2. Qualified Staff Required for Operations
3. Costly Computer Peripherals and Stationery
4. Regular back-up is Required as Data may be Lost for Various Reasons
5. Computer Viruses

Influence of Computerisation in the functions performed by a bank :

1. Computerised Bank Operations
2. Computerised Accounting
3. Accepting Deposits
4. Lending
5. Remittances
6. Clearing of Cheques
7. Standing Instructions

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8. Centralised Banking
9. Automated Banking

Core Bank Components include :

- Core Bank Financial Institution Infrastructure
- Core Bank Product Build
- Core Bank Customer Management and Customer Overview
- Core Bank Account Administration
- Core Bank Payments
- Core Bank Management Information

Information Systems Security

Information Systems Security provides essential information for managing the security of an organisation 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 covers:

- Access control systems and methodologies
- Computer operations security
- e-mail and internet access
- Application and systems development
- Business continuity and disaster recovery planning
- Telecommunications and network security
- Physical security
- Cryptography
- Security management practices
- Law, investigations, and ethics

Internet:

Internet is the inter-connection between several computers of different types belonging to various networks all over the globe.

World Wide Web (WWW):

WWW is a series of servers that are interconnected through hypertext. Hypertext is a method of presenting information in which certain text is highlighted that, when selected, displays more information on the particular topic. These highlighted items are called hyperlinks and allow the users to navigate from one document to another that may be located on different servers.

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Unit - 20 : Banking Operations

Some basic functions performed by the banks are discussed below.

1. Accepting Deposits

(i) Demand Deposits – withdrawable on demand
(ii) Current Account
(iii) Savings Deposits
(iv) Term Deposits – Received for a fixed period

2. Granting Loans and Advances

(i) Overdraft
(ii) Cash Credit:
(iii) Discounting of Bills
(iv) Loans and Advances

Other Functions are :

a. Remittance of Funds
b. Collection and Payment of Credit Instruments
c. Execution of Standing Orders
d. Purchasing and Sale of Securities
e. Collection of Dividends on Shares
f. Income Tax Consultancy
g. Acting as Trustee and Executor
h. Acting as Representative and Correspondent
i. Locker Facility
j. Traveller's Cheques
k. Letter of Credit
l. Collection of Statistics
m. Underwriting Securities
n. Gift Cheques
o. Acting as Referee
p. Foreign Exchange Business

Banks are also permitted to perform following Para Banking Activities :

a. Mutual Fund Business
b. Money Market Mutual Funds
c. Cheque Writing Facility for Investors of Mutual Funds/Money Market Mutual Funds
d. Primary Dealership Business
e. Underwriting Activities

f. Equipment Leasing, Hire Purchase Business and Factoring Services
g. Investment in Venture Capital Funds
h. Sponsors to Infrastructure Debt Funds
i. Insurance Business
j. Pension Fund Management
k. Referral Services
l. Trading on/Membership of SEBI approved Stock Exchanges
m. Portfolio Management Services

Front Office and Back Office of a Bank

A bank front office is the network of bank branches located in its service area. The standard definition of a front office is all of the departments that interface with the public. As service providers, banks are defined by the effectiveness of their front office operations. A reputation for outstanding customer service can drive sales of financial products and provide a competitive advantage.

The Head Office and Regional/Zonal Offices which do not conduct any banking activities directly with the clients are called Back Offices.

Outsourcing of Services by Banks

'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.

Activities that should not be outsourced

Banks cannot outsource core management functions like corporate planning, organisation, management and control and decision-making functions like determining compliance with KYC norms for opening deposit accounts, according sanction for loans and management of investment portfolio.

