Dr AMAR'S CAPSULE

# ACCOUNTING & FINANCE FOR BANKERS(JAIIB)

(SHORT NOTES & PRACTICE WORK BOOK)


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# FOREWORD

Friends,

I have great pleasure in placing this book before the aspirants of the JAIIB.

In my long experience of teaching as a faculty of bank's training centre, I observed that the aspirants remain worry for "Accounts and Finance for Bankers"(JAIIB) and for "Bank Financial Management"(CAIIB). Moreover, their quest for short notes and Multiple Choice Questions.

This book would enable the readers to acquire relevant understanding of the subject. It covers all dimensions through precise notes, followed by Multiple Choice Questions. I have also included solution of some mathematical problems for better understanding.

An effort has been made to make the content of the book relevant, error free. However, due diligence is expected from the readers.

I extend my sincere thanks to BFC Publication for his cooperation and to my son Aniket Amar for his valuable suggestions.

I welcome all constructive comments and suggestions from the readers of this book.

With bundle of blessing for success,

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# DEDICATION

***Dedicated to***
***My beloved parents***
***Shri Prabhu Nandan Singh***
***&***
***Smt. Janki Devi***

# CONTENTS

**MODULE : D : BANKING OPERATIONS**

# MODULE : A

# BUSINESS MATHEMATICS AND FINANCE

## 1. CALCULATION OF INTEREST AND ANNUTIES

**SIMPLE INTEREST:**

Simple interest is the amount of interest calculated as a fixed percentage of the amount at the start and is paid or received at the end.

I = PxRxt ( Interest = Principal x rate x time)

A = P + I = P+ PxRxt = P(1 + Rt)

Whereas,

I = Interest Earned

P = Principal

R = Rate of Interest

t = time (period)

A = Accumulated Amount i.e. (P+I)

**Example**: Kiran invested Rs10000 with the interest rate of 5%. How much interest would be earned after 3 years?

Ans: I = PxRxt

Here, P = Rs10000, R = 5% (5/100= 0.05) and t = 3 years

Now, I = PxRxt

= 10000x0.05x3

= 1500

(A = P+I = 10000+1500 = 11500)

**Example**: Kiran has an SB a/c with the interest rate of 3.5% and an another account with the interest rate of 5% in a bank. If she deposits Rs15000 to SB a/c and Rs18000 in another account, how much money she have after 5 years?

Solution: SB A/C

I = 15000x3.5/100x5 = 2625

A = 15000 + 2625 = 17625

Another Account:

$I = 18000 \times 5/100 \times 5 = 4500$

$A = 18000 + 4500 = 22500$

So, total amount Kiran will have

$= 17625 + 22500 = 40125$

## COMPOUND INTEREST

In simple interest formula, it is presumed that the interest is charged only once during the given period.

If interest is charged more than once during the period and the interest is reinvested, it is called compounding of interest.

Formula for compound interest is

$A = P\,(1+ R)^n$

Whereas,

A = Amount of money accumulated after n year

P = Principal

R = Rate of interest

n = period (number of years)

**Example**: Kiran invested Rs10000 with the interest rate of 5%. How much interest would be earned after 3 years?

## SOLUTION

$A = P\,(1+ R)^n$

$= 10000(1+0.05)^3$

$= 10000(1.05)^3$

$= 11576.25$

(In simple interest it is Rs11500 whereas in compound interest it is Rs 11576.25)

Interest may be accumulated or compounded on yearly/half yearly/ quarterly/monthly or weekly basis.

See, compounding of interest for 1 year

| | | |
|---|---|---|
| Yearly | : | $A = P\,(1+R)$ |
| Half Yearly | : | $A = P\,(1+R/2)^2$ |
| Quarterly | : | $A = P\,(1+R/4)^4$ |
| Monthly | : | $A = P\,(1+R/12)^{12}$ |

So, basic formula for compounding interest is

$A = P\ (1+R/n)^{nt}$

Here, **n** is number of times per year that interest is compounded and **t** is number of years invested.

If yearly compounded then n = 1

So for yearly compounded $A = P\ (1+R)^{t}$

If it is quarterly compounded $A = P\ (1+R/4)^{4t}$

**Example**: Calculate accumulated amount **after 1 Year (t) of Rs10000 (P) @7 %( R)** with yearly/half yearly/ quarterly/monthly compounding period.

| Year of Investment(t) | Compounding frequency(n) | Accumulated Amount(A) |
|---|---|---|
| 1 | Yearly (1) | 10700 |
| 1 | Half yearly(2) | 10712.25 |
| 1 | Quarterly(4) | 10718.59 |
| 1 | Monthly(12) | 10722.90 |

**RULE 72 :**

It gives the number of years within which money doubles. If you divide 72 by Rate of Interest, you will get the number of years in which amount will be doubled.

**Example**: Kiran deposits a sum of Rs10000 in a bank @9%, her deposit will be doubled in

8 years (72/9=8).

**DIFFERENT MODES OF INTEREST**

(1) **FIXED INTEREST RATE:** The rate of interest is fixed. It will not change during entire period of the loan.

(2) **FLOATING INTEREST RATE**: also called **variable interest** rate. The rate of interest changes during the period of loan depending upon the market conditions.

**FRONT- END AND BACK- END INTEREST RATES**

FRONT- END INTEREST RATE: If the interest deducted from the principal amount and the net amount is disbursed, it is called front-end interest. For example – **discounting of bill**.

**BACK- END INTEREST RATE:** When full amount of loan is disbursed and the interest charged subsequently on monthly/ quarterly/agreed basis.

**EQUATED MONTHLY INSTALMENT (EMI)**

It is a combination of interest payment and principal payment, the total monthly amount is calculated in such a way that it remains constant in all through the repayment tenure.

Formula, $E = (pxr)\frac{(1+r)^n}{(1+r)^n - 1}$

Where, E = EMI, P = Principal Loan Amount

r = rate of interest on monthly basis i.e. ROI/12x100

n = tenure (number of months)

**Example :** Calculate EMI of loan amount Rs200000 @ 10% annual interests for a period of 36 months.

**SOLUTION**

$$E = (pxr)\frac{(1+r)^n}{(1+r)^n - 1}$$

$$= \frac{(200000x10/1200)(1+10/1200)^{36}}{(1+10/1200)^{36} - 1}$$

$$= \frac{(200000x0.00833)(1+0.00833)^{36}}{(1+0.00833)^{36} - 1}$$

= 2245.768/0.3480 = 6453

**ANNUITY**

Annuities are a series of fixed payments you are paying or you are receiving at a specified frequency over a fixed period.

Common frequencies may be yearly, half yearly, quarterly or monthly.

**TYPES OF ANNUITIES**:

1) **ORDINARY ANNUITY**: Payments are required at the end of each period.

2) **ANNUITY DUE**: Payments are required at the beginning of each period.

**CALCULATION OF PRESENT VALUE OF AN ORDINARY ANNUITY:**

If you are getting a series of future payments, suppose Rs1000 at the end of each year for 5 years and want to know the PV of payments. What should you do?

You have to calculate PV of each payment and then add them together. It will take long time.

There is a mathematical formula for calculating PV and i.e

$$PV = Cx\frac{(1+r)^n - 1}{r\,(1+r)^n}$$

Where, C = cash flow per period

r = interest rate

n = number of payments

**Example:** You are receiving Rs2000 every year for the next five years. The annual interest rate is 12%. Calculate the Present Value.

**SOLUTION**

$$PV = 2000x\frac{(1+0.12)^5 - 1}{0.12\,(1+0.12)^5} = 2000x\frac{1.7623-1}{0.12x1.7623}$$

$$= 2000x\ 0.7623/0.2115 = 7208.51$$

**CALCULATION OF FUTURE VALUE OF AN ORDINARY ANNUITY:**

Formula for calculation of Future Value of Annuity is

$$FV = C\ x\ \frac{(1+r)^n - 1}{r}$$

Where, C = cash flow per period, r = interest rate and n = number of payments

**Example**: What is the future value of the payment if an annuity consists of monthly payments of Rs.500 made over 10 years @14% rate of interest monthly compounding?

**Answer**: $FV = c \times \frac{(1+r)^n - 1}{r}$

$= 500 \times \frac{(1+0.01166)^{120} - 1}{0.01166}$

$= 500 \times \frac{4.01929 - 1}{0.01166} = 129472.12$

**Example**: How much money you owe, if you borrow Rs.3000 per year @5% interest for 5 years?

**Answer**: $FV = c \times \frac{(1+r)^n - 1}{r}$

$= 3000 \times \frac{(1+0.05)^5 - 1}{0.05}$

$= 3000 \times 1.27628-1/0.05 = 16576.80$

**CALCULATION OF PRESENT VALUE OF AN ANNUITY DUE:**

For the present value of a annuity due, need to discount the formula one period forward. When calculating the present value, we assume that the first payment is made today.

$$PV = C \times \left[\frac{(1+r)^n - 1}{r(1+r)^n}\right] \times (1+r)$$

**Example**: You are receiving Rs2000 at the beginning of every year for five years. The annual interest rate is 12%. Calculate the Present value.

**Answer**: $$PV = C \times \left[\frac{(1+r)^n - 1}{r(1+r)^n}\right] \times (1+r)$$

$$PV = 2000 \times \left[\frac{(1+0.12)^5 - 1}{0.12 \times (1+0.12)^5}\right] \times (1+0.12)$$

$= 2000 \times \frac{0.7623 \times 1.12}{0.2115} = 8073.53$

**Example**: You are receiving Rs2000 at the beginning of every year for the five years. The annual interest rate is 7%. Calculate the Present value.

**Answer**:
$$PV = C \times \left[ \frac{(1+r)^n - 1}{r(1+r)^n} \right] \times (1+r)$$

$$PV = 2000 \times \left[ \frac{(1+0.0.07)^5 - 1}{0.07 \times (1+0.07)^5} \right] \times (1+0.07)$$

$$= 2000\text{x} \frac{0.40255 \text{ x } 1.07}{0.098178} = 8774.44$$

**CALCULATION OF FUTURE VALUE OF AN ANNUITY DUE**: Since in annuity due, each payment in the series is made one period sooner; need to discount the formula one period later.

Hence formula is

$$FV = C \times \left[ \frac{(1+r)^n - 1}{r} \right] \times (1+r)$$

**Example:** You are receiving ₹ 2000 at the beginning of every year for the five years and you invest each payment @ 7%. Calculate the Future value.

Answer:
$$FV = C \times \left[ \frac{(1+r)^n - 1}{r} \right] \times (1+r)$$

$$= 2000 \times \left[ \frac{(1+0.0.07)^5 - 1}{0.07} \right] \times (1+0.07)$$

$$= 2000\text{x} \frac{0.40255}{0.07} \text{ x } 1.07 = 12306.52$$

## 1. KNOW YOURSELF NOW : CALCULATION OF INTEREST AND ANNUTIES (* Please see solution)

[1] If it is presumed that interest is charged only once during the given period, the interest is :

(a) Simple Interest (b) Compound Interest
(c) Annuities (d) Yearly compound interest

[2] The formula for calculating interest earned at simple interest rate is :

(a) A = (I+r)t (b) I = P × r
(c) I = P × r × t (d) I = P × t

[3] A series of fixed payments required at a specified frequency over a fixed period is called;

(a) Annuity (b) Ordinary Annuity
(c) Annuity due (d) Back-end interest

[4] If payments are required at the begining of each period is known as :

(a) Ordinary Annuity (b) Annuity due
(c) Front -end Annuity (d) Annuity

[5] If payments are required at the end of each period is known as:

(a) Yield on investment (b) Annuity
(c) Annuity due (d) Ordinary Annuity

[6] If the interest is deducted from the principal amount and only the net amount is disbursed, it is called :

(a) Front-end interest (b) Back-end interest
(c) Floating interest (d) Fixed interest

[7] If interest is charged more than once during the period and reinvested, it is called

(a) Simple rate of interest (b) Compound rate of interest
(c) Special rate of interest (d) Multiple compounding interest

[8] Interest earned by quarterly compounding interest will be;

(a) More than monthly compounding interest
(b) More than half yearly compounding interest
(c) Equal to any compounding interest
(d) None of the above

[9] If Ramesh deposits ₹10000/- in a bank as fixed deposit and got double amount in 10 years. What is the rate of interest on deposit?

(a) 8.10 % (b) 9.20 %

(c) 7.20 % (d) 7.75 %

[10] The formula for calculating accumulated amount at simple interest is;

(a) P + I (b) P × r × t

(c) P (1 + rt) (d) both (a) & (c)

[11] The basic formula for compounding interest is;

(a) $P(1+\frac{r}{n})^{t}$ (b) $P(1+\frac{r}{n})^{nt}$

(c) $P(1+\frac{r}{n})^{t}-1$ (d) None of the above

[12] If rate of interest changes during the period of loan, it is called;

(a) Floating interest rate (b) Variable interest rate

(c) Changeable interest rate

(d) both (a) & (b)

[13] Accumulated value of all cash flow of an ordinary annuity can be calculated by (FV of ordinary annuity);

(a) $C \times \left[\frac{(1+r)^{n}-1}{r}\right]$ (b) $C \times \left[\frac{(1+r)^{n}-1}{r}\right]$

(c) $C \times \left[\frac{(1+r)^{n}}{r(1+r)^{n}-1}\right]$ (d) $C \times \frac{(1+r)^{n}}{r}$

[14]* If you are receiving ₹ 1000 at the beginning of every year for five years at 10 % pa rate of interest. What is the present value ?

(a) 4169.80 (b) 4036.17

(c) 5050.00 (d) 5500.00

[15]* If you are recieving ₹ 1000 at the beginning of every year for five years @ 10% pa rate of interest. What is the future value?

(a) 6152.63 (b) 5175.05

(c) 5450.00 (d) 6715.50

[16] Interest paid on principal amount and interest thereon is called

(a) Compound interest (b) Simple interest

(c) Annuities (d) Interest on principal amount

[17] Rule 72 is used for -
(a) Calculation of interest
(b) Calculation of maturity value of deposit
(c) Calculation of time during which amount of deposit becomes double
(d) Calculation of EMI of loan amount.

[18]* If a loan amount ₹ 500000 has been sanctioned by bank at 12% compounded interest repayable in 60 monthly installment. EMI would be.
(a) 11666.66 (b) 11122.20
(c) 13333.33 (d) 10333.50

[19]* The simple interest in 3 years and compound interest in 2 years on the certain sum at the same rate are ₹ 7500 and ₹ 5250 respectively. What is the rate of interest ?
(a) 10 % (b) 12 %
(c) 25 % (d) 15 %

[20]* In Problem No-19 what is the principal amount?
(a) 75000 (b) 82750
(c) 25000 (d) 35000

[21] If simple interest is ₹ 17280 for 3 years on ₹ 600000. What is the rate of interest?
(a) 9.60 % (b) 8.75 %
(c) 11.60 % (d) 9 %

[22] If interest is compounded on quartely basis, the formula for calculation of maturity value would be;
(a) $P(1+r)^{t}$ (b) $P\left[1+r\right]^{4t}$
(c) $P\left[1+\frac{r}{4}\right]^{4t}$ (d) $P\left[1+\frac{r}{4}\right]^{4t}$

[23] Rames deposits ₹ 20000 in a banks for 4 years, the rate of interest payable is 7.5% with quarterly compounding. How much he will get on maturity ?
(a) 26000.00 (b) 26722.22
(c) 26922.28 (d) 24500.00

[24] Annuity is;
(a) a series of payments (b) payment of fixed amount
(c) payment for fixed period
(d) all of the above

[25] When full amount of loan is disbursed and the interest charged subsequantly, is called;

(a) Back-end interest (b) Front-end interest
(c) Interest on loan (d) None of the above

[26] The time interval, in between the interest is added to the account, is called;

(a) Compound interest (b) Maturity period
(c) Compounding period (d) Maturity value.

[27]* How much money you have to pay if you borrow ₹ 5000 per year at 10 % interest for 5 years ?

(a) 30000.00 (b) 32275.00
(c) 27500.00 (d) 30525.00

[28]* You plan to purchase a motorcycle for ₹ 150000 after 3 years. What will be the annual savings required to purchase motorcycle if the return is 10% ?

(a) 50000.00 (b) 45317.22
(c) 45000.00 (d) 45322.17

[29]* You want to have ₹ 1000000 in 5 years. The annual savings required if the return is 12% is ;

(a) 157418.34 (b) 250000.00
(c) 200000.00 (d) 168814.43

[30] What would be the EMI for a loan of ₹ 1500000 at an interest rate of 12% pa repayable in 10 years? (hint- as per solution-18)

(a) 24732.00 (b) 27500.00
(c) 22221.70 (d) 21521.74

[31] Rule 72 is the formula to calculate the time when the amount becomes double. What is the formula ?

(a) 72 / period (b) Period / 72
(c) Rate of Interest / 72 (d) 72/Rate of interest

[32] If you want to determine present value of a series of future payments receive at the end of the each period, the mathematical formula is; (present value of ordinary annuity)

a) $C\times\left[\frac{(1+r)^{n}-1}{r(1+r)^{n}}\right]$ (b) $C\times\left[\frac{(1+r)^{n}-1}{r}\right]$

(c) $C\times\left[\frac{(1+r)^{n}}{(1+r)^{n}-1}\right]$ (d) $C\times\left[\frac{(1+r)^{n}-1}{(1+r)^{n}}\right]$

[33] If you want to determine present value of a series of future payments receiving at the beginning of the each period, the mathematical formula (present value of annuity due) is;

(a) $C\times\left[\frac{(1+r)^n-1}{r(1+r)^n}\right]\times(1+r)$ (b) $C\times\left[\frac{(1+r)^n-1}{r(1+r)^n}\right]\times r$

c) $C\times\left[\frac{(1+r)^n}{(1+r)^n-1}\right]\times(1+r)$ (d) $C\times\left[\frac{(1+r)^n-1}{r(1+r)^n}\right]$

[34] If you want to determine future value of a series of future payments receiving at the beginning of the each period, the formula (future value of annuity due) is;

(a) $C\times\left[\frac{(1+r)^n}{r^n}\right]$ (b) $C\times\left[\frac{(1+r)^n-1}{r}\right]$

(c) $C\times\left[\frac{(1+r)^n-1}{r}\right]\times(1+r)$ (d) $C\times\left[\frac{(1+r)^n}{r-1}\right]\times(1+r)$

[35] Ramesh borrowed ₹ 1500 @ 7% for 5 years. What amount will he pay to clear the loan?

(a) 1575.00 (b) 2175.00
(c) 2025.00 (d) 2050.00

[36]* Ramesh borrowed ₹ 1500 @ 7 % yearly compounding rate of interest for 5 years. What amount will he pay to clear the loan?

(a) 2103.82 (b) 2203.50
(c) 2025.00 (d) 2107.28

[37] Ramesh deposited ₹15000 in a rural bank @ 7.5 % with quarterly compounding for 3 years. What will be the maturity value?

(a) 18547.74 (b) 18375.00
(c) 10750.25 (d) 18745.75

[38]* Ramesh borrowed ₹ 100000 from bank at 10 % repayable in 5 years. What is the amount of EMI ?

(a) 2242.70 (b) 2122.83
(c) 2500.00 (d) 2450.50

[39]* If Ramesh has earned 12% return on his investment in mutual fund. What is his real return if the inflation rate during that period is 6 %?

(a) 5.66 % (b) 6 %

(c) 5.50 % (d) 6.55 %

[40]* If Ramesh invested ₹ 200000 in mutual fund @ 12% for 3 years and interest is compounding half yearly basis. What will be the maturity amount ?

(a) 283704.00 (b) 272000.50

(c)282868.68 (d) 274160.00

[41] Ramesh took a loan from Suresh at 12% rate of interest on simple interest. If the total interest paid in 8 years was ₹ 9120, the principal was;

(a) ₹ 9500 (b) ₹ 9600

(c) ₹ 9120 (d) ₹ 10000

[42]* Ramesh has taken a loan of Rs. 8 Lakh for his business at the rate of 10% repayable in 8 yearly installment,what is the amount of installment ?

(a) 165666 (b) 180000

(c) 150350 (d) 149952

[43] Ramesh wants to receive a fixed amount for 10 years by investing ₹ 10.0 lakh @ 10% interest rate. How much he will receive annually ?

(a) 162747 (b) 200000

(c) 150000 (d) 167750

[44]* An inflation rate is 10% and expected nominal cashflow is ₹900000, what will be the value of real cash flow ?

(a) 910000.00 (b) 909000.90

(c) 818181.82 (d) 88811.11

[45]* The effective rate of interest is 10% annually and if it is compounding quarterly, what will be the effective rate of interest?

(a) 10.25 % (b) 10.50 %

(c) 10.36 % (d) 10.38 %

[46] The effective rate of interest is 10% annually and if it is compounding half-yearly, what will be the effective rate of interest?

(a) 10.25% (b) 10.50%

(c) 10.75% (d) 10.15%

[47]* Ramesh deposited ₹ 25000 in a bank at interest rate of 7% pa for 3 years, if interest is compounding on quarterly basis, what will be the maturity value?

(a) 30250.50 (b) 30400.40

(c) 30670.20 (d) 30785.00

[48]* Ramesh got after 5 years a sum of ₹ 15000 against an amount deposited in bank at 6%, quarterly compounding, what was the amount deposited by Ramesh?

(a) 11137.00 (b) 10000.00

(c) 11250.00 (d) 12371.00

[49] A person wants to know as how much a loan would cost by EMI at fixed interest rate. What should be calculated to know this?

(a) Future value of an ordinary annuity

(b) Present value of an ordinary annuity

(c) Future value of annuity due

(d) Ordinary annuity

[50] Aniket deposits ₹ 10000 at 10% of interest rate quarterly comounding for 2 years. What will be the maturity value?

(a) ₹ 12000 (b) ₹ 12500

(c) ₹ 12176 (d) ₹ 12184

## ANSWERS

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1(a) | 2(c) | 3(a) | 4(b) | 5(d) | 6(a) | 7(b) | 8(b) | 9(c) |
| 10(d) | 11(b) | 12(d) | 13(a) | 14(a) | 15(d) | 16(a) | 17(c) | 18(b) |
| 19(a) | 20(c) | 21(a) | 22(c) | 23(c) | 24(d) | 25(a) | 26(c) | 27(d) |
| 28(b) | 29(a) | 30(d) | 31(d) | 32(a) | 33(a) | 34(c) | 35(c) | 36(a) |
| 37(d) | 38(b) | 39(a) | 40(a) | 41(a) | 42(d) | 43(a) | 44(c) | 45(d) |
| 46(a) | 47(d) | 48(a) | 49(a) | 50(d) | | | | |

## SOLUTION Q.N [14]

$$PV = C \times \left[ \frac{(1+r)^n}{r(1+r)^n} \right] \times (1+r)$$

$$= 1000 \left[ \frac{(1+0.10)^5}{0.10(1+0.10)^5} \right] \times (1+0.10)$$

$$= 1000 \left[ \frac{(1.10)^5 - 1}{0.10\,(1.10)^5} \right] \times 1.10$$

$$= 1000 \times \frac{1.6105 - 1}{0.10 \times 1.6105} \times 1.10$$

$= 1000 \times 4.1698$

$= 4169.80$

[15] $$FV = C\left[\frac{(1+r)^n - 1}{r}\right] \times (1+r)$$

$$= 1000 \left[\frac{(1+0.10)^5 - 1}{0.10}\right](1+0.10)$$

$$= 1000 \; \frac{\left[(1.10)^5 - 1\right]}{0.10} \times 1.10$$

$$= 1000 \times \frac{0.6105}{0.10} \times 1.10$$

$= 6715.50$

[18] E(EMI) = $(P \times r)\left[\frac{(1+r)^n}{(1+r)^n - 1}\right]$

$$= (500000 \times 0.01) \left[\frac{(1+0.01)^{60}}{(1+0.01)^{60} - 1}\right]$$

$$= 5000 \times \frac{1.8167}{0.8167}$$

$= 11122.20$

$$r = \frac{12}{1200}$$

$$= 0.01$$

[19,20] Suppose P = Principal, r= rate of interest and

t = time i.e 3 years.

Simple interest $I = P \times r \times t$

$7500 = P \times r \times 3$

$$P \times r = \frac{7500}{3} = 2500 \text{– (A)}$$

Now, Compound interest

$$A = P\left(1+\frac{r}{n}\right)^{nt}$$

$$\begin{array}{l|l} P + I = P(1+r)^2 & n=1 \\ P + I = P(1+r^2+2r) & t = 2 \end{array}$$

$$\text{Put } P = \frac{2500}{r} \text{ (from equation A)}$$

$$\frac{2500}{r} + 5250 = \frac{2500}{r} + \frac{2500}{r} \times r^2 + \frac{2500}{r} \times 2r$$

$5250 = 2500\,r + 5000$

$2500\,r = 5250 - 5000$

$$r = \frac{250}{2500} = 0.10$$

$$= 10\%$$

Now, Put $r = 0.10$ in equation (A)

$P \times r = 2500$

$$P = \frac{2500}{0.10}$$

$$= 25000$$

[27] FV = $FV = C\left[\frac{(1+r)^n - 1}{r}\right]$

$$= 5000\left[\frac{(1+0.10)^5 - 1}{0.10}\right]$$

$$= 5000\left[\frac{(1.10)^5 - 1}{0.10}\right]$$

$$= 5000 \times \frac{1.6105 - 1}{0.10} = 30525$$

[28] $A = P\left[\frac{r}{(1+r)^n - 1}\right]$

$$= 150000\left[\frac{0.10}{(1+0.10)^3 - 1}\right]$$

$$= 150000\left[\frac{0.10}{(1.331 - 1}\right]$$

$$= 150000\left[\frac{0.10}{(0.331)}\right] = 45317 \quad .22$$

[29] $1000000\left[\frac{0.12}{(1+0.12)^5 - 1}\right]$

$$1000000 \times \frac{0.12}{0.7623} = 157418.34$$

[36] Under compound interest

$$A = P\left(1+\frac{r}{n}\right)$$

$$= 1500\left[1+\frac{0.7}{1}\right]^{1\times 5}$$

$= 1500 \times (1.07)^5$

$= 1500 \times 1.40255 = 2103.82$

$n = 1 (Yearly\ compounding)$

$t = 5$

$r = 7\% = \frac{7}{100} = 0.07$

$P = 1500$

[38] $EMI = (P \times r)\left[\frac{(1+r)^n}{(1+r)^n - 1}\right]$

$(n = 5 years = 60 months)$

$\left[r = 10\% = \frac{10}{1200} = 0.0083\right]$

$$= (100000 \times 0.0083)\left(\frac{(1+0.0083)^{60}}{(1+0.0083)^{60} - 1}\right)$$

$$= 830 \times \frac{830x1.642}{0.642}$$

$= 2122.83$

[39] Real Rate of Return = $\left(\frac{(r+1)}{(R+1)}\right) - 1$

Where, r = rate of return

R = Rate of inflation.

So, Real rate of return $= \left[\frac{(0.12+1)}{(0.06+1)}\right] - 1$

$= \left[\frac{1.12}{1.06}\right] - 1$

$= 1.0566-1$

$= 0.0566 = 5.66\ \% \ (0.0566 \times 100)$

[40] A (or FV) $= P\ (1+\frac{r}{n})^{nt}$

$$= 200000\ (1+\frac{0.12}{2})^{2 \times 3}$$

$$= 200000\ (1+0.06)^{6}$$

$$= 200000 \times 1.41852$$

$$= 283704$$

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

$$= (800000 \times 0.10)\left(\frac{(1+0.10)^{8}}{(1+0.10)^{8}-1}\right)$$

$$= 80000 \times \frac{2.1436}{1.1436}$$

$$= 80000 \times 1.8744 = 149952$$

[44] Real cash flow $= \frac{\text{Nominal cash flow}}{(1+\text{InflationRate})}$

$$= \frac{900000}{1+0.10}$$

$$= \frac{900000}{1.10} = 818181.82$$

[45] Effective ROI $= \left(1+\frac{r}{n}\right)^{n}-1$

r = Interest rate

n = Number of compounding in a year

$$= \left(1+\frac{0.10}{4}\right)^4 - 1$$

$= (1+0.025)^4 - 1$

$= (1.025)^4 - 1$

$= 1.1038 - 1$

$= 0.1038$

$= 10.38\%$ $(0.1038 \times 100)$

[47] $$FV = P\left[1+\frac{r}{n}\right]^{nt}$$

$$= 25000\left[1+\frac{0.07}{4}\right]^{4\times 3}$$

*r* = rate of interest
n = number of compounding in a year
t = Period

$= 25000\,(1.0175)^{12}$

$= 25000 \times 1.2314$

$= 30785$

[48] $$PV = \frac{FV}{\left[1+\frac{r}{n}\right]^{nt}}$$

$$= \frac{15000}{\left[1+\frac{0.06}{4}\right]^{4\times 5}}$$

$$= \frac{15000}{(1+0.015)^{20}} = \frac{15000}{(1.015)^{20}}$$

$$= \frac{15000}{1.3468} = 11137$$

## 2. CALCULATION OF YTM

**DEBT**: Debt means a sum of money due one party to another. Most businesses need a mix of debt and equity to run their business. Mix of debt and equity is called **capital structure** of the firm/company.

Debt can arise from Bank, fixed deposits, bonds etc. Here amount is fixed and specific and does not depend upon any future valuation to settle it.

**EQUITY**: It is the capital of promoter/investor.

**BOND:**

(i) Bonds are **negotiable Promissory Notes** that can be used by individuals, business firms and government agencies.

(ii) Debt capital mainly consists of bonds and debentures. The holder of debt capital **does not receive a share of ownership** as he becomes a creditor. He has **right of guaranteed payments** during the life of the bond.

**FEATURES:**

- Bonds issued can be secured or unsecured.
- The rate of interest is fixed and known to investors.
- Bond is redeemable after a specific period.
- Interest is payable at fixed intervals (yearly/half yearly/ quarterly/monthly etc).
- The expected cash flow means interest plus principals.
- The holder of the bond is creditor (lender).
- The issuer of the bond is debtor (borrower).
- Ownership of the bond can be transferred, so it is highly liquid in the secondary market.
- Face value and redemption value may be different but these are fixed and known.
- Market value of the bond may be different from the face value.

## **TERMS ASSOCIATED WITH BONDS**

**FACE VALUE**: Also known as the par value. It represents the amount borrowed by the firm, which it promises to repay after a specified period.

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

**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. Market value may be different from par value or redemption value.

**INTRINSIC VALUE**: It is clear that the holder of a bond receives a fixed annual interest payment for a certain value (equal to par value) at the time of maturity. The intrinsic value is the present value of all expected cash flows, discounted at the appropriate discount rate over the redemption period.

**TYPES OF BONDS**: Types of bonds depend upon different categories based on

- Tax status
- Credit quality
- Issuer type
- Maturity
- Secured/unsecured etc.

(i) **FIXED RATE BONDS**: having coupon that remains constant throughout the life of the bond.

(ii) **FLOATING RATE NOTES(FRNs)**: have a variable coupon that is linked to a reference rate of interest (such as LIBOR = London Inter Bank Offered Rate)

(iii) **ZERO COUPON BONDS**: It does not pay regular interest. They are issued at a discount to at par value.

(iv) **HIGH YEILD BONDS (junk bonds)**: High yield bonds are bonds that are rated below investment grade, as these bonds are more risky than investment grade bonds.

(v) **CONVERTIBLE BONDS**: It gives option to the bondholder to exchange a bond to a number of shares of the issuer's common stock.

**BOND VALUE**

The purchaser of the bonds gets regular interest payment and also the redemption amount on maturity.

**THEOREMS OF BOND VALUE:**

(i) When the required **rate of return is equal** to the coupon rate, **the value of the bond is equal to its par value**.

(ii) When the required rate of return (kd) is greater than the coupon rate, the value of the bond is less than its par value.

(iii) When the required rate of return is less than the coupon rate, the value of the bond is greater than its par value.

(iv) When required rate of return is greater than the coupon rate, the discount on the bond declines as maturity approaches.

(v) When the required rate of return is less than the coupon rate, the premium on the bond declines as maturity approaches.

(vi) A bond price is inversely related to its yield to maturity.

**OTHERS:**

(i) The interest on bond i.e. **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.

(ii) The market price or intrinsic value of bond is different from the face value if the coupon rate is different from the market interest rate at the particular time.

(iii) Market value is equal to Present Value of all the coupon receipts and redemption value discounted at the prevailing market rate.

**BOND VALUE**

**EXAMPLE** : A bond whose par value is Rs1000/- bears a coupon rate of 14% and has a maturity period of 3 years.The required rate of return on the bond is 10%. What is the value of this bond?

Answer: Annual interest payable = 1000x14% = 140

Principal repayment at the end of 3 years = Rs1000

The value of the bond

$=140(\text{PVIFA}10\%, 3\text{years}) + \text{Rs}1000\ (\text{PVIF}10\%, 3\ \text{years})$

$= 140(2.487) + 1000(0.751)$

$= 348.18 + 751$

$= \text{Rs } 1099.18$

**Note :** In solving problems related to bond valuation, usually PVIFA (Present Value Interest Factor of Annuity) and PVIF (Present Value Interest Factor) pertaining to the applicable interest rate is provided.

**EXAMPLE**: A bond whose par value is Rs1000/-, bears a coupon rate of 14% payable quarterly and has a maturity period of 3 years. The required rate of return on bond is 10%. What is the value of this bond?

**Answer**: Quarterly interest payable = $\frac{1000 \text{x} 14\%}{4} = 35$

Principal repayment at the end of 3 years = Rs1000

The value of the bond

$$= 35(\text{PVIFA}\frac{10\%}{4}, 3\text{years}) + \text{Rs}1000\ (\text{PVIF}\frac{10\%}{4}, 3\ \text{years})$$

$= 35(10.24) + 1000(0.744) = 358.40 + 744 = \text{Rs } 1102.40$

**<u>CURRENT YIELD ON BOND</u>**

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.

So, Current yield = $\frac{\text{Coupon Interest}}{\text{Current Market Price}}$

**EXAMPLE :** If a bond of face value Rs1000/- carrying a coupon interest rate of 9% is quoted in the market at Rs800/-. What is the current yield of the bond?

Answer : Current yield = $\frac{\text{Coupon Interest}}{\text{Current Market Price}}$

= 9/800 = 11.25% (for face value Rs1000)

## YIELD – TO- MATURITY OF BOND (YTM)

It is the rate of return earned by an investor, who purchases a bond and holds it until the maturity.

**YTM is discount rate**, which equals the present value of promised cash flow to the current market price/ purchase price.

**EXAMPLE**: Consider a Rs1000/- par value bond, whose current market price is Rs900/-. The bond carries a coupon rate of 9% and has the maturity period of 9 years. What would be the rate of return that an investor earns if he purchases the bond and held until maturity?

**Answer**: Annual interest payable = 1000x9% = 90

Principal repayment at the end of 9 years = Rs1000

If kd is yield to maturity then,

900 = 90(PVIFA kd%, 9 years) +Rs1000 (PVIF kd%, 9 years)

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

= 90(PVIFA12%, 9 years) +Rs1000 (PVIF12%, 9 years)

= 90x 5.382 + 1000x 0.361 = 484.38 + 361 = 845.38

Since the above value is less than 900, we have to try with less than 12%. Let us try with kd = 10%

= 90(PVIFA10%, 9years) +Rs1000 (PVIF10%, 9 years)

= 90x 5.759 + 1000x 0.424 = 518.31 + 424 = 942.31

Now, it is clear that kd lies in between 10% and 12%. Now, have to use linear interpolation in the range of 10% and 12%. Using it,

$$= 10\% + (12\%-10\%) \times \frac{942.31-900}{942.31-845.38}$$

= 10% + 2% x 42.31/96.93

= 10% + 2% x 0.44 = 10% + 0.88 = 10.88%

Therefore, the yield to maturity is 10.88%

## 2. KNOW YOURSELF NOW : CALCULATION OF YTM

(*see solution)

[1] What is capital structure of a company?

- (a) Capital of promoter
- (b) It is outsider's claim
- (c) Mix of fixed deposits and deventure
- (d) Mix of debt and equity

[2] Bonds are.....

- (a) Promissory Note
- (b) Bill of Exchange
- (c) Negotiable Promissory note
- (d) Not transferable

[3] What it Coupon?

- (a) Maturity value of bond
- (b) Amount borrowed by firm
- (c) Value which the bond holder gets on maturity
- (d) Specific rate of interest which bond carries

[4] The value which the bond holder gets on maturity is;

- (a) Intrinsic value
- (b) Market value
- (c) Redemption value
- (d) Maturity value

[5] Market value is;

- (a) Amount of the bond
- (b) Value at which a bond is traded
- (c) Sale price of bond
- (d) All of the above

[6] If the coupon (rate) remains constant throughout the life of the bond, is know as;

- (a) Constant bond-rate
- (b) Fixed rate bond
- (c) Fixed deposit rate
- (d) Fixed rate of interest

[7] What is zero coupon bond?

(a) It bears zero rate of interest

(b) It does not pay regular interest

(c) It is issued at a discount to at par value

(d) both (b) & (c)

[8] When the required rate of return is equal to the coupon rate, the value of the bond is;

(a) More than the par value

(b) Equal to its par value

(c) Less than its par value

(d) It depends upon market value;

[9] When the required rate of return is greater than the coupon rate, the value of the bond is;

(a) Less than the par value

(b) Equal to its par value

(c) It depends upon market value

(d) More than its face value

[10] When the required rate of return is less than the coupon rate, the value of the bond is;

(a) Equal to its par value

(b) Less than the par value

(c) Greater than its par value

(d) It depends upon market value

[11] A bond price is inversely related to its yield on maturity.

(a) True

(b) False

(c) It depends upon market

(d) May be true or false

[12] Current yield on bond measures.....

(a) Amount earned on bond

(b) Rate of return earned on bond

(c) Redemption value of bond

(d) Market value of bond

[13]* A bond of face value is ₹ 1000 carrying a coupon interest rate of 8% is quoted in the market at ₹ 900. What is the current yield of the bond?

(a) 9.41% (b) 11.25%

(c) 8.88% (d) 9.99%

[14]* If 9% coupon rate bond is quoted is the market at ₹ 900. Current yield of this bond is;

(a) 10% (b) 9%

(c) 8.9% (d) 9.5%

[15] If 8.5% coupon rate of bond is quoted in the market at ₹ 800, the current yield of this bond is;

(a) 10% (b) 8.5%

(c) 10.60% (d) 10.63%

[16]* The bond whose par value is ₹ 10000 bears a coupon rate of 9% and has a maturity period of 5 years. The required rate of return on the bond is 10%. What is the value of the bond?

(a) 9000.09 (b) 9379.49

(c) 9620.90 (d) 10000

[17] A bond whose par value is ₹ 1000, bears a coupon rate of 12% and has a maturity period of 3 years. The required rate of return is 15%. What is the value of this bond?

(a) 1030.00 (b) 999.12

(c) 948.62 (d) 931.48

[18] A bond whose par value is ₹ 20000, bears a coupon rate 10% and has a maturity period of 10 year. The required rate of return is 12%. What is the value of this bond?

(a) 21376.22 (b) 17739.60

(c) 17882.28 (d) 17396.06

[19] A bond has face value ₹ 1000 and coupon rate is 10%. It is traded in the market at ₹ 910, what is the current yield of the bond?

(a) 9.40% (b) 9.89%

(c) 9.10% (d) 10.99%

[20] The current yield on bond can be calculated as

(a) Coupon rate divided by face value of the bond

(b) Annual interest rate divided by face value of the bond

(c) Coupon rate divided by market price

(d) Coupon rate plus face value of the bond

[21] The rate of return earned by an investor, who purchases a bond and holds it untill the maturity is known as;

(a) Current yield

(b) Current market price

(c) Yield-to-maturity of bond

(d) Maturity value

[22] When the required rate of return is greater than the coupon rate.......

(a) The Value of the bond is less than its par value

(b) The value of the bond will not change

(c) The discount on the bond declines as maturity approaches

(d) Both (a) & (c)

[23] Bond's duration will be equal to its term to maturity,

(a) If it is a zero coupon bond

(b) If it is high-yield bond

(c) If it is inflation-indexed bond

(d) If it is fixed rate bond

[24] Zero-coupon bonds are issued at;

(a) At par value (b) Discount to par value

(c) Premium to par value (d) At zero rate of interest

[25] The securities available for sale, under the market risk are;

(a) Purchased neither for trade nor with intention to retain till matrurity

(b) Purchased for trading

(c) Purchased till maturity

(d) Purchased only for sale at any time

[26]* A coupon bond has a par value of ₹ 1000, matures in 4 years, has a coupon rate of 10% and yield to maturity of 12%. The current yield on this bond is;

(a) 10.45% (b) 10.95%

(c) 10.65% (d) 10.55%

[27] A bond of face value ₹10000 bearing coupon rate 7% have market price of ₹ 7500. What is the current yield on the bond?

(a) 7.5% (b) 9.33%

(c) 8.50% (d) 6.75%

[28]* A bond whose par value is ₹1000 bears a coupon rate of 10% payable half yearly and has a maturity period 4 years. The required rate of return is 12%. What is the value of this bond?

