**Principal of Accounting**

**Unit-3**

**Banking Company Accounts**

In 1913, when a good number of industrial houses failed, a demand for the regulation of banking business in our country was raised. A scheme for the regulation of banking companies was recommended by the Central Banking Enquiry Committee which was set-up in 1913. But some special provisions relating to banking companies were incorporated in the Indian Companies Act, 1913, not until 1936, although the said provisions were found to be inadequate to protect the interest of the depositors.

(According to Sec. 5A, the provisions of Banking Regulation Act override any contrary provisions contained in the Memorandum and Articles of Association of a banking company or in any agreement made by it or in any resolution passed by it or by its Board of Directors.)

**Banking Company:**

According to Sec. 5 of the Banking Regulation Act, 1949, a banking company means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawn by Cheque, Draft, and Order or otherwise. In short, a banking company means and includes any company which carries on the business or which transacts the business of banking in India.

No company can use as part of its name any of the words bank, banker or banking other than a banking company and, at the same time, no company can carry on business of banking in India unless and until it uses at least one of such words as part of its name.

Sec. 8 states that a banking company cannot deal directly or indirectly in buying or selling or banking of goods except of its legitimate banking business.

A banking company cannot also form a subsidiary company except for the purpose of undertaking and executing trusts, trustee or otherwise and providing of safe deposit vaults, or carry on business of banking exclusively outside India or such other purposes as are incidental to the business of banking if the Reserve Bank grants a written permission.

**Licensing of Banking Companies:**

According to Sec. 22, no company shall carry on banking business in India unless it holds a license issued by the Reserve Bank of India.

**If the following conditions art satisfied, the Reserve Bank of India may grant a license:**

(i) “That the company is or will be in a position to pay its present and future depositors in full as their claims accrue;

(ii) That the affairs of the company are not being or are not likely to be conducted in a manner detrimental to the interests of its present or future depositor;

(iii) That, in the case of a foreign banking company, the carrying on of a banking business by such company in India will be in the public interest, that the Government or law of the country of its origin does not discriminate against Indian banking companies carrying on business in that country, and that it complies with all the requirements of law applicable to it”.

**Cancellation of License:**

**The Reserve Bank of India may cancel a licence if:**

(i) The company ceases to carry on banking business in India;

(ii) The company at any time fails to comply with any of the conditions on which the licence was granted; or

(iii) At any time, any of the conditions, on the satisfaction of which the Reserve Bank of India granted the licence, has not been fulfilled.

**Restrictions on Business:**

**Sec. 6 of the Act lays down that the following business may also be carried on by a banking company, in addition to the usual banking business:**

(a) Acting as agents for any governments or local authority or any other person or persons; the carrying on of agency business of any description including the clearing and forwarding of goods, giving of receipts and discharges and otherwise acting as an attorney on behalf of customers, but excluding the business of a managing agent of a company;

(b) Contracting for public and private loans and negotiating and issuing the same;

(c) Selecting, insuring, guaranteeing, underwriting, participating, in managing and carrying out of any issue, public or private, of state, municipal or other loans or of shares, stock, debentures or debenture stock of any company, corporation or association and of lending of money for the purpose of any such issue;

(d) Carrying on and transacting every kind of guarantee and indemnity business;

(e) Managing, selling and realising any property which may come into the possession of the company in satisfaction or part satisfaction of any of its claims;

(f) Acquiring or holding and generally dealing with any property, or title or interest in any such property which may form the security or part of the security for any loans or advances or which may be connected with any such security;

(g) Undertaking and executing trusts;

(h) Undertaking the administration of estates as executor, trustee or otherwise;

(i) Establishing and supporting associations, institutions, funds, trusts, and convenience for the benefit of employees, ex-employees, their dependants and the general public;

(j) Acquiring, constructing, maintaining and altering any building or works necessary for the purpose of the banking company;

(k) Selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing-off or turning into account or otherwise dealing with all or any part of the property and rights of the company;

(l) Acquiring and undertaking the whole or any part of the business of any person or company when such business is of a nature enumerated or described in Sec. 6.

(m) Doing such other things as are necessary for the efficient conduct of the above-named business, such as acquisition, construction, alteration etc. of any building or works necessary or convenient for the purpose of the company; and

(n) Any other form of business which the Central Govt. may notify in the Official Gazette.

As such, other types of business are prohibited by a banking company.

**Books Maintained by a Bank:**

The methods of preparation and presentation of Profit and Loss Account and a Balance Sheet of a Bank are very important and significant which include certain peculiar terms to this type of organisation. For this purpose, a short description of different books, ledgers, registers and terms which are very important are discussed hereunder.