The key risks in outsourcing that need to be looked into by the banks are: -

(a) Strategic Risk – The service provider may conduct business on its own behalf, which is inconsistent with the overall strategic goals of the bank
(b) Reputation Risk – Poor service from the service provider, its customer interaction not being consistent with the overall standards of the bank
(c) Compliance Risk – Privacy, consumer and prudential laws not adequately complied with
(d) Operational Risk – Arising due to technology failure, fraud, error, inadequate financial capacity to fulfil obligations and/or provide remedies
(e) Exit Strategy Risk – This could arise from over–reliance on one firm, the loss of relevant skills in the bank itself preventing it from bringing the activity back in-house and contracts entered into wherein speedy exits would be prohibitively expensive
(f) Counterparty Risk – Due to inappropriate underwriting or credit assessments

(g) Country Risk – Due to the political, social or legal climate creating added risk
(h) Contractual risk – arising from whether or not the bank has the ability to enforce the contract
I) Concentration and Systemic Risk – Due to lack of control of individual banks over a service provider, more so when overall banking industry has considerable exposure to one service provider.

Banking Operations Manual

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.

A manual is all you will need to train your people effectively. It is cost effective and the items in it will be easier to monitor for compliance. Using a manual to train the frontline will teach them everything they need to know to sell the products and services offered by your bank.

The manual will also have detailed instructions on how to enter information into the system and if they should forget something they can always count on it to show them how to get back on track. Manuals are great because they are easy to adapt and to amend if needed. A banking manual should include all the policies that are to be adhered to as well as the procedures that are needed to remain in compliance with all the laws, rules and regulations that govern banking institutions.

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Unit - 21 : Operational Aspects of KYC/Customer Service

KYC Norms

The objective of KYC guidelines is to prevent banks from being used, intentionally or unintentionally, by criminal elements for money laundering activities. KYC procedures also enable banks to know/understand their customers and their financial dealings better which in turn help them manage their risks prudently. Banks should frame their KYC policies incorporating the following four key elements:

a. Customer Acceptance Policy
b. Customer Identification Procedures
c. Monitoring of Transactions
d. Risk management

Periodical updation of KYC

KYC is required to be done at least every two years for high risk customers, at least every eight years for medium risk customers and ten years for low risk customers. This exercise would involve all formalities normally taken at the time of opening the account.

If there is no change in status with respect to the identity (change in name, etc.) and/or address, such customers who are categorised as 'low risk' by the banks may now submit a self-certification to that effect at the time of periodic updation.

In case of change of address of such 'low risk' customers, they could merely forward a certified copy of the document (proof of address) by mail/post, etc. Physical presence of such low risk customer is not required at the time of periodic updation.

Recent simplified KYC measures by RBI

Measures taken for simplification:

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

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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 if is categorised as 'low risk' by the banks, then she/he can open a bank account by submitting any one of the following documents:

(a) 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;

(b) letter issued by a gazetted officer, with a duly attested photograph of the person.

6. 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.

Physical Aadhaar card/letter issued by UIDAI containing details of name, address and Aadhaar number received through post would continue to be accepted as an 'Officially Valid Document'.

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:

a. 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.

b. Bank representative manning the CSP enters the number into bank's e-KYC application software.

c. The customer inputs his/her biometrics via a UIDAI compliant biometric reader (e.g. fingerprints on a biometric reader).

d. 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).

e. 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).

f. 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.

g. 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.

h. 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.

i. The customer can open bank account subject to satisfying other account opening requirements.

Customer Service in Banks

Service at the counters

1. Business hours/working hours
2. Display of time norms
3. Commencement/Extension of working hours
4. Identity Badges
5. Complaint Box and Book
6. Booklets/Brochures for Guidance to customers
7. Display of information relating to Interest Rates and Service Charges – Rates at a quick glance
8. Disclosure of Information by banks in the public domain
9. Website
10. Need for Bank Branches / ATMs to be made accessible to persons with disabilities
11. Providing banking facilities to Visually Impaired Persons
12. Facility to sick/old/incapacitated non-pension account holders
13. Extended business hours for non-cash banking transactions

The following non-cash transactions should be undertaken by banks during the extended hours, i.e., up to one hour before the close of working hours:

Non-voucher generating transactions

a. Issue of pass books/statement of accounts
b. Issue of cheque books
c. Delivery of term deposit receipts/drafts
d. Acceptance of share application forms
e. Acceptance of clearing cheques
f. Acceptance of bills for collection

Voucher generating transactions

a. Issue of term deposit receipts
b. Acceptance of cheques for locker rent due
c. Issue of travellers cheques
d. Issue of gift cheques
e. Acceptance of individual cheques for transfer credit

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

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(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:

a. Obtains from member banks an Annual Statement of Compliance (ASC)
b. Visits branches to find out the status of ground-level implementation of Codes
c. Studies complaints received from customers and orders / awards issued by Banking Ombudsmen / Appellate Authority to find out whether there is any system-wide deficiency
d. Organizes an annual Conference with Principal Code Compliance Officers of the Member banks to discuss implementation issues.

BCSBI also

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

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Unit - 22 : Operational Aspects of Accounting Entries

There are two types of transactions in a Bank, Cash and non-cash.

Vouchers

There are two types of vouchers.

1. which evidences only debit or credit to an account
2. which contains both debit and credit to different accounts (composite vouchers)

Normal debit vouchers are :

a. Cheques
b. Withdrawal forms
c. Drafts
d. Dividend/interest warrants
e. Travellers' cheques
f. Letter of authority signed by the customers, containing standing instructions.
g. Debit vouchers prepared by the branch
h. Term Deposit receipt presented for payment

Normal Credit vouchers are :

a. Pay-in-slips
b. Applications for issue of DDs, TDs, BCs, RTGS/NEFT, pay orders
c. Challans for deposits into Central/State Govt Accounts
d. Credit vouchers prepared by the branch

Unit - 23 : Operational Aspects of Cash/Clearing

Cash Replenishment at ATMs

Implementation of CTS

Cheque Truncation System (CTS) - Assures certain common minimum security features in cheques printed, issued and handled by banks and customers uniformly across the banking industry.

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".

All banks providing cheque facility to their customers have been advised to issue only 'CTS-2010' standard cheques. Cheques not complying with CTS-2010 standards will be cleared at less frequent intervals i.e. weekly once from November 1, 2014 onwards.

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Cheque collection policies

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, 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.

Outstation Cheques

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

If cheques/instruments 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.

In CTS, 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

a. Cash and small coin balances must be kept in the strong room in the joint custody.
b. No member of staff other than cashier/teller should receive money over the counter.
c. Strong Room and safe must be under the double lock of the Cashier and Supervising Official.
d. Bulk of Cash balances should always be in the strong room/safe in the joint custody. Cashier Hand balance will be kept as low as possible.

Checking of Cash Balance

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

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

At the close of working day, verify that the "Joint Custody balance" corresponds exactly with the entries in the Cash Balance Book.

Before the safe is closed, the supervising official, Head Cashier and Cashier should check the bundles and verify the same with the Reserve Cash Register.

Shortage or Excess in Cash

a. Any shortage in the cash balance should be recovered on the same day from the Head Cashier/Cashier.
b. 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.
c. Head Cashier/Cashier is responsible for any shortage either in Hand or Vault Balance.
d. Cashiers signed the Denomination Slips will be responsible for any shortage in book of notes.
e. Any excess in the Cash Balance must be credited to Sundry Creditors Account on the same day.

Remittance of Cash

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

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

Clearing Operation

Prerequisites for sending cheques for clearing

a. All the instruments presented through the clearing should bear the "Clearing" stamp with Bank and Branch and date.

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b. Bank crossing stamp with MICR code.
c. Verify the name of the payee and on pay-in-slip which should be one and the same.
d. Verify the amount on the cheque and on pay-in-slip which should be one and the same.
e. Cheques with a/c payee crossing must be collected to the payee a/c only.
f. Send the unpaid Return Cheques through the branch courier to reach the clearing branch before stipulated time.