(a) 1120.00 (b) 998.13
(c) 932.17 (d) 937.90

[29]* A bond whose par value is ₹ 1000 bears a coupon rate of 12% payable half yearly and has a maturity period 3 years. The required rate of return is 10%. What is the value of this bond?

(a) 1048.50 (b) 1050.80
(c) 1100.00 (d) 1300.00

[30] A 12% bond with par value of ₹ 1000 is available at ₹ 800. What is the current yield?

(a) 12% (b) 13%
(c) 15% (d) 14%

[31] An instrument has no maturity period, only interest is paid, is known as

(a) Perpetual bond (b) Zero coupon bond
(c) Annuity bond (d) Pension bond

[32] A bond of par value ₹ 1000 bears a coupon rate 15% and maturity of 5 years. If current market interest is 10%. What is the value of bond?

(a) 1189.55 (b) 1100.00
(c) 1150.00 (d) 1155.89

[33]* A bond with par value of ₹1000 and coupon of 10% and maturity of 5 years. If YTM is increased by 1%, the change in price would be;

(a) 2.50% (b) 3.70%
(c) 1.70% (d) 3.23%

[34]* A bond with par value of ₹ 1000 and coupon of 10% and maturity of 5 years. If YTM is decreased by1%, the change in price would be;

(a) 3.33% (b) 1.50%
(c) 3.89% (d) 1.70%

[35] Duration of a bond decreases as the bond approaches maturity.

(a) The statement is true (b) The statement is false
(c) None of the above (d) Either (a) or (b)

[36] Bond volatility is;

(a) Sensitivity of the bond price to change in interest rate
(b) Yield to maturity of the bond
(c) Bond period
(d) High growth of bond value

[37]* A bond of par value ₹ 1000 bears a coupon rate 10% and maturity of 5 years is available is market at ₹ 1000. If market interest rate increases by 1%, what will be the market price?

(a) 1500 (b) 963
(c) 936 (d) 1100

[38] If the price of bond increases,

(a) Yield to maturity decreases (b) Current yield increases
(c) Yield to maturity increases (d) Current yield decreases

[39] The amount of bond, that issuer has to pay to the holder of the bond at the end of term of bond, is known as;

(a) Maturity value (b) Face value
(c) Gross value of bond (d) None

[40] The relationship between the price of bond and yield to maturity is;

(a) Directly proportionate to each other
(b) Inversely proportionate to each other
(c) No relationship between each other
(d) Equal to each other

[41] The bondholder has the right to encash the bond before maturity after a specific date at specified price in called;

(a) Available for sale bond (b) Redeemable bond
(c) Put option bond (d) Ready for sale bond

[42]* A coupon bond that pays interest annually, has a par value of ₹1000 matures in 6 years, has a coupon rate 12% and current market interest is 10%. The current value of the bond is;

(a) 1087 (b) 913
(c) 920 (d) 1020

[43] For a given difference between YTM and coupon rate of the bonds, ——the term to maturity, ——will be the change in price with a change in——.

(a) Longer : greater, YTM (b) YTM : greater, coupon
(c) greater : greater, coupon (d) Shorter : less, coupon

[44] Which of the following is correct?
(a) Longer- term bond is more sensitive to interest rate change.
(b) Longer term bond is less sensitive to interest rate change
(c) Short-term bond is more sensitive than long-term bond to interest rate change
(d) Long-term bond is more sensitive than short-term bond to interest rate change

[45]* If a bond having face value ₹ 1000, coupon rate 10% and year of maturity is 4 years. If YTM is increasing by 1%, this will affect the price of bond by;
(a) 2.5% (b) 3.10%
(c) 1.0% (d) No effect

[46]* If a bond having face value of ₹1000, coupon rate 10% and year of maturity is 6 years. If YTM is increasing by 1%, this will affect the price of bond by;
(a) 4.20% (b) 4.23%
(c) 1.00% (d) No effect

(47)* If a bond having face value of ₹ 1000, coupon rate in 10% and year of maturity is 5 year with YTM 10%, what will be the market value of bond?
(a) 1100 (b) 2000
(c) 1000 (d) 1500

[48]* A bond of face value ₹ 1000 with coupon rate of 15% maturity period of 5 years and YTM of 10%. What is the market value of the bond?
(a) 1200.07 (b) 1150.52
(c) 1100.00 (d) 1189.55

[49] The holding period for which interest rate risk disappears is known as;
(a) Duration of the bond (b) Zero coupon
(c) Redeemable value of bond (d) Risk free bond

[50] The YTM is the discount rate, which equals the present value of promised cash flow to the----
(a) Current market price (b) Purchase price
(c) Coupon rate (d) Both (a) & (b)

## ANSWERS

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1 (d) | 2 (c) | 3 (d) | 4 (c) | 5 (b) | 6 (b) | 7 (d) | 8 (b) | 9 (a) |
| 10 (c) | 11(a) | 12 (b) | 13 (c) | 14 (a) | 15 (d) | 16 (c) | 17 (d) | 18 (b) |
| 19 (d) | 20 (c) | 21 (c) | 22 (d) | 23 (a) | 24 (b) | 25 (a) | 26 (c) | 27(b) |
| 28 (d) | 29 (b) | 30 (c) | 31 (a) | 32 (a) | 33 (b) | 34 (c) | 35 (a) | 36 (a) |
| 37 (b) | 38 (a) | 39(b) | 40 (b) | 41 (c) | 42 (a) | 43 (a) | 44 (d) | 45 (b) |
| 46 (b) | 47 (c) | 48 (d) | 49 (a) | 50(d) | | | | |

## SOLUTION

[13] Current yield $= \dfrac{\text{coupon rate}}{\text{Current market Price}}$

$$= \frac{8}{900} = 8.88\% \text{ (for face value 1000)}$$

[14] If face value of bond is not given, it should be assumed ₹ 1000.

So current-yield is $\dfrac{9}{900}$ x 1000 = 10%

[16] Annual interest = 10000 @ 9% = 900

Principal repayment at the end of 5 years = ₹ 10000

The value of the bond

= 900 (PVIFA 10%, 5 years) + 10000 (PVIF 10%, 5 years)

= 900 (3.791) + 10000 (0.6209)

= 3411.90 + 6209

= 9620.90

**Note :** Normally, PVIFA and PVIF are providend.
However, the formula for

(i) PVIFA = $\left[1-\dfrac{1}{(1+r)^{nt}}\right] \div r$ (ii) PVIF = $\dfrac{1}{(1+r)^{nt}}$

here, r = rate of interest

t = time / period

n = no of compounding frequency (if not given it is yearly)

**Calculation of PVIFA and PVIF**

PVIFA $= \left[1 - \frac{1}{(1+0.10)^5}\right] \div 0.10$

$= \left[1 - \frac{1}{1.6105}\right] \div 0.10$

(1–0.6209) ¸ 0.10 = 0.3791 ¸ 0.10 = 3.791

$$\text{PVIF} = \frac{1}{(1+0.10)^5} = \frac{1}{1.6105} = 0.6209$$

[26] Current yield = $\frac{\text{Coupon interest}}{\text{Current Market Price}}$

here, Coupon interest is 10%

have to calculate first current market price

Current Market Price

= 100 ´ (PVIFA 12% 4yr) + 1000 ´ (PVIF12%, 4 years)

= 100 ´ 3.0375 + 1000 ´ +0.6355

= 303.75 + 635.50

= 939.25

Now, Current yield = $\frac{\text{Coupon interest}}{\text{Current Market Price}}$

$= \frac{10}{939.25} = 10.65\%$ (for 1000 bond value)

**Note :** For PVIFA & PVIF, please see solution of Q.16.

[28] Half yearly interest payable = $1000 \times \frac{10\%}{2} = 50$

Principal repayable at the end of 4 year = 1000

So value of bond,

$$=50\left(\text{PVIFA}\frac{12\%}{2}, 8 \text{ half years}\right) + 1000\left(\text{PVIF}\frac{12\%}{2}, 8 \text{ half years}\right)$$

= 50x6.21+1000x0.6274

= 310.50 + 627.40

= 937.90

**Note:** (i) PVIFA $\frac{12\%}{2}$, 8 half years = $\left[1-\frac{1}{(1+0.06)^8}\right]0.06$

$$=\left[1-\frac{1}{1.5938}\right]\div 0.06 = 6.21$$

PVIF $\frac{12\%}{2}$, 8 half years = $\frac{1}{(1+0.06)^8}$ = 0.6274

**Note :** It satisfies the principle "if the required rate of return is greater than the coupon rate, the value of the bond is less than its par value."

[29] Half yearly interest payable = 1000 ´ $\frac{12\%}{2}$ =60

Principal repayable at the end of 3 years = 1000
So value of bond

= 60 (PVIFA $\frac{10\%}{2}$, 6 half years) + 1000(PVIF $\frac{10\%}{2}$, 6 half years)

= 60 ´ 5.08 + 1000 ´ 0.746
= 304.80 + 746 = 1050.80

**Note :** It satisfies the principle "if the required rate of return is less than the coupon rate, the value of the bond is greater than the par value".

[33] Market value of bond at YTM of 10% is
100 (PVIFA 10%, 5 yrs) + 1000 (PVIF 10%, 5 yrs) = 1000
(If the coupon rate and YTM rate are same, the market value of the bond is equivalent to par value)
Now market value of bond at YTM of 11% (increased by 1%)
100 (PVIFA 11%, 5 yrs) + 1000 (PVIF 11%, 5 yrs)
**first calculate,**

PVIFA $=\left[1-\frac{1}{(1+r)^5}\right]\div r$

$$=\left[\frac{1}{(1+0.11)^5}\right]\div 0.11$$

Now, Market value = (100x3.7)+(1000x0.593)
= 370 + 593
= 963

$$= \left[1 - \frac{1}{1.685}\right] \div 0.11$$
$$= [1 - 0.593] \div 0.11$$
$$= 3.7$$
$$PVIF = \frac{1}{(1+r)^5} = 0.593$$

$$\text{Change in price} = \frac{(1000 - 963)}{1000} \times 100$$
= 3.7% (decrease)

[34] Market value of bond at YTM of 10% is ₹1000
Now market value of bond at YTM of 9% is
100 (PVIFA 9%, 5 yrs) + 1000 (PVIF 9%, 5 yrs)
$(100 \times 3.89) + (1000 \times 0.6499)$
389 + 649.90 = 1038.90

$$\text{Change in price} = \frac{1038.90 - 1000)}{1000} \times 100$$
= 3.89% (increase)

[37] See question no.- (33)
same situation – it is 3.7% decrease
so, 1000–(1000 $\times$ 3.7% )= 963

[42] solve as per Q.No.-16
[45] solve as per Q.No.-33
[46] solve as per Q.No.-33
[47] solve as per Q.No.-16
[48] solve as per Q.No.-16

# 3. CAPITAL BUDGETING

**TIME VALUE OF MONEY (TVM):**

The time value of money is the concept that money available at the present time is worth more than the identical sum in the future due to its potential earning capacity.

Assume you have the option to choose between receiving Rs.1000 now versus Rs.1000 in two years. It is clear; you would choose the first option. Despite the equal value at time of disbursement, receiving Rs.1000 today has more value than receiving it in the future due to the opportunity cost.

**TVM FORMULA**

$$FV = PV \text{ X } [1 + i/n]^{(n \text{ x } t)}$$

Where FV = Future value of Money

PV = Present Value of Money

i = interest rate

n = number of compounding period per year

t = number of years

**Example**: Assume a sum of Rs.1000 is invested for one year at 10% interest. What is the future value of money?

$$FV = 1000\,[1 + \frac{0.10}{1}]^{(1 \text{ x } 1)}$$

$$= 1000\ (1.10)$$

$$= 1100$$

We can also set PV formula i.e.

$$PV = \frac{FV}{(1 + i/n)^{(n \text{ x } t)}}$$

**INTERNAL RATE OF RETURN (IRR):**

The internal rate of return is the average annual return generated by an investment over a specific number of years. The IRR is a component of an investment's net present value and accounts for an investment's net cash flow.

The IRR is effective when several investment options are available. Investments having higher IRRs are preferable. Simply, IRR is the value of the discount rate in NPV equation that leads to zero value for the NPV.

**HOW DOES IT WORK?**

The IRR is the rate that would, in theory, make an investment's NPV equal to zero. It means that the IRR might be negative or positive. A positive IRR value indicates viable future return and negative IRR value indicates loss proposition.

**NET PRESENT VALUE (NPV)**

Net Present value is the value today of an investment's future net cash flows minus the initial investment. Simply, it is the difference between the discounted cash flows and out flows.

**DIFFERENCE BETWEEN NPV AND IRR**

NPV and IRR both are used in the evaluation process of capital expenditure.

The two capital budgeting methods have the following differences:

| | NPV | IRR |
|---|---|---|
| 1. | The NPV method results in money value that a project will produce. | 1 IRR generates the percentage return that the project is expected to create. |
| 2. | NPV method focuses on project surplus. | 2. IRR focuses on the breakeven point. |
| 3. | NPV method requires the use of discount rate. | 3. IRR method does not require the use of discount rate. |

**ACCOUNTING RATE OF RETURN (ARR):**

It is also known as Simple Rate of Return or Average Rate of Return. It is calculated as

$$ARR = \frac{\text{Average Profit}}{\text{Average Investment}}$$

For calculation of Average Profit, add the profits earned in each year and divide by number of years. For example a company earns profit as under;

| Year | Net Profit(Rs) |
|---|---|
| 1. | 10000 |
| 2. | 11000 |
| 3. | 12000 |

Average Profit = (10000+11000+12000)/3 = 11000

For calculation of Average Investment, calculate difference between initial investment and ending book value of investment divided by 2. Normally, ending book value after economic life of investment remains zero unless scrap value is given.

**Example 1**: If investment in a project is Rs800000.00 and the life of project is 5 years, then the Average investment is,

(800000 -0)/2 = 400000.00

**Example 2:** If investment in a project is Rs 800000.00 and the life of project is 5 years and the scrap value is, Rs 50000.00, then the Average investment is,

(800000 -50000)/2 = 375000.00

## 3. KNOW YOURSELF NOW : CAPITAL BUDGETING

(*see solution)

[1] The net difference between the discounted cash flows and out flows is known as :

(a) Present value (b) Net present value

(c) Internal Rate of Return (d) Discounted cash flow

[2] The value of the discounted rate in NPV, that leads to a zero value for the NPV is known as;

(a) Internal Rate of Interest (b) Internal Rate of Return

(c) Internal rate of discount (d) Discounted rate of return

[3] The period where the net cash flow equals the initial cash flow or investment is known as;

(a) Pay back (b) Discounted cash flow

(c) Present value of money (d) Future value of money

[4] A discounting factor suitably discount the cash flow in order to know.....

(a) Net present value (b) Discounted cash flow

(c) Present value (d) Net cash flow

[5] The time value of money concept is;

(a) Present value of money is worth more than the future value

(b) Future value of money is worth more than the present value

(c) Future value of money is worth equal to the present value

(d) Present value of money is worth less than the future value

[6] Time value of money can be calculated as;

(a) $PV \times \left[1+\frac{i}{n}\right]^{n\times t}$

(b) $PV \times \left[\frac{i}{n}\right]^{n\times t}$

(c) $PV \times \left[\frac{i}{n}-1\right]^{n\times t}$

[d) PV x FV

[7]* If Aniket invested a sum of ₹ 5000/- for 5 years at 10% interest rate. What is the future value of money?

(a) 7500.00 (b) 7808.88

(c) 8000.00 (d) 8052.55

[8] IRR method requires the use of discount rate.

(a) False (b) True

(c) It depends upon situation (d) None of the above

[9] The time value of money is not considered in;

(a) Pay back mehtod

(b) Internal rate of return method

(c) Present value method

(d) Future value method

[10] Accounting Rate of Return (ARR) method does not involves;

(a) Average profit after tax

(b) Average value of investment

(c) Time value of money concept

(d) All of the above

[11] Average Rate of Return (ARR) is calculated as;

(a) Profit / Investment

(b) Average profit after tax / Profit before tax

(c) Total investment / total earning

(d) Average profit after tax / average value of investment

**What is the Acoounting Rate of Return,**

[12]* If the initial investment in the project is ₹1000000 and the estimated net profit of a project for 5 years life span is as under;

| Year | Net Profit (Rs) |
|---|---|
| 1 | 25000 |
| 2 | 30000 |
| 3 | 32000 |
| 4 | 34000 |
| 5 | 34000 |

(a) 6.80% (b) 5.00%

(c) 6.10% (d) 6.20%

[13]* If M/s Raj Agro is considering for new machinery for cost ₹50000 which will produce cash flow of ₹ 6000 every year for next 20 years. What is the NPV if the appropriate discount rate is 10%?

(a) ₹ 8410.00 (b) ₹ 20000.00

(c) ₹ 1084.00 (d) ₹ 70000.00

[14] In question no (13) what is the NPV if the appropriate discount rate is 9%?

(a) 20000.00 (b) 70000.00

(c) 4500.26 (d) 4777.32

[15] If Net Present Value is positive, the project can be accepted;

(a) Not necesarly (b) True

(c) False

(d) May or may not, depending upon another factors.

[16]* If a company is considering for new equipment. It's cost is ₹60000 which will produce a cash flow of ₹ 10000 yearly for next 12 years. What is the NPV if the appropriate discount rate is 12%?

(a) 1941 (b) 2000

(c) 2052 (d) 2100

[17] For project appraisal which of the following is discounting techniques?

(a) Internal Rate of Return (b) Accounting Rate of Return

(c) Net Present Value (d) Both (a) & c

[18] If the net present value from any project is negative, then,

(a) Project cannot be taken up

(b) Project may be taken up

(c) It depends upon another factors also

(d) Project can or can't taken up depending upon profit

[19] As per definition of the Internal Rate of Return, which of the following is correct?

(a) Discount rate at which net present value is zero

(b) Discount rate at which net present value is positive

(c) Discount rate at which net present value is negative

(d) Discount rate at which present value is zero

[20] Ramesh invested ₹ 50000 and expected a return of ₹ 5000 per annum for 10 years. What is the present value of the cash flow at 12% discount rate?

(a) 22544 (b) 32671

(c) 28254 (d) 25000

[21] If the Net present value of future cash flow is positive (i.e. higher than the initial investment), the project is

(a) Viable (b) Not to be considered

(c) Not viable (c) None

[22]* If Ramesh invested ₹ 800000 in a business which gives profit ₹ 250000 in the first year, ₹ 275000 in second year and ₹ 400000 in 3rd year. If discount rate is 10%, what is the net present value of business?

(a) 45200 Positive (b) 45200 Negative

(c) 754800 Positive (d) 754800 Negative

[23] If discount factor at 10% interest rate is 0.909, 0.826, 0.751 for 1st year, 2nd year and 3rd year respectively. If the cash flow from the project is ₹ 100000 in each year, what will be the present value of cash inflow?

(a) 284600 (b) 250000

(c) 300000 (d) 248600

[24] On the basis of net present value, one can think for investment, if

(a) Net present value is zero

(b) Net present value is positive

(c) Net present value is negative

(d) Can't think only on NPV basis

[25] If the discount factor at 10% rate of insterest is 0.909, 0.826, 0.751 for 1st year, 2nd year and 3 year respectively. Calculate present value of cash flow, if the cash flow of the project x, y, z is as under;

| | Project x | Project y | Project z |
|---|---|---|---|
| 1st year | 7000 | 5000 | 6000 |
| 2nd year | 8000 | 7000 | 8000 |
| 3rd year | 9000 | 12000 | 10000 |
| Total | 24000 | 24000 | 24000 |

(a) 19339, 19572, 19730 (b) 19730, 19339, 19572

(c) 19339, 19730, 19572 (d) 19730, 19572, 19339

**ANSWERS**

1 (b) 2 (b) 3 (a) 4 (c) 5 (a) 6 (a) 7 (d) 8 (a) 9 (a)
10 (c) 11 (d) 12 (d) 13 (c) 14 (d) 15 (b) 16 (a) 17(d) 18 (a)
19 (a) 20 (c) 21 (a) 22 (b) 23 (d) 24 (b) 25 (b)

## SOLUTION

[7] $$FV = PV\left[1+\frac{i}{n}\right]^{n\times t}$$

$$= 500\left[1+\frac{0.10}{1}\right]^{5\times 1}$$

= 5000 ´ $(1+0.10)^5$

= 5000 x 1.61051

= 8052.55

FV = Future value
PV = Present value
i = rate of interest
n = number of compounting period per year
t = number of years

[12] ARR = $\frac{\text{Average profit after tax}}{\text{Average value of investment}}$

Average profit = (25000 + 30000 + 32000 + 34000 + 34000) /5
= 31000

Average value of investment will be calculated as difference of the beginning and ending value of investment divided by 2. The ending value of investment is either scrap value (if given) or zero (if scrap value is not given).

Here, (1000000–0) ¸ 2 = 500000

So, ARR = $\frac{31000}{500000}\times 100 = 6.20\%$

[13] $$PV = \frac{a}{r}\left[1-\frac{1}{(1+r)^n}\right]$$

$$= \frac{6000}{0.10}\left[1-\frac{1}{(1+0.20)^{20}}\right]$$

$$= \frac{6000}{0.10}\left[1-\frac{1}{6.7275}\right]$$

$$= \frac{6000}{0.10}[1-0.1486]$$

= 60000 x 0.8514 = 51084

NPV = ₹ 51084 – ₹ 50000 = ₹ 1084

[16] (see Q.13)

$$PV = \frac{10000}{0.12}\left[1 - \frac{1}{(1-12)^{12}}\right]$$

$$= 83333\left[1 - \frac{1}{(3.8959)}\right]$$

= 83333 x 0.7433

= 61941

NPV = ₹ 61941 – 60000 = ₹ 1941

[22] Projected cash flow of the business is

= 250000 x discount factor at 10% for 1st year + 275000 x discount factor at 10% for 2nd year + 400000 x discount factor at 10% for 3rd years

So, have to calculate discount factor (most of the cases it is provided)

$$\text{Discount factor} = \frac{1}{(1+\text{discount rate})^n}$$

$$\text{For 1st year} = \frac{1}{(1+0.10)} = 0.909$$

$$\text{For 2nd year} = \frac{1}{(1+0.10)^2} = 0.826$$

$$\text{For 3rd year} = \frac{1}{(1+0.10)^3} = 0.751$$

Now = 2,50,000 x 0.909 + 275000 x 0.826 + 400000 x 0.751

= 227250 + 227150 + 300400

= 754800

NPV = 800000 – 754800 = 45200 (negative)

# 4. DEPRECIATION AND ITS ACCOUNTING

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

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

**CAUSES OF DEPRECIATION**

(i) Wear and Tear: due to actual use.

(ii) Effect of Time: mere passage of time, even it is not used.

(iii) Obsolescence: a new invention or permanent change in demand.

(iv) Accidents: due to accident value of asset may decrease.

(iv) Fall in market price: due to fall in market price of same brand.

**NEED FOR DEPRECIATION:** It is due to,

(a) To know the correct present price.

(b) To show correct financial position.

(c) To make provision for replacement of asset.

**FACTORS OF DEPRECIATION**

For calculating depreciation, the basic factors are,

(a) Cost of the asset

(b) Estimated residual or scrap value at the end of its life.

(c) Estimated number of years of its commercial life.

**METHODS OF DEPRECIATION**

1. **STRAIGHT LINE METHOD (SLM) :** fixed percentage on **original cost** or fixed installment.

   **Example** : Suppose, value of asset is Rs100000, rate of depreciation is 10% and life of asset is 10 years, then, Depreciation for 1st year : 100000

(- ) 10000 (10% of Rs100000)

90000

For 2nd year: (- ) 10000 (10% of Rs100000)

80000

For 3rd year (–) 10000 —(10% of Rs100000)

70000

and so on———

2. **WRITTEN DOWN VALUE METHOD (WDVM):** Fixed percentage on **diminishing balance** or reducing installment.
   **Example** : Suppose, value of asset is Rs100000, rate of depreciation is 10% and life of asset is 10 years, then

   Depreciation for 1st year : 100000

   (- ) 10000 (10% of Rs100000)

   90000

   For 2nd year: (- ) 9000 (10% of Rs 90000)

   81000

   For 3rd year (- ) 8100 (10% of Rs 81000)

   72900

   and so on——

3. **SUM OF YEAR'S DIGIT METHOD :** This is a method of calculating depreciation of an asset that assumes a higher depreciation charge and a greater tax benefit in the early years of an asset's life.
   **Example:** If the useful life of an asset is 10 years, then the sum of the years

   $$= 10+9+8+7+6+5+4+3+2+1 = 55$$

   So, depreciation for 1st year = $\frac{10x100}{55}$ = 18.18% (10/55%)

   for 2nd year = $\frac{9x100}{55}$ = 16.36% (9/55%)

   for 3rd year = $\frac{8 x100}{55}$ = 14.54% (8/55%)

   and so on———

**Problem** : Calculate depreciation of a Plant & Machinery of Rs40000 with a salvage value of Rs 5000 and useful life of 5 years.

**Solution**: For the purpose of calculation of depreciation, the value of asset would be,

Rs40000 – Rs5000 = Rs35000

as the useful life is 5 years so percentage of depreciation would be, 100/5 = 20%

As per SLM,

Depreciation for 1st year: 35000

(-) 7000—(20% of Rs35000)

28000

For 2nd year: (-) 7000—(20% of Rs35000)

21000

For 3rd year (-) 7000—(20% of Rs35000)

14000

and so on——————

As per WDVM,

Depreciation for 1st year: 35000

(-) 7000—(20% of Rs35000)

28000

For 2nd year: (-) 5600—(20% of Rs28000)

22400

For 3rd year (-) 4480—(20% of Rs22400)

17920

and so on——————

As per SUM OF YEARS DIGIT METHOD

Sum of the years = 5+4+3+2+1 = 15

So, percentage of depreciation

for 1st year $= \frac{5 \times 100}{15} = 33.33\%$

for 2nd year $= \frac{4 \times 100}{15} = 26.66\%$

for 3rd year = $\frac{3 \times 100}{15}$ = 20%

and so on———

now, depreciation

for 1$^{st}$ year: 35000

(-) 11665—(33.33% of Rs35000)

23335

For 2$^{nd}$ year: (-) 9331—(26.66% of Rs35000)

14004

For 3$^{rd}$ year (-) 7000—(20% of Rs35000)

7004

and so on——

**SINKING FUND**

We know that depreciation expense is a non- cash expense i.e. cash is usually paid out in the year the asset is acquired, but the expense is distributed over several years. Such a fund is called sinking fund. Sinking funds are used to replace fixed assets as they wear out or become obsolete, to buy new equipment.

For example, some organization set aside an amount of cash equal to the amount of their yearly depreciation so that money will be available to purchase a new asset once the current one is fully depreciated.

Under this method, Depreciation Fund or Sinking Fund is created and amount is invested in ready salable securities.

**APPLICATION:**

– Depreciation does not apply to Forest, Plantation, Goodwill, Livestock, Wasting assets and Expenditure on research and development.

## 4. KNOW YOURSELF NOW : DEPRECIATION

(*see solution)

[1] A method which assumes that asset will lose an equal amount of value in year is known as;
(a) Declining balance method of depreciation.
(b) Staight line method of depreciation
(c) None of the above
(d) Both (a) & (b)

[2] A method in which a percentage rate is applied to the resudial balace is known as;
(a) Straight line method of depreciation.
(b) Declining balance method of depreciation
(c) Both (a) & (b)
(d) None of the above

[3] The cause (s)of depreciation is/are;
(a) Wear and Tear (b) Effect of time
(c) Multiple sale purchage (d) Both (a) & (b)

[4] In Stainght Line Method, fixed percentage of depreciation applies on;
(a) Residual value (b) Previous year's value
(c) Depreciated Cost. (d) Original Cost.

[5]* A car of ₹ 500000 having expected life of 5 years. How much depreciation amount on it will be charged every year ?
(a) ₹ 50000 (b) ₹ 150000
(c) ₹ 100000 (d) ₹ 200000

[6] In Strainght Line Method the depreciation amount---
(a) Will remain variable (b) Will ramian constant
(c) Will increase next year (d) Will decrease every year.

[7] There are — types of depreciation;
(a) Two (b) Three
(c) Four (d) Five

[8] The basic factor(s) for calculating depreciation is/are.
(a) Cost of asset (b) Scrap value
(c) Economic life of asset (d) All of the above

[9] In written down value method, percentage of depreciation remains;
(a) Fixed
(b) Variable
(c) Depends upon various factors
(d) Depends upon nature of asset.

[10] In written down value method fixed percentage of dereciation applies on

(a) Original cost of asset (b) Scrap value

(c) Diminishing balance (d) All of the above

[11]* A X-ray machine of Rs. 40 lakh whose expected economic life is 10 years is purchased. Depreciation for the second year as per SLM and as per WDVM respectively will be;

(a) 40000, 40000 (b) 40000, 36000

(c) 36000, 40000 (d) 32000, 40000

[12] What is the treatment of Scrap value in calculation of depreciation?

(a) It is added to original cost

(b) It is added to depreciated cost

(c) It is subtracted to original cost

(d) It has no use for calculation of depreciation.

[13] The method that assumes a higher depreciation charge and greater tax benefit in the early year is know as;

(a) Straight Line Method (b) Sum of year's digit method

(c) Written Down Value Method

(d) High Value Method

[14]* If the useful life of an asset is 10 years then what will be the percentage of depreciation according to sum of year's digit method in 2nd year?

(a) 10% (b) 20%

(c) 14.54% (d) 16.36%

[15] If an asset of ₹ 2,40,000 with a salvage value of ₹ 30000 and useful life of 10 years, what will be the amount of depreciation each year under SLM?

(a) 24000 (b) 27000

(c) 21000 (d) 22000

[16]* In above question what will be the amount of depreciation in 2nd year under WDVM?

(a) 21000 (b) 18900

(c) 19800 (d) 24000

[17]* In question number (15), what will be the amount of depreciation in 3rd year under Sum of Year's digit method?

(a) 30344 (b) 21000

(c) 24000 (d) 30534

[18] Depreciation is a part of ........

(a) Balance Sheet (b) Profit and Loss Account

(c) Trading Account (d) Fund Flow Statement

[19] Depreciation is a ........

(a) Cash expenditure (b) Non-Cash expenditure
(c) Not expenditure (d) Just concept

[20] Under depreciation, expense is distributed over years, such a fund is known as;

(a) Interest Accrued (b) Sundry Fund
(c) Sinking Fund (d) Emergency Fund

[21] What is the purpose of Creation of sinking fund?

(a) To repay the loan for asset (b) To buy new asset
(c) To increase income (d) None of the above

[22] What is the standard rate of depreciation on livestock?

(a) Depends upon age of livestock
(b) Depends upon breed of livestock
(c) Depends upon lactation period
(d) Depreciation does not apply.

[23] There is a project of research for 5 years. What will be the rate of depreciation?

(a) 20% (b) 10%
(c) 25% (d) 00%

[24] If an asset is sold, depreciation will be calculated;

(a) Till time of its use
(b) For full economic life
(c) For full year in which assets is being sold
(d) Not calculated for this year

[25] Depreciation amount will remain costant under ..................

(a) Written down value method
(b) Straight line method
(c) Sum of year's digit method
(d) None of the above

[26] Under written down value method, the depreciation amount will;

(a) Increase every year
(b) Remain constant
(c) Decrease every year
(d) Either increase or decrease depending upon nature of assets.

[27] An asset loses an equal amount of value every year, this is the assumption of which method of depreciation?

(a) Straight Line Method (b) Written Down Value Method
(c) Sum of year's digit method (d) All of abobe.

[28] If an equipment's cost is Rs.6.0 lakh and annual rate of depreciation is 10%. What will be the depreciated value in 2nd year and 3rd year according to written down value method?

(a) 60000, 54000 (b) 54000, 54000

(c) 60000, 60000 (d) 54000, 48600

[29] Amount of depreciation decreases every year in .....................

(a) Straight line method (b) Written down value method

(c) Sum of year's digit method (d) Both (b) & (c)

[30]* What is double declining method of depreciation?

(a) It is 200% of the straight line rate of depreciation

(b) It is applied on book value

(c) It is applied two times is a year

(d) Both (a) & (b)

[31] If a company wants to replace a machinery or equipment earlier than its useful life, which method of depreciation be applied?

(a) Written down value method

(b) Accelerated depreciation method

(c) Special rate of depreciation

(d) Straight line method.

[32]* A car is purchased for ₹ 800000 and its salvage value is ₹ 40000. The car is sold for ₹ 400000 at the end of 3rd year. What is the loss or profit if depreciation is made on WDVM and useful life of car is 5 years?

(a) ₹ 29120 Loss (b) ₹ 29120 Profit

(c) ₹ 10880 Profit (d) ₹ 10880 Loss

[33] What is single declining method of depreciation?

(a) It is SLM

(b) It is declining balance method

(c) It is sum of year's digit method

(d) None of the above.

[34] What is accelerated depreciation method?

(a) It allows greater deduction in the earlier years.

(b) It is applicable for those assets which get absolete more quickly.

(c) Any method fo depreciation

(d) Both (a) & (b)

[35] If an asset get absolete quickly, which method of depreciation is appropriate?

(a) Accelerated depreciation method

(b) Double declining method

(c) Sum of year's digit method

(d) Any one of above.

[36] The depreciation under sum of year's digit method is calculated by;

(a) $\text{Original Cost} \times \dfrac{\text{Remaining useful life}}{\text{Sum of year's digit}}$

(b) $(\text{Original Cost} - \text{Salvage value}) \times \dfrac{\text{Remaining useful life}}{\text{Sum of year's digit}}$

(c) $\text{Cost} \times \dfrac{\text{Sum of year's digit}}{\text{Remaining useful life}}$

(d) $(\text{Cost} - \text{Salvage value}) \times \dfrac{\text{Sum of year's digit}}{\text{Useful life}}$

[37]* An equipment is purchased for ₹ 200000, its economic life is 5 years and estimated salvage value is ₹ 20000. What is the amount of depreciation for 3rd year and 5th year at double declining balance method?

(a) 25920, 9331 (b) 28800, 5920
(c) 28800, 10288 (d) 25920, 23328

[38]* A quipment is purchased for ₹ 200000 with a salvage value of ₹20000 and useful life is 5 years, what ia depreciation amount for 3rd year as per sum of year's digit method?

(a) 40000 (b) 36000
(c) 45000 (d) 38000

[39]* If a mill purchased a machinery for ₹ 500000 and charge depreciation @ 10%, 8% and 6% for 1st year, 2nd year and 3rd year respectively, what will be its written down value at the end of 3rd year?

(a) 389160 (b) 414000
(c) 436840 (d) 390000

[40] A car for ₹ 700000 is purchased by Ramesh, its useful life is 5 years and estimated salvage value is ₹ 40000. Calculate depreciation amount of 2nd year as per straight line method and written down value method.

(a) 132000 and 105600 (b) 140000 and 112000
(c) 140000 and 186000 (d) 132000 and 140000

## ANSWERS

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1 (b) | 2 (b) | 3 (d) | 4 (d) | 5 (c) | 6 (b) | 7 (b) | 8 (d) | 9 (a) |
| 10 (c) | 11(b) | 12 (c) | 13 (b) | 14 (d) | 15 (c) | 16 (b) | 17 (d) | 18 (b) |
| 19 (b) | 20 (c) | 21 (b) | 22 (d) | 23 (d) | 24 (a) | 25 (b) | 26 (c) | 27 (a) |
| 28 (d) | 29 (d) | 30 (d) | 31 (b) | 32 (a) | 33 (b) | 34 (d) | 35 (a) | 36 (b) |
| 37 (b) | 38 (b) | 39 (a) | 40 (a) | | | | | |

## SOLUTION

(5) Expected life is 5 years

so yearly depreciation percentage will be $\frac{100}{5} = 20\%$

Cost of Car = ₹ 5,00,000

So, depreciation amount = 5,00,000 × 20%

= 1,00,000

(11) Expected economic life is 10 years

So yearly depreciation percentage will be = $\frac{100}{10} = 10\%$

Cost of X-ray machine is ₹ 4,00,000

| | So As per SLM | As per WDVM |
|---|---|---|
| | 400000 | 400000 |
| 1st year | 40000 | 40000 |
| | 360000 | 360000 |
| 2nd year | 40000 | 36000 |
| | 320000 | 324000 |

(14) Use ful life is 10 years

So sum of year's digit = 10+9+8+7+6+5+4+3+2+1 = 55

1st year depreciation = 10/55 = 18.18%

2nd year depreciation = 9/55 = 16.36%

[16]

| | |
|---|---|
| | 2,40,000 |
| | (-) 30,000 |
| | 2,10,000 |
| 1st year @ 10% | 21,000 |
| | 189000 |
| 2nd year @ 10% | 18,900 |
| | 1,70,100 |

[17] Useful life is 10 years

Sum of years = 10+9+8+7+6+5+4+3+2+1 = 55

Depreciation for 1st year = $\frac{10}{55} \times 100 = 18.18\%$

Depreciation for 2nd year = $\frac{9}{55}\times 100 = 16.36\%$

Depreciation for 3rd year = $\frac{8}{55}\times 100 = 14.54\%$

Now, (2,40,000 - 30,000) × 14.54% = 30534

[30] The double declining balance depreciation method is an accelerated depreciation method that counts as an expense twice as much of the asset's book value each year compared to straight line depreciation.

**Example:** Suppose a business purchased a machinery for Rs. 50,00,000 which economic life is 10 years.

Under SLM, business will deduct ₹ 5,00,000 per year for 10 years. Using the double decling balance method, it would deduct 20% (double of 10%) in first year, and 20% of 40,00,000 in second year and so on---

| | | |
|---|---|---|
| | 50,00,000 | |
| 1st year (-) | 5,00,000 | – (20% of original cost) |
| | 45,00,000 | |
| 2nd year (-) | 4,50,000 | – (20% of book value) |
| | 40,50,000 | |

and so on ..........

So, the double declining balance method is a type of declining balance method with a double depreciation rate.

Accelerated depreciation is any method of depreciation that allows greater deductions in the earlier years of the life of an asset.

(32) Cost for depreciation = 800000 - 40000
= 760000

% of depreciation = 20% as useful life is 5 years

| | | |
|---|---|---|
| depreciation : | 7,60,000 | |
| 1st year : | 1,52,000 | – (20% of 760000) |
| | 60,8,000 | |
| 2nd year : | 1,21,600 | – (20% of 608000) |
| | 4,86,400 | |
| 3rd year : | 97,280 | – (20% of 486400) |
| | 3,89,120 | |

Value at the end of 3rd year = 389120 + 40000 (Salvage value)
= 4,29,120

Sale price = ₹ 4,00,000

so ₹ 29120 Loss

(37) Economic life is 5 years, so rate of depreciation would be 20% and in double declining balance method, rate of depreciation would be 40%

| | | |
|---|---|---|
| Now, | 2,00,000 | |
| | <u>80,000</u> | – 1st year |
| | 1,20,000 | |
| | <u>48,000</u> | – 2nd year |
| | 72,000 | |
| | <u>28,800</u> | – 3rd year |
| | 43,200 | |
| | <u>17,280</u> | – 4th year |
| | 25,920 | |
| Salvage value (-) | <u>20,000</u> | |
| | 5,920 | – depreciation required for 5th year. |

(38) Useful life is 5 years, so rate of depreciation would be 20%
sum of year's = 5+4+3+2+1 =15
depreciation under sum of year's digit method

$$= (\text{Original cost} - \text{Salvage value}) \times \frac{\text{Remaining useful life}}{\text{Sum of year's digit}}$$

= (2,00,000 - 20,000) × 3/15
= 36,000

Note – 3 for 3rd year (for 1st year – useful life is 5 year for 2nd year – 4, 3rd year – 3, 4th year-2 and for 5th year – 1)

(39)

| | | |
|---|---|---|
| | 5,00,000 | |
| 1st year | <u>50,000</u> | – (@ 10% of 5,00,000) |
| | 4,50,000 | |
| 2nd year | <u>36,000</u> | – (@ 8% of 4,50,000) |
| | 4,14,000 | |
| 3rd year | <u>24,840</u> | – (@ 6% of 4,14,000) |
| | 389160 | |

# 5. FOREIGN EXCHANGE ARITHMETICS

"Foreign Exchange" means the general mechanism by which a bank converts the currency of one country into that of another.

## FUNDAMENTALS OF FOREIGN EXCHANGE

There are three fundamentals of foreign exchange.

1. Every country has its own currency.
2. The exchange of currency mostly put through by the banks.
3. Almost all exchanges of one currency for another are affected with the help of credit instruments.

## SOME CONCEPTS:

**Concept: I:** Home currency or Domestic currency:

Currency of own country is called home currency or domestic currency. For example;

| Country | Currency | Home Currency |
|---|---|---|
| USA | $ | Home Currency |
| India | ₹ | Home Currency |

**Concept: II:** Foreign Currency:

For any country, currency of other country is foreign currency.

For example ₹ is foreign currency for USA and likewise $ is a foreign currency for India.

## DIRECT AND INDIRECT QUOTE:

A currency quotation is the price of a currency in terms of another currency.

For example, $1= ₹ 70, means, one dollar can be exchanged for ₹ 70 or we may say that we have to pay ₹ 70 to buy one dollar.

The foreign exchange quotation can be either **direct quotation** or/ and **indirect quotation**.