**Books Section**

**Cash Book**

**Cash Balance**

**Day Book:**

**Ledger and Register Sections**

**Ledger Section**

**Current Account Ledger**

**Savings Bank Ledger**

**Fixed Deposit Ledger**

**General Ledger**

**Register Section**

**The Slip System of Ledger Posting**

**Advantages:**

**The advantages of this system are:**

(i) It reduces the possibility of errors and frauds;

(ii) It saves a lot of time since it is prepared by the customers themselves;

(iii) It provides a good system of internal check etc.

**Disadvantages:**

The system is also not free from snags. It suffers from the risk of loss, misappropriation or destruction of slips since they are loose.

**Principal Provisions of Banking Regulation Act:**

**Prohibition of Trading (Sec. 8):**

According to Sec. 8 of the Banking Regulation Act, a banking Company cannot directly or indirectly deal in buying or selling or bartering of goods. But it may, however, buy, sell or barter the transactions relating to bills of exchange received for collection or negotiation.

**Non-banking Assets (Sec. 9):**

According to Sec. 9 **“A banking company cannot hold any immovable property, howsoever acquired, except for its own use, for any period exceeding seven years from the date of acquisition thereof. The company is permitted, within the period of seven years, to deal or trade in any such property for facilitating its disposal”.** Of course, the Reserve Bank of India may, in the interest of depositors, extend the period of seven years by any period not exceeding five years.

**Management (Sec. 10):**

**Sec. 10(a) states that not less than 51% of the total number of members of the Board of Directors of a banking company shall consist of persons who have special knowledge or practical experience in one or more of tie following fields:**

(a) Accountancy;

(b) Agriculture and Rural Economy;

(c) Banking;

(d) Cooperation;

(e) Economics;

(f) Finance;

(g) Law;

(h) Small Scale Industry.

The Section also states that at least not less than two directors should have special knowledge or practical experience relating to agriculture and rural economy and cooperation. Sec. 10(b)(1) further states that every banking company shall have one of its directors as Chairman of its Board of Directors.

**Minimum Capital and Reserves (Sec. 11):**

**Sec. 11 of the Banking Regulation Act, 1949, provides that no banking company shall commence or carry on business in India, unless it has minimum paid-up capital and reserve of such aggregate value as is noted below:**

**(a) Foreign Banking Companies:**

In case of banking company incorporated outside India, its paid-up capital and reserve shall not be less than Rs. 15 lakhs and, if it has a place of business in Mumbai or Calcutta or in both, Rs. 20 lakhs. It must deposit and keep with the R.B.I, either in Cash or in unencumbered approved securities (i) the amount as required above, and (ii) after the expiry of each calendar year, an amount equal to 20% of its profits for the year in respect of its Indian business.

**(b) Indian Banking Companies:**

**In case of an Indian banking company, the sum of its paid-up capital and reserves shall not be less than the amount stated below:**

(i) If it has places of business in more than one State, Rs. 5 lakhs, and if any such place of business is in Mumbai or Calcutta or in both, Rs. 10 lakhs.

(ii) If it has all its places of business in one State, none of which is in Mumbai or Calcutta, Rs. 1 lakh in respect of its principal place of business plus Rs. 10,000 in respect of each of its other places of business in the same district in which it has its principal place of business plus Rs. 25,000 in respect of each place of business elsewhere in the State. No such banking company shall be required to have paid-up capital and reserves exceeding Rs. 5 lakhs and no such banking company which has only one place of business shall be required to have paid-up capital and reserves exceeding Rs. 50,000. In case of any such banking company which commences business for the first time after 16th September 1962, the amount of its paid-up capital shall not be less than Rs. 5 lakhs.

(iii) If it has all its places of business in one State, one or more of which are in Mumbai or Calcutta, Rs. 5 lakhs plus Rs. 25,000 in respect of each place of business outside Mumbai or Calcutta. No such banking company shall be required to have paid-up capital and reserve excluding Rs. 10 lakhs.

# Insurance Company Accounts

General insurance business means business other than life insurance business. General insurance companies operating in India were nationalized on 13th May, 1971 by the Ordinance of the President of India. The accounts of the General Insurance Companies were maintained according to the provisions of Insurance act 1938. Under the previous law, separate Revenue Account had to be prepared for each type of business-fire, marine, accident, etc.