Follow all the specified instructions for :

a. Inward clearing cheques
b. Outward clearing cheques
c. High Value clearing
d. Electronic Clearing System (ECS)
e. Clearing House Account Reconciliation
f. Balancing of Clearing House Account

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Unit - 24 : Operational Aspects of Deposit Accounts

Current Accounts

Current Account is an account in which there is no limit on the no. of transactions that can be done in a day and are therefore also referred to as Transactional Accounts. These type of accounts are held neither for the purpose of Investment nor for the purpose of Savings but only for the convenience of the business as these accounts are the most liquid type of accounts.

Banks don't pay any interest on the amount lying in these accounts and in some cases also charge a small fee for the services they provide. These types of Bank Accounts are usually opened by businesses as there no. of transactions are on the higher side.

a. Current Accounts (C/As) can be opened by individuals, partnership firms, private and public limited companies, HUFs, societies, trusts, clubs, associations, Govt Departments etc.
b. No interest is payable on credit balances in Current Accounts.
c. The customers may receive the statements of account according to the frequency desired by them.
d. Cheque books are issued to all Current Account holders and all withdrawals should be made only through issue of cheques.
e. 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.

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Main Features of Savings Bank Account

a. There is no restriction on the number and amount of deposits.
b. However, mandatory PAN details are required for doing cash transactions exceeding Rs.50,000.
c. Withdrawals are allowed subject to certain restrictions.
d. The money can be withdrawn either by cheque or withdrawal slip of the respective bank.
e. The rate of interest payable is between 4% to 6% p.a in India.
f. Saving account is of continuing nature. There is no maximum period of holding.
g. A minimum amount has to be kept on saving account to keep it functioning.
h. No loan facility is provided against saving account.
i. Electronic clearing System (ECS)/E-Banking/Net Banking/Mobile Banking facilities are available.

Eligibility to open Savings Bank Accounts

a. Individuals
b. Two or more persons in joint names
c. Associations or clubs if eligible as per RBI guidelines
d. Minor above 10 year
e. A bank should not open more than one SB account for the same person in his individual name
f. If joint accounts, operating instructions and survivorship should be obtained

Prohibited to open Savings Bank Account

a. Government Departments
b. Municipal corporations
c. Municipal Committees
d. Panchayat Samitis
e. State Housing Boards
f. Water and Sewerage/Drainage Boards
g. State Text BookPublishing Corporations
h. Societies
i. Metropolital Development Authority
j. State/District level Housing Co.op Socieities
k. Any trading business or professional concern
l. Political Party

The above prohibition will not apply in case they are eligible as per RBI guidelines.

Unclaimed Deposits and Inoperative/ Dormant Accounts

a. 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:

b. 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.

c. 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.

d. 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.

e. 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.

f. 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.

g. 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.

h. 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.

i. 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.

j. There should not be any charge for activation of inoperative account.

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k. 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.

l. 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.

Basic Savings Bank Deposit Account (BSBDA)

Banks are advised to offer a 'Basic Savings Bank Deposit Account' which will offer following minimum common facilities to all their customers:

a. The BSBAD should be considered a normal banking service available to all.
b. This account shall not have the requirement of any minimum balance.
c. 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;
d. 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;
e. Facility of ATM card or ATM-cum-Debit Card;
f. 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'.
g. 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.
h. 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.
i. 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.
j. 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.
k. The existing basic banking 'no-frills' accounts should be converted to BSBDA.

Photographs of Account Holders

a. The banks should obtain photographs of the depositors/account holders who are authorised to operate the accounts at the time of opening of all new accounts. The customers' photographs should be recent and the cost of photographs to be affixed on the account opening forms may be borne by the customers.
b. Only one set of photographs need be obtained and separate photographs should not be obtained for each category of deposit. The applications for different types of deposit accounts should be properly referenced.

c. Photographs of persons authorised to operate the deposit accounts viz. S.B. and Current accounts should be obtained. In case of other deposits viz. Fixed, Recurring, Cumulative etc. photographs of all depositors in whose names the deposit receipt stands may be obtained, except in the case of deposits in the name of minor, where guardians' photographs could be obtained.
d. The banks should also obtain photographs of 'Pardanashin' women.
e. The banks should also obtain photographs of Non-Resident (External) (NRE), Non-Resident Ordinary (Rupee) (NRO), Foreign Currency Non-Resident (FCNR) account holders.