**DIRECT QUOTE**: It is the home currency price of one unit of the foreign currency, i.e. $1= ₹ 70 is direct quote of Indian Currency.

**INDIRECT QUOTE**: It is the foreign currency price of one unit of the home currency, i.e. ₹ 1=$0.0143 is an indirect quote.

- wef 02.08.1993 Banks began quoting on direct basis only.

**TYPES OF EXCHANGE RATE:**

Types of Exchange Rate are based on **Value Date**. The value date is a date on which the exchange of currencies actually takes place.

**TYPES**:

**(i)** **CASH/READY:** It is the rate when an exchange of currencies takes place on the date of the deal.

**(ii)** **TOM:** When the exchange of currencies takes place on the next working day after the date of deal i.e. tomorrow, it is called the TOM rate.

**(iii)** **SPOT:** When the exchange of currencies takes place on the second working day after the date of the deal, it is called the SPOT rate.

**(iv)** **FORWARD RATE:** If the exchange of currencies takes place after a period of SPOT date, it is called forward rate. Forward rates generally expressed by indicating a Premium/Discount for the forward period.

**(v)** **PREMIUM:** When currency is costlier in forward or say for a future value date, it is said to be at premium.

In the direct method of quotation, the premium is added to both the selling and buying rate.

**(vi)** **DISCOUNT :** If currency is cheaper in the forward or for a future value date, it is said to be at a discount.

In the case of a direct quotation, the discount is subtracted from both the rates, i.e. buying and selling rates.

**QUOTE:**

First, it should be clear that rate is **quoted by Bank** and this quote will be **from bank's point of view**.

Bank may quote rate like;

a) $1= ₹ 60 or

b) $1= ₹ 60.10 – 60.20 or $1= ₹ 60.10/20

What does it mean?

**Quote like (a)** is called **one way Exchange Rate quotation**, means Bank will buy and sell at same rate, i.e. $1= ₹ 60. We may call that in one way Exchange Rate quotation, the **Bid rate** (buying rate of Bank) and the **Ask Rate** (selling rate of bank) are same.

**Quote like (b)** is called **two way Exchange Rate quotation**, means Bank will buy and sell on different rate. In this quote Bank will buy @$1= ₹ 60.10 and sale @ $1= ₹ 60.20. So we may say that the buying rate or Bid rate is $1=₹ 60.10 and selling rate or Ask rate is $1= ₹ 60.20.

**Note:** Normally Ask rate always remains more than Bid rate.

**(Ask rate>Bid rate)**

**CROSS RATE**: If a person wants to remit Euro from India, but Rupees/Euros rates are normally not quoted then, Indian Bank have to buy dollar first against the Rupees and same dollars will be disposed off overseas to acquire the Euros.

**Example-1**: If Samar wants to remit Euros from India, but normally Rupees/Euros are not quoted. If the quote available is

$1= ₹ 60.1250/355 in India and

$1=Euro 0.8757 in London

Calculate Euro/Rupee quote.

**Answer**: We have to find out that how many Rupees is equivalent to one Euro. First understand the actions those shall take place with the help of following diagram;


It is clear from the above diagram that Samar will pay to Indian Bank in Rupees, Indian Bank will pay to Foreign Bank in dollar and for the value of dollar Foreign Bank will pay to Indian Bank in Euro and ultimately Indian Bank will pay to Samar in Euro.

Now, see Euro 0.8757 = $1

Again, $1= ₹ 60.1355 (it is selling price)

Euro 0.8757 = ₹ 60.1355

So Euro1 = ₹ 60.1355/ 0.8757

Euro1 = ₹ 68.6713

**CALCULATION OF FORWARD POINT**:

Forward points can be calculated as under;

$$\text{Forward point} = \frac{\text{Spot rate} \times \text{Interest rate differential} \times \text{forward period}}{100 \times \text{Number of days in a year}}$$

**CALCULATION OF INTEREST DIFFERENCIAL:**

Interest Rate Differential can be calculated as under;

Interest differential or Interest rate differential

$$= \frac{100 \times \text{No of days in a year} \times \text{forward point}}{\text{Spot rate} \times \text{forward period}}$$

**METHODS OF QUOTING FORWARD RATES:**

In forein exchange market forward rates are not quoted directly for one month, two months, three months, etc. Spot rate and forward defferentials are quoted seperately and to arrive at forward rate, the spot rate is to be adjusted. For example;

Quote available like, $1 = ₹ 65.3180/90

1 month forward = 35 - 32

2 months forward = 72 - 70

3 months forward = 110 - 107

It means 1 month forward rate is $1 = Rs 65.3215/65.3222

Here, $ is on discount and Rupees is on premium.

**V ALUE DATE:** The value date is a date on which the exchange of currencies actually takes place.

**CHAIN RULE**: Calculation of cross rate is based on chain rule with similar steps.

**ARBITRAGE**: Arbitrage is an operation by which one can make risk free profits by undertaking off setting transactions.

## 5. KNOW YOURSELF NOW : FOREIGN EXCHANGE

(*see solution)

[1] What is home currency?
- (a) Currency of foreign country
- (b) Currency of any country
- (c) Currency of own country
- (d) Currency of one's possession

[2] If home currency price is quoted against one unit of foreign currency is called;
- (a) Direct quote
- (b) Indirect quote
- (c) Home currency quote
- (d) Foreign currency quote

[3] If the foreign currency price is quoted against one unit of home currency is called;
- (a) Direct quote
- (b) Indirect quote
- (c) Home currency quote
- (d) Foreign currency quote

[4] If quotation like $1 = ₹ 60 is available, it means it is -
- (a) Direct quote
- (b) Indirect quote
- (c) Foreign currency quote
- (d) Home currency quote

[5] The date on which the exchange of currency actually takes place is known as;
- (a) Exchange date
- (b) Transaction date
- (c) Value date
- (d) All of the above.

[6] If the exchange of currency takes place on the date of deal, the type of exchange rate is known as;
- (a) Spot rate
- (b) TOM rate
- (c) Cash/ready rate
- (d) Premium rate

[7] When the exchange of currency takes place on next working day, the type of exchange is called;
- (a) Cash rate
- (b) TOM rate
- (c) Spot rate
- (d) Forward rate

[8] When the exchange of currencies takes place on the second working day after the date of deal, the type of exchange rate is called;
- (a) Ready rate
- (b) TOM rate
- (c) Spot rate
- (d) Forward rate

[9] If the exchange of currencies takes place after a period of spot date, the type of exchange rate is called;
- (a) Ready rate
- (b) TOM rate
- (c) Spot rate
- (d) Forward rate

[10] When currency is costlier in forward or for future value date, it is said to be at ......

(a) Discount (b) High rate
c) High value (d) Premium

[11] If currency is cheaper in forward or for future value date, it is said to be at .....

(a) Discount (b) Lower value
(c) Cheaper value (d) Costly

[12] Ask rate is ......

(a) Selling rate (b) Buying rate
(c) Both of the above (d) None of the above

[13] Bid rate is ......

(a) Selling rate (b) Buying rate
(c) Market rate (d) All of the above

[14] If quotation is like $ 1 = ₹ 67, what does it mean?

(a) It is one way exchange rate of quotation
(b) It is buying rate
(c) It is selling rate
(d) Bid rate and ask rate is same
(e) All of the above

[15] If quotation is like $ 1 = ₹ 67.10/20, what does it mean?

(a) It is two way exchange rate of quotation
(b) The buying rate is ₹ 67.10
(c) The selling rate is ₹ 67.20
(d) All of the above

[16] If direct quote of foreign currency is not available, the rate is calculated through common currency quote is known as;

(a) Indirect quote (b) Forward rate
(c) Cross rate (d) Foreign-domestic quote.

[17] Calculation of cross rate is based on ;

(a) Chain rule
(b) Off setting transactions
(c) Exchange rule
(d) All of the above

[18] A person can make risk free profits by undertaking off setting transactions is known as;

(a) Profit (b) Forward profit
(c) Risk free profit (d) Arbitrage

[19] ...............is an operation in which a person borrows foreign currency in one market and lend in other market.

(a) Cross transaction
(b) Off setting transaction
(c) Foreign transaction
(d) Preferential transaction

[20]* If available quote is Euro 1 = $ 27, then the dollar is worth .......... Euro.

(a) 0.037 (b) 27
(c) 27.037 (d) 27.01

[21]* If available quote is $ 1 = 111.11 yen and $ 1 = Rs. 76.0, then the Rs. is worth ....... yen.

(a) 0.8466 (b) 0.6840
(c) 1.6491 (d) 1.4619

[22] The price at which one can enter into contract today to buy/sell a currency after 60 days from today is called .........

(a) Spot Rate (b) TOM Rate
(c) Forward Exchange Rate (d) Future Exchange Rate.

[23] The forward rate has .......... components.

(a) Two (b) Three
(c) One (d) Four

[24] The components of forward rate are;

(a) Spot rate, bid rate, selling rate
(b) Spot rate, premiun and discount
(c) Spot rate, Tom rate, forward point
(d) Both (a) and (c)

[25] The formula for calculation of forward point is;

(a) $\frac{(\text{Spot rate} \times \text{Interest rate differential}) \times \text{Forward period}}{100 \times \text{Number of days in a year}}$

(b) $\frac{\text{Spot rate} \times 365}{\text{Forward Period}}$

(c) $\frac{(\text{Spot rate} \times \text{Interest rate differential}) \times \text{Number of days in a year}}{\text{Forward Period}}$

(d) Both (a) & (c)

[26] The formula for interest rate differential is;

(a) $$\frac{(100\times \text{Number of days in a year})\times \text{Forward point}}{\text{Spot rate}\times \text{Forward Period}}$$

(b) $$\frac{\text{Forward point}\times \text{Forward period}}{\text{Spot rate}\times 365}$$

(c) $$\frac{\text{Forward period}\times \text{Forward point}}{(\text{Spot rate}\times \text{Interest rate differential})\times \text{Number of days in a year}}$$

(d) None of the above.

[27]* What will be the forward point, if Spot exchange rate is 1.2500 and interest differential is 3%; the forward period is 120 days?

(a) 0.1250 (b) 0.1520
(c) 0.0123 (d) 0.1230

[28]* Calculate interest differential, if the forward point is 0.0123 and spot rate is 1.2500 and forward period is 120 days.

(a) 3% (b) 4%
(c) 2.90% (d) 2.89%

[29]* Calculate the interest differential if forward point is 0.0125 and spot rate is Euro 1 = $ 1.7135, forward period is 120 days and number of days in a year is 360 days.

(a) 2.36% (b) 2.71%
(c) 2.81% (d) 2.18%

[30]* If Spot exchange rate is $ 1 = ₹ 75.0 and the interest rate differential is 4%. Calculate forward points for 120 days forward period.

(a) 0.2700 (b) 0.8976
(c) 0.9863 (d) 1.2222

[31] What is forward differential?

(a) Spot rate (b) TOM rate
(c) Swap rate (d) Forward rate

[32] The Spot exchange rate and the forward exchange rate differ by the.....

(a) Type of trade
(b) Timing of the actual currency exchange
(c) Type of currency
(d) All of the above.

[33] What is the meaning of "INR (Rs.) rose from 66.57 to 65.75" in respect of $ 1 ?

(a) The US gains and INR loses
(b) The INR gains and US loses
(c) These numbers refer to Tom rate
(d) These numbers refer to forward rate

[34] If dollar - INR is equal to ₹ 67.75 and dollar- BTK (Bangladeshi Taka) is BTK 95.17, the cross rate INR- BTK rate is;

(a) 1.4047 INR for BTK
(b) 1.4047 BTK for INR
(c) 8.0347 BTK for INR
(d) 1.5027 INR for BTK

[35] The benefit of using foreign exchange broker is that the broker provides;

(a) Low-Cost trading services
(b) Technical support
(c) Prompt information
(d) Liaison service between traders

## ANSWERS

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1 (c) | 2 (a) | 3 (b) | 4 (a) | 5 (c) | 6 (c) | 7 (b) | 8 (c) | 9 (d) |
| 10 (d) | 11 (a) | 12 (a) | 13 (b) | 14 (e) | 15 (d) | 16 (c) | 17 (a) | 18 (d) |
| 19 (b) | 20 (a) | 21 (d) | 22 (c) | 23 (b) | 24 (b) | 25 (a) | 26 (a) | 27 (c) |
| 28 (a) | 29 (d) | 30 (c) | 31 (c) | 32 (b) | 33 (b) | 34 (b) | 35 (a) | |

## SOLUTION

[20] Euro 1 = $ 27
or $27 = Euro 1
so $1 = Euro 1/27
= Euro 0.037

[21] $1 = 111.11 yen
and $1 = Rs. 76
so Rs. 76 = 111.11 yen
Rs. 1 = 111.11/76 yen
= 1.4619 yen

[27] $$\text{Forward point} = \frac{(\text{Spot rate} \times \text{Interest rate differential}) \times \text{forward period}}{100 \times \text{Number of days in a year}}$$

$$= \frac{1.2500 \times 3 \times 120}{100 \times 365}$$

$$= 0.0123$$

Note : If no of days is not provided, it should be 365

[28] Interest differential or Interest rate differential

$$= \frac{100 \times \text{No of days in a year} \times \text{forward point}}{\text{Spot rate} \times \text{forward period}}$$

$$= \frac{100 \times 365 \times 0.0123}{1.2500 \times 120}$$

= 3%

[29] Interest differential or Interest rate differential

$$= \frac{100 \times \text{No of days in a year} \times \text{forward point}}{\text{Spot rate} \times \text{forward period}}$$

$$= \frac{100 \text{x} 360 \text{x} 0.0125}{1.7135 \text{x} 120}$$

= 2.18%

[30] Forwardpoint

$$= \frac{\text{Spot Rate x Interest Rate Differcatial x Forward Point}}{\text{100 x Number of days in a year}}$$

$$= \frac{75 \times 4 \times 120}{100 \times 365}$$

= 0.9863

[34] \$ 1 = ₹ 67.75 and \$ 1 = BTK 95.17
So, ₹ 67.75 = BTK 95.17

So, ₹ 1 = BTK $\frac{95.17}{67.75}$

₹1 = BTK 1.4047

# MODULE: B
# PRINCIPLES OF
# BOOKKEEPING & ACCOUNTANCY

## 6. DEFINITION, SCOPE AND ACCOUNTING STANDARDS

According to American Institute of Certified Public Accounts- "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 a financial character and interpreting the results thereof."

**BOOK KEEPING:**

Book keeping means recording the business transactions.

**ACCOUNTANCY**:

Accountancy means compilation of accounts in such a way that one is in a position to know the state of affairs of the business. Accountancy (accounting procedure) involves the following;

(a Systematic classification of business transactions for recording them in the books of accounts.

(b) Summarizing of recorded events and presents them in a systematic way viz;

- Trial Balance
- Profit and Loss Accounts and
- Balance Sheet

(c) Interpreting the financial transactions from the data and financial statements.

**PURPOSE \OF ACCOUNTANCY**:

1. **To keep systematic records**: Accounting records the business transactions take place and also assets and liabilities of the business.
2. **To ascertain the results of the operations**:

   Accounting helps in ascertaining the result like **profit or loss** as business entities prepare trading and profit & loss account or income and expenditure account that shows profit or loss of business.

3. **To ascertain financial position of the business:**

   It also helps to ascertain the **assets and liabilities** as well as the amounts **receivables** from debtors and **payable** to creditors.

4. **To Facilitate rational decision making**:

   Accounting provides the financial information that helps in making rational decisions about various aspects of business.

5. **To satisfy the requirements of law**:

   As per different laws, entities like company, society etc are compulsorily required to maintain accounts.

**ADVANTAGE/OBJECTIVE OF ACCOUNTANCY**:

(i) To provide information for making economic decisions.

(ii) To provide information to investors/creditors.

(iii) To provide information for comparing, judging the management's ability.

(iv) To provide information to various users like Income Tax authority, Sales Tax authority, business associates etc.

**TYPES OF ACCOUNTING**:

1. **<u>FINANCIAL ACCOUNTING</u>:** Financial accounting is important in providing the reliable and sufficient information to investors in order to be able to make efficient investment decisions.
2. **<u>COST ACCOUNTING</u> :** Cost accounting is concerned with the application of costing principles, methods and techniques for ascertaining the costs, with a view to controlling them, and assessing the profitability and efficiency of the enterprise.
3. **<u>MANAGEMENT ACCOUNTING</u>:** Management accounting is concerned with the preparation and presentation of accounting and controlling information for various decisions making.
4. **<u>SOCIAL RESPONSIBILITY ACCOUNTING</u>:** Social responsibility accounting is such type of accounting who considers the social effects of business decisions, in addition to the economic effects.
5. **<u>HUMAN RESOURCE ACCOUNTING</u>:** Human Resource accounting seeks to report and emphasize the importance of human resources like knowledgeable, trained, loyal, committed employees etc and valuing and accounting of human resources based either on costs or economic value of human resources.

6. **<u>INFLATION ACCOUNTING</u>:** Inflation accounting is concerned with the adjustment in the value of assets and of profit, in the light of changes in the price level.

**ACCOUNTING STANDARDS IN INDIA:**

- Institute of Chartered Accountants of India (ICAI) recognizing the need to harmonize the diverse accounting policies and practices, constituted an Accounting Standards Boards (ASB) on 21.04.1977.
- ASB formulates accounting standard so that the council of ICAI may mandate such standards.
- The auditors who are members of ICAI are require to follow the accounting standards.
- Section 134(5) of the Company Act 2013 makes responsible to Board of Directors to comply with mandatory accounting standards.
- To advice the Central Government for adoption of accounting policies and accounting standards by the corporate sectors "National Advisory Committee on Accounting Standards" had been notified on 15.06.2001.

**Accounting Standards (Mandatory):**

| **No** | **Particulars** |
|---|---|
| **AS 1** | Disclosure of Accounting policies |
| **AS 2** | Valuation of Inventories |
| AS 3 | Cash Flow Statements |
| **AS 4** | Contingencies and Events Occurring after the Balance Sheet Date |
| **AS 5** | Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies. |
| **AS 6** | Depreciation Accounting |
| AS 7 | Construction Contracts |
| AS 8 | Accounting for Research and Development |
| AS 9 | Revenue Recognition |
| AS 10 | Accounting for Fixed Assets |
| AS 11 | The effects of changes in Foreign Exchange Rate |

| | |
|---|---|
| AS 12 | Accounting for Government Grant |
| AS 13<br>AS 14 | Accounting for Investment<br>Accounting for Amalgamation |
| AS 15 | Accounting for Retirement Benefits in the Financial Statements of Employee. |
| AS 16 | Borrowing Cost |
| **AS 17** | Segment Reporting |
| **AS 18** | Related Party Disclosure |
| AS 19 | Leases |
| AS 20 | Earnings per Share |
| AS 21 | Consolidated Financial Statements |
| **AS 22** | Accounting for Taxes on Income |
| **AS 23** | Accounting for Investments in Associates in Consolidated Financial Statements. |
| AS 24 | Discontinuing Operations |
| **AS 25** | Interim Financial Reporting |
| **AS 26** | Intangible Assets |
| AS 27 | Financial Reporting of Interests in Joint Ventures. |
| **AS 28** | Impairment of Assets |
| AS 29 | Provisions, Contingent Liabilities and Contingent Assets. |

**Acconting Standards (Not Mandatory):**

| No | Particulars |
|---|---|
| AS 30 | Financial Instruments; Recognition and measurement |
| AS 31 | Financial Instruments; Presentation |
| AS 32 | Financial Instruments; Disclosure |

**GENERALLY ACCEPTED ACCOUNTING PRINCIPLES OF USA (US GAAP):**

- GAAP is the accounting standard used in USA. GAAP refers to the standard framework of guidelines for financial accounting used in any given jurisdiction.

- The GAAP is not written in law, however US Security and Exchange Commission (SEC) requires that it should be followed in financial reporting.
- GAAP are imposed on companies so that investors have a minimum level of consistency in financial statements used for investment decision.
- GAAP requires financial statements like balance sheet, income statement, change in equity, cash flow statement, foot notes etc.
- Companies are expected to follow GAAP rules in reporting.
- GAAP provides separate objectives for business entities and non-entities.

**INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS):**

- International Financial Reporting Standards are designed as a common global language for business affairs so that company accounts are understandable and comparable across international boundaries.
- IFRS is the accounting standard used in over 100 countries around the world.
- IFRS aim to provide relevant information to a wide range of users.
- IFRS has one objective for all types of entities.

**TRANSFER PRICING MECHANISM**:

- It is pricing of goods and services within a multidivisional organization, particularly with regard to cross- border transactions.
- Transfer price, in the context of banking, is the interest charged by the surplus funds to the deficit funds branch on the transfer of fund (through Head Office account). The price (rate of interest) may vary from bank to bank.

## 6. KNOW YOURSELF NOW : DEFINITION, SCOPE AND ACCOUNTING STANDARDS

[1] A set of documents that shows the results of business operation during a period is called;

(a) Accounting Standard (b) Financial Statements
(c) Accounting (d) USGAAP

[2] What is transfer pricing mechanism?

(a) It is interest paid by bank to customer
(b) It is interest charged by bank to customer
(c) It is interest charged by the surplus fund's branch to the deficit fund's branch.
(d) It is interest paid by the surplus funds branch to the deficit funds branch.

[3] Recording, classifying and summarising business transactions are known as

(a) Balance sheet (b) Profit & Loss Account
(c) Accounting (d) Costing

[4] Accounting Standard Board (ASB) is constituted by;

(a) Government of India
(b) Institute of Chartered Accountants fo India (ICAI)
(c) Ministry of Company Affairs
(d) SEBI

[5] Accounting standards are formulated by;

(a) ICAI (b) SEBI (c) ASB (d) GOI

[6] Accounting standards are issued by;

(a) ICAI (b) ASB (c) SEBI (d) GOI

[7] Accounting standard AS-1 relates to;

(a) Revenue Recognition
(b) Accounting for Taxes of Income
(c) Impairment Assets
(d) Disclousure of Accounting Policies.

[8] The number of Accounting Standars are;

(a) 29 (b) 3 (c) 32 (d) 22

[9] The number of Mandatory Accounting Standars are;

(a) 29 (b) 32 (c) 3 (d) 22

[10] The number of Non-mandatory Accounting standards are;

(a) 29 (b) 32 (c) 3 (d) 22

[11] Accounting standard As -6 ralates to;

(a) Leases (b) Earning per Share
(c) Intangible Assets (d) Depreciation Accounting

[12] Accounting Standard AS-13 relates to;
- (a) Accounting for investment
- (b) Revenue Recognition
- (c) Accounting for Research & Development
- (d) Accounting for Amalgamation

[13] The accounting rules used to prepare financial statements for the publicly traded company and many private companies are known as:
- (a) Generally Accepted Accounting Principles (GAAP)
- (b) Accounting Standard
- (c) Financial Reporting Standard
- (d) International Financial Reporting Standard (IFRS)

[14] GAAP are followed in;
- (a) India
- (b) USA
- (c) All over world
- (d) None

[15] Match the following:
- (i) AS - 3 : (A) Provisions, Contingent Liabilities/assets
- (ii) AS - 29 : (B) Accounting of Government grants
- (iii) AS - 10 : (C) Cash Flow Statement
- (iv) AS - 12 : (D) Accounting for Fixed Assets.
- (a) (i) (C), (ii) (A), (iii) (D), (iv) (B)
- (b) (i) (B), (ii) (A), (iii) (C), (iv) (D)
- (c) (i) (C), (ii) (D), (iii) (A), (iv) (B)
- (d) (i) (C), (ii) (B), (iii) (D), (vi) (A)

[16] Which of the following is correct match?
- (a) AS : 26 – Intangible Asset
- (b) AS : 18 – Related Party Disclosure
- (c) AS : 7 – Cash Flow Statement
- (d) Both (a) & (b)

[17] Who formulates the International Accounting Standards?
- (a) US - GAAP
- (b) International Financial Reporting Standards
- (c) International Accounting Standard Board
- (d) International Chartered Accounted Association.

[18] The price at which two unrelated and non-desperate parties would agree to a transaction is known as;
- (a) Agreed price
- (b) Arm's Length Price
- (c) Mutual Price
- (d) Comparable Uncontrolled Price (CUP)

[19] Accounting who has concern with the application of costing principles, methods and techniques for ascertaining the costs is know as;

(a) Basic Accounting (b) Cost Accounting
(c) Company Accounting (d) General Accounting

[20] ............ is concerned with adjustment in the value of assets (current and fixed) and of profit, in the light of changes in the price level.

(a) Valuation Accounting
(b) Depreciation
(c) Asset Maintenance Accounting
(d) Inflation Accounting

[21] Which of the following does not match?

(a) AS : 12 - Accounting for Government Grants
(b) AS : 24 - Discounting Operation
(c) AS : 29 - Borrowing Cost
(d) AS : 21 - Consolidated Financial Statement.

[22] If a company does not follow mandatory accounting standard, the role of auditor of the company is;

(a) To report to Accounting Standard Board
(b) To ask couses of doing so from company
(c) To quantify their audit report.
(d) To report to Registrar of Company.

[23] AS : 4 relates to;

(a) Contingent Liabilities
(b) Contingent Assets
(c) Borrowing Cost
(d) Contigencies and events accuring after the Balance Sheet date

[24] Who advises the Government of India on the formulation and laying down of accounting policies and accounting standards?

(a) Department of Company Affairs
(b) The Institute of Chartered Accountants of India
(c) Accounting Standard Board
(d) National Advisory Committee on Accounting Standard

[25] Under Section 129(5) of the Comapany Act 2013, if the financial statement donot comply with the accounting standards, which of the following has to be disclosed by the company?

(a) The deviation from the accounting standards
(b) The reasons for such a deviation
(c) The financial effects arising out of such deviation.
(d) All of the above.

[26] A company listed on stock exchange in India ..........,
- (a) has to follow GAAP
- (b) has to follow International financial reporting
- (c) has to follow Accounting Standards
- (d) any one of the above.

[27] Who determine the area of Accounting Standard?
- (a) The Institute of Chartered Accountant of India
- (b) Accounting Standard Board
- (c) Security and Exchange Board of India
- (d) Auditor of the company.

[28] As per Accounting Standard 25, what is interim reporting period?
- (a) The period, which is not a complete financial period
- (b) Period of two financial periods
- (c) More than one financial period
- (d) None of the above.

[29] Financial Statements normally includes;
- (a) Balance Sheet
- (b) Statement of Profit and Loss
- (c) Cash Flow Statement
- (d) Notes on accounts
- (e) All of the above

[30] What is Interim reporting?
- (a) Financial Reports for less than complete financial period
- (b) Financial Reports for two financial periods
- (c) Financial reports for part of two financial periods
- (d) All of the above.

[31] Components of an interim financial report are:
- (a) Condensed balance sheet
- (b) Condensed statement of profit and loss
- (c) Selected explanatory notes
- (d) Condensed cash flow statement
- (e) All of the above.

## ANSWERS

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1 (b) | 2 (c) | 3 (c) | 4 (b) | 5 (c) | 6 (a) | 7 (d) | 8 (c) | 9 (a) |
| 10 (c) | 11(d) | 12 (a) | 13 (a) | 14 (b) | 15 (a) | 16 (d) | 17 (c) | 18 (b) |
| 19 (b) | 20 (d) | 21 (c) | 22 (c) | 23 (d) | 24 (d) | 25 (d) | 26 (c) | 27 (b) |
| 28 (a) | 29 (d) | 30 (a) | 31 (e) | | | | | |

# 7. BASIC ACCOUNTANCY PROCEDURES

Accounting is called the language of business and for effectiveness of language, it is necessary that it should be based on certain uniform standards. These standards are termed as accounting principles.

Accounting principles are guidelines to establish standards for sound accounting practices and procedures.

## CONCEPT

Accounting concepts, based on fundamental ideas or on basic assumptions are utilized at two stages,

i) at the recording stage and ii) at the reporting stage.

## AT THE RECORDING STAGE

(i) Cost Concept

(ii) Money Measurement Concept

(iii) Business Entity Concept

(iv) Realization Concept

(v) Dual Aspect Concept

(vi) Historical Records Concept

## AT THE REPORTING STAGE

(i) Going Concern Concept

(ii) Matching Concept

(iii) Accounting Period Concept

(iv) Full Disclosure Concept

(v) Materiality Concept

(vi) Conservatism Concept

(vii) Consistency Concept

## COST CONCEPT

* Every business transaction is recorded in the book at cost price (cost + freight+ installation charge).
* Fixed assets are kept at cost price not on market price.
* Every transaction is recorded with present value and not any future value.
* Unrealized gains are ignored.
* An item that has no cost is not taken in book.

## MONEY MEASUREMENT CONCEPT

* Every transaction that is recorded in books of accounts must be measured in terms of money. It means any inflation or deflation in the value of any asset will not be included.

## BUSINESS ENTITY CONCEPT

* Proprietor and business are two separate entities, so capital contributed by the owner is liability for business.
* Any money withdrawn by owner is drawings.
* Profit is liability and loss is an asset.
* All entries are kept from business point of view and not from owner point of view.

## REALISATION CONCEPT

* This concept explains when revenue is treated as realized or earned.
* It is realized or earned on the date when the property in the goods pass to the buyer and he becomes legally liable to pay.
* No future income is considered.

## DUAL ASPECT CONCEPT

* Every transaction has a double effect i.e. debit and credit.
* The accounting equation is ASSETS = CAPITAL + LIABILITY

## HISTORICAL RECORDS CONCEPT

* The business transactions are recorded as and when they take place, i.e. date wise. This leads to the preparation of historical records of all transactions.

**GOING CONCERN CONCEPT**

* This concept explains that the business is going concern and transactions are recorded accordingly.
* If an expense incurred and utility is consumed during the year, then it is treated as expense, otherwise it is recorded as an asset.
* The fixed assets are valued at cost price, not at market value.
* Current assets are valued at market price or cost price whichever is less.
* Reserve and provisions are created for any future liability.
* Deferred revenue expenditures are written off over a number of years.

**MATCHING CONCEPT**

* This concept explains that the income of a certain period have to match with expenses of that period only.
* Deferred revenue expenditure concept arises due to this concept.

**ACCOUNTING PERIOD CONCEPT**

* It is assumed that business will run for a long period, so accounts of each period are recorded.

**FULL DISCLOSURE CONCEPT**

* The record should not conceal anything.
* All information relating to the activities of the business should be provided honestly.
* Disclosure of material facts that don't reported in accounting statements, like contingent liabilities, market value of investment.

**MATERIALITY CONCEPT**

* All material information must be recorded.
* Non- material (insignificant) items are not required to recorded (paisa is not a material item).
* If combined total of any item is less than 10%–15%, then they are insignificant.

**CONSERVATISM CONCEPT**

* All possible losses must be taken into consideration.
* All anticipated profits should be ignored.

* Provision for doubtful assets.
* Valuation of stock: cost or market value whichever is less. This is also called principles of prudence.

**CONSISTENCY CONCEPT**

Whatever method is adopted for recording must be regularly followed in the future also. For example, for calculating depreciation SLM is chosen then it should be followed in future also. If it is necessary to change, then the effect of such change must be mentioned.

**DOUBLE ENTRY SYSTEM**

* Double entry system is scientific.
* For every transaction, two parties must be interested.
* Double entry system means every debit entry has a corresponding credit entry.

**MERIT OF DOUBLE ENTRY SYSTEM**

(i) It keeps complete record of business transactions.

(ii) It provides a check on the arithmetical accuracy, since every debit has corresponding credit to it and vice-versa.

(iii) The Balance- Sheet or Profit & Loss account can be prepared any time.

## 7. KNOW YOURSELF NOW : BASIC ACCOUNTANCY PROCEDURES

[1] The guidelines who establish standards for sound accounting practices and procedures in reporting the financial status is known as;

(a) Accounting principles (b) Concept of accountancy
(c) Accounting conventions (d) Accounting practice

[2] Fixed assets are kept at the cost of purchase and not their market value is....

(a) Dual aspect concept
(b) Cost concept
(c) Money measurement concept
(d) Consistency concept

[3] Any inflation or deflation in the value of any asset will not be included, this concept is called as;

(a) Money measurement concept
(b) Cost concept
(c) Historical record concept
(d) None of the above

[4] Profit is a liability while loss is an asset is due to;

(a) Dual aspect concept (b) Business entity concept
(c) Realisation concept (d) None of the above

[5] The concept who tells when is the revenue treated as realised or earned is known as;

(a) Realisation concept
(b) Cost concept
(c) Profitability concept
(d) Revenue realisation concept

[6] According to which of the following concepts, the entity of the proprietor is different from that of a firm?

(a) Realisation concept (b) Business entity concept
(c) Materiality concept (d) There is nothing as such

[7] The accounting equation Assets = Capital + Liability is due to...

(a) Dual aspect concept (b) Realisation concept
(c) Conservatism concept (d) Matching concept

[8] The term 'book value' is used for....

(a) Value of the asset
(b) Cost of the asset
(c) Cost after depreciation
(d) Amount shown in accounting record

[9] Every transaction has two aspects i.e. debit and credit, this concept comes under;
(a) Dual aspect concept (b) Conservatism concept
(c) Realisation concept (d) None of the above

[10] All possible losses must be taken into consideration, whereas all anticipated profits should be ignored, this concept is;
(a) Convention of consistency (b) Realisatism concept
(c) Conservatism concept (d) Convention of conservatism

[11] If an expense is incurred and its utility is consumed during the year, then it is treated as expenditure, otherwise it is recorded as an asset, this is the concept of–
(a) Accounting period concept
(b) Going concern concept
(c) Profitability concept
(d) Cost concept

[12] Deferred revenue expenditure concept arises due to....
(a) Going concern concept
(b) Accounting period concept
(c) Cost concept
(d) Matching concept

[13] Accounting concepts are used at (i) the recording stage (ii) the reporting stage (iii) planning stage
(a) (i) & (ii) (b) (i), (ii) & (iii)
(c) (i) & (iii) (d) (iii) & (iii)

[14] If the straight line method of depreciation is once chosen, then it should be followed in future, is....
(a) Going concern concept
(b) Accounting period concept
(c) Convention of consistency
(d) Convention of materiality

[15] What is/are the merits of double entry system?
(a) It keeps the complete record of business transactions
(b) It provides a check on arithmetical accuracy
(c) The balance sheet can be prepared at any time
(d) All of the above

[16] The concept of conservatism is also known as;
(a) The concept of expenditure cutting
(b) The concept of profitability
(c) The concept of prudence
(d) Both (a) & (c)

[17] Which concept recognises distinction between the receipt of cash and the right to receive it?
(a) Accounting record
(b) Accounting concept
(c) The accrual concept
(d) Revenue recognition concepts

[18] "All significant accounting practices and policies should be disclosed," this assumption is under;
(a) Honesty policy
(b) Convention of full disclosure
(c) Convention of materiality
(d) Honest accounting practice

[19] "Transactions are to be recorded in the books of account as and when they take place i.e. in chronological manner and date wise," this concept is know as;
(a) Materiality concept (b) Historic record concept
(c) Cost concept (d) Business entity concept

[20] "All transactions recorded in the books of account should be evident and supported by objective documentary evidence", this concept is known as;
(a) Materiality concept
(b) Business entity concept
(c) Full disclosure concept
(d) Objective evidence concept

[21] Only those transactions that can be recorded in monetary term should be recorded, comes under which concept?
(a) Consistency concept
(b) Going concern concept
(c) Money measurement concept
(d) Cost concept

[22] The rules and conventions that are used as guidelines to prepare, control and record business transactions are known as;
(a) Accounting concept
(b) Accounting principles
(c) Convention of accounting
(d) Generally accepted accounting practices

[23] Provisions against doubtful debt/assets is made under;
(A) Materiality concept (b) Conservatism concept
(c) Cost concept (d) Accounting policy

[24] Items of small significance need not to be recorded, this concept is known as;

(a) Convention of materiality
(b) Convention of conservatism
(c) Cost concept
(d) Convention of consistency

[25] If you purchase a car, as a result cash will decrease equivalent to cost of car and car will be added as asset, this comes under;

(a) Double entry system
(b) Dual aspect concept
(c) Cost concept
(d) Asset - liability concept

[26] Accounting assumes that the business will continue to operate for a long time. This concept is know as;

(a) Going concern concept
(b) Consistency concept
(c) Business entity concept
(d) All of the abov

## ANSWERS

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1 (a) | 2 (b) | 3 (a) | 4 (b) | 5 (a) | 6 (b) | 7 (a) | 8 (d) | 9 (a) |
| 10 (d) | 11 (b) | 12 (d) | 13 (a) | 14 (c) | 15 (d) | 16 (c) | 17 (c) | 18 (b) |
| 19 (b) | 20 (d) | 21 (c) | 22 (d) | 23 (b) | 24 (a) | 25 (b) | 26 (a) | |

## 8. MAINTENANCE OF CASH/SUBSIDIARY BOOKS AND LEDGER

Bookkeeping is defined as "**the art of recording business transactions** with a view to having a permanent record of them and of showing their effect on wealth."

By bookkeeping a trader is able to ascertain;

- Nature and value of assets
- The amount of liability
- The profit or loss position during a given period.

### SOME BOOKS

**JOURNAL :**

- Journal is a book of original entry.
- Journal records each transaction.
- If anyone wants to find out a transaction affecting a person or expenses account, one has to turnover all pages of journal.
- Hence transactions are posted from journal to particular pages of ledger.
- Hence journal contains a column L.F (Ledger Folio).

**CASH BOOK:**

- Cash book keeps record of all cash transactions i.e. cash receipt and cash payment.
- All **receipts** are recorded on the **debit side** and all payments are recorded on the credit side.
- For cash transactions, cash book is book of original entry.
- There are three types of cash book, viz; Simple Cash Book, Two (double) columns Cash Book and Three (triple) columns Cash Book.

**LEDGER:**

Ledger is the principal book of accounts where similar transactions relating to a particular person or property or revenue or expense are recorded. The main function of a ledger is to classify or sort out all the items appearing in the journal.

**RELATIONSHIP BETWEEN JOURNAL AND LEDGER**

(i) The transactions are recorded first in the journal and then they are posted in the ledger.

(ii) The process of recording transactions in journal is called JOURANALISING and that of in ledger is called POSTING.

**BASIS OF RECORD KEEPING**

1. **RECORDING:** All transactions should be recorded in the journal as and when they take place.
2. **CLASSIFYING:** After journalizing, all entries are posted to the appropriate ledger account to find out at a glance the total effect of all such transactions.
3. **SUMMARISING:** The last stage is to prepare the trial balance and final accounts to know the financial position and/or Profit and Loss position of the business.

**CATEGORIES OF ACCOUNT**

Accounts are generally categorized into two classes;

(1) PERSONAL ACCOUNTS and

(2) IMPERSONAL ACCOUNTS

**PERSONAL ACCOUNTS**

Personal account is divided into;

i. **Natural Personal Account:** account of a person who is creation of God. For example, Rajesh's account, Proprietor's account, Supplier's account etc.

ii. **Artificial Personal Account:** recognized as person in business i.e. corporate accounts. For example- Company's account, Bank's account, Firm's account, Club's account etc.

iii. **Representative Personal Account:** these are accounts that represent a certain person or group of person.

**IMPERSONAL ACCOUNTS**

Impersonal Account is further divided into;

(a) REAL ACCOUNT and

(b) NOMINAL ACCOUNT

**<u>REAL ACCOUNT</u>:** divided into two types of account;

i. **<u>Tangible Real Accounts</u> :** Account of such things that are tangible (which can be seen, touched, felt physically). For example – cash, land, building etc.

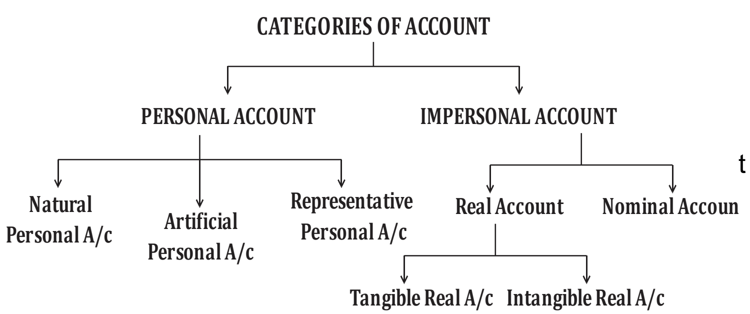
ii. **<u>Intangible Real Account</u>:** Such accounts represent such things that can't be touched, may be measured in money. For example- goodwill, trademarks, patent, copyright etc.

**<u>NOMINAL ACCOUNT</u>**

Nominal accounts are opened in the books to explain the nature of transactions. For example- in business, salary is paid to employee, then cash goes out (cash is a real account) but salary account does not exist. This salary account is nominal accounts. So all expenses, losses, gains are nominal accounts.

**EXAMPLES:**

| PERSONAL ACCOUNTS | REAL ACCOUNTS | NOMINAL ACCOUNTS |
|---|---|---|
| -Bank(artificial person) | - Stock-in-hand | - Salary |
| -Samar Kumar(personal) | - Cash | - Wage |
| -M/s R.K Pvt .Ltd (Company) | -Plant & - Machinery | -Rent |
| -Bank Loan(artificial person) | -Bills receivable | -Interest |
| -Capital(Samar is owner) | -Investment | Etc |
| -Interest Outstanding (representative personal account) | Etc | |



## DEBIT AND CREDIT CONCEPT

- Every transaction affects at least two accounts, one account receives a benefit of certain value and another account would give a benefit of the same value. In other words we may say that one account will be debited by certain value and other account will be credited by same value.
- Debit entry is always recorded first and then the credit entry.