**The following accounts were used to be prepared in the case of General Insurance Companies:**

#### ****(a) Revenue Account:****

A separate revenue account is prepared for each type of business. Incomes and expenses of a particular business are recorded separately and profit or loss arising there from is transferred to Profit and Loss Account.

#### ****(b) Profit and Loss Account:****

General incomes and expenses not belonging to a particular business are recorded in it and balance of profit or loss is transferred to Profit and Loss Appropriation Account.

#### ****(c) Profit and Loss Appropriation Account:****

Appropriations of profit for various purposes are shown in it and it’s balance is transferred to balance sheet.

#### ****(d) Balance Sheet:****

It shows various assets and liabilities of general insurance companies. Performa of Balance Sheet is same for general and life insurance companies.

Before the incorporation of IRDA Act, 2000 which allowed private players, general insurance business was conducted by General Insurance Corporation of India and its four subsidiaries.

**But now, Final account of general insurance business are required to be prepared as per IRDA Regulations, 2002 which consist of:**

(a) Revenue Account (as per Form B-RA);

(b) Profit and Loss Account (Form B-PL);

(c) Balance Sheet (Form B-BS).

### ****Reserve for Unexpired Insurance:****

According to the provisions of Insurance Act, 1938, provision for unexpired risks in case of fire, marine, cargo and miscellaneous business is to be created-@ 40% of the net premiums received and 100% in case for marine Hull. However, income determination of general insurance business is done as per section 44 of Income-tax Act, 1961 and Rule 6 E of the Income-tax Rules.

They provide for reserve for unexpired risk allowed as deduction up to 50% of net premium income in case of fire insurance and miscellaneous insurance and 100% of net premium in case of marine insurance.

As such, reserve is to be made at 50% of the net premium income in case of fire and other insurance businesses and at 100% of the net premium income in case of marine insurance business. A prudent insurance company may make additional reserve in case of fire and miscellaneous insurance business, if it considers it necessary.

### ****Commission to Agents:****

Commission on policies effected through insurance agents cannot exceed 5% of the premium in respect of fire and marine business and 10% in case of miscellaneous business. In case of policies effected through principal agents the maximum limits are 20% for fire and marine policies and 15% in the case of miscellaneous insurance less any commission payable to an insurance agent with respect to the policy concerned. Certain concessions are available in this respect to principal agents having a foreign domicile.

### ****Claims:****

Claims paid must include all expenses directly incurred in settling claims such as legal expenses, medical expenses, surveyor’s expenses etc.

No claim of Rs. 20,000 or more can be paid, except as the Controller of Insurance may otherwise direct, unless there is a report in respect thereof from an approved surveyor or loss assessor (licensed under the Insurance Act).

**Departmental Accounts**

Departmental stores have many types of stores under a single roof, for example one departmental store may have a cosmetic store, shoe store, stationery store, readymade departmental store, grocery stores, medicines, and many more.

It is essential to know the profit and loss account of each departmental store at the end of the accounting year. However, it can be done by maintaining the department wise Trading & Profit and Loss account.

**Objectives of Departmental Accounting**

Following are the main objectives of the departmental accounting:

* To know the financial position of each and every department separately, it is helpful to make a comparison.
* Calculate commission of the managers department wise.
* Evaluate performance, planning, and control.

**Advantages of Departmental Accounting**

Following are the advantages of a department accounting:

* It is helpful in evaluating the result of each department.
* It helps to know the profitability of each department.
* Investors and outsiders may know the detailed information.
* It is helpful in making comparison of each expenses (same department) of the different accounting years and different expenses (other departments) of the same accounting year.

**Methods of Departmental Account**

There are two methods of keeping Departmental Accounts:

* Separate Set of Books for each department
* Accounting in Columnar Books form

**Separate Set of Books for each Department**

Under this method of accounting, each department is treated as a separate unit and separate set of books are maintained for each unit. Financial results of each unit are combined at the end of accounting year to know the overall result of the store.

Due to high cost, this method of accounting is followed only by very big business houses or where to do so is compulsory as per the law. Insurance business is one of the best examples, where to follow this system is compulsory.

**Accounting in Columnar Books Form**

Small trading unit generally uses this system of accounting, where accounts of all departments are maintained together by central accounts department in the columnar books form. Under this method, sale, purchase, stock, expenses, etc. are maintained in a columnar form.

It is necessary that to prepare a departmental Trading and Profit and Loss Account, preparation of subsidiary books of accounts having different columns for the different department is required. Purchase Book, Purchase Return Book, Sale Book, Sales return books etc. are the examples of the subsidiary books.