Accounts with survivor/ nominee clause

In the case of deposit accounts where the depositor had utilised the nomination facility and made a valid nomination or where the account was opened with the survivorship clause ("either or survivor", or "anyone or survivor", or "former or survivor" or "latter or survivor"), the payment of the balance in the deposit account to the survivor(s)/nominee of a deceased deposit account holder represents a valid discharge of the bank's liability provided:

a. The bank has exercised due care and caution in establishing the identity of the survivor(s)/nominee and the fact of death of the account holder, through appropriate documentary evidence;
b. There is no order from the competent court restraining the bank from making the payment from the account of the deceased

c. It has been made clear to the survivor(s)/nominee that he would be receiving the payment from the bank as a trustee of the legal heirs of the deceased depositor, i.e., such payment to him shall not affect the right or claim which any person may have against the survivor(s)/nominee to whom the payment is made.

It may be noted that since payment made to the survivor(s)/nominee, subject to the foregoing conditions, would constitute a full discharge of the bank's liability. Therefore, while making payment to the survivor(s)/nominee of the deceased depositor, the banks are advised to desist from insisting on production of succession certificate, letter of administration or probate, etc., or obtain any bond of indemnity or surety from the survivor(s)/nominee, irrespective of the amount standing to the credit of the deceased account holder.

Accounts without the survivor/nominee clause

In case where the deceased depositor had not made any nomination or for the accounts other than those styled as "either or survivor" (such as single or jointly operated accounts), banks are advised to adopt a simplified procedure for repayment to legal heir(s) of the depositor keeping in view the imperative need to avoid inconvenience and undue hardship to the common person. In this context, banks may, keeping in view their risk management systems, fix a minimum threshold limit, for the balance in the account of the deceased depositors, up to which claims in respect of the deceased depositors could be settled without insisting on production of any documentation other than a letter of indemnity.

Operating Instructions on Joint Accounts

Banks should encourage the opening of joint accounts on terms such as, payable to

(a) Either or Survivor
(b) Former or Survivor
(c) Later or Survivor
(d) Anyone or Survivors, or Survivor

Salient features of Nomination

a. Nomination facilitates faster and easier release of funds/articles without insistence on Succession Certificate/Probate of Will.
b. Nomination facility is available to account holders operating current accounts, savings bank accounts and all types of term deposit accounts, safe deposit lockers or safe custody of articles.
c. Nomination facility is intended for individuals only.
d. 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.
e. 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.
f. In case of a joint account of individuals, nomination should be made by all depositors jointly.
g. 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.
h. 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.
i. A nomination will continue to be in force even on renewal of term deposit, unless specifically cancelled or changed.
j. 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.
k. 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.
l. 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.

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Safe custody of articles:-

a. Nomination can be made in favour of one individual only.
b. Where the nominee is a minor, the customer shall, while making the nomination, appoint another individual not being a minor, to receive the articles on behalf of the nominee, in the event of the death of the customer during the minority of the nominee.
c. Nomination facilities are available only in case of individual depositors and not in respect of persons jointly depositing articles for safe custody.

Safe deposit lockers:-

a. In case of a sole hirer of a safe deposit locker, nomination can be made in favour of only one individual.
b. Where the safe deposit locker is hired from the bank by two or more individuals, nomination can be made in favour of one or more persons.
c. Where the safe deposit locker is hired in the name of a minor, the nomination shall be made by a person lawfully entitled to act on behalf of the minor.
d. A minor can be appointed as a nominee for delivering contents of a hired locker. Section 45 ZE of the Banking Regulation Act, 1949 does not preclude a minor from being a nominee, for obtaining delivery of the contents of a locker. However, the bank in such cases, when the contents of a locker are sought to be removed on behalf of the minor nominee, hand over the articles to a person who, in law is competent to receive the articles on behalf of the minor.