  For correct debit and credit of accounts, rules should be followed.

**Rules for debit and credit**

**1. PERSONAL ACCOUNT**

- Debit the receiver and credit the giver.

**Example:** If you purchase goods from Samar on credit. Here Samar gives and you receive, so Samar's account (personal account) will be credited and Goods Purchase Account will be debited.

**2. REAL ACCOUNT**

- Debit what comes in and Credit what goes out.

**Example :** If you purchase a car for cash.

Here what comes? The Car is coming. So Car Account, a real account will be debited and Cash Account will be credited as cash goes out.

**3. NOMINAL ACCOUNT**

- Debit all expenses and losses and credit all incomes and gains.

**Example :** If you pay salary to your staff.

Here, salary account and cash account will be affected.

- Cash(real account) goes out, so Cash Account – credited
- Salary Account (nominal account) is an expense, so salary account will be debited.

SUMMARY OF RULES (**GOLDEN RULES OF DEBIT &CREDIT**)

| **TYPES OF ACCOUNT** | **DEBIT** | **CREDIT** |
|---|---|---|
| PERSONAL | The receiver | The giver |
| REAL | What comes in | What goes out |
| NOMINAL | Expenses/Losses | Income/gains |

## IMPORTANT POINTS FOR PASSING JOURNAL ENTRIES

1. Find out two corresponding accounts involved in it.
2. Then find out the category of account, viz; personal, real, nominal.
3. Apply the golden rules of debit and credit and find out which account is to be debited and which is to be credited.
4. Enter date in date column, short description of transaction in particular column, amount in debit or credit column.
5. If it is not stated, whether transaction is on cash or on credit basis and name of party is not given, it should be considered on cash basis.

   For example: Purchase goods : Rs7000/-

   Sold goods : Rs5000/-

   Above accounts will be considered on cash transaction.
6. When name of party is given but not stated, whether transaction is on cash or on credit basis, it should be considered as on credit transaction.

   For example: Purchase goods from Samar : Rs7000/-

   Sold goods to M/s Raj Agro : Rs5000-
7. If the word 'Received' or 'Paid' appears in the transaction, it means cash is received or paid.
8. When goods are returned by customer, the 'Sale Return' or 'Returns Inward' should be used.
9. When goods are returned to supplier, the term 'Purchase Return' or 'Returns Outward' should be used.
10. Entries relating to goods are made in five separate accounts depending on the nature of the transaction, viz; Sale Account, Purchase Account, Sales Return Account, Purchase Return Account and Stock Account.

## DISCOUNT

**CASH DISCOUNT ALLOWED:** Discount given when payment is received before the due date.

**CASH DISCOUNT RECEIVED:** Discount received when payment is made before the due date.

**TRADE DISCOUNT:** A discount given for purchases by the wholesalers to the retailers for bulk purchase.

## 8. KNOW YOURSELF NOW : MAINTENANCE OF CASH / SUBSIDIARY BOOKS AND LEDGER

[1] Accounting cycle includes;
(a) Recording, classifying, summarising
(b) Classifying, recording, summarising
(c) Summarising, classifying
(d) Recording, summarising, classifying

[2] The book that keeps records of all cash transactions is known as;
(a) Cash book (b) Journal
(c) Ledger (d) Cash register

[3] 'An art of recording business transactions with a view to permanent record of them and of showing their effect on wealth' is the definition of;
(a) Balance sheet (b) Housekeeping
(c) Bookkeeping (d) Recording

[4] The book of original entry or first entry is;
(a) Ledger (b) Journal
(c) Cash book (d) Register

[5] The process of recording transactions in ledger is known as;
(a) Entry (b) Posting
(c) Writing (d) Recording

[6] The process of recording transactions in journal is known as;
(a) Journalising (b) Recording
(c) Entry (d) Transactions

[7] Accounts are broadly classified into.......classes.
(a) Two (b) Three
(c) Four (d) Six

[8] The accounts of corporate bodies or institutions are classified under;
(a) Real Accounts
(b) Nominal accounts
(c) Artificial personal accounts
(d) Representative personal accounts

[9] Proprietor's account or supplier's account will classify under;
(a) Artificial personal accounts (b) Natural personal accounts
(c) Real accounts (d) Nominal accounts

[10] The amounts standing in 'Provision Account' for payment of arrears to staff members is classify under;
(a) Real account
(b) Artificial account
(c) Nominal account
(d) Representative personal account

[11] The accounts of expenses and incomes are— accounts
(a) Nominal accounts (b) Real accounts
(c) Impersonal accounts (d) Personal accounts

[12] The account for plant and machinery is......
(a) Real account (b) Artificial account
(c) Nominal account (d) Personal account

[13] Rule debit the receiver and credit the giver will apply to which account?
(a) Personal account (b) Real accounts
(c) Nominal accounts (d) All accounts

[14] Which of the following is nominal account?
(a) Salary paid (b) Income account
(c) Rent receivable (d) (a) & (b) both

[15] Which of the following is real account?
(a) Stock-in-godown (b) Cash
(c) Investment (d) All of the above

[16] Personal accounts can be classified into.....categories;
(a) Two (b) Three
(c) Four (d) Five

[17] Capital i.e. owner's contribution is.....
(a) Real account (b) Nominal account
(c) Personal account (d) None of the above

[18] Discount received or commission received is....
(a) Income account (b) Nominal account
(c) Personal account (d) Profit earned account

[19] Rule debit 'what comes in' and credit 'what goes out' will apply to which account?
(a) Personal accounts (b) Real accounts
(c) Nominal accounts (d) All accounts

[20] If a real account is debited by ₹ 50000. What will be the effect on balance of the account?
(a) Balance will increase by ₹ 100000
(b) Balance will decrease by ₹ 50000
(c) Balance will increase by ₹ 50000
(d) Balance will decrease by ₹ 25000

[21] Rule debit 'expenses or losses' and credit 'incomes or gains' will apply to which account?

(a) Personal accounts (b) Real accounts

(c) Nominal accounts (d) All accounts

[22] Credit balance of nominal account represents;

(a) Income (b) Expenditure

(c) Assets (d) Liabilities

[23] If there is a credit balance in personal account and another entry is written on debit side, this will...

(a) Increase the balance

(b) Decrease the balance

(c) Balance will be declined by double amount

(d) Both (b) & (c)

[24] A credit entry in the real account shows that....

(a) Value of assets has increased

(b) Value of assets has decreased

(c) Any old assets has been sold

(d) Both (b) & (c)

[25] Choose the correct matches.

(a) Accounts of persons who are the creation of god- Natural personal account

(b) Accounts of tangible things– Tangible real account

(c) Accounts of corporate bodies– Artificial personal account

(d) All of the above

[26] Which of the following is wrong match?

(a) Bank acount – real account

(b) Account for building – real account

(c) Income or expenditure account – nominal account

(d) Capital (owner's contribution) account – artificial personal account

[27] Which of the following is not a real account?

(a) Bill receivables (b) Trademarks

(c) Bank loan (d) Investment

[28] 'All expenses are recorded on the debit side of the cash book."

(a) True (b) False

[29] The book where the cash transactions are recorded first is journal.

(a) True (b) False

[30] What is cash discount allowed?
(a) Discount given when payment is received
(b) Discount given for heavy purchase
(c) Discount given on late payment
(d) Discount on purchase

[31] A discount given for purchases by the whole salers to the traders for bulk purchase, is called;
(a) Cash discount allowed
(b) Cash discount received
(c) Trade discount
(d) Heavy discount or bulk discount

[32] If Ramesh purchases furniture worth ₹ 15000 for cash. Which accounts will be affected?
(a) Debit furniture a/c and credit cash a/c
(b) Debit cash a/c and credit furniture a/c
(c) Debit cash a/c and credit capital a/c
(d) Both (b) & (c)

[33] If Ramesh receives ₹ 50000 from Aniket. Which accounts will be affected?
(a) Credit Ramesh's a/c and debit Aniket's account
(b) Credit Aniket's a/c and debit Ramesh's a/c
(c) Debit cash account and credit Ramesh's a/c
(d) Debit cash account and credit Aniket's a/c

[34] If a firm pays rent ₹ 10000 in cash to property owner. Which accounts will be affected?
(a) Debit cash account and credit firm's a/c
(b) Debit cash account and credit owner's a/c
(c) Credit cash account and debit rent a/c
(d) Credit cash a/c and bebit firm's a/c

[35] If a firm purchases machinery and pays ₹ 5000 in cash as freight. Which accounts will be affected?
(a) Debit cash a/c and credit firm's a/c
(b) Debit expenditure a/c and credit cash a/c
(c) Credit cash a/c and debit machinery a/c
(d) Credit machinery a/c and debit cash a/c

[36] The treatment of loss of goods by any means should be;
(a) Debit loss a/c (b) Credit goods a/c
(c) Credit purchase a/c (d) Credit sales a/c

[37] The debit balance of petty cash is;

(a) An asset (b) A profit

(c) A loss (d) A liability

[38] If the balance of the accounts is increased by debit entries, it means the nature of account is;

(a) Real account (b) Stock-in-trade account

(c) Cash account (d) Both (a) & (b)

[39] The term imprest system is used in terms of....

(a) Cash book (b) Petty cash book

(c) Journal entry (d) Ledger entry

[40] The net difference of debit and credit total of an account is known as

(a) Balance (b) Net outstanding

(c) Cash balance (d) Gross outstanding

[41] Entries relating to goods are made in ...... separate accounts depending on the nature of the transactions.

(a) Two (b) Three

(c) Four (d) Five

[42] Which accounts are related to goods (i) Sales account (ii) Purchases account (iii) Sales return account (iv) Purchases return account (v) Stock account

(a) (i), (ii) and (v) (b) (i), (ii), (iii) and (iv)

(c) (i), (ii), (iii) and (v) (d) (i), (ii), (iii), (iv) and (v)

[43] which of the following is not correct?

(a) Journal is a book of original entry

(b) A ledger is a principal book of accounts

(c) The book that keeps records of all cash transactions is called cash book.

(d) Process of transferring transaction from the journal into ledger accounts is known as journalising

[44] Sales book is maintained to record the sale on...

(a) Credit (b) Cash

(c) Credit as well as cash (d) None

[45] If a Rice Mill purchases a machinery on cash, the effect of this transaction would;
- (a) Increase assets and liability also
- (b) Increase fixed assets and capital as well
- (c) Increase current assets and decrease fixed assets
- (d) Reduce current assets and increase fixed assets

[46] Cash discount allowed to a debtor should be credited to–
- (a) Discount a/c (b) Customer's a/c
- (c) Sale a/c (d) Income a/c

[47] Withdrawals by proprietor would–
- (a) Reduce liabilities (b) Reduce assets
- (c) Reduce owne's equity (d) Both (b) & (c)

[48] Petty cash book records....
- (a) Postage expenses (b) Small expenses paid in cash
- (c) All expenses (d) stationary expenses

[49] The depreciation value of an asset will be credited on;
- (a) Debit side (b) Credit side
- (c) Any one side (d) No entry as it is non-cash item

[50] A credit in nominal account implies that...
- (a) There is a profit or income
- (b) Some expense or loss has diminished
- (c) There is a loss or expenditure
- (d) Both (a) and (b)

[51] Purchase account shows...
- (a) All purchases of goods and assets
- (b) Cash purchases only (c) Purchases on credit only
- (d) All cash and credit purchase of goods.

## ANSWERS

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1 (a) | 2 (a) | 3 (c) | 4 (b) | 5 (b) | 6 (a) | 7 (a) | 8 (c) | 9 (b) |
| 10 (d) | 11 (a) | 12 (a) | 13 (a) | 14 (d) | 15 (d) | 16 (b) | 17 (c) | 18 (b) |
| 19 (b) | 20 (c) | 21 (c) | 22 (a) | 23 (a) | 24 (d) | 25 (d) | 26 (d) | 27 (c) |
| 28 (a) | 29 (b) | 30 (a) | 31 (c) | 32 (a) | 33 (d) | 34 (c) | 35 (c) | 36 (c) |
| 37 (a) | 38 (d) | 39 (b) | 40 (a) | 41 (d) | 42 (d) | 43 (d) | 44 (a) | 45 (d) |
| 46 (b) | 47 (d) | 48 (b) | 49 (b) | 50 (d) | 51 (d). | | | |

## 9. BANK RECONCILIATION STATEMENT

Bank is a business entity and maintains its books of accounts. There is a double entry system in the bank, meaning thereby if there is a credit entry, there must be debit entry and vice-versa.

**Example 1:** If a customer deposits a sum of Rs10000, the voucher/ entry (in bank) will be,

Cr – Depositor's A/C : Rs10000

Dr - Cash A/C : Rs10000

**Example 2:** Suppose you have a business firm and maintains account books. If you issue a cheque for Rs15000 in favour of Samar, the entry of your cash book will be,

Cr – Bank's A/c : Rs15000

Dr - Samar's A/c: Rs 15000

Now, Samar may receive payment today or later date. On receipt of cash from bank the entry will be,

Dr - Bank's A/c (of business) : Rs15000

Cr - Cash A/c : Rs15000

For you it will reflect in Passbook as **PASSBOOK is a mirror image of cash book.**

We can see that entries complete with double vouchers.

**PRINCIPLES OF BANK RECONCILIATION**:

(i) Bank Reconciliation is based on the **principle of double entry.**

(ii) Credit the giver and debit the receiver.

(iii) Debit balance of cash book is credit balance of passbook.

(iv) Credit balance of cash book is debit balance of passbook.

(v) Bank Reconciliation shows causes of difference between cash book and passbook balance.

**CAUSES OF DIFFERENCES:**

1. ERRORS: There can be error in both the passbook and cash book. Some errors such as, under casting, over casting, recording entry in wrong heads. Due to these errors, bank balance and cashbook balance may not tally.

2. Cheque issued but not presented for payment (don't require change in cashbook).
3. Cheque deposited but not yet realized (don't require change in cashbook).
4. Bank charges (require change in cashbook).
5. Interest on Deposit Account (require change in cashbook).
6. Interest on Overdraft (require change in cashbook).
7. Amount collected by Bank on Standing Instruction (require change in cashbook).
8. Amount paid by Bank on Standing Instruction (require change in cashbook).
9. Direct payment into the Bank by Trader's customer/ third party (require change in cashbook).
10. Dishonour of cheque (require change in cashbook).

**UNDERSTANDING OF RECONCILIATION:**

The bank statement is received periodically, normally on monthly basis, or updates the passbook. First, we check the clerical errors, and if any, we obtain a corrected statement from bank.

Now, tally the balances of bank statement and cash book and if not tallied, start to find out errors/reasons (from customer's point).

(1) Entries are present in the cashbook (Debit or credit) but not in the bank statement.

(**ADJUSTED BANK BALANCE –** do not require change in cashbook)

(2) Entries are present in the bank statement (Debit or credit) but not in the cash book. It requires **change in cashbook.**

(3) Finding out wrong entries in cash book and correct these (mistakes on behalf of bank has already been corrected). It requires **change in cashbook.**

On the basis of these 3 steps, Bank Reconciliation Statement is prepared.

**PREPARING RECONCILIATION STATEMENT:**

Based on above illustrations, following format may be used for Bank Reconciliation.

(A) Closing Balance as per Bank Statement : Rs——

**Add**: Cheques deposited but not yet credited : Rs——

**Subtract**: Cheques issued but not presented to bank for payment : Rs——

Adjusted balance in the bank statement : Rs——

(B) Balance as per cashbook : Rs——

a) +/- clerical errors : Rs——

b)+ Bank credited but not shown in cashbook : Rs——

Adjusted cashbook balance : Rs——

If Adjusted Bank Balance i.e. (A) and Adjusted Cashbook Balance i.e. (B) is equal, then balances are reconciled.

**BANK RECONCILIATION STATEMENT**

**EXAMPLE:**

From the following extracts of the cash book (bank column only) and the pass book of M/s Raj Agro, prepare a bank reconciliation statement as on 28.02.2019.

**CASH BOOK** Amt in Rs

| Date | Particulars | Amount | Date | Particulars | Amount |
|---|---|---|---|---|---|
| 01.02.19 | To b/f | 12500 | 05.02.19 | By Gupta | 3000 |
| 06.02.19 | To Munna | 3000 | 08.02.19 | By Pintu | 4000 |
| 10.02.19 | To Gaurav | 5000 | 11.02.19 | By Guha | 2000 |
| 16.02.19 | To Vijay | 8000 | 15.02.19 | By Jay | 8000 |
| 20.02.19 | To Sony | 10500 | 21.02.19 | By Baiju | 5000 |
| 28.02.19 | To dividend | 840 | 23.02.19 | By Babu | 100 |
| | | | 28.02.19 | By Mandal | 4000 |
| | | | | By c/f | 13740 |
| | | **39840** | | | **39840** |

**BANK PASS BOOK** Amt in Rs

| Date | Particulars | Withdrawal(Dr) | Deposit(Cr) | Balance |
|---|---|---|---|---|
| 01.02.19 | By b/f | | 12500 | 12500 |
| 06.02.19 | To Gupta | 3000 | | 9500 |
| 06.02.19 | By Munna | | 3000 | 12500 |
| 09.02.19 | To Pintu | 4000 | | 8500 |
| 09.02.19 | By Gaurav | | 5000 | 13500 |
| 16.02.19 | To Jay | 8000 | | 5500 |
| 16.02.19 | By Vijay | | 8000 | 13500 |
| 22.02.19 | By dividend | | 480 | 13980 |
| 22.02.19 | To Baiju | 5000 | | 8980 |
| 28.02.19 | To Charge | 500 | | 8480 |
| 28.02.19 | To c/f | 8480 | | |
| | | **28980** | **28980** | |

**SOLUTION:**

**BANK RECONCILIATION STATEMENT AS ON 28.02.2019.**

**(A)** Amt in Rs

| | |
|---|---|
| Closing Balance in Bank Statement | 8480 |
| a) Add : cheque deposited but not yet credited | 10500 |
| b) Subtract: cheque issued but not presented for payment | 2000 |
| | 100 |
| | 4000 |
| Adjusted balance in bank statement | **12880** |

**(B)**

| | |
|---|---|
| Balance as per cash book | 13740 |
| a) Subtract: clerical error | 360 |
| b) Subtract: debit entry shown in the bank statement but not in cash book | 500 |
| Adjusted cashbook balance | **12880** |

## 9. KNOW YOURSELF NOW : BANK RECONCILIATION STATEMENT (*see solution)

[1] M/s Raj Agro maintains a current account in a bank, the cash book of M/s Raj Agro shows the debit balance of ₹ 2500 as on 31.05.2019. Cheque for ₹ 1500 issued but not presented and cheque for ₹ 2000 deposited for clearing but not yet credited and bank has remitted ₹ 1000 to LIC as per standing instruction. What will be the balance as per bank's pass book as on 31.05.2019?

(a) 3500 (b) 2500
(c) 1000 (d) 2000

[2] Bank reconciliation statement is–
(a) Bank account
(b) Banker's certificate about balance
(c) Banker's account in another bank
(d) A statement showing difference between the balance in the pass book and cash book

[3] Advantage(s) of preparing the bank reconciliation statement is/are;
(a) To check the accuracy of the entries made in the cash book.
(b) To detect errors and to take timely action for correction
(c) Shows the correct bank balance at any time
(d) All of the above

[4] Out of which following reasons, balances in passbook and cashbook may differ?
(a) Cheque issued but not presented for payment
(b) Cheque deposited into bank but not yet collected
(c) Interest charged by bank
(d) All of the above

[5] Which of the following entries require change in cash book?
(a) Bank charges
(b) Interest charged in loan account
(c) Interest credited by bank in SB a/c
(d) All of the above

[6] Direct payments into the bank made by Trader's Account, require to be change in–
(a) Cash book (b) Pass book
(c) No change required (d) Both (a) & (b)

[7] While preparing the Bank Reconciliation Statement, what will be treatment for cheque deposited but not got credited?

(a) Subtract : cash book (b) Subtract : bank balance

(c) Add : cash book (d) Add : bank balance

[8] What will be the treatment of debit entries shown in the bank statement but not appearing in cash book while preparing Bank Reconciliation Statement?

(a) Subtract : cash book (b) Add : cash book

(c) Subtract : bank balance (d) (a) or (b)

[9] What will be the treatment if cheque issued but not presented to the bank for payment, while preparing Bank Reconciliation Statement?

(a) Add : Cashbook (b) Add : Bank balance

(c) Subtract : Bank balance (d) Subtract : Cash book

[10] Balance in the cashbook of a firm is ₹ 30000. It is under cast by ₹ 27000. Firm has deposited cheques for ₹ 15000 but ₹ 10000 has been credited so far and firm has issued cheque for ₹ 12000 but cheque ₹ 7000 has not been presented for payment. The balance as per cash book be;

(a) 6000 (b) 33000 (c) 1000 (d) 12000

[11] In question no 10, the balance as per pass book should be;

(a) 1000 (b) 6000 (c) 12000 (d) 15000

[12]* The cash book of a firm shows ₹ 17800 as balance at the bank as on 31.05.2019, but the balance of the bank as on date shows ₹ 29500. On scrutiny you find that firm has deposited a cheque for ₹ 8000 that has not been credited so far, cheque issued for ₹ 15000/- by firm has not been presented for payment and ₹4700 has been credited by traders in bank. The balance of cash book should be;

(a) ₹ 34100 (b) ₹ 27100 (c) ₹ 22500 (d) ₹ 15500

[13] It is observed that the bank has debited ₹ 500 as service charges and credited ₹ 5000 by mistake, not related to firm. Firm had issued a cheque for ₹ 4000 that has not been presented for payment. The balance in the bank a/c is ₹ 45000. What will be the balance in cash book?

(a) 41200 (b) 36500 (c) 39500 (d) 41000

[14] If bank remitted ₹ 7500 to LIC as per standing instruction of the firm. This will be recorded

(a) On credit side of pass book
(b) On debit side of pass book
(c) On debit side of cash book
(d) None of the above

[15] If a trader directly deposited ₹ 12000/- in the account of firm in bank. This will be recorded;

(a) On credit side of pass book
(b) On debit side of pass book
(c) On credit side of cash book
(d) Both (a) & (c)

[16] A cheque is issued by firm infavour of supplier but not presented for payment and a trader deposited ₹10000 in bank's account of firm directly. In the first case entry will be made by—— first and in second case entry will be made by——first.

(a) Firm : Firm (b) Bank : Bank
(c) Bank : Firm (d) Firm : Bank

[17] As per cash book there is a balance of ₹ 8576. Bank has charged ₹ 200 as commission whereas firm has issued a cheque for ₹4000 that has not been presented for payment so far. What shall be balance in the bank pass book?

(a) ₹ 12576 (b) ₹ 12376
(c) ₹ 12776 (d) ₹ 4776

[18] While preparing Bank Reconciliation Statement you observed that;

(i) Firm issued a cheque for ₹ 7000 but not presented for payment
(ii) Bank has charged commission ₹ 100
(iii) A trader has directly deposited bank account of firm for ₹10000
(iv) A dividend of ₹ 500 has been credited in the account

Cash book shows a debit balance of ₹ 21000, what should be the balance as per pass book?

(a) 38600 (b) 38400
(c) 36400 (d) 38000

[19] If there is a credit balance in pass book, which side it will appear in cash book?

(a) Credit side

(b) Debit side

(c) It will not appear in cash book

(d) (a) or (b) as per situation

[20] if a firm's account pass book shows a credit balance of ₹ 20000. At the time of reconciliation you observe that a cheque issued for ₹ 2000 has not been debited yet, and interest for ₹ 500 has been credited in the account. What shall be balance of cash book?

(a) 18500 (b) 17500

(c) 20500 (d) 22000

[21] The pass book balance of an overdraf account is ₹ 25000. At the time of reconciliation you observed that a cheque for ₹ 5000 has not been paid yet and a cheque for ₹ 7000 has deposited for clearing but not credited so far. What shall be the balance of cash book?

(a) 23000 (b) 27000

(c) 30000 (d) 32000

[22] The pass book balance of an overdraft account is ₹ 17775. A cheque for ₹ 3225 has been issued but not presented for payment. What shall be the balance of cash book?

(a) 14550 (b) 17725

(c) 21000 (d) 3225

[23] A cheque issued by firm not presented for payment till date of reconciliation. At the time of reconciliation this do not require change in....

(a) Cash book

(b) Pass book

(c) Both (a) and (b)

(d) Both (a) and (b) require change

[24] The entries present in the pass book (or bank's statement of account) but not is cash book. It requires change in...

(a) Cash book (b) Pass book

(c) Statement of account (d) Both (a) & (b)

[25] The entries present in the cash book but not is pass book (bank's statement of account). It requires change in...

(a) Cash book (b) Bank statement

(c) Both (a) & (b) (d) Neither (a) nor (b)

[26]* The cash book of M/s Raj shows ₹ 9776 as balance at the bank as on 31.05.2019, whereas bank pass book shows balance of ₹11437.

On scrutiny, following discrepancies have been observed,

(i) On 24.05.2019, payment side of the cash book was under casted by ₹ 500

(ii) A cheque of ₹ 900 issued on 27.05.2019, not presented for payment

(iii) Dividend of ₹ 300 collected by bank on 21.05.2019 but not recorded in cash book

(iv) A cheque of ₹ 900 issued on 27.05.2019 was recorded twice in the cash book

(v) ₹ 150 has been charged by bank on 31.05.2019

(vi) ₹ 211 has been credited as interest by bank on 31.05.2019

(vii) Cheque for ₹ 1000 deposited but not credited by bank

What shall be the correct balance of cash book as well as pass book?

(a) 11687 (b) 10737

(c) 12637 (d) 11537

[27] If cash book shows credit balance, pass book will show debit balance. The statement is---

(a) True (b) False

[28] Debit balance of pass book shows, it is balance of–

(a) Saving bank account

(b) Current account

(c) Over draft account

(d) (a) or (b)

[29]* The cash book of M/s Aman shows credit balance of ₹ 75800 with bank. At the time of reconciliation you observed that,

(i) A cheque for ₹ 5000 has not been debited by the bank

(ii) A cheque for ₹ 3000 has been debited twice by the bank

(iii) A cheque of ₹ 8080 deposited with the bank but not credited in the account

Reconcile and find the balance as per pass book. It is–

(a) 84880 (b) 81880

(c) 81780 (d) 81980

[30] Pass book is a mirror image of the cash book only in the sense that;

(a) Credit entries in cash book are reflected as debit entries in the pass book

(b) Debit entries in the cash book are reflected as credit entries in the pass book

(c) Debit balance in cash book is reflected as credit balance in the pass book

(d) Credit balance in cash book is reflected as debit balance (overdraft) in the pass book

(e) All of the above

**ANSWERS**

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1 (c) | 2 (d) | 3 (d) | 4 (d) | 5 (d) | 6 (a) | 7 (d) | 8 (a) | 9 (c) |
| 10 (a) | 11(a) | 12 (c) | 13 (b) | 14 (b) | 15 (a) | 16 (d) | 17 (b) | 18 (b) |
| 19 (b) | 20 (b) | 21 (a) | 22 (c) | 23 (a) | 24 (a) | 25 (b) | 26(d) | 27 (a) |
| 28 (c) | 29 (b) | 30 (e) | | | | | | |

**SOLUTION**

[12] Closing balance in bank statement : ₹ 29500

**Adjustments to the balance in the bank statement**

(a) Add : cheque deposited but not yet credited : ₹ 8000

(b) Subtract : cheque issued but not presented for payment : ₹ 15000

Adjusted balance in the bank statement : ₹ 22500

Balance as per cash book : ₹ 17800

**Adjustment made to cash book**

(a) Add : direct credited by trader in bank : ₹ 4700

Adjusted (corrected) cash book balance : ₹ 22500

[26] The bank reconciliation statement will be as under;

| | |
|---|---|
| Closing balance in bank statement | : ₹ 11437 |
| **Adjustments to the balance in the bank statement** | |
| (a) Add : cheque deposited but not yet credited | : ₹ 1000 |
| (b) Subtract : cheque issued but not presented for payment | : ₹ 900 |
| Adjusted balance in the bank statement | : ₹ 11537 |
| Balance as per cash book | : ₹ 9776 |
| **Adjustment made to cash book** | |
| (a) Add : clerical errors (i) under casting | : ₹ 500 |
| (ii) double entry | : ₹ 900 |
| (b) Add : credit shown in bank statement but not appearing in cash book (i) interest | : ₹ 211 |
| (ii) dividend | : ₹ 300 |
| (c) Subtract : debit shown in the bank statement but not appearing in cash book (charge) | : ₹ 150 |
| Adjusted (corrected) cash book balance | : ₹ 11537 |

[29] Closing balance as per bank statement : ₹ 75800

**Adjustment to the balance in the bank statement**

(a) Add : (i) Clerical error (cheque debited twice) : ₹ 3000

(ii) Cheque deposited but not yet credited : ₹ 8080

(b) Subtract : Cheque issued but not presented for payment : ₹ 5000

Adjusted balance in the bank statement : ₹ 81880

# 10. TRIAL BALANCE, RECTIFICATION OF ERRORS AND ADJUSTING & CLOSING ENTRIES

**TRIAL BALANCE**: Trial Balance is a statement showing debit and credit balances taken from ledger including cash and bank balances on a particular date.

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

**FEATURES OF TRIAL BALANCE:**

(i) It is a list of debit and credit balances.

(ii) It includes cash and bank balances also.

(iii) It is usually prepared at the end of the year, but it can be prepared any time.

**PURPOSE OF TRIAL BALANCE:**

(i) To establish/check the arithmetical accuracy of transactions i.e. debit total and credit total must be equal.

(ii) It enables the trader to know amounts receivables from customers and amount payable to suppliers.

(iii) It facilitates the preparation of final accounts i.e. Trading and Profit & Loss Accounts and Balance Sheet.

**TYPES OF TRIAL BALANCE**:

There are two types of trial balance.

1. GROSS TRIAL BALANCE: Each debit and credit entries taken into the accounts.
2. NET TRIAL BALANCE: Netting of debit and credit entries is taken into the accounts.

**TYPES OF ERROR**: It may be divided into two types, viz;

1. CLERICAL ERRORS
2. PRINCIPLE ERRORS

**CLERICAL ERRORS**

These errors can be classified into,

**(a) Errors of Omission**: When transaction is completely or partially omitted to be recorded in the books of accounts. This can be of two types;

**i)** **<u>ERROR OF COMPLETE OMISSION</u>:** When a transaction is completely omitted from recording in the books. For example- purchase on credit from supplier Rs250000 not entered in the Purchase Journal.

**ii)** **<u>ERROR OF PARTIAL OMISSION</u>:** If the above entry is recorded in the Purchase Journal but remains to be posted to the supplier's account, then it will be called error of partial omission.

**Note:** Error of complete omission will not affect the trial balance but due to the partial omission, trial balance will not tally.

**(b) Errors of Commission**: These are the errors which are committed due to

(i) Posting of correct amount but on the wrong side.

(ii) Posting of wrong amount but on correct side.

(iii) Posting of wrong amount on wrong side.

(iv) Wrong totalling or wrong balancing of the accounts, wrong casting of the subsidiary ledgers etc.

**Example: 1**. Credit sale of goods to a customer for Rs1750 recorded correctly in the sales book but is posted in customer's account as Rs1570.

**Example:2**. Rajesh paid Rs7500 to his supplier, this transaction was correctly recorded in the cashbook, but during the course of posting to the ledger, supplier's account was debited with Rs750 only.

**(c) COMPENSATING ERRORS**: When one mistake nullifies the wrong effect of another, it is called compensating errors. It may be two or more in number and balance each other.

| | | | |
|---|---|---|---|
| **Example :** 1. suppose expenditure for rent is | | : | Rs 2000 |
| expenditure for printing is | | : | Rs 4000 |
| | **Total** | **:** | **Rs 6000** |

But during entries it reverses like,

| | | | |
|---|---|---|---|
| Expenditure for printing | | : | Rs 2000 |
| Expenditure for rent | | : | Rs 4000 |
| | **Total** | **:** | **Rs 6000** |

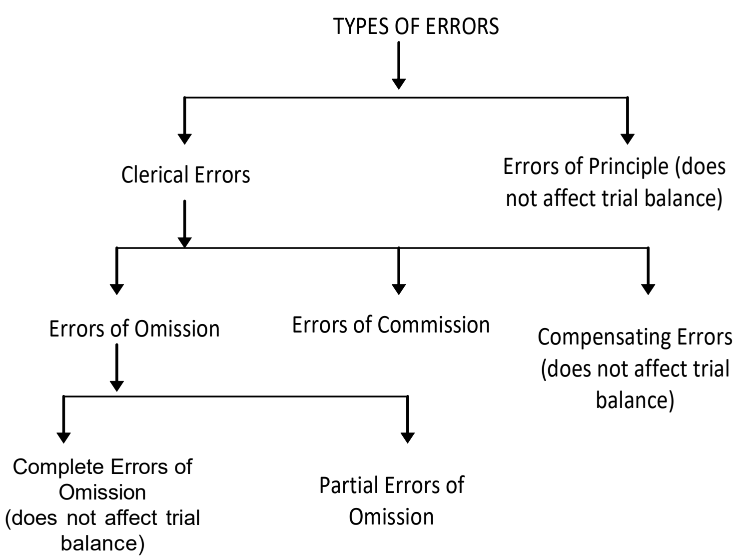
Example: 2.

| | | | |
|---|---|---|---|
| If it over cast/under cast like, rent expenditure | | : | Rs 2500 |
| Printing expenditure | | : | Rs 3500 |
| | **Total** | **:** | **Rs 6000** |

Both the errors will compensate each other and there will be no effect on the agreement of trial balance.

**PRINCIPLE ERRORS**: These are the errors arising from not observing the accounting principles correctly.

For example- a amount spent on maintenance and repairs of Plant and Machinery should be treated as REVENUE EXPENDITURE. Instead, if this amount is debited to CAPITAL EXPENDITURE i.e. purchase of Plant and Machinery.



**RECTIFICATION OF ERRORS**:

**(A)** If the trial balance shows some difference, then we should first ascertain the exact amount of difference and try to locate it. Steps be taken;

a) **CHECK:** total of debit and credit sides of trial balances.

b) **VERIFY:** cash and bank balances are correctly shown in the trial balance.

When exact amount of difference is ascertained, say credit side is excess by Rs2000, then

i) Check - whether credit of Rs2000 appears twice in trial balance?

OR

Take half the amount of difference i.e. Rs1000. If there is any item appearing in Trial Balance on credit side, while it should be on debit side, then after correcting the item Trial Balance will tally.

**Example:**

WRONG (untallied) TB

Amt in Rs

| Dr | Cr |
|---|---|
| 25000 | 5000 |
| 5000 | 24000 |
| | 2000 |
| | 1000 |
| **30000** | **32000** |

CORRECT (tallied) TB

Amt in Rs

| Dr | Cr |
|---|---|
| 25000 | 5000 |
| 5000 | 24000 |
| 1000 | 2000 |
| **31000** | **31000** |

ii) CHECK – any debit item of Rs2000 is omitted from trial Balance.

**(B) ONE SIDED ERRORS:** Such type of errors can be rectified by simply correcting the posting. No voucher or any entry is required to be passed.

Example: Rectify the following errors.

(i) Rent paid Rs1000, but posted as Rs10000.

**Wrong Entry(rent)**

| Particular | Dr | Cr | Bal |
|---|---|---|---|
| To rent (expenditure) | 10000 | | 10000 |

**Correct Entry(rent)**

| Particular | Dr | Cr | Bal |
|---|---|---|---|
| To rent (expenditure) | 1000 | | 1000 |

**Correction**

| Particular | Dr | Cr | Bal |
|---|---|---|---|
| To rent (expenditure) | 10000 | | 10000 |
| By excess debit | | 9000 | 1000 |

(ii) Amount received from Aniket Rs5000, but posted to debit side.

**Wrong Entry**

| Particular | Dr | Cr | Bal |
|---|---|---|---|
| b/f | | | 10000 |
| To cash | 5000 | | 5000 |

**Correct entry**

| Particular | Dr | Cr | Bal |
|---|---|---|---|
| b/f | | | 10000 |
| By cash | | 5000 | 15000 |

Here, difference appears double in amount. After detection, no entry is required to be passed, rather double of amount i.e. Rs10000 be credited.

**Correction**

| Particular | Dr | Cr | Bal |
|---|---|---|---|
| b/f | | | 10000 |
| To cash | 5000 | | 5000 |
| By adjustment of wrong entry dt..... | | 10000 | 15000 |

**(C)TWO SIDED ERRORS:** In such type of errors, two or more accounts are affected and probably debit and credit are equally affected. While rectifying the errors,

- First pass the correct entry.
- Then show wrong entry which is already passed.
- Then by comparing wrong entry with the correct one, rectification entry can be passed.

**Example:** Rent paid to Rs1000 wrongly debited to postage account. Rectify the errors.

**Wrong Entry**

| Particular | Dr | Cr | Bal |
|---|---|---|---|
| To postage | 1000 | | 1000 |

**Correct entry**(but not passed)

| Particular | Dr | Cr | Bal |
|---|---|---|---|
| To rent | 1000 | | 1000 |

**Correction**

| Particular | Dr | Cr | Bal |
|---|---|---|---|
| To postage | 1000 | | 1000 |
| By correction dt- | | 1000 | NIL |

| Particular | Dr | Cr | Bal |
|---|---|---|---|
| To rent | 1000 | | 1000 |
| | | | |

## 10. KNOW YOURSELF NOW : TRIAL BALANCE

[1] Trial balance remains untallied due to errors of...
(a) Omission (b) Commission
(c) Principle (d) All of the above

[2] While making the posting, credited the account of the firm instead of account of the partner. This error is–
(a) Error of commission (b) Error of Omission
(c) Compensating error (d) Both (a) & (c)

[3] The closing balance of trial balance will be transferred to–
(a) Profit and loss account (b) Trading account
(c) Balance Sheet (d) Fund flow statement

[4] An error that compensates or nullified effect of wrong entry is known as;
(a) Error of commission (b) Error of ommission
(c) Compensating error (d) Error of principles

[5] Wages outstanding appearing in trial balances is posted in
(a) Profit and loss a/c (b) Balance sheet
(c) Trading account (d) All of the above

[6] Which of the following will not affect trial balance?
(a) Postage a/c credited instead of debit
(b) Expenses for postage is debited for rent paid
(c) Goods sold on credit but not recorded in books
(d) Both (b) & (c)

[7] Functions of the trial balance is/are;
(a) To check the arithmetical accuracy of the accounting
(b) To act as starting point for preparation of final accounts
(c) To provide summary position
(d) All of the above

[8] An entry of ₹ 1000 wrongly posted to postage account instead of wages account is an example of....
(a) Errors of commission (b) Error of partial commission
(c) Error of principle (d) Error of omission

[9] Balance sheet is prepared....
(a) For over a period (b) As on particular date
(c) On last date of any month (d) On last date of quarter

[10] Balance sheet shows....
(a) Financial status of the business
(b) Sale & purchase of the business
(c) Income and expenditure of the business
(d) Total capital and total fixed assets

[11] Expenditure incurred as freight is shown as;
(a) Value of goods (b) Value of sale
(c) Expenditure (d) Closing stock

[12] If an expenditure for repairing of building has been treated as capital expenditure. This is the...
(a) Error of omission (b) Error of commission
(c) Compensating error (d) Error of principle

[13] A credit sale of goods to Ramesh for ₹ 8500 recorded correctly in the sales journal but while posting to Ramesh's account, it is posted as ₹ 5800. This error is
(a) Error of principle (b) Error of omission
(c) Error of commission (d) Complete omission

[14] Goods are purchased on credit from Ramesh but this transaction is not recorded in the purchase journal. This is called error of....
(a) Commission (b) Complete omission
(c) Partial omission (d) Principle

[15] Goods are purchased on credit recorded in purchase journal but not posted in the supplier's account. This will be called...
(a) Error of omission (b) Error of commission
(c) Error of Partial omission (d) Error of complete omission

[16] Fixed assets are purchased on credit recorded in purchase journal. This is the error of–
(a) Principle (b) Omission
(c) Commission (d) No error

[17] If postage account is over casted by ₹ 2000 and rent account is under casted by ₹ 2000. The trial balance will disagree by;
(a) ₹ 2000 (b) ₹ 4000
(c) Will not disagree (d) ₹ 6000

[18] The error of Q.N.-17, such type of error is known as
(a) Error of principle (b) Compensating error
(c) Error of omission (d) clerical error

[19] Which of the following is/are types of trial balance?

(a) Complete trial balance (b) Gross trial balance

(c) Net trial balance (d) Both (b) & (c)

[20] If each debit and credit entries taken into the account in trial balance, this is called;

(a) Complete trial balance (b) Net trial balance

(c) Trial balance (d) Gross trial balance

[21] If netting of debit and credit entries is taken into the accounts for preparation of trial balance, then such trial balance is called;

(a) Net trial balance

(b) Trial balance

(c) Gross trial balance

(d) Provisional balance sheet

[22] Which of the following is error of principle?

(a) Posting of wrong amount on wrong side of the account

(b) Debting revenue expenditure for purchase of machinery

(c) Undercasting of rent account balance

(d) Purchase on credit not recorded

[23] One sided errors can be rectify by;

(a) Correcting the posting (b) Posting new entries

(c) Passing new entries (d) Any one of the above

[24] Goods purchased from Ramesh wrongly recorded in sale register. Such type of error is known as;

(a) One sided error (b) Error of omission

(c) Error of commission (d) Two sided error

[25] What is suspense account in respect of trial balance?

(a) An account opened to tally the trial balance temporarily

(b) An account opened for temporary expenditure

(c) It is miscellaneous account

(d) An account opened for unknown expenditure

[26] If credit side of trial balance is more than the debit side, the difference will be;

(a) Placed on debit side of suspense account

(b) Placed on debit side of any account

(c) Placed on credit side of suspense account

(d) Debited by difference amount of any credit balance account for agreement of trial balance

[27] What will be the nature of errors which affect one account?

(a) Errors of omission (b) Errors of posting

(c) Errors of commission (d) (a) or (c)

[28] If the credit side of trial balance is less than the debit side, the difference will be;

(a) Placed on debit side of suspense account

(b) Placed on credit side of suspense account

(c) Placed on credit side of any account

(d) None of the above

[29] Suppose trial balance has prepared and it is tallied, now an error located. How it will be rectified?

(a) By suspense account

(b) By contra voucher of any account

(c) By debit expenditure account

(d) By credit income account

[30] Wrong balancing of an account is a/an...

(a) Error of commission

(b) Error of principle

(c) Clerical error

(d) No error

[31] A firm spent ₹ 50000 for repair of building and debited to building account. How it will be rectified?

(a) Debit repair/credit building account

(b) Debit repair/credit expenditure account

(c) Credit repair/debit expenditure account

(d) (b) or (c)

[32] Rent of building for March'2019 is not received but books are closed on 31.03.2019. What type of adjustment is required?

(a) Debit rent accrued account/credit rent-income account

(b) Debit rent account/credit income account

(c) Debit cash/credit income

(d) Debit expenditure/credit outstanding rent- income account

[33] If purchase book is undercasted by ₹ 500. What would be the amount of gross profit if it is shown as ₹ 12000 at present?

(a) 11500 (b) 12500

(c) 12000 (d) 11000

[34] An equipment was purchased for ₹ 600000 but recorded in journal for ₹ 60000. What would be the amount of gross profit if it is ₹ 700000 now?

(a) 160000 (b) 1240000
(c) 700000 (d) 640000

[35] Amount received from Ramesh but by mistake credited to Aniket's Account. How it will be corrected?

(a) Debit Aniket a/c and credit Ramesh a/c
(b) Debit Ramesh a/c and credit Aniket a/c
(c) Debit cash and credit Ramesh a/c
(d) None of the above

[36] No adjustment entry is passed by May'2019 for an amount of ₹10000 relating to interest accrued account outstanding on 31.03.2019. How it will affect gross profit of ₹ 22000 as on today?

(a) Decrease by ₹ 10000 i.e. ₹ 12000
(b) Increase by ₹ 10000 i.e. ₹ 32000
(c) It will remain same i.e. ₹ 22000
(d) Decrease by ₹ 5000

[37] ₹ 1000 received as interest on mutual fund, instead of credit income account, debited by ₹ 1000. How it will affect trial balance?

(a) Debit side be less by ₹ 1000
(b) Credit side be less by ₹ 1000
(c) Debit side be less by ₹ 2000
(d) Credit side be less by ₹ 2000

[38] If there is an error in personal account, it will affect;

(a) Trading account (b) Profit and loss account
(c) Balance sheet (d) None of the above

[39] The value of depreciation of an equipment is ₹ 2800 but not posted to depreciation account. If total outstanding of debit side of trial balance is ₹ 247200. What should be actual outstanding?

(a) 244400 (b) 247200
(c) 250000 (d) 252800

[40] If expenditure for postage of ₹ 5500 is posted to expenditure for rent of ₹ 5500. It will affect trial balance sheet by;

(a) 5500 (b) 1100
(c) 5000 (d) None of above

[41] In Q.No.-40, such type of errors is know as;

(a) Error of principle (b) Compensating errors

(c) Error of omission (d) Error of commission

## ANSWERS

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1 (d) | 2 (d) | 3 (c) | 4 (c) | 5 (b) | 6 (d) | 7 (d) | 8 (c) | 9 (b) |
| 10 (a) | 11 (a) | 12 (d) | 13 (c) | 14 (b) | 15 (c) | 16 (a) | 17 (c) | 18 (b) |
| 19 (d) | 20 (d) | 21 (a) | 22 (b) | 23 (a) | 24 (d) | 25 (a) | 26 (a) | 27 (b) |
| 28 (b) | 29 (a) | 30 (a) | 31 (a) | 32 (a) | 33 (a) | 34 (c) | 35 (a) | 36 (c) |
| 37 (d) | 38 (c) | 39 (c) | 40 (d) | 41 (b) | | | | |

# 11. CAPITAL AND REVENUE EXPENDITURE

We are very much acquainted with the heads and components of Trading, Profit and Loss Account and that of Balance Sheet.

- All expenses and receipts of **revenue nature** are shown in the Trading and Profit & Loss Account.
- All expenses and receipts of **capital nature** are taken to Balance Sheet.

So, it is important to know that what is **revenue receipt** and what is **capital receipt** and simultaneously what is **revenue expenditure** and **capital expenditure**?

**EXPENDITURE**

Expenditure is decided “capital” or “revenue” depending upon a number of factors, like

(a) Nature of expenditure

(b) Effect of revenue earning capacity

(c) Benefit from the expenditure

**REVENUE EXPENDITURE**

Revenue expenditure is an amount that is expensed immediately which helps to generate income/revenue in the current year. If the benefit from expenditure incurred is of short duration, is considered as revenue expenditure. For example, repair of P/M.

**CAPITAL EXPENDITURE**

Capital expenditure is expenditure, the benefit of which is enjoyed or consumed over many years. It is the expenditure incurred to acquire a long term asset such as building, plant and machinery, vehicle etc. The main purpose of incurring such expenditure is to earn income over a period of years to increase the earning capacity.

**DIFFERENCE BETWEEN CAPITAL AND REVENUE EXPENDITURE**

| CAPITAL EXPENDITURE | REVENUE EXPENDITURE |
|---|---|
| 1. Amount incurred is usually large. | 1. Amount incurred is relatively small. |
| 2. Purpose is to improve or enhance business or productivity or earning capacity. | 2. Purpose is to maintain the fixed assets in good working condition. |
| 3. Long duration benefit. | 3. Short duration benefit. |
| 4. It is non- recurring. | 4. It is recurring by nature. |
| 5. It is Balance Sheet item. | 5. It is Trading and Profit & Loss item. |

**Example:**

1. Cost of repair of vehicle/machinery is revenue expenditure.
2. Expenditure incurred in purchasing Plant & Machinery/ car is capital expenditure.
3. Expenditure incurred in acquiring a building is capital expenditure.
4. Cost of repairing of building is revenue expenditure.

**RECEIPTS**

**CAPITAL RECEIPTS:** Capital receipts are from issue of Equity/ preference share/ from sale of Fixed Assets/ Long Term investment or from grants received from government for building of capital assets.

Capital receipts are not part of Profit and Loss Account.

**REVENUE RECEIPTS:** Revenue receipts are from day to day operations of the Company or receipts where there is no further obligation on the entity to perform certain actions.

Revenue receipts are part of Profit and Loss Account.

## 11. KNOW YOURSELF NOW : CAPITAL AND REVENUE EXPENDITURE

[1] The benefit of the expenditure is enjoyed for a long period is called;

(a) Revenue expenditure (b) Long expenditure

(c) Long period expenditure (d) Capital expenditure

[2] Capital expenditure is....

(a) A recurring expenditure

(b) A non-recurring expenditure

(c) A part of profit and loss account

(d) A part of balance sheet

(e) Both (b) & (d)

[3] The expenses related to operations of the business of an accounting period is known as;

(a) Balance-sheet expenditure (b) Revenue expenditure

(c) Financial year expenditure (d) Maintenance expenditure

[4] Revenue expenditure is shown in....

(a) Balance sheet (b) Trading account

(c) Profit and loss account (d) No where

[5] Nature of revenue expenditure is

(a) Recurring (b) Non-recurring

(c) Once (d) Occasional

[6] Receipts from day to day operations of the company or receipts where there is no further obligation lies, is known as;

(a) Revenue Receipts (b) Capital Receipts

(c) Income (d) Capital gain

[7] The receipt from sale of fixed assets is–

(a) Revenue receipts (b) Capital receipt

(c) Income from sale of assets (d) Revenue from sale of assets

[8] Receipts from issue of equity / preference share/ capital instruments are known as;

(a) Capital receipts (b) Revenue receipts

(c) Capital expenditure (d) Revenue expenditure

[9] Grants received from government for construction of building is;

(a) Capital receivables (b) Capital receipts

(c) Revenue receivables (d) Revenue receipts

[10] The expenditure incurred for maintenance of fixed assets is;
(a) Capital expenditure
(b) Revenue expenditure
(c) Miscellaneous expenditure
(d) Expenditure for maintenance

[11] The expenditure incurred for improvement of productive or earning capacity is...
(a) Production expenditure
(b) Expenditure for improvement
(c) Capital expenditure
(d) Expenditure for earning capacity

[12] Expenditure on advertisement for market-expansion for products which effect remains more than a year is;
(a) Capital expenditure
(b) Revenue expenditure
(c) Miscellaneous expenditure
(d) Deffered revenue expendirure

[13] Revenue expenditure is deducted from;
(a) The gross sale proceeds or gross profit
(b) Net profit
(c) Capital
(d) None of the above

[14] Expenditure incurred for purchase of goods for resale is
(a) Deferred expenditure
( b) Deferred revenue expenditure
(c) Revenue expenditure
(d) Capital expenditure

[15] Expenditure incurred for acquiring patent is
(a) Capital expenditure
(b) Revenue expenditure
(c) Deferred revenue expenditure
(d) Deferred capital expenditure

[16] Wages paid to Ramesh is---
(a) Capital expenditure
(b) Revenue expenditure
(c) Establishment expenditure
(d) Miscellaneous expenditure

[17] Discount allowed is....

(a) Revenue receipts (b) Revenue expenditure

(c) Loss (d) Income

[18] An expenditure on shifting of an office to a new building is...

(a) Revenue expenditure (b) Capital expenditure

(c) Deferred revenue expenditure (d) None of the above

[19] The expenditure incurred for purchase a car is---

(a) Capital receipts (b) Capital expenditure

(c) Revenue expenditure (d) Either (b) or c

[20] The expenditure incurred for research purposes is

(a) Capital expenditure

(b) Deferred capital expenditure

(c) Revenue expenditure

(d) Deferred revenue expenditure

[21] The expenditure incurred for repair of car is----

(a) Deferred revenue expenditure

(b) Capital expenditure

(c) Revenue expenditure

(d) Any one of the above

**ANSWERS**

1 (d) 2 (e) 3 (b) 4 (c) 5 (a) 6 (a) 7 (b) 8 (a) 9 (b)
10 (b) 11 (c) 12 (d) 13 (a) 14 (c) 15 (a) 16 (b) 17 (b) 18 (a)
19 (b) 20 (d) 21 (c)

## 12. BILL OF EXCHANGE

In a business, credit transactions play very important role, credit may be granted by money lender, a banker or a financial institution.

Credit is generally provided by obtaining a written document called "Instrument of Credit". This serves as a proof of existence of credit.

The most commonly used instruments of credit are,

1. BILL OF EXCHANGE(u/s 5 of NI Act)
2. PROMISSORY NOTE(u/s 4 of NI Act)

**BILL OF EXCHANGE**

Bill of exchange is defined as

- an instrument in writing
- signed by the maker
- containing an unconditional order
- to pay a certain sum of money only
- to a person, named in instrument, or to his order or to bearer
- on a certain fixed future date or on demand.

**Format of Bill of Exchange**

| | | |
|---|---|---|
| | **STAMP** | |
| Rs10000 | | 202, Mulchand Path, |
| | | Patna |
| | | 16th March,2019 |
| Two months after date, pay me or my order, a sum of Rs. ten thousand only, for value received. | | |
| To | Accepted | |
| Raj Kumar | Raj Kumar | Aniket |
| Kankarbagh | (Signature) | (signature) |
| Patna – 800020 | 19.03.2019 | |

Now, see the above format of BOE, there are three parties,

1. Drawer – a person who draws the bill i.e. Aniket, 202, Mulchand Path, Patna.
2. Drawee - a person on whom the bill is drawn i.e. Raj Kumar.
3. Payee – a person who is going to receive money.

(Drawer may be payee also)

Date of Bill is 16.03.2019 and Date of Acceptance is 19.03.2019 Period of Bill is 2 months.

**PROMISSORY NOTES**

A written undertaking by the buyer to make a payment on a specified date on demand.

First, see the **format of promissory note**,

| | |
|---|---|
| **STAMP** | |
| Rs10000 | Kankarbagh, Patna |
| | 16th March,2019 |
| Two months after date, I promise to pay Mr. Aniket or his order, a sum of Rs ten thousand only, for value received. | |
| To | |
| Mr Aniket | Raj Kumar |
| 202, Mulchand Path | (signature) |
| Patna – 800020 | |

Now see, it is written by buyer (debtor), promising the seller (creditor) to pay a specified sum (Rs10000) after a specified period (after two months).

Thus it can be defined as,

- an instrument in writing
- containing an unconditional undertaking
- signed by maker to pay a certain sum of money to or to order or to a bearer of the instrument.

Normally there are two parties of Promissory Notes;

1. Maker – A person who draws the Promissory Notes and promise to make the payment, i.e. Raj Kumar. Maker is drawer and drawee both.

2. Payee - A person who is to receive the money, i.e. Aniket.

**Conclusion**:

i. DRAWER = MAKER = BUYER

ii. PAYEE = SELLER

iii. MAKER = DRAWER = DRAWEE = BUYER

( Drawee and Drawer are same person)

**DISTINCTION BETWEEN BILL OF EXCHANGE AND PROMISSORY NOTE**

| BILL Of EXCHANGE | PROMISSORY NOTE |
|---|---|
| 1. Unconditional order to pay. | 1. Unconditional promise to pay. |
| 2. Made by creditor. | 2. Made by debtor. |
| 3. Accepted by debtor. | 3. Acceptance not required. |
| 4. There are three parties of Bill of Exchange. | 4. There are two parties of Promissory Note. |
| 5. On dishonour of Bill, noting is necessary by notary. | 5. Noting is not necessary. |

**DUE DATE OF A BILL**

The period of a bill is called 'Term' or 'Tenor' of the bill. The date on which the bill is payable is called its due date. Due date is calculated after adding **three days of grace** to the actual period of the bill.

Let us suppose, a bill is drawn on 1st January for a period of two months, then, its due date will be 1st March plus three days of grace i.e. 4th March. If the due date falls on public holiday, then it becomes due on previous working day.

**NOTING :**

On dishonour of a bill, the holder in due course presents the bill to a notary public to make necessary entries(reasons) regarding non-payment (dishonour) of bill. It is called noting.

Amount paid to notary public for noting is called "Noting Charge".

## 12. KNOW YOURSELF NOW : BILL OF EXCHNAGE

(*see solution)

[1] Ramesh is drawer of a bill and Aniket is acceptor of the bill; Ramesh endorses the bill to Suresh, but the bill is dishonoured on due date. What type of entry Ramesh will pass?

(a) Debit Aniket's account (b) Credit Aniket's account

(c) Debit Suresh's account (d) Credit Suresh's account

[2] What is noting?

(a) Noting the records for dishonour of bill

(b) Noting of cause of action

(c) Noting the reasons of dishonour of bill by notary public

(d) All of the above

[3] Aniket draws a bill on Ramesh on 06.05.2019 for 3 months for ₹25000. What is the due date of the bill?

(a) 06.08.2019 (b) 05.08.2019

(c) 08.08.2019 (d) 09.08.2019

[4]* Aniket draws a bill on Ramesh on 06.05.2019 for 3 months for ₹24000. Ramesh pays the bill to Aniket on 09.06.2019 at 10% discount, what will be the amount of discount?

(a) 2400 (b) 400

(c) 600 (d) 840

[5]* On 01.03.2019 Ramesh draws a bill on Aniket for 3 months for ₹48000. On 04.04.2019 Aniket pays the bill to Ramesh at 10% discount. The amount of discount will be;

(a) 400 (b) 480

(c) 800 (d) 4800

[6] On dishonour of a bill, the holder in due course presents the bill to a notary public to record the reasons of dishonour, it is known as;

(a) Notarise

(b) Notary comments for dishonour of bill

(c) Noting

(d) Noting of remarks

[7] A bill is received by endorsement, on dishonour, which account will be debited?

(a) Bills receivable a/c (b) Bills payable a/c

(c) Payee a/c (d) Endorser's a/c

[8] The period for which the bill is drawn is known as;
(a) Life of bill (b) Due date of bill
(c) Tenor of bill (d) Period of bill

[9] What is retirement in terms of bill of exchange?
(a) Payment of bill before due date
(b) Not paid on due date
(c) Payment of bill after due date
(d) Dishonour of bill

[10] For drawer, the bill is---
(a) Bill receivable (b) Bill payable
(c) Liability (d) None of the above

[11] The date on which bill is payable is called
(a) Maturity date (b) Due date
(c) Payment date (d) Payable date

[12] The book where all the bills, which are received, are recorded and posted directly to customer's account is known as;
(a) Bill received book
(b) Bill received and disposal book
(c) Bill book
(d) Bills receivable book

[13] Bills are drawn by seller (creditor) on debtor (buyer), the statement is;
(a) True
(b) False
(c) Depends upon nature of transaction
(d) Information is not sufficient

[14]* In accommodation bills, the relationship between the parties concerned is;
(a) Debtor - creditor
(b) Creditor - debtor
(c) No debtor - creditor relationship
(d) Drawer - payee

[15] The person who is legally entitled to receive money on due date is;
(a) Receiver (b) Holder
(c) Holder in due course (d) Payee

[16] The holder of a negotiable instrument is called holder in due course if he satisfies which of the following conditions?

(a) He obtained the instrument for valuable consideration

(b) He becomes holder of the instrument before its maturity

(d) He had no cause to believe that any defect existed in the title of the person from whom he derives his title.

(d) All of the above

[17] When the drawee pays the amount of the bill on due date, the bill is said to be;

(a) Met (b) Honoured

(c) Paid (d) Both (a) or (b)

[18] The due date of a bill is calculated after adding— days of grace to the actual period of the bill.

(a) Two (b) Three

(c) Four (d) Zero

[19] If the due date falls on public holiday, then it becomes due on;

(a) Previous working day (b) Next working day

(c) As decided by parties (d) (a) or (b)

[20] The drawer of the bill is;

(a) Creditor (b) Debtor

(c) Endorsee (d) Drawee

[21] Match the following in the context of bill of exchange.

| | | | |
|---|---|---|---|
| (A) | Demand bill : | (i) | The amount of bill is payable in future on a pre decided date |
| (B) | Dividend : | (ii) | The amount will be paid only when payment is demanded |
| (C) | Bad bebt : | (iii) | The amount received from the private estate of insolvent person |
| (D) | Usance bill : | (iv) | The amount not recoverable from the insolvent |

(a) A (i), B (ii), C (iii), D (iv) (b) A (ii), B (iv), C (i), D (iii)

(c) A (ii), B (iii), C (iv), D (i) (d) A (ii), B (iii), C (i), D (iv)

[22] A bill dated 06.06.2019 is payable 3 months after. Its due date of payment would be;

(a) 09.08.2019 (b) 06.09.2019

(c) 09.09.2019 (d) 30.09.2019

[23] A bill of exchange dated 31.05.2019 is payable 4 months after. It is presented on 03.06.2019 and accepted by the drawer on 06.06.2019. Its due date of payment would be;

(a) 03.10.2019 (b) 06.10.2019

(c) 09.10.2019 (d) 30.09.2019

[24] A bill dated 31.05.2019 is payable 4 months after sight. It is presented on 03.06.2019 and accepted by the drawee on 06.06.2019. Its due date of payment would be;

(a) 03.10.2019 (b) 06.10.2019

(c) 09.10.2019 (d) 30.09.2019

[25] When one party accepts the bill drawn on him by another, without any consideration, the bill is said to be;

(a) Usance bill (b) Accommodation bill

(c) Enforcement of bill (d) Acceptance bill

[26] Before the due date of the bill, the holder may endorse the bill in favour of his banker and get immediate cash from the banker. This is called;

(a) Honouring of bill

(b) Discounting of bill

(c) Encashment of bill

(d) Payment of bill by bank

[27] A bill of exchange dated 31.05.2019 is payable within 4 months of the presentment. It is presented on 02.06.2019 and accepted on 03.06.2019. Its due date of payment would be;

(a) 31.10.3019 (b) 30.09.2019

(c) 05.10.2019 (d) 06.10.2019

[28] If bill is not paid on due date. The holder in due course presents the bill to a notary public for noting. Which of the following facts are recorded is the noting of a bill?

(a) Facts of dishonour (b) Date of dishonour

(c) Reasons of dishonour (d) All of the above

[29] If part payment of bill is paid on due date or before due date to drawer and request for issue of a fresh bill for the balance amount. If drawer agrees and issues a fresh bill. This is called;

(a) Renewal of the bill

(b) Accommodation of the bill

(c) Retirement of the bill

(d) Mutually accepted bill

[30] The promissory note has....parties

(a) Two (b) Three (c) Four (d) Five

[31] Noting is not necessary on dishonour of promissory note.

(a) True (b) False

[32] 'A cheque is a bill of exchange drawn upon a specified banker and payable on demand.' This is stated under

(a) u/s 6 of NI Act (b) u/s 4 of NI Act

(c) u/s 5 of NI Act (d) u/s 35 of BR Act

[33] Ramesh drew a bill of ₹ 25000 for 3 months on Aniket for mutual accommodation on equal sharing basis. If bill is discounted at 10% .How much amount would be received by Aniket?

(a) 12500 (b) 12187.50

(c) 11250 (d) 12000.30

[34] When a bill is paid by the drawee before its due date and some allowance is given to drawee for advance payment. This is known as;

(a) Subvention (b) Rebate

(c) Mercy (d) Benefit

[35] Transfer of bill to some other person by the holder is known as

(a) Withdrawal of bill (b) Transfer of bill

(c) Endorsement of bill (d) Surrender of bill

[36] What will be due date for a bill dated 06.06.2019 payable 45 days after date;

(a) 24 July '2019 (b) 21 July '2019

(c) 21 July '2019 (d) 22 July '2019

[37] Amount paid to notary public for recording the facts of dishonour of bill is called;

(a) Fee (b) Notary charge

(c) Court fee (d) Noting charge

**ANSWERS**

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1(a) | 2 (c) | 3 (d) | 4 (b) | 5 (c) | 6 (c) | 7 (d) | 8 (c) | 9 (a) |
| 10 (a) | 11(b) | 12 (d) | 13 (a) | 14 (c) | 15 (b) | 16 (d) | 17 (d) | 18 (b) |
| 19 (a) | 20 (a) | 21 (c) | 22 (c) | 23 (a) | 24 (c) | 25(b) | 26 (b) | 27 (c) |
| 28 (d) | 29 (a) | 30 (a) | 31 (a) | 32 (a) | 33 (b) | 34 (b) | 35 (c) | 36 (a) |
| 37 (d) | | | | | | | | |

## SOLUTION

[4] Discount for ₹ 24000 @ 10% for one year is

24000 x 10% = 2400

as the payment is made before two months,

so discount for 2 months = $\frac{2400}{12} \times 2 = 400$

[5] Discounted @ 10% of ₹ 48000 = $\frac{48000 \times 10}{100} = 4800$

₹ 4800 discount is for one year i.e. 12 months

discount for 2 months (as Aniket pays before 2 months)

= $\frac{4800}{12} \times 2 = 800$

[14] ACCOMMODATION BILL:

When one party accepts the bill drawn on him by another, without any consideration, for the purpose of mutual help, the bill is known as accommodation bill.

# MODULE : C
# FINALACCOUNTS

## 13. BALANCE SHEET EQUATION

What is Financial Statements?

Financial statements include

i) Profit and Loss Account.

ii) Balance Sheet

iii) Fund/Cash Flow Statement

iv) Change in Equity(if any)

**IMPORTANT POINTS:**

- Assets are equal to the liabilities.
- Liability = Owner's Claim (i.e. Capital + reserve & Surplus) + Other's/Outsider's claim.
- Capital and Reserve & surplus are also called Net Worth.
- Net Worth is also known as Liability towards Owner.
- Other/Outsider's claims include Term Liabilities and Current Liabilities (i.e. Creditor).

For better understanding see the Performa and components of a Balance Sheet (for broad idea only).

| LIABILITIES | ASSETS |
|---|---|
| **Capital+ Reserve & surplus**<br>(Owner's claim) | **Fixed Assets** (Land, building, furniture, machinery etc) |
| **LIABILITIES(TL+CL)**<br>(Other/Outsider's claim) creditors, outstanding expenses, bank loan(TL), bank loan(CC), Bills payable etc | **CURRENT ASSETS**<br>(Cash, Bank deposit, debtors, bills receivables, stock etc |

**BALANCE SHEET EQUATION:**

Always the total liabilities will be equal to the total assets of the business.

We can express the same as;

Assets = Capital + Liabilities —— (I)

or, Capital = Assets – Liabilities —— — (II)

or, Liabilities = Assets – Capital —— —- (III)

**COMPUTATION OF BALANCE SHEET EQUATION:**

If any change in amount of assets or liabilities will accordingly affect the Capital.

For example (1): If assets increase and no change in Liabilities, it means Capital is increasing.

For example (2): If assets decrease and liabilities increase, it means there is a reduction in Capital.

Now equate the entries,

1. Suppose, you start a business with Rs50000 as capital.

The Balance Sheet will stand as follows:

Amt in Rs

| Liabilities | | Assets | |
|---|---|---|---|
| Capital | 50000 | Cash | 50000 |

2. Suppose, business purchased a machine for Rs5000.

   The Balance Sheet will stand as follows:

Amt in Rs

| Liabilities | | Assets | |
|---|---|---|---|
| Capital | 50000 | Machine<br>Cash (50000-5000) | 5000<br>45000 |
| Total | 50000 | Total | 50000 |

3. Suppose, business purchased goods valued to Rs25000, out of which Rs6000 on credit.

The Balance Sheet will stand as follows:

Amt in Rs

| Liabilities | | Assets | |
|---|---|---|---|
| Capital<br>Creditor | 50000<br>6000 | Machine<br>Goods<br>Cash (45000-19000) | 5000<br>25000<br>26000 |
| Total | 56000 | Total | 56000 |

4. Suppose, business sells goods on credit for Rs8000, the cost of goods is Rs5000.

The Balance Sheet will stand as follows:

Amt in Rs

| **Liabilities** | | **Assets** | |
|---|---|---|---|
| Capital | 50000 | Machine | 5000 |
| Reserve | 3000 | Goods (25000-5000) | 20000 |
| Creditor | 6000 | Debtor | 8000 |
| | | Cash | 26000 |
| Total | 59000 | Total | 59000 |

5. Suppose, business pays Rs1500 to labour and Rs1000 for rent.

The Balance Sheet will stand as follows:

Amt in Rs

| **Liabilities** | | **Assets** | |
|---|---|---|---|
| Capital | 50000 | Machine | 5000 |
| Reserve (3000-1500-1000) | 500 | Goods | 20000 |
| Creditor | 6000 | Debtor | 8000 |
| | | Cash | 23500 |
| Total | 56500 | Total | 56500 |

Now, it is apparent from above transactions that every transaction has a double effect. Decreasing or increasing of an asset will have a corresponding effect on liabilities or capital.

## 13. KNOW YOURSELF NOW : BALANCE SHEET EQUATION

(*see solution)

## Q. A FIRM'S BALANCE SHEET IS AS UNDER

| Liabilities | Amt in ₹ | Assets | Amt in ₹ |
|---|---|---|---|
| Capital | 200000 | Fixed assets | 425000 |
| Reserves | 50000 | Goodwill | 75000 |
| Term Loan | 350000 | Sundry debtors | 100000 |
| Cash Credit | 250000 | Cash | 100000 |
| Sundry creditor | 50000 | Stock | 300000 |
| Provisions | 100000 | | |
| | **10,00,000** | | **10,00,000** |

[1]* Net worth is;
(a) 200000 (b) 50000
(c) 250000 (d) 300000

[2]* Net working capital is;
(a) 10000 (b) 100000
(c) 150000 (d) 75000

[3]* Tangible net worth is;
(a) 150000 (b) 200000
(c) 175000 (d) 425000

[4]* Current ratio is;
(a) 1.33 : 1 (b) 1.25 : 1
(c) 1 : 1 (d) 1.50 : 1

[5] Out side liabilities or outsider's claim is;
(a) 900000 (b) 950000
(c) 750000 (d) 700000

[6] Quick ratio or acid test ratio is;
(a) 0.50:1 (b) 1:1
(c) 0.75:1 (d) 1:0.50

[7] Which of the following equations is correct?
(a) Assets = liabilities + capital
(b) Assets = cash + current assets
(c) Assets = liabilities – fixed assets
(d) Liabilities = capital – fixed assets

[8] What is net worth?
(a) Capital and current assets
(b) Current assets – current liabilities
(c) Assets – liabilities
(d) Capital and balance of reserve and surplus

[9] Net worth is;
(a) An asset (b) A liability
(c) Current liability (d) Current assets

[10] A person who owes money to the firm is known as;
(a) Creditor (b) Debtor
(c) Supplier (d) Customer

[11] A person to whom money is owed by the firm is called;
(a) Creditor (b) Debtor
(c) Supplier (d) Customer

[12] The equation, asset = net worth + creditor is;
(a) True (b) False

[13] What will be the effect if assets increase and liabilities do not increase?
(a) The capital will decrease (b) The reserve will increase
(c) The capital will increase (d) Entity is gaining profit

[14] What will be the effect if liabilities increase and assets do not increase?
(a) Reduction in capital (b) Reduction in assets
(c) Entity is gaining loss (d) Other reasons

[15] If a company purchases a car out of cash available with the company. It will appear as;
(a) Increase in liabilities (b) Decrease in assets
(c) Increase in assets (d) No effect

[16] If a firm receives a car as donation. It will---
(a) Increase the liabilities
(b) Increase the assets
(c) Reduce the liabilities
(d) Not affect assets and liabilities

[17]* If the current assets are ₹ 320000 and total liabilities are ₹ 680000, the fixed assets are;

(a) 350000 (b) 340000

(c) 360000 (d) 320000

[18]* If the current ratio is 1.25:1 and the current liabilities are ₹ 40000, current assets are;

(a) 45000 (b) 50000

(c) 60000 (d) 80000

[19]* If Ramesh started a business with capital for ₹ 5.0 lakh and during the year he earned ₹ 50000 as net profit, but at the same time he has borrowed ₹ 100000 from bank, calculate total assets of the business.

(a) 600000 (b) 550000

(c) 650000 (d) 450000

[20] If Net Working Capital (NWC) is ₹ 225000, calculate current liabilities, if current assets is 400000

(a) 625000 (b) 375000

(c) 175000 (d) 275000

## ANSWERS

1 (c) 2 (b) 3 (c) 4 (b) 5 (c) 6 (a) 7 (a) 8 (d) 9 (b)
10 (b) 11(a) 12 (a) 13 (c) 14 (a) 15 (d) 16 (b) 17 (c) 18 (b)
19 (c) 20 (c)

## SOLUTION

[1] Net worth = Capital + Reserve & surplus
= 200000 + 50000
= 250000

[2] Net working capital = Current assets – current liabilities
= (100000 + 100000 + 300000) – (250000 + 50000 + 100000)
= 500000 – 400000 = 100000

[3] Tangible net worth = Net worth – Intangible assets
= 250000 – 75000 (goodwill)
= 175000

[4] Current ratio = $\dfrac{\text{Current Assets}}{\text{Current liabilities}}$

$$= \frac{500000}{400000}$$

= 1.25 : 1

[17] Total liabilities = Fixed assets + current assets

680000 = Fixed assets + 320000

Fixed assets = 680000 – 320000

= 360000

[18] Current ratio = $\dfrac{\text{Current Assets}}{\text{Current liabilities}}$

$$1.25 : 1 = \frac{1.25}{1} = \frac{\text{Current assets}}{40000}$$

Current assets = 1.25 x 40000

= 50000

[19] Liabilities : Capital = 500000

+ Net profit = 50000

+ Bank loan =100000

Total liabilities = 650000

Total liabilities = Total assets

So, total assets = 650000

## 14. PREPARATION OF FINAL ACCOUNTS

- At the end of accounting year, all ledger accounts are balanced.
- Then trial balance is prepared.
- From the trial balance, final accounts, i.e. trading, profit and loss account and balance sheet are prepared.
- The final account balances, after the proposed adjustments, are known as the adjusted account balances and used in preparation of financial statement.
- The trial balance is not a financial statement.

**ADJUSTMENT OF ENTRIES:**

Some entries are important for preparation of correct and fair financial statements.

**For example**:

Rent not paid for last month, but has to pay.

**Adjustment:**

During the course of preparation of Profit and Loss Account, all expenses and incomes of the year i.e. accounting period have to be considered.

**<u>ENTRIES RELATED TO INCOME/EXPENDITURE</u>**

i. Suppose expenditure for salary of March passed but not paid in actual.

Then, Dr: Expenditure (salary)

Cr: Salary Payable

ii. Advance payment: Suppose advance payment of salary for the month of April has paid in March.

- In this case this is not the expenditure for March, rather the person received the advance salary is **debtor**.

Dr: Debtor or Receivables

Cr: Payment made

iii. Income Accrued but not received

Dr: Interest receivable

Cr: Income

iv. Income Received but not Accrued

For instance advance rent i.e. for April received, but it is not the income of March.

So, Dr: Rent A/c

Cr: Advance Rent Received

## FINANCIAL STATEMENTS FROM TRIAL BALANCE

- After recording all transactions, their arithmetical accuracy has been checked by the trial balance, and if required, adjusting entries has been made.
- Before finalizing the financial statements, the entries in ledger for that transaction which has not actually taken place like, depreciation have to be posted.

## 14. KNOW YOURSELF NOW : PREPARATION OF FINAL ACCOUNTS (*see solution)

[1] The reduction in the value of the fixed assets during a year is to be deducted from;
(a) Cash profit earned during the year
(b) Income
(c) Current liabilities (d) None of the above

[2] 'The depreciation is an actual expense, though not a cash expense of the business.' This statement is;
(a) True (b) False
(c) Occasionally true (d) None of the above

[3] While calculating the depreciation amount and debit it to expense account, which account will be credited?
(a) Income account (b) Cash in hand
(c) Fixed assets account (d) Sinking fund account

[4] Cost of goods sold can be calculated by;
(a) Cost of goods sold = Purchases – closing stock
(b) Cost of goods sold = opening stock + purchases – closing stock
(c) Cost of goods sold = (Opening stock + purchases) – (closing stock + expenses)
(d) Cost of goods sold = opening stock – closing stock

[5] Final accounts of a business entity means;
(a) Profit and loss account (b) Trading account
(c) Balance sheet (d) All of the above

[6] The goods sold on credit became bad debt as debtors did not pay. The adjustment entry will be made as;
(a) Debit bad debt account and credit debtor's account
(b) Debit debtor's account and credit bad debt account
(c) Debit expenditure account and credit provision account
(d) None of the above

[7] The value of inventory is ascertained as;
(a) Perpetual inventory (b) Periodic inventory
(c) Random basis (d) Both (a) and (b)

[8] Out of following, which are the components of inventory?
(a) Raw material (b) Stock in process
(c) Finished goods (d) All of the above

[9] The closing stock is that which was received last, so valuation of acquiring the last materials is applied in;

(a) First in first out method (b) Last in first out method
(c) First in last out method (d) Average last method

[10] The closing stock is that which was received first, so cost of acquiring the first materials is applied in;

(a) Last in first out method (b) First in first out method
(c) Average cost method (d) None of the above

[11] Accounting standard 2 (revised) permits use of which method for valuation of inventory?

(a) First in first out method (b) Last is first out method
(c) Weighted average method (d) Either (a) or (b) only

[12] At the end of each accounting period, all the income and expenses account should be closed. The entries passed for this purpose are called;

(a) Income - expenditure entries (b) Closing entries
(c) Final vouchering (d) Contra entries

[13] The stock register gives the inventory balances at any time under which of the following methods?

(a) Perpetual inventory (b) Periodic inventory
(c) Random inventory (d) All of the above

[14] If the closing stock of a firm on 31.03.2018 is ₹ 19000. Sales during 2018-19 is ₹ 250000, while purchases during the period is ₹ 190000. If the closing stock as on 31.03.2019 is ₹ 20000. What is the gross profit as on 31.03.2019?

(a) 21000 (b) 31000 (c) 61000 (d) 39000

[15] The components of liabilities are---

(i) Capital (ii) Long term liabilities
(iii) Short term liabilities (iv) Receivables
(a) (i), (ii), (iii) & (iv) all (b) (i), (ii), (iii) only
(c) (i) & (ii) only (d) (i) only

[16] Sundry debtor is;

(a) Asset (b) Liability (c) Capital (d) Stock

[17] Expenditure for rent of premises have been incurred but will be paid to owner in next month, what type of adjustment entries will be passed?

(a) Debit expenditure (rent) account and credit to rent payable account
(b) Debit expenditure & credit profit account
(c) Debit rent receivables & credit rent payable
(d) Debit expenditure accounts & credit sundry account

[18] If advance payment of salary say for the month of April has been paid in March. It is not the expenditure of current financial year, so the employee who received the amount is treated as;

(a) Creditor (b) Debtor

(c) Receiver (d) Payee

[19] If a firm has invested a sum of ₹ 100000 in mutual fund. It is payable on maturity along with principal amount. For accounting what type of voucher will be passed?

(a) Debit interest and credit income

(b) Debit interest payable and credit income

(c) Debit interest receivable and credit income (interest) account

(d) No entry will be passed

[20] If a firm received advance payment of rent that does not pertain to current financial year, the entries will be passed as;

(a) Debit rent account and credit advance rent received

(b) Debit advance rent received and credit income account

(c) Debit advance rent received and credit sundry account

(d) Not required to pass any entries.

[21] M/s Raj Agro has total debtor of ₹ 20 lakh against which 1.50% provision has already been made. Now M/s Raj Agro wants to increase the provision up to 2.5%, what type of adjustment will be required?

(a) Debit provision and credit P/L account for ₹ 50000

(b) Debit P/L account and credit provision account for ₹ 20000

(c) Debit P/L account and credit provision account for ₹ 50000

(d) Debit provision account for ₹ 30000 and credit provision account for ₹50000

[22]* M/s Rohit had total debtor of ₹ 20.0 lakh, out of which the debtors worth ₹ 700000 is not traceable, so treated as bad debt. M/s Rohit wants to make provision for bad debt @ 7.5%. Calculate net bad debt.

(a) 647500 (b) 52500

(c) 1300000 (d) 1850000

[23]* M/s Raj and Co. has earned a net profit of ₹ 12.0 lakh before payment of incentive to employees. The employees are entitled to get 4% incentive on net profit. What is the amount of incentive?

(a) 48000 (b) 46080

(c) 36080 (d) 46156.80

[24] What is net sale?

(a) Gross sale minus operating cost of sale

(b) Gross sale minus owner's drawing

(c) Gross sale minus excise duty etc.

(d) Sale plus rebate received

[25] "Adjustment of entries in ledger for that transaction which has not actually taken place have to be posted before finalising the financial statement". The statement is;

(a) True (b) False

(c) Not required (d) As per desire

**ANSWERS**

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1(a) | 2(c) | 3(a) | 4(b) | 5(d) | 6(a) | 7(b) | 8(b) | 9(c) |
| 1 (a) | 2 (a) | 3 (c) | 4 (c) | 5 (d) | 6 (a) | 7 (d) | 8 (d) | 9 (a) |
| 10 (a) | 11 (d) | 12 (b) | 13 (a) | 14 (c) | 15 (b) | 16 (a) | 17 (a) | 18 (b) |
| 19 (c) | 20 (a) | 21 (b) | 22 (a) | 23 (b) | 24 (c) | 25 (a) | | |

**SOLUTION**

[22] Total debtor = ₹ 2000000

out of which bad debt = ₹ 700000

provision of bad debt @ 7.5% = $\frac{700000 \times 7.5}{100}$

= 52500

So, net bad bedt = (700000 – 52500)

= 647500

[23] Net Profit before incentive = ₹ 1200000

(-) incentive @ 4% = ₹ 48000

So, net profit = 1152000

entitlement of incentive is on net profit

so, incentive @ 4% of ₹ 1152000

= 46080

## 15. RATIO ANALYSIS

The term Ratio refers to the numerical or quantitative relationship between two items/ variables which are connected with each other. These variables are taken from Balance Sheet or Profit and Loss Account.