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Unit - 25 : Operational Aspects of Loan Accounts

Types of Borrowers

a. An individual
b. Sole Proprietary Firm
c. Partnership firm and joint venture
d. HUF
e. Companies
f. Statutory Corporations
g. Trusts and Co-Op societies

Go through these following terms in details with book

a. Funded and Non-Funded Credit Facilities
b. Term Loans
c. Demand Loans

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d. Bills Purchased
e. Bills Discounted
f. End use of funds
g. Primary Securities
h. Collateral Securities
i. Personal Security of Guarantor
j. Fixed Charges
k. Floating Charges
l. Margin
m. Priority Sector
n. Refinance
o. Credit Risk Management
p. Credit Exposure Norms
q. Base Rate System of Interest on Advances
r. Fixed/Floating Rate of Interest on Loans
s. Penal Rate of Interest
t. Security
u. Documents of Title of Goods
v. Banker's General Lien
w. Negative Lien
x. Restrictions on Advances
y. Rehabilitation
z. Recovery
aa. Fair Practice Code

Operational Process of Loans in the Banks

a. Receipt of Loan Application
b. Assessment of viability and credit worthiness
c. Sanction
d. Disbursement
e. Monitoring and supervision
f. Inspections
g. Review of the conduct of the account
h. Renewal of advances

Operating instructions – Advance against Goods and Warehouse Receipts

Go through these following operating instructions in details with book

a. Documentation
b. Margin
c. Valuation
d. Marketability

e. Godown Board
f. Insurance
g. Godowns in a Pledge Account
h. Pledging of Stocks
i. Storage of goods pledged in the godowns where goods not pledged are also stored
j. Delivery of stocks pledged
k. Submission of stock statements in Hypothecation accounts
l. Goods hypothecated in the godowns where goods not hypothecated are also lying
m. Staff accountability
n. Charges for inspection of Godowns/Assets/Securities etc.
o. Godown charges
p. Selective credit control
q. Advances against warehouse receipts

Operational aspects of few common loan products

Gold Loans

a. Must be covered under policy framed by Bank's Board
b. Prohibited from granting any advance against bullion/primary gold
c. End use of the funds to be ensured
d. Ownership of the ornaments to be ensured
e. Valuation of gold ornaments to be done
f. Prefer hallmarked jewellery
g. Purpose of loan can be for both Agriculture and non-agriculture purposes
h. Loan to Value (LTV) to be maintained (Max. 75 % of value of gold ornaments)
i. Maximum amount of loan should be within board approved limit
j. Record of security
k. Custody of ornaments
l. Repayment should not be more than 12 months (other than agriculture)
m. Return of ornaments on repayment
n. Delivery to third parties should be by a letter of authority from the buyer
o. Default is to be informed to the borrower that the ornaments would be auctioned
p. Should be insured for the approved value
q. Surprise verification of the pockets to be carried out

Educational Loans

a. Service area norms
b. Eligibility criteria
c. Student eligibility
d. Expenses considered for loan
e. Quantum of finance
f. Margin

g. Security
h. Documentation
i. Sanction
j. Disbursement
k. Repayment
l. Follow up
m. Processing charges
n. Capability certificate

Home Loans

1. Valuation of property
2. Eligibility
3. Loan to Vale (LTV) ratio
4. Interest rate
5. Security
6. Insurance
7. Disbursal – for purchase of constructed property/built up property
8. Disbursal – for building construction
9. Repayment
10. No Foreclosure charges/Prepayment penalty for floating rate individual borrowers

Vehicle Loans

a. Purpose of Auto Loan – New/used Car, MUVs, SUVs, Two wheelers
b. Eligibility
c. Documents required to be submitted
d. Loan Tenure
e. Loan to Vale (LTV) ratio
f. Interest rate – Fixed/Floating
g. Calculation of interest
h. Penal interest
i. Bounced cheque/ECS or SI dishonorurs
j. Intimation of change in base rate
k. Repayment
l. Security
m. Insurance
n. Prepayment penalty is waived
o. Inspection
p. Fees and charges
q. Disbursement