### CLASSIFICATION OF RATIOS

Ratios can be classified on the following basis

1. Traditional Classification
2. Functional Classification

### TRADITIONAL CLASSIFICATION

It is on the basis of financial statements, i.e.

i) Profit and Loss Account Ratio

ii) Balance Sheet Ratio

iii) Composite Ratio or Inter Statement Ratio(P/L + BS)

### FUNCTIONAL CLASSIFICATION

It serves as tool for financial analysis.

i) Profitability Ratio

ii) Turnover or Acidity Ratio

iii) Financial or Solvency Ratio

Financial or Solvency Ratios may be further classified into two categories;

a) Short Term Solvency Ratios: disclose the financial position or solvency of the firm in the short period. It is also called 'Liquidity Ratio'.

b) Long Term Solvency Ratios: disclose the financial position or solvency of the firm in the long period. It is also called 'Solvency Ratio'.

**RATIOS**

- Traditional
  - P/L A/c Ratio
  - B/s Ratio
  - Composite Ratio
- Functional
  - Profitability Ratio
  - Turnover or activity Ratio
  - Financial or Solvency Ratio
    - Short-term Solvency Ration or Liquidity Ratio
    - Long-term solvency ratio or solvency Ratio

**Ratios are broadly classified into four groups**:

(i) Liquidity Ratios: To evaluate the liquidity position of the firm.

(ii) Leverage or Solvency Ratios: To evaluate the strength of the firm to raise long term loans.

(iii) Profitability Ratios: To understand as to how profitable is the business.

(iv) Activity Ratios: To examine the efficiency with which the assets are being used.

**Liquidity Ratios:** Liquidity Ratios indicate the Liquidity of the firm meaning thereby the ability of an enterprise to meet its current (Short-term) obligations. These are:

(a) Current Ratio

(b) Net Working Capital

(c) Acid Test or Quick Ratio

(d) Working Capital GAP

**(a) CURRENT RATIO:** Current Ratio is the ratio of Current assets to current liabilities. The ratio helps in knowing about the liquidity position of a firm during the course of a year. It is calculated as under :

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

Bankers accept the Current Ratio of 1.33:1 as satisfactory.

**(b) NET WORKING CAPITAL**: Net Working Capital (NWC) is not a ratio. It is however, frequently employed as measure of the liquidity position. NWC represents the excess of current assets over current liabilities and is calculated as under :

NWC = Current Assets – Current Liabilities

The greater the amount of NWC, the more would be the liquidity of the enterprise. There are no predetermined criteria as to what constitutes an adequate NWC.

**(c) ACID TEST OR QUICK RATIO**: Also called as Liquid Ratio. The quick ratio is the ratio between quick assets and current liabilities. The ratio measures the capacity of the organization to pay off current liabilities of the urgent nature immediately.

Quick Assets = Cash/bank balances + receivables upto 6 months + quickly realizable securities such as government securities or quickly marketable shares and bank FD.

Simply, Quick Assets = Current assets – Inventory.

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

A high Acid Test Ratio/Quick Ratio is better than a low one, but generally, a Ratio of 1:1 is considered to be satisfactory.

**(d) WORKING CAPITAL GAP** : It is calculated as under

WCG = Current assets – (Current Liabilities – Bank borrowing)

**Note:** Increasing Current Ratio, quick ratio and net working capital are indictors of improvement.

**LEVERAGE OR SOLVENCY RATIOS**

The long-term creditors judge the soundness of an enterprise on the basis of its long-term financial strength. The long term solvency can be judged by solvency ratios, most important of which is

- Debt – Equity Ratio and
- Debt Service Coverage Ratio (DSCR)

**DEBT EQUITY RATIO (D/E Ratio):** D/E Ratio is the relationship between borrowed funds (debts) and owners Capital (Equity).

The ratio is important because it shows the dependence of the unit on outside long term finance. It can be calculated as:

$$\text{D/E Ratio} = \frac{\text{Long term outside Liabilities}}{\text{Tangible Net worth}}$$

D/E Ratio of 2:1 is considered desirable by the banks.

(Long term outside liabilities are liabilities of Long term nature and Tangible net worth is net worth minus intangible assets.)

**Higher the ratio more the pressure on the liquidity** of the organization, when repayment of liabilities falls due. Lower the D/E ratio of a firm is good.

**DEBT SERVICE COVERAGE RATIO (DSCR)**

The ratio indicates the ability of an enterprise to meet its liabilities by the way of payments of term loans and interests thereon from out of cash accruals. The ratio is used for judging repayment capacity and fixing the repayment schedules for term loans.

The ratio is calculated as under:

$$\text{DSCR} = \frac{\text{Profit after tax + Depreciation + Interest on term loans}}{\text{Instalment of loan payable + Interest on T/L}}$$

Generally the Bank considers a DSCR at 2:1 as comfortable.

**PROFITABILITY RATIOS:**

Profitability indicates the efficiency of the organization in generation of income and surplus, which provide a sound diagnosis of the financial health of the enterprise.

Profitability Ratios can be determined on the basis of either sales or investments.

(i) Profitability Ratios Related to Sales

These are,

(a) Profit margin (Gross and Net) and

(b) Expenses Ratio or Operating Ratio

**PROFIT MARGIN:**

The profit margin measures the relationship between profit and sales. As profit may be Gross Profit and Net Profit, the profit margin is also of two types i.e. Gross Profit margin and Net profit margin.

**GROSS PROFIT MARGIN:**

$$\text{Gross Profit Margin} = \frac{\text{Gross Profit}}{\text{Net Sale}} \times 100$$

Since Gross Profit is equal to sales minus cost of goods sold, the Gross Profit Margin can also be calculated as:

$$\text{Gross Profit Margin} = \frac{\text{Sales} - \text{Cost of goods sold}}{\text{Net Sales}} \times 100$$

A low gross profit margin needs a thorough investigation. An enterprise should have a reasonable gross profit margin which will cover the operating expenses and also ensure sufficient return.

**NET PROFIT MARGIN:**

$$\text{Net Profit Margin (Ratio)} = \frac{\text{Net Profit}}{\text{Net Sales}} \times 100$$

The Net Profit is the Surplus of gross profit after meeting other expenses. A high net profit margin ensures adequate return to the firm.

**EXPENSES RATIO:** The term 'Expenses' includes

(i) Cost of goods sold
(ii) Administrative expenses
(iii) Selling and distribution expenses
(iv) Interest, taxes etc. There are different variants of the ratio like.

(a) $\text{Cost of Goods Sold Ratio} = \frac{\text{Cost of goods sold}}{\text{Net Sales}} \times 100$

(b) $\text{Operating Exp Ratio} = \frac{\text{Administrative exp} + \text{selling exp}}{\text{Net Sales}} \times 100$

(c) $\text{Administrative Ex Ratio} = \frac{\text{Administrative Expenses}}{\text{Net Sales}} \times 100$

(d) $\text{Selling Expenses Ratio} = \frac{\text{Selling Expenses}}{\text{Net Sales}} \times 100$

(e) $\text{Operating Ratio} = \frac{\text{Cost of goods sold} + \text{operating Exp}}{\text{Net Sales}} \times 100$

**ACTIVITY RATIOS:**

Activity Ratios measure the efficiency of the organization in using the available funds particularly the fund raised on short term basis.

The following ratios could be worked out:

(i) Inventory turnover = $\frac{\text{Sales}}{\text{Average stock}}$

(ii) Debtor turn Over = $\frac{\text{Sales}}{\text{Average debtor}}$

(iii) Fixed Assets Turnover = $\frac{\text{Sales}}{\text{Fixed Assets}}$

(iv) Current assets/working capital turn over

$$= \frac{\text{Net Sales}}{\text{Average working capital i.e. CA}}$$

(v) Debtors Velocity or Debt Collection Period

$$= \frac{\text{Average Book debts}}{\text{Sales}} \text{ x } 12$$

(vi) Creditors velocity or Creditors Payments period

$$= \frac{\text{Average Creditors}}{\text{Purchases}} \text{ x } 12$$

(vii) Raw Material Holding= $\frac{\text{Stock of Raw material}}{\text{Raw Material consumed during one year}}$ x 12

(viii) Stock in Process Holding = $\frac{\text{Stock of Stock in process}}{\text{Cost of Production during one year}}$ x 12

(ix) Finished goods holding = $\frac{\text{Stock of finished goods}}{\text{Cost of Production during one year}}$ x 12

**Note:** The lower ratio of holding of raw material, stock in process or finished goods indicate effective use of the working capital components.

## 15. KNOW YOURSELF NOW : RATIO ANALYSIS (*see solution)

[1] The ratios that disclose the financial position or solvency of the firm in the short period is know as
- (a) Solvency ratio
- (b) Profitability ratio
- (c) Short term solvency ratio
- (d) Short term solvency ratio or liquidity ratio

[2] The ratios that disclose the financial position or solvency of the firm in the long period is called
- (a) Solvency ratio
- (b) Liquidity ratio
- (c) Long-term solvency ratio
- (d) Both (a) & (c)

[3] Overall profitability ratio is also known as
- (a) Profit
- (b) Yield on investment
- (c) Return on investment
- (d) Operating profit

[4] Overall profitability ratio or return on investment is calculated on the basis of which of the following formula?
- (a) Gross profit/capital x 100
- (b) Operating profit/capital employed x100
- (c) Net profit x capital
- (d) Capital employed/net profit x100

[5]* If a firm's gross profit is ₹ 800000 and net sale is ₹ 2800000. What is the gross profit ratio?
- (a) 25%
- (b) 26.72%
- (c) 28.57%
- (d) 32.12%

[6] Liquid ratio is also known as–
- (a) Acid test ratio
- (b) Debt - equity ratio
- (c) Quick ratio
- (d) Both (a) and (c)

[7] Which of the following is/are profitability ratio?
- (a) Gross profit margin/ratio
- (b) Net profit margin/ratio
- (c) Expense ratios
- (d) All of the above

[8] A term loan has been rescheduled by the Bank. As a result of this, which of the following has been affected?
- (a) Debt - Equity rate
- (b) Acid test ratio
- (c) Profitability ratio
- (d) Debt Service Coverage Ratio (DSCR)

[9]* A company has net worth ₹ 9.50 lakh, term liabilities of ₹ 10.0 lakh. Fixed assets of ₹ 16.0 lakh and current liabilities of ₹ 12.0 lakh. Calculate net working capital and current ratio.

(a) 3.50 lakh; 1.33 : 1 (b) 4.00 lakh; 1.25 : 1

(c) 3.50 lakh; 1.29 : 1 (d) 2.00 lakh; 1.66 : 1

[10] Why debt - equity ratio is calculated?

(a) To know the ratio of debt against equity

(b) To ascertain the soundness of long-term financial status

(c) To ascertain long-term solvency of the business

(d) There is no specific purpose

[11]* If the current ratio of a firm is 2 as on 31.03.2019. What will be the effect on current ratio if current liability is paid by 50%?

(a) Current ratio will increase to 3 : 1

(b) Current ratio will decrease to 1 : 1

(c) Current ratio will increase to 4 : 1

(d) Current ratio will decrease to 1 : 4

[12] What will be the effect on current ratio if bill receivable dishonoured?

(a) Current ratio will decrease (b) Current ratio will increase

(c) Current ratio will not change

(d) No effect

[13] What can be measured by Activity ratios?

(a) Efficiency of the organisation in using the available fund raised on short-term basis

(b) How a firm is functioning

(c) How a firm is active (d) Firm's profit or loss

[14] The lower ratios of holding of raw material, stock in process or finished goods indicate;

(a) Least use of working capital

(b) Firm is not running good

(c) Lower ratios means low risk

(d) Effective use of the working capital components

[15] Which ratio indicates the ability to repay the loan amount and interest thereon from out of cash accrual?

(a) Current ratio (b) Net working capital

(c) Solvency ratio

(d) Debt Service Coverage Ratio

[16] What can be measured by Liquid ratio?

(a) Current Assets (b) Current Liabilities

(c) Cash available with firm (d) Liquidity position of firm

[17]* If quick ratio is 1.5 : 1 current ratio is 2 : 1 and current liabilities are ₹ 90000. What is the value of stock?

(a) 180000 (b) 45000

(c) 135000 (d) 90000

[18] Debtor turnover ratio is also knows as;

(a) Debtor's Velocity (b) Receivable turnover ratio

(c) Payable turn over ratio (d) Both (a) and (b)

[19] The profit margin ratio measures;

(a) Net income earned (b) Operating income

(c) Income after tax (d) Income before tax

[20] Which of the following is considered as profitability measures?

(a) Sale per day (b) Percentage of profit

(c) Return on assets (d) None of the above

[21] Calculate Net Working Capital (NWC) of a firm if current ratio is 1.4 : 1 and quick ratio is 0.80 : 1 and stock-in-trade is ₹ 600

(a) 200 (b) 400

(c) 600 (d) 800

[22] What is ratio of interest earned on simple interest for five year and interest earned on quarterly compounding interest for same period at 10% rate of interest?

(a) 1 : 1.25 (b) 1 : 3.00

(c) 1 : 1.27 (d) 1 : 3.27

[23] To measure the ability of an enterprise to meet its current obligation, which of the following ratios is preferable?

(a) Liquidity ratio (b) Solvency ratio

(c) Profitability ratio (d) Activity ratio

[24] To measure the capacity to pay off current liabilities of the urgent nature immediately, which of the following ratios is preferable?

(a) Acid test ratio (b) Quick ratio

(c) Current ratio (d) Both (a) & (b) are same

[25] The formula to calculate working capital gap is

(a) Current asset – current liabilities

(b) Current assets – (current liabilities-inventory)

(c) Current assets– (current liabilities - bank borrowing)

(d) Capital – current liabilities

[26] How can be calculated Debt- Equity ratio?

(a) $\frac{\text{Long term outside liabilities}}{\text{Tangible net worth}}$

(b) $\frac{\text{Liability}}{\text{Net worth}}$

(c) $\frac{\text{Liability}}{\text{Tangible net worth}}$

(d) $\frac{\text{Current liabilities}}{\text{Equity}}$

[27] If debt equity ratio is higher, what is its consequence?

(a) It is good for the firm

(b) Higher the ratio more the pressure on liquidity. When payment of liabilities fall due

(c) Liquidity is more than required

(c) The financial health of the firm is satisfactory

[28] Debt Service Coverage Ratio can be calculated by which of the following formula?

(a) $\text{DSCR} = \frac{\text{Profit}}{\text{Installment}}$

(b) $\text{DSCR} = \frac{\text{Profit after tax} + \text{Depreciation}}{\text{Installment} + \text{Interest}}$

(c) $\text{DSCR} = \frac{\text{Profit after tax} + \text{Depreciation} + \text{Interest on T/L}}{\text{Installment of T/L} + \text{Interest on T/L}}$

(d) $\text{DSCR} = \frac{\text{Cash Accrual}}{\text{Installment}}$

[29] Dividend yield ratio can be calculated by-

(a) $\frac{\text{Dividend per share}}{\text{Market price per share}}$

(b) $\frac{\text{Dividend}}{\text{Value of share}}$

(c) $\dfrac{\text{Total dividend received}}{\text{Total investment}}$

(d) $\dfrac{\text{Investment}}{\text{Dividend}}$

[30] The manipulation of accounts in such a way, as to conceal vital facts to show a better position than what actually is, known as;

(a) Concealment of facts
(b) Misrepresentation of datas
(c) Window dressing
(d) Fake datas

**ANSWERS**

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1 (d) | 2 (d) | 3 (c) | 4 (b) | 5 (c) | 6 (d) | 7 (d) | 8 (d) | 9 (c) |
| 10 (b) | 11(c) | 12 (a) | 13 (a) | 14 (d) | 15 (d) | 16 (d) | 17 (b) | 18 (d) |
| 19 (a) | 20 (c) | 21 (b) | 22 (c) | 23 (a) | 24 (d) | 25 (c) | 26 (a) | 27 (b) |
| 28 (c) | 29 (a) | 30 (c) | | | | | | |

**SOLUTION**

[5] Gross profit ratio = $\dfrac{\text{Gross Profit}}{\text{Net Profit}} x100$

$= \dfrac{800000}{2800000} x100$

= 28.57%

[9] Assets = Liabilities

Fixed assets + current assets = net worth + term liabilities + current liabilities

16 + current assets = 9.50 + 10.0 + 12

Current assets = 31.50 - 16

= 15.50

Net working capital = current assets = current liabilities

= 15.50 – 12

= 3.50

Current ratio = $\dfrac{\text{Current Assets}}{\text{Current liabilities}}$

$= \dfrac{15.50}{12} = 1.29:1$

[11] Current ratio is 2 means 2 : 1

So $\frac{\text{Current Assets}}{\text{Current liabilities}} = \frac{2}{1}$

Now, current liabilities is paid by 50%, it means current liabilities remained 0.50

So, Current ratio would be = $\frac{2}{0.50} = 4:1$

[17] Quick ratio = $\frac{\text{Current assets - stock}}{\text{Current liabilities}}$

Current ratio = $\frac{CA}{CL} = \frac{CA}{90000} = 2:1$

$= \frac{180000}{90000}$

So, CA = 180000, put it in quick ratio

Quick ratio = $\frac{180000 - \text{Stock}}{90000} = 1.5:1$

So, 180000 – Stock = 90000 x 1.5

180000 – Stock = 135000

Stock = 45000

## 16. FINAL ACCOUNTS OF BANKING COMPANIES

**Definition (Bank/Banking) :** As per section 5b of Banking Regulation Act 1949 "accepting deposit from public, for the purpose of lending or investment, repayable on demand or otherwise, withdrawable by cheque, draft, order or otherwise".

**REQUIREMENT:**

A company registered under the Company Act 2013 is required to present its financial statements i.e. Balance Sheet and Profit and Loss account. The Performa of said financial statements is laid down in Schedule III of Company Act 2013.

Banking Company is also required to prepare and submit its accounts in specified Performa laid down in Schedule III of Banking Regulation Act, 1949. RBI has issued Form A for Balance Sheet and Form B for Profit and Loss Account.

**Section 29 of B.R.Act, 1949:** Financial statements of Banking Company incorporated in India should be signed by Manager or Principal Officer and at least three directors (or all directors if number of directors is less than three).

Provision of this section is also applicable to RRBs.

**Section 30 of B.R.Act, 1949:**

Accounts must be audited by a person duly qualified under any law. Prior approval of RBI is required before appointing, reappointing and removing of any auditor.

**Section 31 of B.R.Act, 1949:**

Three copies of Balance Sheet and Profit and Loss account along with auditor's report must be submitted to RBI within three months from the end of the period. RBI can extend the period for next three months.

**Section 32 of B.R.Act, 1949:**

Three copies of Balance Sheet and Profit and Loss account along with auditor's report must be submitted to ROC (Registrar of Company) at the same time when submitted to RBI. It is applicable for banking company (for the banks registered under company act and not to other banks) only.

**PUBLICATION**:

**Rule 15** of Banking Regulating (companies) Rule, 1949: Accounts and auditor's report be published in local newspaper within 6 months form end of the period to which they relate.

**IMPORTANT BOOKS:**

As per Section 2(3) of the Banker's Books Evidence Act, 'Banker Books' include ledger, day book, cash book, account books etc. Normally following books are maintained by bank.

1. **CASH BOOK**: All cash receipt and payments are recorded in Cash Receipt Register and Cash Payment Register respectively.
2. **GENERAL BOOK:** The following ledger books are maintained;

i) Current Account Ledger

ii) SB Account Ledger

iii) RD Account Ledger

iv) FD Account Ledger

v) Loan Ledger

vi) Investment Ledger

vii) Bills discounted Ledger

Besides these ledgers, General Ledger (GL) contains the total accounts of each ledger.

**1. OTHER BOOKS:**

i) Securities Register

ii) Draft Register

iii) Clearing Register

iv) Safe Deposit Vault Register

v) Letter of Credit Register

vi) Bill for Collection Register

vii) Cheque dishonoured Register, etc

**FINANCIAL STATEMENTS OF BANK**

**(1) BALANCE SHEET**

**Form of Balance Sheet**

(Third Schedule: Form A)

Balance Sheet as on 31.03. ——

| **Capital and Liabilities** | **Schedule No** | **Amt in Rs** |
|---|---|---|
| Capital | 1 | — |
| Reserve & Surplus | 2 | — |
| Deposit | 3 | — |
| Borrowings | 4 | — |
| Other liabilities and provisions | 5 | — |
| Total | | |

| **Assets** | **Schedule No** | **Amt in Rs** |
|---|---|---|
| Cash and balance with RBI | 6 | — |
| Balance with Bank and money at Call and Short Notice | 7 | — |
| Investment | 8 | — |
| Advances | 9 | — |
| Fixed Assets | 10 | — |
| Other assets | 11 | — |
| Total | | |
| Contingent Liabilities | 12 | — |

## (2) PROFIT AND LOSS ACCOUNT

**Form of Profit and Loss Account**

(Third Schedule: Form B)

| Profit and Loss Account for the year ended on 31.03. —— | | | |
|---|---|---|---|
| | | Schedule No | Amt in Rs |
| I. | Income | | |
| | Interest Earned | 13 | — |
| | Other Income | 14 | — |
| | Total | | — |
| II. | Expenditure | | |
| | Interest Expenses | 15 | — |
| | Operative Expenses, | | |
| | Provisions & contingencies | 16 | — |
| | Total | — | — |
| III. | PROFIT/LOSS | | |
| | Net Profit/Loss | | — |
| IV. | APPROPRIATION | | |
| | Transfer to Statutory Reserve, | | |
| | Transfer to other Reserves. | | |
| | Balance c/f to BS | | |
| | Total | | |

Significant Accounting Policies 17

Notes of Accounts 18

**DISCLOSURE**:

Banks are required to make Pillar III disclosure at least on a half yearly basis, but following disclosures on quarterly basis;

1. CAPITAL ADEQUACY
2. CREDIT RISK: General Disclosure for all Banks
3. CREDIT RISK: Disclosure of Portfolios.

## 16. KNOW YOURSELF NOW : FINAL ACCOUNTS OF BANKING COMPANIES

[1] The Bank is prohibited from buying, selling or dealing in goods, under which of the following act?

(a) U/s 5 of banking regulation act
(b) U/s 8 of banking regulation act
(c) U/s 24 of Reserve bank of India act
(d) U/s 31 of Indian contract act

[2] Before declaring dividend, every banking company has to transfer..... percent of the current year's profit to——.

(a) 50%; reserve
(b) 20%; CRR
(c) 24%; SLR
(d) 20%; Statutory reserve

[3] Money borrowed by one bank from another bank is known as,

(a) Loan
(b) Overdraft
(c) Money at call and short notice
(d) Discount

[4] Banks have to prepare audited balance sheet and profit and loss account as on 31.03.——every year, according to which of the following?

(a) Company act 2013
(b) Government of India direction
(c) RBI, Act
(d) Banking regulation act

[5] Which of the following is correct regarding financial statements of banking company under sec 29 of BR Act?

(a) Financial statements should be signed by all directors
(b) Financial statements should be signed by the manager or principal officer of the banking company
(c) Financial statements should be signed by the auditor
(d) Financial statements should be signed by manager or principal officer and at least three directors

[6] As per section 30 of banking regulation act, accounts must be audited by a person—— under any law, to be auditor's of the company with the prior approval of——

(a) Duly qualified : NABARD
(b) Entitled : RBI
(c) Duly qualified : RBI
(d) Of RBI : Government of India

[7] Three copies of balance sheet and profit and loss account must be submitted to—within— months according to——
(a) Government of India : 6 months : RBI Act
(b) RBI : 6 months : Government of India
(c) RBI : 3 months : Government of India
(d) RBI : 3 months : sec 31 of BR Act

[8] The time for submission of balance sheet and profit and loss account can be extended upto further period of—by— under—
(a) 3 months : RBI : BR act
(b) 3 months : RBI : Company Act
(c) 3 months : RBI : sec 31 of BR Act
(d) 3 months : GoI : sec 3 of BR Act

[9] A banking company (not other types of banks) requires to furnish three copies of annual accounts and auditor's report to— according to——
(a) NABARD; RBI act
(b) GoI : RBI act
(c) Registrar of Companies : see 32 of BR Act
(d) Registrar of Companies : see 32 of Co Act

[10] Accounts and auditor's report shall be published within—— according to——
(a) 3 months : sec 15 of BR Act
(b) 6 months : sec 15 of BR Act
(c) 6 months : rule 15 of banking regulating (companies) rule
(d) 3 months : rule 15 of banking regulating (companies) rule

[11] Banking company is required to prepare and submit balance sheet as per;
(a) Form prescribed in schedule III of company act
(b) Form A of schedule III of B.R. act
(c) Form B of schedule III of B.R. act
(d) Form prescribed by auditor

[12] RBI has issued guidelines to follow new form B for the preparation of——
(a) Balance sheet
(b) Profit and loss account
(c) Trading account
(d) Auditor's report

[13] Balance sheet has two parts viz-

(a) Capital and liabilities
(b) Capital and assets
(c) Capital & liabilities and assets
(d) None of the above

[14] Capital and liabilities have——schedules.

(a) Four (b) Five
(c) Six (d) Seven

[15] Assets have——schedules.

(a) Five ((b) Six
(c) Seven (d) Eight

[16] Contingent liabilities are mentioned under which schedule?

(a) Schedule-11 (b) Schedule-12
(c) Schedule-17 (d) Schedule-18

[17] Profit and loss account has——schedule.

(a) Five (b) Four
(c) Six (d) Three

[18] Which of the following can be treated as a credit voucher for a bank branch?

(a) Transfer credit voucher prepared by branch
(b) Pay-in-slip for deposit of cheque
(c) Application for NEFT
(d) All of the above

[19] As per RBI guidelines provisions for secured and unsecured portion of substandard categories of NPA are——and—— respectively.

(a) 15% : 40% (b) 25% : 40%
(c) 15% : 25% (d) 25% : 100%

[20] As per RBI guidelines provisions for secured portion of $D_1$ and $D_2$ categories of NPA are ——and ——respectively

(a) 25% : 50% (b) 100% : 100%
(c) 50% : 50% (d) 25% : 40%

[21] If a company is dissolved, the provision for bad and doubtful debts will be transferred to—

(a) Loan account (b) Income account
(c) Realisation account (d) Capital account

[22] Schedule 18 of the balance sheet of a bank relates to which of the following?
(a) Capital (b) Other liabilities
(c) Disclosure of notes of accounts
(d) Significant accounting policies

[23] Schedule 17 of the balance sheet of a bank relates to which of the following?
(a) Reserve and surplus
(b) Disclosure of significant accounting policies
(c) Contingent liabilities (d) None of the above

[24] Schedule 13 to the profit and loss account of a bank relates to which of the following?
(a) Net profit / loss (b) Other income
(c) Other expenditure (d) Interest earned

[25] Banking has been defined under section——of———
(a) U/s 5 of RBI act (b) U/s 5 of BR act
(c) U/s 5 (b) of BR act (d) U/s 5 of NI act

[26] Schedule 4 of balance sheet of a bank relates to which of the following?
(a) Borrowings (b) Deposits
(c) Capital (d) Reserve and surplus

[27] The financial statements of a foreign banking company are to be signed by——
(a) The manager (b) The principal officer
(c) Agent of principal officer
(d) The manager or agent of the principal officer in India

[28] The amount of bank guarantee is——and will be reported in schedule——
(a) Contingent liabilities : 12 (b) Advance : 9
(c) Other liabilities : 05 (d) Other assets : 11

[29] Interest paid on deposit is interest expended, it will be reported under—
(a) Schedule-11 (b) Schedule-14
(c) Schedule-15 (d) Schedule-16

[30] Depreciation on bank's property will be reported under—
(a) Schedule-13 (b) Schedule-14
(c) Schedule-15 (d) Schedule-16

[31] Schedule 10 and 11 to the balance sheet of a bank relate to which of the following?
(a) Assets and liabilities
(b) Liabilities and assets
(c) Fixed assets and other assets
(d) Current liabilities and term liabilities

[32] Gold appears under——and silver appears under—
(a) Assets : assets
(b) Investment : Investment
(c) Investment : other assets
(d) Assets : investment

[33] Banks are required to make pillar III disclosures at least on—
(a) Quarterly basis
(b) Monthly basis
(c) Half yearly basis
(d) Yearly basis

[34] Which of the following disclosures would be made at least on quarterly basis by banks?
(a) Capital adequacy
(b) Credit risk : general disclosure
(c) Credit risk, disclosure of portfolios
(d) All of the above

[35] Unearned discount in respect of those bills maturing after balance sheet date is called,
(a) Bills discount
(b) Rebate on bill discount
(c) Unrealised income
(d) Interest accrued

## ANSWERS

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1 (b) | 2 (d) | 3 (c) | 4 (d) | 5 (d) | 6 (c) | 7 (d) | 8 (c) | 9 (c) |
| 10 (c) | 11(b) | 12 (b) | 13 (c) | 14 (b) | 15 (b) | 16 (b) | 17 (b) | 18 (d) |
| 19 (c) | 20 (d) | 21 (c) | 22 (c) | 23 (b) | 24 (d) | 25 (c) | 26 (a) | 27 (d) |
| 28 (a) | 29 (c) | 30(d) | 31 (c) | 32 (c) | 33 (c) | 34 (d) | 35 (b) | |

## 17/18: COMPANY ACCOUNTS

A company is an association of persons who contribute money or money's worth to a common stock and uses it for a common purpose.

There are different forms of business organization. viz;


*In proprietary firm, capital requirement is very small. In partnership firm capital requirements are met by partners.

Proprietary firm or partnership firm is not suitable where large investment is required. For fulfillment of large investment Joint Stock Company came into existence.

**FEATURE OF JOINT STOCK COMPANY**:

1. **INCOPORATED ASSOCIATION:** A company is a registered body of individuals and registration of Joint Stock Company is mandatory.
2. **ARTIFICIAL PERSON:** It is an artificial person created by law. It is different from its members.
3. **PERPETUAL SUCCESSION:** A company has a perpetual succession. Existence of a company is not affected by death, insolvency etc of a member.
4. **COMMON SEAL:** A company is an artificial person who can't sign, so it has a common seal which is treated as signature of company.
5. **LIMITED LIABILITY:** The liability of the members of the Joint Stock Company is limited to the face value of shares held by them, but if a company fails to enhance its minimum paid up capital (i.e. one lakh for private limited company and five lakh for public limited company) each director or manager or shareholder will have unlimited liability.

6. **<u>SEPERATION OF MANAGEMENT FROM OWNERSHIP:</u>** Shareholders can't participate in the management of the company. They elect their representatives known as 'Board of Directors'
7. **<u>TRANSFERABILITY OF SHARES</u>:** Shares are freely transferable.
8. **SEPARATE LEGAL STATUS:** A company has an independent legal status, so shareholders or the owners are not liable for the acts of company.
9. **<u>LARGE MEMBERSHIP:</u>** Membership is large.

   For Private Limited Company: Minimum- 02, Maximum – 200

   For Public Limited Company: Minimum- 07, Maximum - No Limit

**TYPES OF COMPANIES**

| ON THE BASIS OF INCORPORATION | ON THE BASIS OF OWNERSHIP | ON THE BASIS OF LIABILITY |
|---|---|---|
| 1.Chartered Company | 1.Private Company | 1.Company limited by shares |
| 2.Statutory Company | 2.Public Company | 2.Company limited by guarantee |
| 3. Registered Company | 3. Government Company | 3.Company with unlimited liability |
| 4.Foreign Company | 4.Holding Company | |

**SHARE CAPITAL:** It can easily understand by the following diagram.

Further,

**SHARE CAPITAL**

- Equity share capital
  - with voting power or
  - with differential rights
- Preferece share capital
  - enjoys some preferential right
  - as to the payment of dividend at a fixed rate
  - as to return of capital on winding up of the company

**PREFERENCE SHARE CAPITAL**

- CUMULATIVE (Right to dividend doesn't lapse when there is no profit or inadequate profit, but it is carried forward to the next year/ year of profit).
- REDEEMABLE (it can be redeemed)
- PARTICIPATING (right to participate in the surplus after payment of equity, capital in case of winding up of Company)

-Preference shares are cumulative and non- participating normally.

**TYPES OF SHARE CAPITAL**

- **AUTHORISED CAPITAL:** Authorized capital is the amount up to which the company can raise the capital. It remains mentioned in 'Memorandum of Association'
- **ISSUED CAPITAL:** It is the capital which has been issued by the company to public or to vendors against the purchase consideration. Issued capital can be less than or equal to Authorized Capital.
- **SUBSCRIBED CAPITAL:** Out of issued capital it is actually subscribed by Public. It can be less than or equal to the issued capital.
- **CALLED UP CAPITAL:** The amount which has been asked by the company to pay.
- **PAID UP CAPITAL:** The amount of capital actually paid by the shareholders against called up capital.

**ISSUES OF SHARE**

Two types of shares are issued – (i) Equity Share and (ii) Preference Share.

After issue, it is subscribed by the public.There are three probabilities;

(i) Under Subscribed: subscribed less than issue capital by public.

(ii) Equal to issue capital (it is hypothetical situation).

(iii) Over Subscribed: Applied for more shares than what the company proposes to issue.

**ALLOTMENT**

**RESPONSIBLE FOR FAIR ALLOTMENT:**

(i) Regional Stock Exchange

(ii) Post issue lead merchant banker and

(iii) Registrar of the issue.

**BASIS OF ALLOTMENT**

There is no problem in case of under subscribed or equal subscribed. In the case of oversubscribed, there may be three situations;

(a) Some applications accepted in full and some applications rejected in full.

(b) Accepted all applications on prorate basis.

(c) Rejected some applications fully, accepted some applications fully and allot shares to remaining applications on prorate basis.

Before, understanding the accounting entries, we must know about the nature of shares being issued or may be issued, for example

1. **ISSUE OF SHARES AT PAR**
   - Issued at face value of shares.
   - Shares applications money does not become a part of shares capital, so money received is credited to 'share application account'.

2. **ISSUE OF SHARE AT PREMIUM**
   - Issued at higher than the face value of the shares.
   - Amount of premium is credited to ' share premium account'
   - Share premium amount is a capital profit, hence not available for dividend distribution and recorded under the 'Reserve and Surplus' in balance sheet.

3. **ISSUE OF SHARE AT DISCOUNT**

   A company can't issue shares at discount, except sweat equity shares.

4. **ISSUE OF SWEAT EQUITY SHARES**

   Issued by company to employees, directors at discount.

5. **EMPLOYEES STOCK OPTION SCHEME(ESOS)**

   ESOS is a scheme under which the company grants option to an employee for share of the company at a pre determined price.

6. **FORFEITURE**

   If a shareholder does not pay dues on shares which he holds, even after final notice of 14 days, company can forfeit his shares and the amounts already paid by him are forfeited.

7. **RE-ISSUE OF SHARES**

   - Forfeited shares can be re-issued at any time.
   - Such shares can't be re –issued at lower price than the amount in arrears.

8. **ISSUE OF BONUS SHARE**

   Bonus shares are issued by the company to its existing equity shareholders without any consideration.

   **ACCOUNTING ENTRIES**:

1. **SHARES AT PAR**

   (a) Before allotment but after receiving

   Dr: Bank

   Cr: Share Application account

   (b) After allotment

   Dr: Share Application Account

   Cr: Share Capital account

2. **SHARES AT PAR, IF OVER SUBSCRIBED**

   (a) After receiving but before allotment

   Dr: Bank

   Cr: Share Application account

**(b) After allotment**

Dr: Share Application Account

Cr: Share Capital Account

Cr: Bank A/c(refund)

Cr: Share Allotment Account

3. **SHARES AT PREMIUM**

(a) After receiving but before allotment

Dr: Bank

Cr: Share Application account

(b) After allotment

Dr: Share Application Account

Cr: Share Capital Account

Cr: Share Premium account

Cr: Share Allotment Account

4. **FORFEITURE OF SHARE**

Dr: Share Capital Account

Cr: Call in arrear Account

Cr: Forfeiture Account

5. **RE- ISSUE OF SHARES**

Dr: Bank Account

Dr: Forfeiture Account

Cr: Share Capital Account

Cr: Capital Reserve account

**COMPANY ACCOUNTS – II**

**In case of sole proprietorship or partnership firms**

- Trading and Profit & Loss account
- Balance Sheet

Their financial statements are desirable, not compulsory by law.

**IN CASE OF LIMITED CO.**

- Profit & Loss Account
- Balance Sheet

The financial statements are compulsory by law.

U/s -128 (of Company Act, 2013) - Compulsory to keep certain books of accounts.

U/s – 129 (of Company Act, 2013) – Governs the preparation of final accounts.

Schedule – III (of Company Act. 2013) – Prescribes,

- Forms for balance sheet and profit & loss account.
- General instructions for preparation of the financial statements.

Balance sheet should be either vertical or horizontal.

## 17/18. KNOW YOURSELF NOW : COMPANY ACCOUNTS I & II

[1] A company is defined as a company incorporated under—— or under any previous company law.

(a) Incorporation of company act
(b) U/s 20 of company act 2013
(c) Indian contract act
(d) Reserve Bank of India act

[2] For a Private Ltd company, the minimum paid up capital required is;

(a) ₹ 5.0 lakh (b) ₹ 10.0 lakh
(c) ₹ 1.0 crore (d) ₹ 1.0 lakh

[3] For a Public Ltd company, the minimum paid-up capital required is;

(a) ₹ 5.0 lakh (b) ₹ 5.0 crore
(c) ₹ 1.0 crore (d) ₹ 50.0 lakh

[4] Registration of a company is;

(a) Not compulsory
(b) Compulsory under Co. act
(c) Obligatory under law (d) None of the above

[5] The amount upto which the company can raise the capital is called——which remains stated in the——

(a) Paid-up-capital : memorandum of association
(b) Authorised capital : article of association
(c) Issued capital : bye laws
(d) Authorised capital : memorandum of association

[6] Which of the following is not correct for authorised capital of a company?

(a) It is also known as nominal and registered capital
(b) It is the maximum amount upto which company can issue capital
(c) This capital is divided into equity share capital and preference share capital.
(d) Authorised capital is part of subscribed capital

[7] When a public issue is made by the company to raise the capital is known as—

(a) Subscribed capital (b) Issued capital
(c) Paid-up capital (d) Called-up capital

[8] Money is received with the application against issued capital, the money—

(a) is credited temporarily to a account called share application account

(b) is a part of share capital

(c) is income of the company

(d) is distributed as dividend

[9] Liability of partners of a firm is——

(a) Limited (b) Unlimited

(c) Equal to his share (d) Optional

[10] A company which is incorporated outside India but has a place of business in India is called,

(a) Subsidiary company (b) Chartered Company

(c) Holding company (d) Foreign company

[11] A limited company enjoys perpetual existence, but a partnership firm does not have a perpetual existence. The statement is...

(a) True (b) False

[12] The membership of a private company can be minimum—— members and maximum——members.

(a) 10 : 100 (b) 2 : 50

(c) 5 : 200 (d) 2 : 200

[13] A public limited company can be formed with minimum of—— members and maximum——members.

(a) 10 : 100 (b) 20 : 200

(c) 15 : no limit (d) 07 : no limit

[14] On retirement of a partner, the profit on revaluation of assets should be credited to—

(a) Reserve account

(b) Capital of remaining partners

(c) Income a/c

(d) Capital a/c of all the partners in profit sharing

[15] Dividend is declared by a company out of——

(a) Profits of company

(b) Profit or loss, it is mandatory

(c) Equity of the company

(d) Profit of current year and undistributed profit of previous year.

[16] The authorised capital of a company is ₹ 500 crore, against which company issued to raise capital worth ₹ 400 crore, but received application with application monies ₹ 300 crore. Match the following

| | | |
|---|---|---|
| (A) | Authorised capital | (i) ₹ 400 crore |
| (B) | Issued capital | (ii) ₹ 300 crore |
| (C) | Subscribed capital | (iii) ₹ 500 crore |
| (D) | Paid up capital | (iv) ₹ 300 crore |

(a) A (iv), B (iii), C (i), D (ii) (b) A (iii), B (i), C (ii)
(c) A (i), B (iii), C (ii), D (iv) (d) A (ii), B (iv), C (i)

[17] The amount which the company has asked its shareholders to pay is called,
(a) Subscribed capital (b) Issued capital
(c) Paid-up-capital (d) Called-up capital

[18] The share capital of a company limited is of——types and they are———and——
(a) One : issued capital
(b) One : equity share capital
(c) Two : equity share capital : preference share capital
(d) Two : cumulative share capital : participating share capital

[19] Preference shares enjoys the preferential right of–
(a) The payment of dividend at a fixed rate
(b) The return of capital on winding up of the company
(c) Both (a) & (b) (d) None of the above

[20] Who is responsible for fair allotment of share?
(a) Regional stock exchange
(b) Post issue lead merchant banker
(c) Registrar of the issue (d) All of the above

[21] If a share is issued at higher value than the face value of shares is called;
(a) Share at par (b) Share of discount
(c) Share at premium (d) Sweat equity share

[22] A company can't issue shares at discount, except;
(a) Preference share (b) Sweat equity share
(c) To government (d) In emergency of fund

[23] What is sweat equity share?
- (a) Shares issued to relatives of employees
- (b) Shares issued to family members of directors
- (c) Shares issued to employees and directors
- (d) Shares issued to employees and directors at discount

[24] A scheme under which the company grants options to an employee for shares at a predetermined price is known as;
- (a) Employees share
- (b) Employees Stock Option Scheme (ESOS)
- (c) Share scheme for employees
- (d) Motivational share scheme for employees

[25] There are—types of preference shares?
- (a) Two
- (b) Four
- (c) Three
- (d) five

[26] Claim of dividend do not lapse when there is no profit, but it is forwarded for next year or year of profit, this type of shares are known as;
- (a) Equity share
- (b) Cumulative preference share
- (c) Participating preference share
- (d) Redeemable preference share

[27] Right to participate in the surplus remaining after payment of equity capital in case of winding up of company is known as;
- (a) Redeemable preference share
- (b) Equity share
- (c) Guaranteed share
- (d) Participating preference share

[28] The preference share that are repaid back after some time, this type of share is called;
- (a) Participating preference share
- (b) Non participating preference share
- (c) Redeemable preference share
- (d) Fixed term share

[29] If it is mentioned in memorandum of association of a company that its capital would be ₹ 50 crore equity share of ₹ 10. The type of the capital is;
- (a) Paid-up capital
- (b) Issued capital
- (c) Authorised capital
- (d) Called-up capital

[30] The company has invited the public for its ₹ 40 crore equity share of ₹ 10 each. This is——

(a) Authorised capital (b) Issued capital

(c) Subscribed capital (d) Paid-up capital

[31] Against issued capital of ₹ 40 crore equity share of ₹ 10 each, company has received application for ₹ 35 crore share. The applications so received are known as :

(a) Under subscribed capital

(b) Over subscribed capital

(c) Issued capital

(d) Paid-up capital

[32] The amount of capital which has actually been paid by the shareholders is called;

(a) Paid-up capital (b) Called-up capital

(c) Authorised capital (d) Subscribed capital

[33] The performa of profit & loss account and balance sheet for company have been prescribed in;

(a) Guidelines issued for Company by GoI

(b) Income tax instructions for companies

(c) Schedule III of Company Act ,2013

(d) No where

[34] If a company decided to issue sweat equity shares, these should be issued within——after permission from——

(a) 3 months : registrar of company

(b) 6 months : board of directors

(c) 1 month : general body

(d) 2 months : company law board

[35] The shares issued by a company by capitalization of reserves and profits is known as;

(a) Bonus share

(b) Sweat equity share

(c) Equity share

(d) Participating preference share

[36] The maximum discount, a company can offer on issue of fresh equity share is;

(a) 5% of face value (b) 10% of face value

(c) 12% of face value (d) None

[37] A preference share has been issued by a company but type of preference share is not mentioned, then it should be treated as;

(a) Irredeemable preference share

(b) Redeemable preference share

(c) Participating preference share

(d) Cumulative and non participating preference share

[38] A company holds more than 50% of share capital of another company is known as;

(a) Holding company (b) Public company

(c) Private company (d) Allied company

[39] Forfeited shares can be re-issued at any time at;

(a) Lower price

(b) Higher price

(c) Not lower than the amount in arrears

(d) Predetermined price

[40] The financial statements are desirable, not compulsory by law in case of sole proprietorship or partnership firm, whereas financial statements are compulsory in case of Limited Co. This statement is;

(a) True (b) False

[41] The guidelines for preparation of financial statements of company is prescribed u/s;

(a) U/s 128 of company act (b) U/s 129 of company act

(c) U/s 130 of company act (d) U/s 35 of income tax act

[42] Minimum capital requirement is expressed in terms of—

(a) Credit risk (b) Specific risk

(c) General market risk (d) Both (b) & (c)

[43] When a company issues a share less than par value. The issue would be called at,

(a) Premium (b) Discount

(c) Depreciated value (d) Lower value

[44] Except the provisions stated in section 54 of company act, if any company issues share at discount price, they shall be punishable with fine——

(a) ₹ 1.0 lakh (b) ₹ 5.0 lakh

(c) ₹ 1:0 lakh to ₹ 5.0 lakh

(d) Imprisonment of officer in default upto six months

(e) Either (c) or (d) or both

[45] Which of the sections of company act 2013 prohibits to issue of any preference share that is irredeemable?

(a) Sec 55 (b) Sec 128

(c) Sec 55 (i) (d) Sec 129

[46] The balance amount due on shares after allotment is called up in one or more installments. These installments are known as;

(a) Dues (b) Due amount

(c) Calls (d) Call money

[47] The single call amount should not exceed— of the face value of the share

(a) 25% (b) 50%

(c) 75 % (d) 20%

[48] Suppose a company has issued to raise equity share at par. After receiving the applications with monies, what should be the accounting entries?

(a) Dr – Bank a/c : Cr – capital

(b) Dr – Capital : Cr – share capital a/c

(c) Dr – Bank a/c : Cr – Share application a/c

(d) Dr – Share capital a/c : Cr Bank a/c

[49] Accounts showing profits available for distribution and transfer to reserves is known as;

(a) Surplus

(b) Net profit

(c) Profit & loss appropriation account

(d) Reserve & surplus accounts

[50] Which section of the company act makes it compulsory for a company to keep certain books of account?

(a) Sec 55 (b) Sec 55 (i)

(c) Sec 128 (d) Sec 129

[51] Liabilities that will arise on the happening of certain events is known as;

(a) Risk factors

(b) Emergency liabilities

(c) Contingent liabilities

(d) None of the above

[52] When a Board of Directors of a company accepts the applications for allotment, which of the following entry will be passed?
(a) Debit bank account, credit share application account
(b) Debit share application accounts, credit share capital account
(c) Debit share capital account, credit bank account
(d) Debit capital account, credit bank account

**ANSWERS**

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1 (b) | 2 (d) | 3 (a) | 4 (b) | 5 (d) | 6 (d) | 7 (b) | 8 (a) | 9 (b) |
| 10 (d) | 11(a) | 12 (d) | 13 (d) | 14 (d) | 15 (d) | 16 (b) | 17 (d) | 18 (c) |
| 19 (c) | 20 (d) | 21 (c) | 22 (b) | 23 (d) | 24 (b) | 25 (c) | 26 (b) | 27 (d) |
| 28 (c) | 29 (c) | 30 (b) | 31 (a) | 32 (a) | 33 (c) | 34 (d) | 35 (a) | 36 (b) |
| 37 (d) | 38 (a) | 39 (c) | 40 (a) | 41 (b) | 42 (d) | 43 (b) | 44 (e) | (45 (c) |
| 46(c) | 47 (a) | 48 (c) | 49 (c) | 50 (c) | 51 (c) | 52 (b) | | |

## 19. ACCOUNTING IN COMPUTERISED ENVIRONMENT

### COMPUTERISED ACCOUNTING

Computerized accounting system helps to manage big financial transactions, data, reports and statements with high efficiency, speed and better accuracy, better quality work, lower operating cost, minimum errors are some of the advantage of computerized accounting.

**FEATURES OF COMPUTERISED ACCOUNTING**:

The main features are:

(1) **Simple and integrated**: It helps by automating and integrating all the business activities.

(2) **Speed and accuracy**: Computerized accounting has customized templates for users which allow fast accurate data entry and it generates the information and reports automatically.

(3 **Security**: Secured data and information can be kept confidential.

(4) **Reliability**: It generates the report with consistency and accuracy.

(5) **Lower operating cost**: It is cheaper than human labour.

**<u>TERMS USED IN COMPUTERISED ACCOUNTING</u>**

The terms, generally used in computerized accounting are:

(1) Data: Accounting entries.

(2) Record: Group of data

(3) File: Compiled data maintained in pre- arranged order.

(4) System: Various components that process the data.

(5) Software: A computer is run on the basis of a set of instructions called software programme.

**Difference between computerized and manual accounting**

| Computerized accounting | Manual accounting |
|---|---|
| 1. Data not visible physically. | 1. Data remains visible. |
| 2. The data records in a computer are on risk of manipulation. | 2. It is not so easy as any manipulation will be seen physically. |
| 3. Number of reports can be generated. | 3. It is not possible. |
| 4. Analysis of data is easy. | 4. Analysis of data requires expertise. |

**ADVANTAGE OF COMPUTERISED ACCOUNTING**

1. Better quality work.
2. Lower operating cost.
3. Improves efficiency.
4. Error free accounting
5. Better control.
6. Greater accuracy.
7. Facilitates standardization.
8. Relieve monotony.
9. High speed.

**DISADVANTAGE OF COMPUTERISED ACCOUNTING**

1. Requires special programme.
2. Requires qualified personnel.
3. Costly affairs.
4. Computer viruses threat.
5. Threat of data loss.
6. Requires back-up.

**INFLUENCE OF COMPUTERISATION**

(1) Computerized banking
(2) Computerized accounting.
(3) Computerized account opening
(4) Standing Instruction.
(5) Clearing of cheque
(6) Remittance - NEFT/RTGS etc
(7) CBS
(8) ATM

**PASSOWORD MANAGEMENT**

Users are responsible for all activities originating from their password.

## CONSTRUCTION OF PASSWORD

Password should be easy to remember but difficult to guess. So be remain careful in constructing password.

### Don't

(1) Don't use name, surname and short name of self or relatives.

(2) Don't use telephone number, vehicle number, date of birth of self /kids etc.

(3) Don't use common name or number.

(4) Don't use commonly used religious number or name.

### DOES

(1) Maintain minimum length of 8 characters including alphabet, numerical, special character etc.

(2) Do not create complex password, it should be easy to remember, but difficult to guess.

### Protection of password

(1) Don't share password to anyone.

(2) Beware at the time of use of password. Don't allow any body to watch the password.

(3) If password need to be shared, it should be documented and ensure to change it before use by you.

(4) Change password regularly, at least once in thirty days.

## INTERNET

The internet is the global system of interconnected computer networks that use the internet protocol suite (TCP /IP) to link device worldwide.

## WORLD WIDE WEB (WWW)

World Wide Web 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, display 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.

## 19. KNOW YOURSELF NOW : ACCOUNTING IN COMPUTERISED ENVIRONMENT

[1] Maintaining books of account and preparing final statement using a computer is known as;—

(a) Accounting (b) Computerisation

(c) Computerised accounting (d) Preparation of statement

[2] Any facts, observations, assumptions or occurrences to be passed in books of account to prepare financial statement is called,

(a) Accounts (b) Entries

(c) Data (d) Software

[3] A series of servers that are interconnected through hypertext is called

(a) World Wide Web (www) (b) Hyperlinks

(c) Browser (d) Home page

[4] Various components that process the data, i.e. transactions, occurrences and give outputs is called–

(a) File (b) Data (c) System (d) Record

[5] Which of the following is/are features of computerised accounting?

(a) Simple and integrated (b) Speed and accuracy

(c) Reliability (d) Secured and confidential

(e) All of the above

[6] A computer is run on the basis of set of instructions i.e. called

(a) Computerised instruction (b) Core banking

(c) Programming (d) Software programme

[7] It is said regarding password that it should be easy to—— but difficult to——

(a) Make; remember (b) Remember; break

(c) Remember; guess (d) Originate; operate

[8] Normally password should be minimum of——characters,

(a) Seven (b) Six (c) Eight (d) Ten

[9] The global system of interconnected computer networks is called

(a) Net (b) Internet (c) Protocol (d) Device

[10] Internet use the internet protocol suite (TCP/IP) to link device worldwide. The statement is...

(a) True (b) False

[11] Through Automated Teller Machines (ATM), out of the following, which transaction(s) can be made?

(a) Withdrawal of cash (b) Balance enquiry

(c) Deposit of cash/cheque (d) All of the above

[12] Transactions made through ATM are accounted for in the respective accounts within—

(a) 24 hours (b) 02 hours

(c) On their occurrence immediately (d) 05 minutes

[13] Which of the following major transactions are processed online with the help of computer?

(a) Account and customer creation

(b) Financial transaction (c) Enquiries

(d) Maintenance (e) All of the above

[14] Core banking solutions work on two basic software. They are— and—

(a) Finacle 7 : Finacle 10.x (b) B @ ncs 24 : Finacle 7

(c) B @ ncs 24 : Finacle 1 (d) B @ ncs 24 : Finacle 10.x

[15] ———software takes care of all the transactions that have been put through at the branches.

(a) B @ ncs 24 (b) Finacle 1

(c) Finacle 7 (d) Finacle 10.x

[16] ——software takes care of posting in the general ledger.

(a) B @ ncs 27 (b) Finacle 7

(c) Finacle 10. x (d) Finacle 1

[17] The interface for the posting between B @ ncs 24 and Finacle 1 is known as;

(a) General Ledger (GL)

(b) General Ledger Interface (GLI)

(c) General Ledger Interface File (GLIF)

(d) None of the above

[18] Which types of difficulties are faced in computerised accounting?

(a) Data stored in computer are not visible

(b) The trail of events is difficult to establish

(c) Tracing of documents into its entry is more difficult

(d) All of the above

[19] Which of the following is part of an accounting system?
(a) Capturing transactions in the form of accounting entries
(b) Accounting entries are used for preparation of financial statement
(c) Financial statements are prepared on the basis of accounting standard
(d) Various financial reports are prepared on the basis of financial statements
(e) All of the above

[20] Which of the following services are possible only due to computerised accounting/banking?
(a) m-banking (b) NEFT / RTGS
(c) Internet banking (d) All of the above

[21] Which of the following is the disadvantage of computerised accounting?
(a) It is costly affairs (b) Computer viruses threat
(c) Threat of data loss (d) It requires back-up
(e) All of the above

[22] Manipulation is easier in——than——
(a) Manual accounting : Computerised accounting
(b) Computerised accounting : manual accounting
(c) CBS : bancmate (d) None of the above

[23] What is mischievous computer software which damages data inside a computer?
(a) Interfaces of data base (b) Delivery layer
(c) Core banking component (d) Computer virus

[24] What is the name of that software who helps the users to navigate the www?
(a) Microsoft (b) Excel
(c) Browser (d) Hyperlinks

[25] COBOL, Foxpro etc and on operating platform windows, UNIX etc are example of——browser
(a) Browser (b) Computer
(c) Computer language (d) Computer software

## ANSWERS

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1 (c) | 2 (b) | 3 (a) | 4 (c) | 5 (e) | 6 (d) | 7 (c) | 8 (c) | 9 (b) |
| 10 (a) | 11(d) | 12 (c) | 13 (e) | 14 (c) | 15 (a) | 16 (d) | 17 (c) | 18 (d) |
| 19 (e) | 20 (d) | 21 (e) | 22 (b) | 23 (d) | 24 (c) | 25 (c) | | |

# MODULE : D
# BANKING OPERATIONS

## 20. BANKING OPERATION

**Banking:** u/s 5 (b) of Banking Regulation Act 1949;

"Accepting deposit from public for the purpose of lending or investment, repayable on demand or otherwise, withdrawable by cheque, draft, order or otherwise."

**U/s – 6**: a bank is permitted to engage in certain classes of business which are incidental to the business of banking.

**U/s - 8**: Prohibits a bank from buying, selling or dealing in goods.

### FUNCTION OF BANK

(a) Accepting deposits

Deposit
- Demand Deposits
- Term Deposits

(b) Granting Loans and advances

(c) LC / BG

(d) Dealing in foreign exchange

(e) Remittances – DD/RTGS / NEFT etc.

(f) Collection of Various instruments – Cheques, Draft, Pay order, traveler's cheques, dividend etc.

(g) Cash management product.

(h) ATMs

(i) Govt. Business

(j) Credit Card / Debit Card

(k) Lockers etc.

### OTHERS AS PARA-BANKING ACTIVITIES

(i) Leasing, Hire purchase and factoring services.

(ii) Mutual Fund Business.

(iii) Portfolio Management Services.

(iv) Investment in Venture Capital Funds.

(v) Primary Dealership Business.

(vi) Retailing of Govt. Securities.

(vii) Insurance Business.

(viii) Pension Fund Management etc.

**FRONT OFFICE & BACK OFFICE**

**FRONT OFFICE:** Front office is bank's departments that remain in contact with clients.

These include – Marketing, sales, customer relations operations etc.

– The front office staff directly produces the revenue.

– The branches of banks perform the function of the front office.

**BACK OFFICE**

- Back offices are not in touch with clients directly.
- Back offices are manufacturing or developing the products or involved in administration but without being seen by customers.
- Back offices normally located somewhere other than the bank branch or bank office.

**OUTSOURCING:**

- The main aim of outsourcing is to reduce cost and making use of expertise not available internally.
- "A bank's use of a third party to perform activities on a continuing basis that would normally be under taken by the bank itself, now or in the future" is called outsourcing.

**ACTIVITIES NOT TO BE OUTSOURCED**

- Internal Audit.
- Compliance function.
- Determining compliance with KYC norms for opening deposit accounts.
- Sanctioning of loan.
- Management of investment portfolio etc.

## OPERATING INSTRUCTIONS & OPERATIONS MANUAL

Banks need to establish formal operating procedures, well-defined limits for individual discretion and system of internal control, like,

– About cash and Negotiable instruments – Physical security and transfer of instruments.
– About transactions that are initiated, recorded and managed at different locations.
– About non-fund based commitments (off-balance sheet items) for significant amounts.
– About transactions on Internet, mobile banking, ATMs etc.
– About systematic risk - as banks are linked to national and international settlement systems.

### MANUAL

**PURPOSE:** To provide a ready guide to the staff of the bank in day-to-day banking operations.

It requires frequent updating to reflect the changes took place during the period as well as implementation of Core Banking Solutions. It should be placed on internal employee portal so that it is easily accessible to the employees.

### CONTENTS

Operations manual does not provide any full fledged legal frame work of banking operations and is in the nature of a guide to operatives and not a substitute of circular instructions. So, the banking operations manual of a bank contains operating instructions for the staff for all activities undertaken by bank.

For example -

- Opening of accounts
- Handling cash
- Clearing
- Loans and advances
- Remittances – RTGS / NEFT etc.
- KYC process
- Customer Services etc.

## 21. OPERATIONAL ASPECTS OF KYC/CUSTOMER SERVICE

- KYC guidelines were introduced by RBI in August 2002, u/s 35A of B.R.Act 1949.
- Objective of the KYC guidelines is "to prevent banks from being used, intentionally or unintentionally by criminal elements for money laundering or terrorist financing activities".
- Revised in November 2004 as per recommendations of Financial Action Task Force (FATF) on Anti Money Laundering (AML) Standards and Combating Financing of Terrorism (CFT).

Banks have to comply at present with

(1) RBI's KYC direction-2016 and

(2) Obligations under PML Act'2002

**KYC:**

Banks are required to follow certain customer identification procedure for opening of accounts and monitoring/reporting of transactions of suspicious nature like;

**(a) CUSTOMER ACCEPTANCE POLICY:** This policy covers;

- No account should be opened in anonyms or fictitious /benami name(s).
- Transaction will be permitted only after compliance of CDD(Customer Due Diligence)
- Neither new account should be opened nor should existing account be closed if a bank is unable to verify the identity.

**(b) CUSTOMER IDENTIFICATION PROCEDURE:** The identification procedures to be carried out while opening the account of the prospective customer. The account should be opened only after furnishing of proper proof of identity and address proof.

**Documents Required**

1. **For individual** : Any one of Officially Valid Document (OVD), i.e.
   - (a) Passport
   - (b) Driving license
   - (c) PAN card
   - (d) Voter's identity card
   - (e) MNREGA job card
   - (f) Aadhar card

2. **Accounts of Trust & Foundation**:
   - (a) Registration certificate, if registered
   - (b) Power of Attorney
   - (c) Any Officially Valid Document to identify Trustees, Settlers, Beneficiaries, Founder/Managers/Directors
   - (d) Resolution
   - (e) Telephone bill.

3. **Accounts of Company**:
   - (a) Memorandum of Article
   - (b) Memorandum of Association
   - (c) Resolution of Board of Directors
   - (d) Power of attorney
   - (e) PAN
   - (f) Telephone Bill

**(c) MONITORING OF TRANSACTIONS**

Banks has to monitor high turnover or complex or unusual transactions accounts as well as to identify suspicious transactions and filing STRs (Suspicious Transaction Reports) to FIU-IND.

**(d) RISK MANAGEMENT**

Bank should pay special attention to any money laundering threats. An effective KYC programme by establishing appropriate procedures and their effective implementation should be ensured.

**PERIODIC UPDATION OF KYC:**

As per RBI guidelines periodical updation of customer identification data and photograph(s) are required to be updated according to the risk category of the account. viz-

(1) High risk category accounts : Full KYC, once in two years.

(2) Medium risk category accounts : Full KYC, once in 8 years.

(3) Low risk category accounts : Full KYC, once in 10 years.

(4) Fresh photograph(s) will be obtained from minor customers on becoming major.

**SIMPLIFIED KYC MEASURES**

1. **Single document for proof of identity and proof of address:**

   Initially two documents viz -Proof of ID and proof of address were required for opening an account. Now any one of OVD (Officially Valid Document) is sufficient for opening of an account. E-KYC is also valid.

2. **No separate proof of address is required for current address**

   If address mentioned in OVD is different from the present place of residence (may be in case of migrant workers, transferred employees etc), then besides OVD, a self declaration by him/her about his /her current address is sufficient.

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

4. **SMALL ACCOUNTS:**

   Small accounts can be opened by those persons who have not any of the OVDs, on the basis of

   - A self attested photograph and
   - putting signature or thumb impression in presence of bank officials.

   **Validity:**

   - Normally the account will remain valid for twelve months.
   - If the account holder provides a document showing that he/she has applied for any of the OVDs within 12 months from date of opening of the accounts, may allow to continue for further twelve months.

**FEATURE OF SMALL ACCOUNTS:**

(i) Aggregate credits should not more than Rs.1.0 lakh in a year.

(ii) Aggregate withdrawals should not be more than Rs.10000 in a month.

(iii) Balance in the account should not be more than Rs.50000 at any point of time.

**5. Relaxation regarding Officially Valid Documents (OVD) for low risk customers:**

A person categorized under low risk category by bank and has no any OVD, then he /she can open account by submitting following documents;

(i) ID card issued by Central /State government department / statutory regulatory authorities, PSUs, schedule commercial banks & public financial institutions.

(ii) Letter issued by gazetted officer with duly attested photograph of the person.

**6. OTHER RELAXATION**

(i) Foreign students have been allowed a time of one month for furnishing the proof of local address.

(ii) Low risk category customer may submit the documents to the bank within a period of six months from the date of opening of account, if unable to submit KYC due to genuine reasons.

**CUSTOMER SERVICE IN BANK**

**SERVICE AT COUNTER:**

1. Business and working hour.
2. Display of time norms
3. Customers who enter the banking hall before the close of business hours is attended.
4. Enquiry or "May I Help You" counters (except very small branches)
5. Identity badges.
6. Complaint register/box.
7. Brochures /pamphlets for guidelines to customer.
8. Display of bank /service charges.
9. Cheque drop facility and acknowledgement of cheque facility.
10. Customer services.
11. Banking facilities to visually challenged person.
12. Term deposit maturity intimation in advance.
13. Extended business hours for non-cash transaction.
14. Website etc.

## BANKING CODES AND STANDARDS BOARD OF INDIA (BCSBI)

- In November 2003, RBI constituted the committee on Procedures and Performance Audit of Public Services under the chairmanship of Shri S.S Tarapore.
- The committee recommended for setting up of BCSBI to ensure the interest of customers.
- BCSBI is independent and autonomous body.
- Membership of BCSBI is voluntary and open to all schedule banks.

### OBJECTIVE

- To plan, evolve, prepare, develop and publish comprehensive codes and standards for banks, for providing fair treatment to customers.
- To function as an independent and autonomous body to monitor and to ensure that the codes and standards adopted by banks adhere to, while delivering services to their customers.

### Methods for monitor and implementation by BCSBI

- Obtains an annual statement of compliance (ASC) from member bank.
- Visit branches to find out the status of ground level implementation of codes.
- Studies complaints of customers and orders passed by Banking Ombudsman to find out whether there is any system-wide deficiency, though BCSBI is not a forum for grievance redressal.
- Organize an annual conference with Principal Code Compliance Officer of the member banks to discuss implementation issue.

### FUNCTION

- Spread awareness of codes amongst customers and bank.
- Participates in on-location workshop held by or for member banks.
- Provide faculty support.
- Publishes quarterly newsletter titled “CUSTOMER MATTERS”.

## 22. OPERATIONAL ASPECTS OF ACCOUNTING ENTRIES

It has already been discussed in previous chapter that there is a double entry system in accounting. The ultimate purpose of recording financial transactions is to prepare actual and accurate profit and loss account and balance sheet.

In bank cash transaction or non- cash transaction or transfer transaction appears. For cash transactions -withdrawal slip, cheque, pay- in- slip, debit or credit cash vouchers are being used and for non- cash transactions normally transfer vouchers are being used . Transfer voucher may be for debit transfer or for credit transfer separate or both debit and credit in one called composite voucher.

**NORMAL DEBIT VOUCHERS:**

(i) Cheque

(ii) Withdrawal form

(iii) Debit Transfer Voucher

(iv) FDR presented for payment

(v) Draft

(vi) Traveller's cheque

(vii) Letter of authority for Standing Instruction etc

**NORMAL CREDIT VOUCHER**

(i) Pay- in- slip

(ii) Challan

(iii) Credit transfer voucher

(iv) Application for issue of DD/TD /BC /RTGS /NEFT etc.

## 23. OPERATIONAL ASPECTS OF HANDLING CASH/ CLEARING

Cash transaction has important role in financial system, though it is now moving towards digitalization process. Cash transaction at counter and cash replenishment at ATMs are significant cash transactions.

**CTS (Cheque Truncation System)**

Under this system, cheque is not physically sent to the payee bank. Instead, an electronic image is sent with MICR band , date of presentation , presenting bank etc.

Certain benchmarks have been prescribed viz-quality of paper, watermark, logo of bank in invisible ink void pantograph etc. These benchmark prescriptions are known as “CTS-2010” standard.

Under section 6 of Negotiable Instrument Act, electronic image of a truncated cheque and electronic cheques are valid and treated equal to a physical cheque.

### COLLECTION OF CHEQUES

Directions as passed in case no.82 of 2006 before national consumer dispute redressal commission regarding collection of cheque are;

### LOCAL CHEQUE

For local cheques, credit shall be given on same day or next day of their presentation in clearing. Ideally, in respect of local clearing, bank shall permit usage of the shadow credit afforded to the customers’ account 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, subject to usual safe guards.

### OUT STATION CHEQUE

| State capital | Major cities | Other locations |
| --- | --- | --- |
| Within 7 days | Within 10 days | Within 14 days |

If any delay in collection, interest shall be paid as per bank's policy or in absence of policy, at the rate of fixed deposit for corresponding period.

**LOST IN TRANSIT /CLEARING PROCESS**

In such cases bank should immediately bring the same to the notice of the presenting customers, so that stop payment can be recorded and can also take care that other cheques issued anticipating the credit arising out of the lost cheque is not dishonoured due to non credit of the amount of the lost cheque.

**RETURN OF CHEQUE**

- As per RBI guidelines, the cheque return charges can be levied only in cases where the customer is at fault.
- The cheque should be represented within 24 hours with due intimation to the customer.

**CASH AND ITS CUSTODY**

(1) Cash and coin must be kept in the strong room in the joint custody.

(2) No member of staff other than cashier /teller should receive cash over the counter.

(3) Strong room and safe must be under double lock of the cashier and officer in charge of cash.

(4) Cash at counter should be as low as possible and rest in the strong room.

**CHECKING OF THE CASH BALANCE**

At the time of taking joint custody, cash balance should be checked in the following manner by cash-in charge official.

(1) Personally count all notes of denomination above Rs 10.

(2) Count all other notes as clip system.

(3) Occasionally check the entire cashier's hand balance of loose notes.

(4) Verify at the close of working day.

(5) He should accompany the cashier to the safe room when cash is kept under joint custody.

## SHORTAGE OR EXCESS IN CASH

(a) Any shortage or excess of cash should be recorded.

(b) In case of shortage, if recovery is not made on same day, suspense A/c be debited and person responsible for such shortage will sign the voucher on reverse or on margin.

(c) In case of excess, sundry account be credited on same day.

(d) Cashier will held responsible for any shortage.

### REMITTANCE OF CASH

During remittance, following precautions must be ensured;

(a) Should not be allowed without armed guard.

(b) The box should be chained and locked.

(c) A register should be maintained to record all cash remittance.

(d) Always entrusted to an authorized employee with experienced subordinate employee.

(e) Night journey and unusual halts should be avoided.

(f) Cash should be remitted within limit and covered under Blanket Insurance Policy.

### CLEARING OPERATIONS

**Pre-requisite for sending cheques in clearing**

(i) All instruments should bear the clearing stamp with Bank and Branch abbreviation.

(ii) Bank crossing stamp with MICR Code.

(iii) Verify the amount on the cheque and that of pay-in-slip which should be same.

(iv) Verify name of payee.

(v) Return cheque should be send to concerned branch with due care and quick mode.

(vi) Instruments of high value shall be separately presented.

## 24. OPERATIONAL ASPECTS OF DEPOSIT ACCOUNTS

It is inherent in the definition of banking that "accepting deposit from public for ………………….," so acceptance of deposit from the public is one of the basic functions of the banking business.

There are two types of deposit - (i) Demand deposit (Payable on demand) and (ii) Term / Time deposit (fixed tenure of deposit).

**DIFFERENT DEPOSIT ACCOUNTS**

### [1] CURRENT ACCOUNT

It is a demand deposit account.

(i) Who can open CA?

Individual/Corporate/Institutions/HUF/Club/Firm/Company/Trust etc.

(ii) Who can't open CA?

Illiterate/Blind/Minor (Self Operated)/Purdanashin Lady.

**FEATURES**

– No restriction on number of transaction.

– Normally no interest is payable.

– Operated only through cheque.

– For individual account, ATM is provided.

**TYPES OF CURRENT ACCOUNT**

**(a) PARTNERSHIP FIRM**

– Authority letter to open an account alongwith partnership deed. Registration certificate (if registered) and valid KYC documents are required for opening a current account in the name of partnership firm.

– Account can't be opened in the name of partner on behalf of the firm.

– AOF will be signed by all as partner not as an individual.

– Complete instruction regarding operation of the account is required.

– Any partner can make 'Stop Payment' of a cheque issued by any other partners (s).

**(b) HINDU UNDIVIDED FAMILY (HUF)**

HUF consists of one common living ancestor and his male and female members up to three generation.

Senior most member of the family is a Karta and rest family members are coparceners. Karta is empowered to handle the affairs of HUF property or business.

– AOF should be signed by Karta and all major members.
– Karta will sign AOF on behalf of male minor (if any) apart from signing in the capacity of Karta and the consent of the minor will be obtained on his attaining majority.
– For HUF, only Karta can enter into contract.
– Coparcener can't make 'Stop Payment'.
– HUF will not dissolve on the death of any coparcener.

**(c) JOINT STOCK COMPANIES**

At the time of opening of Current Account of Joint Stock Companies, following documents have to obtain;

– Copy of Memorandum of Articles.
– Copy of Memorandum of Association.
– Certified copy of Board resolution to the effect of opening of bank account and mode of operation and authority of operation duly signed by the chairman of the board meeting.

**(d) TRUSTS**

At the time of opening of Current Account of a Trust, following documents have to obtain,

– Copy of Trust deed.
– Trust letter and resolution duly signed by all trustees.
– Account should be opened in the name of trust.
– AOF should be signed by all trustees.

**[2] SAVING BANK ACCOUNT**

In Saving Bank account transaction are comparatively less.

**WHO CAN OPEN SB ACCOUNT?**

(a) Individual. (b) Joint Account by two or more persons

(c) Minor above 10 years (self operated)

(d) Association, Club if permitted by law/RBI. (e) SHG

**WHO CAN'T OPEN SB ACCOUNT?**

(a) Government Department (b) Municipal Corporation
(c) Political Party (d) Societies
(e) State Housing Board (f) Panchayat Samittees
(g) Housing Co-operative society etc.

**OTHER**

- There is a limit on number of transactions.
- SB Accounts are not for business or trading activities.
- SB Accounts can be operated either with cheque or without cheque.
- PAN details are required for cash deposit exceeding Rs. 50000.
- For same person in his individual name only one account will be opened.
- Minimum balance prescribed by bank must be maintained.
- 1% extra rate of interest over the standard rate is allowed to staff /ex-staff.
- Interest will be calculated even in Inoperative Account.
- If there are no transactions in account for more than two years, the account will be treated as Inoperative / Dormant Account.
- The amount of inoperative account of more than 10 years as well as unclaimed amount of more than 10 years will transferred to DEAF (Depositor Education and Awareness Fund) with RBI within a period of three months from the expiry of the said period of 10 years.
- As per RBI guidelines now introducer is not required for opening of an account.

**[3] BASIC SAVING BANK DEPOSIT ACCOUNTS (BSBD Account)**

Earlier 'no frills accounts' have been converted to basic savings bank deposit account.

· No minimum balance requirement.
· ATMs facility is available.
· No limit on number of deposit.
· Maximum four withdrawals in a month including ATM

withdrawals are allowed.

- Debit card facility is available.
- KYC required.

**(4) SMALL ACCOUNTS**

If OVD for KYC is not available, even then small accounts can be opened.

– Self attested photograph is required.

– Total credit in a financial year does not exceed Rs.1.0 Lakh.

– In a month total withdrawals (either by cash or transfer) should not exceed Rs.10000.

– The balance in the account should not exceed Rs.50000 at any point of time.

– Foreign remittance not allowed.

– Initially it is valid for 12 months; next 12 months may be extended if account holder provides evidence of having applied for any OVD (Officially Valid Documents).

**(5) MINOR ACCOUNT**

– As per sec 3 of Indian Majority Act 1875, a minor is one who has not completed the age of 18.

– In case of minor whose guardian is appointed by the court, he will remain minor upto the age of 21 years.

– Normally, there are three types of minor account.

(a) Account in the name of minor operated by guardian.

(b) Account in the name of minor and guardian operated by guardian.

(c) Account in the name of minor operated by self, subject to the condition that his age should be 10 years and more and can sign uniformly. In this account there will be no nomination.

– Cheque book can be issued (bank's policy may be different) to self operated minor account.

– Fresh AOF duly signed by account holder be obtained on attaining majority.

**NOMINATION**

Nomination facilities to bank customers were introduced wef 29.03.1985 under section 45ZA to 45ZF of Banking Regulation Act 1949 under the Banking laws (amendment) Act' 1983.

- Nomination facility is available to individual customers only.
- Nomination facility is not available to non-individual customers (company,Trust, club, society etc).
- Individual can be a nominee, non-individual can't be a nominee.
- In single name account nomination is mandatory.
- If any depositor have more than one account, separate nomination for each account is required.
- Minor can be a nominee but minor can't nominate.
- In case of minor nominee, there should be an authorized person who will get deposit on behalf of minor.
- Authentication of signature is not required but authentication of thumb impression is required by two persons.
- Nomination can be made/cancel/change at any time.
- Status of nominee is as 'Trustee of legal heirs.'
- Forms :

| | | |
|---|---|---|
| DEPOSIT A/c | : | DA –1 (Registration) |
| | : | DA –2 (Cancellation) |
| | : | DA– 3 (Variation) |
| SAFE CUSTODY | : | SC – 1 (Registration) |
| | : | SC – 2 (Cancellation) |
| | : | SC – 3 (Variation) |
| LOCKERS | : | SL – 1 (Registration - Single name account) |
| | : | SL – 1A (Registration - Joint Account) |
| | : | SL – 2 (Cancellation) |
| | : | SL – 3 (Variation – Single name account) |
| | : | SL – 3A (Variation –Joint Account) |

- Number of nominee should be one only in all accounts except in locker account where in joint account operation is jointly.
- In case of term deposit, nomination made at the time of opening of account will remain valid even after renewal of the account.

## 25. OPERATIONAL ASPECTS OF LOAN ACCOUNTS

Loan is an important portfolio for bank from earning point of view. It is one of the important functions of bank.

In fact, nature of loans are either term loan or cash credit, jointly it is called composite loan. Apart from these types of loan, banks also provide non -fund based facilities like, BG, LC etc.

**TYPES OF BORROWER**

(1) Individual (2) Proprietary firm (3) Partnership firm

(4) Company (5) HUF (6) Trust (7) Society

**TYPES OF LOAN PRODUCT**

(1) Retail loan - for individual customers, like housing loan, education loan, personnel loan, credit card etc.

(2) Commercial loan- big loans

**SECURITIES**

(1) Primary securities: The assets created out of bank loan. It is principal security.

(2) Collateral security: Addition security, other than primary security.

(3) Guarantor: It is personal security by a third party. He remains liable to pay dues in case of default.

**CHARGES**

(1) **Fixed charges**: It is created on specific properties almost of fixed nature like building, plant and machinery. The debtor can't dispose of the assets without consent of creditor.

(2) **Floating charges**: Floating charges is created on assets which undergo changes like stocks -in-trade. Under these charges securities (stock) are allowed to be used. A floating charges becomes a fixed charge when money becomes payable. It is also called crystallization of charges.

**PARI PASSU CHARGE**

Charge created on same asset in favour of several creditors is called pari passu charge. The priority remains on proportionate basis.

**OTHER SECURITY/ CHARGE**

Feature of good securities (MAST)

M- Marketability

A- Ascertainability (of value)

S- Stability (of value)

T- Transferability

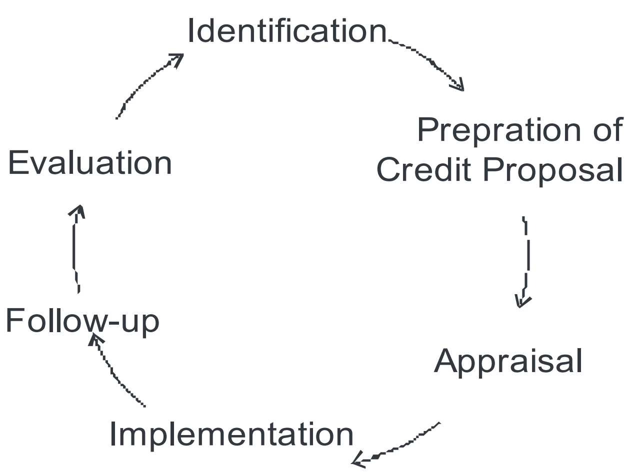
**DIFFERENT CHARGES**

(1) Mortgage (2) Hypothecation (3) Pledge

(4) Assignment (5) Lien/Negative lien.

**OPERATIONAL PROCESS OF LOANS IN THE BANKS**

The procedures involved in loan process can be understood easily with following steps;




1. **Identification:** Preliminary talk and decided whether loan has to be extended or not. If yes, then,
2. **Preparation of credit proposal**: asked to submit proposal with all required documents, then,

3. **Appraisal**: Bank start pre sanction appraisal and processing of proposal. At this juncture bank may reject or sanction the proposal. If everything is as per norms, then,

4. **Implementation**: It means Sanction, Documentation and Disbursement. Now,

5. **Monitoring**: Follow up the account and lastly,

6. **Evaluation**: Evaluate the reasons of success or failure, means whether account is regular or irregular and reasons thereof.

**ASSESSMENT OF WORKING CAPITAL/CMA FORMATS**

Bank can now, adopt their own method of working capital assessment; however Nayak committee recommendation and Tandon committee recommendation may be used for working capital assessment.

For MPBF (Maximum Permissible Bank Finance), CMA (Credit Monitoring Arrangement) formats are being used by many banks.

CMA formats consist of following forms;

| | | |
|---|---|---|
| FORM I | : | Particular of existing limits |
| FORM II | : | Operating statement |
| FORM III | : | Analysis of Balance Sheet and Ratios |
| FORM IV | : | Comparative statements of Current Assets and Current Liabilities. |
| FORM V | : | Assessment of MPBF |
| FORM VI | : | Fund flow statement |

**APPLICABLE FOR ALL LOANS**

(i) KYC compliance and proper verification thereof.

(ii) CIBIL disclosure- Borrower should agree and give consent for disclosure by bank.

(iii) In case of default, proper follow -up like, reminder should be sent.

(iv) Disposal of loan application should be well within stipulated time frame.

(v) All loans schemes for which loan will be sanctioned must be approved by the bank.

## SOME LOAN SCHEMES

### [1] GOLD LOAN

**GENERAL –** No loan against bullion / primary gold.

- Use of loan amount must be for approved, non-speculative purposes.
- To ensure that the weight of the coin does not exceed 50gm per customer.

**OWNERSHIP**

Ownership of ornaments should be verified and should obtain declaration from the borrower that ornaments are his own property.

**VALUATION**

Accepted only on the basis of bank's approved assessor's certificate regarding weight, purity and content of gold.

**LOAN AMOUNT:** As per bank loan scheme.

**REPAYMENT:** 12 Months

**OTHERS**

- After adjustment of loan, ornaments should be returned to the borrower.
- Jewels should be insured for full value against risk of burglary.

### [2] HOUSING LOAN / HOME LOAN

**ELIGIBILITY:**

- Individual
- Groups of individuals
- Co-operative societies

**PURPOSE**

- For construction
- For outright purchase of house/flat
- For purchase of under construction house/flat
- For repair/renovation/addition
- For purchase of land and construction of house thereon.