Apart from the above, all the loans sanctioned must comply with :

a. KYC – proper verification of KYC
b. CIBIL disclosure – Borrower should agree and give consent for disclosure by the Bank
c. Default – In case of default, the borrower must be sent with reminders through post, fax, email, SMS
d. Time taken for disposal of allocations – should be disposed within stipulated time

Unit - 26 : Operational Aspects of CBS Environment

Core Banking Solutions (CBS)

Core Banking is the integrative approach that efficiently unites different banking systems in selling their products and services with the aid of information technology. Unison of different banking system facilitates to open up the market thus ideally increases the opportunity for banks to acquire more customers and a better customer retention.

Core Banking Solutions (CBS) is the process which is completed in a centralized environment i.e.Core Banking Solution under which the information relating to the customer's account i.e. financial dealings, profession, income, family members etc are dealt with. These information are stored in the Central Server of the bank that is available to all the networked branches instead of the branch server. The word Core in Core Banking Solutions (CBS) stands for Centralized Online Real-time Environment.

CBS is networking of branches, which enables customers to operate their accounts, and avail banking services from bank on CBS network, regardless of where they maintain their account. Thus, CBS is a step towards enhancing customer convenience through "Anywhere and Anytime Banking".

Need for Core Banking Solution

a. Improve operational efficiency - reduce cost of operations
b. Improve customer service
c. Comply with Anti Money Laundering (AML) / Know Your Customer (KYC) requirements
d. Integrate with electronic payment systems

Benefits of CBS

CBS will provide the following benefits:

a. Anytime and Anywhere banking (online mediums/SMS)
b. Standardised, simple and automated processes
c. Increase in quality of the service provided to the customers
d. Timely and accurate information for management decision making
e. Strong audit and internal controls

f. Bring down the cost of transaction and thereby improving operational efficiency
g. Paving way for new value added services thereby generating additional revenue for the Department

Objectives of CBS

The key objectives are as below:

a. To increase the number of customers
b. To provide multiple delivery channels like internet, mobile banking, ATMs, thereby bringing access to financial services to the doorsteps of the customers
c. To enable faster money fund transfers to reach out to more customers
d. To become one stop solution for financial inclusion initiatives of the Government of India

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Unit - 27 : Back Office Operations/Handling of Unreconciled Entries in Banks

Functions performed by the Back Office

Back office functions can be grouped as under :

a. Book keeping and accounting – Transaction processing, maintenance of General Ledger and other book of accounts
b. Deposits – Calculation and posting of interest, service charges
c. Loans – processing end-to-end loan originations, calculation of EMI, calculation and posting of interest, penal interest, processing fee, commission, charges, risk management
d. Regulatory compliance – Identifying KYC gaps, customer grievance redressal system
e. e-Banking – handling transactions through internet, mobile banking or ATMs
f. Other functions – Clearing, collection, remittances

Reconciliation functions in Banks

a. Reconciliation of accounts for payments involving intermediaries
b. Reconciliation of accounts for with correspondent banks
c. Reconciliation of bank accounts with RBI and other banks and institutions
d. Reconciliation of Inter branch entries
e. Reconciliation of Inter Office transactions

RBI guidelines regarding inter office entries
Reconciliation set up and process at the banks

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ALL THE VERY BEST FOR YOUR EXAMS

SHORT NOTES FOR
JAIIB
ACCOUNTING & FINANCE FOR BANKERS

Though we had taken enough care to go through the notes provided here, we shall not be responsible for any loss or damage, resulting from any action taken on the basis of the contents. Creation of these short notes is the efforts of so many persons. First of all we thank all of them for their valuable contribution. We request everyone to go through the Macmillan book and update yourself with the latest information through RBI website and other authenticated sources. In case you find any incorrect/doubtful information, kindly update us also (along with the source link/reference for the correct information).

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