**LOAN AMOUNT/RATE OF INTEREST/MARGIN**

- As per bank's scheme.

## LOAN TO VALUE RATIO (LTV)

It has direct co-relation with margin.

In respect of individual housing loan following LTV ratio must be maintained.

| | | |
|---|---|---|
| (a) | Up to Rs. 20.0 Lakh | : 90% |
| (b) | Above Rs.20 lakh but Up to Rs. 75.0 Lakh | : 80 % |
| (c) | Above Rs 75.0 Lakh | : 75 % |

**SECURITY**

The house constructed or purchased out of bank loan should be mortgaged (either Equitable Mortgage or Registered Mortgage) in favour of bank.

**INSURANCE**

- The property should be comprehensively insured with full value.
- Borrower may also be insured (optional).

**DISBURSEMENT**

**For outright purchase:** One lump sum installment or as per agreement of sale between seller and purchaser (borrower).

**For Construction:** As per need, but before release of next installment, end use must be verified.

**For Under Construction:** As per agreed terms and conditions.

**OTHERS -** No foreclosure charges shall be applied.

### [3] VEHICLE LOAN

**ELIGIBILITY:**

- Individual (Singly or jointly)
- Corporate

**PURPOSE:**

For purchase of new car/old car, two wheelers.

**DOCUMENTS**

(i) ITR for last 3 years / salary certificate/ Form 16/ financial statements for last 3 years.

(ii) Quotation.

(iii) KYC documents.

(iv) Driving license (not necessarily)

**LOAN AMOUNT:**

- As per repaying capacity.
- Loan for more than one vehicle can be sanctioned.

**REPAYMENT**

For New Vehicle : Maximum 84 Months

For Old Vehicle : Maximum 60 Months.

**SECURITY**

- Hypothecation of the vehicle purchased out of bank loan.
- Joint Registration of vehicle, noting the charge in favour of the bank.

**INSURANCE**

Vehicle will remain insured with full value of vehicle.

**INSPECTION**

(a) For Regular Account: : Not required after first inspection.

(b) Irregular with one EMI : Inspection required

(c) NPA Account : Half yearly

**DOCUMENTATION / PROCESSING FEE**

As per bank guidelines.

**DISBURSEMENT**

Direct to supplier.

**OHTERS**

- No pre payment penalty.
- Change of interest rate must be intimated.

**[4] EDUCATION LOAN**

**ELIGIBILITY**

**COURSE ELIGIBILITY**

**In India**

- School Education including + 2
- Graduation Courses
- Post graduation courses
- Professional Courses
- Vocational Courses
- ICWA / CA / CFA etc.
- MBA /MBBS etc.

**In Abroad**

- Graduation
- MCA / MBA / MS etc.
- Courses conducted by CIMA – London, CPA – USA etc.

**STUDENT ELIGIBILITY**

- Should be an Indian National.
- Selected for admission through Entrance Test / Selection Process.

**LOAN AMOUNT**

Need based, includes – tuition fee, hostel fee, examination/library/ laboratory fee, purchase of books, laptop, cloths, expenses for study trip etc.

**MARGIN**

(i) Up to 4.0 Lakh : No margin

(ii) Above 4.0 Lakh : as per bank norms

**REPAYMENT**

5-7 years after moratorium period.

Moratorium period: Course period + 6 months after getting the job, or Course period + 1 year (if not got job), whichever is earlier.

**SECURITY**

(i) Up to Rs 4.0 Lakh : No collateral

(ii) Above 4.0 lakh : Collateral security

**DISBURSEMENT**

- As per demand / need.

**OTHERS**

- Loan documents should be executed by student and the parents / guardian both.
- No service area concept.
- Branch can issue capability certificate for students going abroad for higher education.
- No dues certificate should not be insisted upon.

## 26. OPERATIONAL ASPECTS OF CBS ENVIRONMENT

### CORE BANKING SOLUTIONS (CBS)

Today banking as a business has grown tremendously and transformed itself from only a deposits taking and loan providing system to an institution which provides an entire gamut of product and services under a wide umbrella.

In fact 'CORE' is an acronym for 'Centralized Online Real-time Exchange', thus the bank's branches can access applications from centralized data centres.

**NEED FOR CORE BANKING SOLUTION**

i) Improve Customer Service.

ii) Improve efficiency.

iii) To meet the competition.

iv) To increase customer satisfaction and satisfy demand.

v) To make time available for other development activities.

**ACCOUNTING OF TRANSACTIONS IN CBS**

CBS works on two level and accounting takes place as follows:

Suppose, there is a transaction through transfer, debit Rs.5000 of Account No- X and credit the same amount i.e. Rs.5000 to Account no –Y.

The system will post through as intermediary account known as balancing account.

Stage – I

| | | |
|---|---|---|
| Dr: A/c No X | : | Rs. 5000 |
| Cr: Balancing A/c | : | Rs. 5000 |

Stage – II

| | | |
|---|---|---|
| Dr: Balancing A/c | : | Rs, 5000 |
| Cr: A/c No Y | : | Rs. 5000 |

If it is multiple vouchers, i.e. one debit and 5 credit entries, suppose debit Account No- X for Rs. 5000 and credit Rs.1000 each in A/c NO A, B, C, D, E, then,

Stage I:

| | | | | |
|---|---|---|---|---|
| Dr | : | A/c No X | : | Rs. 5000 |
| Cr | : | Balancing A/c | : | Rs. 5000 |

Stage II:

| | | | |
|---|---|---|---|
| (i) | Dr : Balancing A/c | : | Rs. 1000 |
| | Cr : A/c No A | : | Rs. 1000 |
| (ii) | Dr : Balancing A/c | : | Rs. 1000 |
| | Cr : A/c No B | : | Rs. 1000 |
| (iii) | Dr : Balancing A/c | : | Rs. 1000 |
| | Cr : A/c No C | : | Rs. 1000 |
| (iv) | Dr : Balancing A/c | : | Rs. 1000 |
| | Cr : A/c No D | : | Rs. 1000 |
| (v) | Dr : Balancing A/c | : | Rs. 1000 |
| | Cr : A/c No E | : | Rs. 1000 |

**OPERATIONAL ASPECTS RELATING TO PARAMETER / MASTER FILE**

In CBS common facts are not supposed to be fed at branch level. It should be fed by authorized person at corporate level because these are applicable to entire banks, like;

(i) Authorized person will mark the holidays into the software in the start of the year.

(ii) Any change in any parameter in between will be marked by authorized person.

**OPERATIONAL ASPECTS RELATING TO PASSWORD CONTROL**

(i) Password should be easy to remember but difficult to guess.

(ii) Password register should be maintained for recording and updating of password.

(iii) Secrecy of password should be maintained.

(iv) In need, if password is shared, then it should be mentioned in password-register and ensure to change password before next logging.

**END OF DAY (EOD)**

Actually the EOD is done at central data centre for the bank, however branch has to do EOD to check, whether any transactions are pending for authorization.

**BEGIN OF DAY (BOD)**

BOD is done before the day's operation starts by branch.

## 27. BACK OFFICE FUNCTIONS/HANDLING UNRECONCILED ENTRIES IN BANKS

The back office is the supporting department of a financial company. Back office generally located somewhere other than bank/branch office comparatively at cheaper rent.

### FUNCTIONS OF BACK OFFICE

The back office functions relating to banking activities are,

(a) Book Keeping and Accounting**:** Maintenance of general ledger & other books, balancing, reconciliation, preparation of financial statements etc.

(b) Deposit: Calculation and posting of interest, opening of accounts etc.

(c) Loans: Processing of Proposal, calculation of EMI, interest charge, risk management etc.

(d) Compliance: Grievance redressal, KYC compliance etc.

(e) E-Banking**:** Handling mobile banking, ATM, internet banking etc.

(f) Other Function**:** Clearing, Collection, remittance etc.

### RBI GUIDELINES REGARDING INTER OFFICE ENTRIES

(i) Segregate the credit entries outstanding for more than 5 years in inter-branch accounts and transfer them to a separate account.

(ii) Maintain category-wise accounts for various types of transaction put through inter-branch accounts.

(iii) Make provision against the net debit balance in the inter-branch account for entries outstanding for more than six months.

(iv) Segregate inter-branch transactions relating to demand draft from other inter-branch transactions.

(v) To restrict originating debits to HO account to cash/fund transfer, purchase of securities/capital assets, withdrawals from PF, advances to inspectors and other staff members.

# KNOW YOURSELF NOW

## MODULE - D

[1] Instrument payable to order can be transferred by;
(a) Delivery only (b) Endorsement and delivery
(c) Can't transferred (d) Both (a) & (b)

[2] A minor can open self operated account, when;
(a) His age is above ten years
(b) He is literate
(c) His age is 10 years and more and signs uniformly
(d) He can write and read

[3] In a self operated minor account, who can be a nominee?
(a) Father or mother of minor only
(b) Legal heirs of nominee
(c) Any one (d) Minor can't nominate

[4] If a minor depositor deceased, the deposit will be paid to---
(a) His/her father (b) His/her mother
(c) His/her nominee (d) His/her legal heir(s)

[5] The maximum amount which can be remitted through NEFT is;
(a) ₹ 2.0 lakh (b) ₹ 5.0 lakh
(c) ₹ 25.0 lakh (d) No upper limit

[6] Nomination facility is available for–
(a) Individual accounts only
(b) Non-individual accounts only
(c) Individual as well as non-individual accounts
(d) None of the above

[7] The maturity amount of a fixed deposit will be paid through SB or Current Account, if the amount is–
(a) ₹ 5000 (b) ₹ 100000
(c) ₹ 20000 and more (d) Irrepective of amount

[8] The minimum amount that can be remitted through RTGS is;
(a) ₹ 5.0 lakh (b) ₹ 2.0 lakh
(c) ₹ 1.0 lakh (d) ₹ 1.0 lakh

[9] As per RBI guidelines, the claim of deceased account should be settle in— , if all documents have been provided.
(a) 1 month (b) 15 days
(c) 3 months (c) 45 days

[10] The Banking Ombudsman is appointed by;

(a) Reserve Bank of India (b) NABARD

(c) Ministry of Finance, GoI (d) Indian Bank Association

[11] 'Customer' is defined under which of the following?

(a) RBI act, 1934

(b) Banking Regulation act '1949

(c) Know Your Customer Guidelines

(d) Negotiable Instrument act 1981

[12] Maximum time frame for collection of cheques drawn on major cities is;

(a) 7 days (b) 14 days

(c) 15 days (d) 10 days

[13] Which of the following are called back office?

(i) Branch office (ii) Regional office (iii) Head office

(a) (i) & (ii) (b) (ii) & (iii)

(c) (i) & (iii) (d) (i), (ii) and (iii)

[14] KYC guidelines have been issued under the provision of;

(a) Sec 34 of RBI Act (b) Sec 35A of B.R. Act

(c) Sec 6 of N.I. Act (d) Sec 31 of B.R. Act

[15] KYC guidelines take into account the recommendations of an International Financial Action Task Force on (i) anti money laundering standards, (ii) Combating finance of terrorism and (iii) Assets liabilities management

(a) (i), (ii) & (iii) (b) (i) and (iii)

(c) (i) and (ii) (d) (ii) and (iii)

[16] A minor have a FD A/c with the bank. He wants premature payment. Can bank allow premature payment?

(a) Yes, bank can allow pre mature payment

(b) No, premature payment can't be allowed to minor

(c) Bank can allow by taking consent of the guardian

(d) Bank can allow demand loan but not premature payment

[17] As per prevention of money laundering act, the banks are required to maintain record of transactions for a period of;

(a) 5 years (b) 1 year

(c) 7 years (c) 10 years

[18] Full KYC exercise will be required to be done at least every two years for;

(a) Low risk individuals and entities

(b) Medium risk individuals and entities

(c) High risk individuals and entities

(d) All types of customers

[19] Full KYC exercise will be required to be done for low risk individuals and entities at least every;

(a) Two years (b) Five years

(c) Eight years (d) Ten years

[20] Full KYC exercise will be required to be done for medium risk individuals and entities at least every;

(a) Eight years (b) Five years

(c) Seven years (d) Ten years

[21] Which committee recommended setting up of the banking codes and standard board of India?

(a) Committee on procedures and performance audit for public services.

(b) Committee on banking procedures

(c) Banking regulation committee

(d) Tarapore committee

[22] Who was the chairman of committee on procedure and performance audit for public services?

(a) P.R. Nayak (b) Y. Chandra Chur

(c) C.K. Subrahmanyam (d) S.S. Tarapore

[23] Suspicious transactions have to be reported to;

(a) Income Tax authority (b) Government of India

(c) Reserve Bank of India

(d) Financial Intelligence Unit-India

[24] As per prevention of money laundering act, the banks are required to submit to FIU-IND, suspicious transactions report (STR) of ....

(a) Rs Ten lakh or its equivalent in foreign currency within 15 days

(b) Rs ten lakh and above within 7 days

(c) Any amount within 7 days

(d) Rs one crore within 7 days

[25] The banks are required to submit to FIU-IND cash transaction report (CTR) for Rs——within —— as per prevention of money laundering act.

[a] ₹ 10 lakh; 7 days (b) ₹ 10 lakh; 15 days

(c) ₹10 lakh; one month (d) Above ₹ 10 lakh; 15 days

[26] Which of the following statements are correct?

Banks have to maintain proper record of ....

(i) All cash transactions of value more than ₹ 10 lakh or its equivalent in foreign currency

(ii) All series of transactions, may be less than ₹ 10 lakh but the aggregate of such transactions within a month is more than ₹ 10.0 lakh or equivalent in foreign currency

(a) Only (i) (b) Only (ii)

(c) Both (i) & (ii) (d) None of the above

[27] Which of the followings are Officially Valid Documents (OVD)?

(a) Passport (b) Driving license

(c) Aadhar (d) PAN

(e) MNREGA job card (f) Voter ID card

(g) All of the above

[28] Electricity bill is the proof of address. It should not be older than–

(a) Three months (b) Six months

(c) Four months (d) Two months

[29] If a person have no OVD (officially valid document), even then he can open an account namely—

(a) Saving bank account (b) Current account

(c) Small account (d) Any account for 6 months

[30] Which of the following are limitations of small account?

(a) Aggregate credits should not more than ₹ 1.0 lakh in a year

(b) Aggregate withdrawal should not more than ₹ 10000 in a month

(c) Balance in the account at any point of time should not remain more than ₹ 50000

(d) All of the above

[31] Small accounts would be valid normally for——

(a) 12 months (b) 6 months

(c) 3 months (d) 24 months

[32] Which of the following are not a debit voucher?
(a) Pay-in-slip for deposit
(b) Withdrawal forms
(c) Cheques issued by customers
(d) TDR presented for renewal, payment

[33] A voucher first entered in the—and then in the—— in the bank.
(a) Journal; ledger
(b) Ledger : Journal
(c) Cash book; ledger
(d) Journal; cash book

[34] Which of the following in not a credit voucher?
(a) Pay-in-slip for deposit
(b) Challan for deposit into Govt account
(c) Application for issue of DD
(d) Draft

[35] The voucher which contains both debit and credit to different account in known as;
(a) Debit voucher
(b) Credit voucher
(c) Composite vouchers
(d) Vouchers

[36] A current account cannot be operated by;
(a) Minor
(b) Illiterate persons
(c) Blind persons
(d) Purdanashin women
(e) All of the above

[37] A current account can't be opened by individual.
(a) True
(b) False

[38] Who can make 'stop payment' in a joint account of saving bank account, if the mode of operation is jointly?
(a) Any one
(b) Jointly by all
(c) Only former
(d) Only latter

[39] The 'stop payment' instruction can be revoked by— in a joint saving bank account if the mode of operation is jointly?
(a) Any one
(b) Who has make 'stop payment'
(c) Jointly by all
(d) None

[40] Whether the interest in inoperative S.B. accounts will be calculated or not?
(a) Interest will be calculated
(b) Interest will not be calculated
(c) Interest will be calculated on demand
(d) Interest will be calculated as per policy of bank

[41] The mode of operation of deposit account is either or survivor. In this case who can close the account?

(a) Any one (b) Only former

(c) Only latter (d) Both jointly

[42] A saving as well as current account should be treated as inoperative/dormant if there are no transactions in the account for over a period of—

(a) Three years (b) Two years

(c) One year (d) Five years

[43] The credit balance of any account which is not operated for a period of— shall be credited to 'The Depositor Education and Awareness Fund' (DEAF) within a period of—.

(a) 5 years; 3 months

(b) 10 years; 3 months

(c) 10 years; 6 months

(d) More than 10 years : 3 months

[44] Any amount remaining unclaimed for——shall be credited to DEAF.

(a) 10 years (b) 5 years

(c) More than 10 years (d) More than 5 years

[45] Which of the following services are available in basic saving bank deposit accounts?

(a) Deposit and withdrawal of cash at branch and ATMs

(b) Credit of money through electronic payment channels

(c) No limit on the number of deposits

(d) All of the above

[46] Which of the following restrictions are available in Basic Saving Bank Deposit Account?

(a) Only four deposits in a month is allowed

(b) Facility of ATM card is not available

(c) Maximum of four withdrawals in a month is allowed

(d) Withdrawal from ATM is not allowed

[47] The minimum period of fixed deposit at present is——whereas the maximum period is——

(a) 15 days; 10 years (b) 07 days; 120 months

(c) 30 days; 120 months (d) 6 months; 120 months

[48] If a fixed deposit matures and proceeds are unpaid, the maturity amount will attract;

(a) No interest

(b) Contractual rate of interest

(c) One percent less than contractual interest

(d) Saving bank rate of interest

[49] At the time of opening of an account, introduction is required by–

(a) Two persons

(b) Person known to bank

(c) Person known to depositors

(d) It is not mandatory

[50] In case of a minor whose guardian is appointed by the court, the minority status continues up to;

(a) 18 years (b) 17 years

(c) 21 years (d) 20 years

[51] Electronic image of a truncated cheque and under electronic cheques are valid under....

(a) Sec 7 of B.R. Act (b) Sec 24 of RBI Act

(c) Sec 6 of NI Act (d) RBI guideline

[52] If a customer's account has debited but did not receive cash from ATM. The amount should be reimbursed whithin a maximum period of—

(a) 7 days (b) 10 days

(c) 15 days (d) One month

[53] The time limit to settle claims in deceased accounts, if all documents are in order is—

(a) 7 days (b) 15 days

(c) 3 months (d) One month

[54] Life certificate in respect of pensioners is obtained once every year in—

(a) January (b) July

(c) November (d) Any month of the year

[55] BCSBI code of commitment provides that current account/saving bank account should be closed within—days of receiving the application

(a) 2 days (b) 3 days

(c) 5 days (d) 7 days

[56] In case of payment in deceased a/c, no sureties is required for claim up to Rs———

(a) 100000 (b) 160000

(c) 50000 (d) 25000

[57] Cash payment of banker's cheque, Draft, FDR can be paid in cash if the amount is Rs——

(a) ₹ 20000 and less (b) ₹ 25000

(c) ₹ 21000 (d) Less than ₹ 20000

[58] Corrective Action Plan is to be finalized within—— days from reporting under SMA-2

(a) 15 days (b) 30 days

(c) 45 days (c) 60 days

[59] For opening a current account of private company, which of the following documents is not essentially required?

(a) Memorandum of Association

(b) Article of Association

(c) Resolution of the Board

(d) Business commencement certificate

[60] Bank can't out source for;

(i) Management of investment portfolio

(ii) According sanctions for loan

(iii) Recovery of loan

(a) (i) & (ii) (b) (i), (ii) and (iii)

(c) (ii) & (iii) (d) (i) & (iii)

[61] One of the important steps to be taken while opening NRI account is—

(a) Authentication of signature by gazetted officer

(b) Verification of signature by police officer

(c) Authentication/verification of the signature by Indian Embassy

(d) Verification of signature by foreign ministry

[62] In case of societies, the important document to be taken and verified is—

(a) Registration form

(b) No objection certificate given by government

(c) Copy of bye-laws

(d) Nothing as such

[63] Out of following, who can open a current account?
(a) Blind person (b) Illeterate person
(c) Minor (d) Sole proprietor

[64] Which is not among the three pillars of BASEL II ?
(a) Risk based supervision
(b) Market discipline
(c) Supervisory review process
(d) Minimum capital requirement

[65] KYC policy, as per RBI directives should provide for
(i) Customer acceptance policy
(ii) Customer identification procedure
(iii) Monitoring of transactions
(iv) Risk management
(a) (i), (ii) & (iii) (b) (ii), (iii) & (iv)
(c) (iii) & (iv) (d) (i), (ii), (iii) & (iv)

[66] Nomination facility is available in which of the following account?
(a) Partnership firm (b) Society account
(c) Current account (d) Trust account

[67] At the time of death of a partner, his total share is given to—
(a) His legal heir (b) His executor account
(c) His loan account (d) His current account

[68] In joint account of two individuals, number of nominee can be–
(a) Two only (b) One only
(c) Nomination not allowed (d) As desired by depositors

[69] Maximum time frame for collection of cheque drawn on state capital is—
(a) 3 days (b) 10 days
(c) 7 days (d) 14 days

[70] Against a fixed deposit in the name of minor operated by guardian, while sanctioning demand loan, how the interest of minor is watched?
(a) By obtaining an undertaking from the guardian that the amount of loan will be utilised for the benefit of the minor only
(b) Taking consent of minor
(c) Giving instructions to the guardian that the amount of loan will be utilised for the benefit of the minor only
(d) Loan can't be sanctioned

[71] There is a current account of partnership firm of three partners. Any one can operate the account. Partner A retires on 31.05.2019 but has issued a cheque for ₹ 50000 infavour of Ramesh on 30.05.2019.. Ramesh presents this cheque on 11.06.2019 for payment. What is the fate of this cheque?

(a) Amount will be paid as A has signed prior to his retirement.

(b) Amount will be paid if cheque is in order.

(c) The payment would not be paid as the capacity of signatory on the date of presentation is not there.

(d) Can be paid with the consent of remaining partners.

[72] Which of the following is exempted from requirement of photograph for opening of bank account?

(a) Municipal corporation (b) Banks

(c) Government department (d) All of the above

[73] A minor can be a nominee but minor can not nominate.

(a) True (b) False

[74] Where a safe deposit locker is hired by two or more individuals. Which of the following is correct regarding nomination?

(a) The nomination should be in favour of one only if the mode of operation of locker is either or survivor

(b) If the account is operated jointly more than one nomination is possible

(c) In case of locker nomination facility is not available

(d) Both (a) & (b)

[75] Solvency means;

(a) Weak capital position of a company

(b) Financial soundness of business

(c) Firm/business in loss

(d) Business in profit

[76] What is the quantum of charge for activation of inoperative account into operative account?

(a) ₹ 100 (b) 0.50% of amount of deposit

(c) ₹ 20 per month (d) No charge

[77] Which of the following categories of accounts, even if they remain dormant, need not be transferred to inoperative accounts?

(a) If operation in the account is stopped under garnishee order/ court order
(b) If the account showing debit balance
(c) Both (a) & (b)
(d) None of the above

[78] The maturity period of CD (Cash Deposit or Certificate of Deposit) issued by banks should not be less than— and more than——

(a) One year : 10 years
(b) 7 days : 10 years
(c) One month : One year
(d) 7 days : one year

[79] The minimum amount of CD (Cash Deposit or Certificate of Deposit) should be;

(a) ₹ 10000
(b) No minimum amount
(c) ₹ 50000
(d) ₹100000

[80] There is a saving bank account operated by a minor. Minor deposit s a cheque for collection. What bank should do?

(a) Cheque may allow for collection
(b) Collection of cheque should not be allowed
(c) Collection of cheque be allowed with the consent of guardian
(d) None of the abovex

[81] A person named in the will and derives title immediately after the death of Testor for the purpose of administration of the property of deceased in known as;

(a) Administrator
(b) Executor
(c) Commissioner
(d) Testate

[82] A person appointed by the court to manage the property of the deceased who had died without leaving any will is known as;

(a) Testate
(b) Legal heir
(c) Commissioner
(d) Administrator

[83] Out of the following which is essential to open an account in the name of Hindu Undivided Family?

(a) The account should be opened in the name of karta
(b) Account in the name of family business can be opened
(c) HUF declaration duly signed by the karta and coparceners will be obtained by the bank.
(d) All of the above

[84] A deposit account in the name of HUF, who will be the nominee?
(a) Any coparcener
(b) The person to whom karta nominates
(c) Nomination is not allowed
(d) All coparceners

[85] Can a nomination be made by the pensioner in the account to which his pension amount is credited?
(a) Nomination may be made
(b) No, nomination is not allowed in pension account
(c) Nomination, only in favour of spouse be made
(d) None of the above

[86] Nomination once made can be changed or cancelled during the currency of the deposit. Which is not correct regarding change/cancellation of nomination?
(a) In joint a/c, if mode of operation is E/S, any one can change the nomination.
(b) In joint a/c, mode of operation is jointly, nomination may be change with the consent of all depositors.
(c) Change or cancellation of nomination can be made any time
(d) A nomination/change of nomination/cancellation of nomination will be deemed to be in force even when the relative deposit is renewed.

[87] An order of the court obtained by the judgement creditor attaching the funds belonging to a judgment debtor with bank is known as;
(a) Court order (b) Attachment order
(c) Civil procedure code (d) Garnishee order

[88] The court normally issue Garnishee order in two parts. First order called as—where as second order is called——
(a) First order; second order (b) Initial order; final order
(c) Intimation, attachment order (d) Order NISI; order absolute

[89] The security acquired by the borrower with bank finance is known as;
(a) Security (b) Primary security
(c) Bank's security (d) Collateral security

[90] Which type of mortgage is created mere by delivery/ deposit of title deeds or other documents of the title with intent to create security thereof;

(a) Registered Mortgage (b) Hypothecation

(c) Equitable Mortgage (d) Pledge

[91] Right of Lien is available on....

(a) Deposits (b) FDR

(c) NSC (d) Goods/securities

[92] An HUF can not become partner in a partnership firm.

(a) True (b) False

[93] In HUF account, in absence of Karta, who will operate the account?

(a) All coparceners jointly

(b) A coparcener authorised by karta

(c) Senior coparcener

(d) Any person authorised by mandate or power of attorney

[94] The joint account of illeterate persons can be operated by;

(a) Either or survivor (b) Former or survivor

(c) Only jointly by both (d) Latter or survivor

[95] A Trustee cannot delegate his powers

(a) True (b) False

[96] A cheque is issued by a sole depositor on 11.06.2019, but he died on 12.06.2019. Cheque presented to bank for payment on 14.06.2019. What is the fate of cheque?

(a) Payment will be made

(b) Payment will be made if it is in order

(c) Payment can be made through transfer only

(d) Payment will not made if bank has information about death of depositor

[97] What is the status of a nominee?

(a) Nominee is the owner of a deposit

(b) Nominee is legal heir of deceased

(c) Nominee is 'Trustee of legal heirs'

(d) Nominee is mandate holder

[98] At the time of opening of current account of a trust, which of the following documents bank have to obtained?

(a) Copy of trust deed

(b) Trust letter and resolution duly signed by all trustee

(c) Copy of certificate issued by charity commissioner in case of public trust

(d) All of the above

[99] If a cheque is presented for clearing and returned due to any reason. What among the following is correct action?

(a) The cheque return charge can be levied only in case where the customer is at fault.

(b) In all cases return charge will be levied

(c) The cheque should be represented within 24 hours with the due intimation to the customer

(d) Both (a) and (c)

[100] Under cheque truncation system, certain benchmarks have been prescribed, these benchmark prescriptions are know as;

(a) CTS (b) Cheque of truncation

(c) Standard of clearing (d) CTS-2010 standard

[101] If a foreign student opens an account in the bank in India, how much time will be allowed for furnishing the proof of local address?

(a) One month (b) Two months

(c) Three months (d) Six months

[102] Customer acceptance policy covers which of the following?

(a) No account should be opened in anonyms or fictitious name.

(b) Transactions will be permitted only after compliance of customer due diligence.

(c) If bank is unable to verify the identity, no account should be opened or closed.

(d) All of the above

[103] As per model deposit policy of IBA, a minor can open which of the following accounts?

(a) Current account (b) Saving bank account

(c) Fixed deposit accounts (d) All of the above

[104] If a partnership firm is not registered with registrar of firm, what is the risk?

(a) No legal entity of the firm

(b) It can't sue 3rd party

(c) Any partner can do anything

(d) Account can not be opened in bank

[105] The objective of a company remains mention in which of the following documents?

(a) Memorandum of Articles

(b) Memorandum of Association

(c) Certificate of incorporation

(d) Certificate of commencement of business

[106] A director of company who operates account has been declared insolvent. Now what will the bank do?

(a) Stop operation of the account

(b) Ask for other resolution of the board regarding operation of the account

(c) Operations shall remain continue

(d) Account will be closed

[107] The concept of working capital was recommended by;

(a) Nayak committee (b) Tandon committee

(c) Jalan committee (d) Kapoor committee

[108] A document executed on two different date viz 12.06.2019 and 14.06.19. The document is—and the date of document will be treated as dt——

(a) Not valid; 14.06.2019 (b) Not valid; 12.06.2019

(c) Valid; 12.06.2019 (d) Valid; 14.06.2019

[109] What is Loan to Value (LTV) ratio?

(a) Loan sanctioned against jewellery

(b) Current value of gold jewelley

(c) Total outstanding in the account to loan amount sanctioned

(d) Total outstanding in the account including interest accrued to current value of security

[110] A bank sanctions ₹ 1500000 for construction of house. Here the land on which house would be constructed will stand as— and the charge thereon should be;

(a) Security; pledge

(b) Primary security; hypothecation

(c) Collateral security; pledge

(d) Primary security; mortgage

[111] The provision required for unsecured portion of sub-standard category of NPA is;

(a) 25% (b) 40% (c) 60% (c) 15%

[112] As per RBI guidelines, the provision required for unreconciled debit entries for more than six months is;

(a) 25% (b) 40%

(c) 60% (d) 100%

[113] Which of the following activities can be outsourced by a bank?

(a) Internal audit (b) According sanction of loan

(c) Compliance function (d) Marketing of products

[114] A document is signed abroad. When it should be stamped in India?

(a) Documents signed abroad, stamping not required in India

(b) To be stamped within 6 months

(c) To be stamped within 3 months from date of entry in India

(d) If properly stamped abroad, not required to be stamped in India;

[115] CRM is–––approach to address customer needs and expectations by analyzing information for all channels and data sources,

(a) A pro-active approach (b) A punative approach

(c) A preventive approach (d) A customer relationship

[116] One of the banker's obligation is 'duty to honour cheques of customer' in mentioned in—

(a) U/s 6 of NI Act (b) U/s 31 of NI Act

(c) U/s 31 of NI Act (d) Know Your Customer

[117] Out of following which is the banker's right?

(a) Right of lien (b) Right of set-off

(c) Right of appropriation (d) All of the above

[118] Right of lien is available on—

(a) Deposit (b) Immovable assets

(c) Movable assets (d) Goods and securities

[119] A loan account has ₹ 50000/- as overdue amont and a FD in the name of loanee is also lying in your branch which will mature on future date. To recover the overdue amount you want to adjust the FD amount. You can do so under;

(a) Right of set-off (b) Right of lien

(c) Right of appropriation (d) Can't do so

[120] What is the target for micro enterprises under priority sector?

(a) 10% of total outstanding

(b) 7.5% of Adjusted Net Bank Credit (ANBC)

(c) 8% of ANBC

(d) 18% of ANBC

[121] What is Adjusted Net Bank Credit (ANBC)?

(a) Total loan outstanding minus subsidy

(b) Total loan outstanding minus investment

(c) Net bank credit + subsidy

(d) Net bank credit plus investment in non-SLR bond (HTM)

[122] Out of the following which one will classify as priority sector housing loan?

(a) For metro, loan upto ₹ 35.0 lakh and overall cost upto ₹ 40.0 lakh

(b) For other centre, loan upto ₹ 25.0 lakh and overall cost upto ₹ 30 lakh

(c) Both (a) & (b)

(d) ₹ 20.0 lakh

[123] What is the exposure limit for group borrowings?

(a) 50% of capital fund (b) 40% of capital fund

(c) 15% of capital fund (d) No exposure limit

[124] What is the exposure limit for single borrower?

(a) 15% of capital fund (b) 25% of capital fund

(c) 30% of capital fund (d) 35% of capital fund

[125] Capital fund consists of—

(a) Tier I & Tier II capital (b) Paid-up capital

(c) Authorised capital (d) Capital of the bank

[126] The cash transaction report (CTR) for cash transactions of above ₹ 10.0 lakh is to be reported to FIU-IND within,

(a) 10 days

(b) 7 days of close of month

(c) 15 days of close of month

(d) 7 working days of close of month

[127] The suspicious transaction report (STR) is to be reported to FIU-IND within;

(a) 7 days (b) Immediately

(c) 7 days from confirmation of suspicion

(d) 15 days from confirmation of suspicion

[128] CCR (Counterfeit Currency notes Report) has to be reported on —----basis and within——

(a) Half yearly : 7 working days

(b) Quarterly : 15 working days

(c) Monthly : 7 working days

(d) Yearly : 15 working days

[129] Ombudsman can give maximum award upto—

(a) ₹ 10.0 lakh (b) ₹ 20.0 lakh

(c) ₹ 50.0 lakh (d) ₹ 75.0 lakh

[130] Bank has to implement the award of Ombudsman within— form the date of receipt of the acceptance from the—

(a) 15 days; bank (b) One month; complainant

(c) Three month; complainant (d) 7 days; borrower

[131] If a bank is responsible for delayed collection of cheque in SB a/c for 60 days, bank has to pay–

(a) @ SB rate + 2% (b) No penalty

(c) @ FD interest (d) @ SB rate + 3%

[132] If a collection of cheque in SB A/c is delayed beyond 90 days, the bank has to pay,

(a) FD rate of interest for delayed period

(b) No interest will be paid

(c) Saving bank rate of interest

(d) Saving bank rate of interest plus 2%

[133] What is the extent of loan (minimum/maximum) under stand-up India scheme?

(a) 10.0 lakh : 100 lakh (b) 25.0 lakh : 100 lakh

(c) 25.0 lakh : 200 lakh (d) 25.0 lakh : 250 lakh

[134] Limitation for execution of decree is for–

(a) 12 years

(b) 3 years

(c) 12 years from date of decree

(d) 13 years from date of decree

[135] Limitation for CC (pledge) is for—

(a) 3 years from date of documentation

(b) 3 years from limit allowed

(c) 3 years from overdue (d) Not applicable

[136] Security acquired by the borrower out of bank finance or the one against which credit is provided by bank is called;

(a) Personal security (b) Collateral security

(c) Primary security (d) First security

[137] Bill purchased refers to—whereas bill discounted refers to—

(a) Cheque; bill of exchange (b) Bill of exchange; cheque

(c) Demand bill; usance bills (d) Bill; promissory note

[138] Which of the following is characteristics of a good security?

(a) Marketability (b) Ascertainability

(c) Stability (d) Transferability

(e) All of the above

[139] Which of the following charges is effected by mere deposit (or delivery) of title deeds or other documents of title with intent to create security thereof?

(a) Registered mortgage (b) English mortgage
(c) Mortgage (d) Equitable mortgage

[140] Bailment or delivery of goods by the borrower to the lending bank with the intention of creating a charge thereon is known as;

(a) Bailment (b) Mortgage
(c) Hypothecation (d) Pledge

[141] The hypothecation is defined under which of the following?

(a) Banking regulation Act '1949
(b) Reserve Bank of India Act ' 1934
(c) SARFAESI Act ' 2002 (d) Know Your Customer

[142] Statutory right of a creditor to adjust the debit balance in the debtor's account against any credit balance lying in another account of the debtor is known as;

(a) Right of set-off (b) Right of lien
(c) Right of appropriation (d) None of the above

[143] The right of retaining the goods / securities unless a debt due by a debtor is paid to creditor is known as;

(a) Right of set-off (b) Right of lien
(c) Hypothecation (d) Negative lien

[144] An undertaking given by the borrower to the bank that he will not create any charge over his immovable and movable properties without the prior permission of the bank is known as;

(a) Right of lien (b) Pledge
(c) Mortgage (d) Negative lien

[145] What is limit of loan amount which needed to be reported to central repository of information for large credit (CRILC) on monthly basis, if it is stressed?

(a) ₹ 20 billion and above (b) ₹ 30 billion and above
(c) ₹ 40 billion and above (d) ₹ 50 billion and above

[146] What do you mean by ultra vires?

(a) Beyond the power (b) Valid
(c) Lawful (d) None of the above

[147] A cheque for ₹ 15000 has been issued by a borrower against installment due in his loan account, but due to insufficient fund the cheque bounced; under which of the following action can be initiated?

(a) U/s 18 of limitation act (b) U/s 11 of Indian contract act

(c) U/s 138 of Negotiable instrument act

(d) U/s 35 A of banking regulation act

[148] Moratorium period for education loan is

(a) Course period (b) Course period + 1 year

(c) Course period + 6 months

(d) Course period + 1 year or 6 months after getting jobs whichever is earlier

[149] Interest on loan amount will be applied on ——with——rest.

(a) Loan amount; quarterly

(b) Sanctioned amount; monthly

(c) Daily reducing balance; monthly

(d) Daily reducing balance; yearly

[150] Punishment for violation of prevention of money laundering (amendment) act, 2012 is;

(a) ₹ 10000/- (b) ₹ 25000/-

(c) ₹ 100000/- (d) ₹ 10000 to ₹ 100000

[151] The facility of nomination is available under which of the followings?

(a) U/s 138 of NI act (b) U/s 45Z A to 45ZF of BR Act '1949

(c) U/s 42 of RBI Act (d) U/s 35A of BR Act

[152] Nomination in deposit account should be in favour of one, but more than one nominee can be in—

(a) Joint account operation E/s (b) Firm's account

(c) Joint account of locker and if operation is jointly

(d) Joint deposit account and operation is jointly

[153] Electronic fund transfer from one bank account to another bank account using service of clearing house for bulk transfer is known as;

(a) NEFT (b) RTGS

(c) ECS (d) ECS payment

[154] CBS facilitated introduction of ATM, eBanking, mBanking etc that are collectively known as;

(a) Multiple delivery channels (b) Multiple use of CBS

(c) Bulk operation (d) Miscellaneous delivery channels

## ANSWERS

| | | | | | | |
|---|---|---|---|---|---|---|
| 1 (b) | 2 (c) | 3 (d) | 4 (d) | 5 (d) | 6 (a) | 7 (c) |
| 8 (b) | 9 (b) | 10 (a) | 11(c) | 12 (d) | 13 (b) | 14 (b) |
| 15 (c) | 16 (a) | 17 (a) | 18 (c) | 19 (d) | 20 (a) | 21 (a) |
| 22 (d) | 23 (d) | 24 (c) | 25 (d) | 26 (c) | 27 (g) | 28 (d) |
| 29 (c) | 30 (d) | 31 (a) | 32 (a) | 33 (b) | 34 (d) | 35 (c) |
| 36 (e) | 37 (b) | 38 (a) | 39 (c) | 40 (a) | 41 (d) | 42 (b) |
| 43 (b) | 44 (c) | 45 (d) | 46 (c) | 47 (b) | 48 (d) | 49 (d) |
| 50 (c) | 51 (c) | 52 (a) | 53 (b) | 54 (c) | 55 (d) | 56 (c) |
| 57 (d) | 58 (c) | 59 (d) | 60 (a) | 61 (c) | 62 (c) | 63 (d) |
| 64 (a) | 65 (d) | 66 (c) | 67 (b) | 68 (b) | 69 (c) | 70 (a) |
| 71 (c) | 72 (d) | 73 (a) | 74 (d) | 75 (b) | 76 (d) | 77 (c) |
| 78 (d) | 79 (d) | 80 (b) | 81 (b) | 82 (d) | 83 (d) | 84 (c) |
| 85 (a) | 86 (a) | 87 (d) | 88 (d) | 89 (b) | 90 (c) | 91 (d) |
| 92 (a) | 93 (d) | 94 (c) | 95 (a) | 96 (d) | 97 (c) | 98 (d) |
| 99 (d) | 100 (d) | 101 (a) | 102 (d) | 103 (b) | 104 (b) | 105 (b) |
| 106 (c) | 107 (b) | 108 (d) | 109 (d) | 110 (d) | 111 (a) | 112 (d) |
| 113 (d) | 114 (c) | 115 (a) | 116 (b) | 117 (d) | 118 (d) | 119 (c) |
| 120 (b) | 121 (d) | 122 (c) | 123 (b) | 124 (a) | 125 (a) | 126 (c ) |
| 127(c ) | 128 (c) | 129 (b) | 130 (b) | 131 (a) | 132 (a) | 133 (a) |
| 134 (c) | 135 (d) | 136 (c) | 137 (c) | 138 (e) | 139 (d) | 140 (d) |
| 141 (c) | 142 (a) | 143 (b) | 144 (d) | 145 (d) | 146 (a) | 147 (c) |
| 148 (d) | 149 (c) | 150 (d) | 151 (b) | 152 (c) | 153 (d) | 154 (a) |