Specimen of a Sale Book is given below:

**Sales Book**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **L.F.** | **Department A** | **Department B** | **Department C** | **Department D** |
|  |  |  |  |  |  |  |

A Trading account in columnar form is prepared to know the department wise gross profit of the concern.

Function wise classification may also be done in a business unit like Production department, Finance department, Purchase department, Sale department, etc.

**Allocation of Department Expenses**

* Some expenses, which are specially incurred for a particular department may be charged directly to the respective department. For example, hiring charges of the transport for delivery of goods to customer may be charged to the selling and distribution department.
* Some of the expenses may be allocated according to their uses. For example, electricity expenses may be divided according to the sub meter of each department.

Following are the examples of some expenses, which are not directly related to any particular department may be divide as:

* **Cartage Freight Inward Account**: Above expenses may be divided according to purchase of each department.
* **Depreciation**: Depreciation may be divided according to the value of assets employed in each department.
* **Repairs and Renewal Charges**: Repair and renewal of the assets may be divided according to the value of the assets used by each department.
* **Managerial Salary**: Managerial salary should be divided according to the time spent by the manager in each department.
* **Building Repair, Rents & Taxes, Building Insurance, etc.**: All the expenses related to the building should be divided according to the floor space occupied by each department.
* **Selling and Distribution Expenses**: All the expenses relating to selling and distribution expenses should be divided according to the sales of each department, such as freight outward, travelling expenses of sales personals, salary and commission paid to salesmen, after sales services expenses, discount and bad debts, etc.
* **Insurance of Plant & Machinery**: The value of such Plant & Machinery in each department is the basis of the insurance.
* **Employee/worker Insurance**− Charges of a group insurance should be divided according to the direct wage expenses of each department.
* **Power & Fuel**− Power & fuel will be allocated according to the working hours and power of the machine (i.e. Hours worked x Horse power).

**Inter-Department Transfer**

An inter-department analysis sheet is prepared at a regular interval such as weekly or monthly basis to record all the inter-departmental transfers of goods and services. It is necessary, as each department is working as a separate profit center. Transfer of the prices of such transactions can be cost base, market price, or duel basis.

Following Journal entry will pass at the end of that period (weekly or monthly) −

Journal Entry Receiving Department A/c                      Dr

To Supplying Department A/c

**Inter-Department Transfer Price**

There are three types of transfer prices:

* **Cost based transfer price:** Where the transfer price is based on standard, actual, or total cost, or marginal cost is called cost based transfer price.
* **Market based transfer price:** Where the goods are transferred at selling price from one department to another is known as market based price. Therefore, unrealized profit on the goods sold is debited from the selling department in the form of a stock reserve for both the opening and the closing stock.
* **Dual pricing system:** Under this system, the goods are transferred on the selling price by the transferor department and booked at the cost price by the transferee department.

## Branch Accounting

Branch Accounting is a system in which separate books of accounts are maintained for each branch. These branches are divided as per geographical locations and [each branch has its own profit center](https://www.wallstreetmojo.com/profit-center/) and cost center. In this accounting system, separate [Trial Balance](https://www.wallstreetmojo.com/preparing-trial-balance/), [Profit & loss statement](https://www.wallstreetmojo.com/profit-and-loss-statement-format/) and [balance sheet](https://www.wallstreetmojo.com/balance-sheet/) are prepared by each branch.

### Types of Branches

#### #1 – Dependent Branch

Dependent branches are those branches that do not maintain separate books of accounts completely, there profit & loss statement and Balance sheets are collectively maintained by the Head office only. Only a few information has been maintained by branches separately like Cash Accounting, Debtors Accounting, and Inventory.

#### #2 – Independent Branch

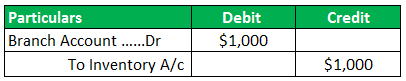
Independent branches are those branches which maintain separate books of accounts completely and their profit & loss statement and Balance sheets are maintained separately from their Head office. In this case, Head office and Branches are treated separate entity.

**E.g.** – If Head Office sending material to its branch then the Head office will record sales in the HO book and raise an invoice in the name of branch and branch will record this as purchase in branch books of accounts.

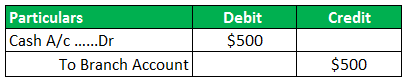
### Journal Entries of Branch Accounting

The following are the journal entries of branch accounting

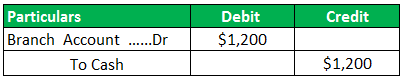
**#1 – Inventory** – If Head office transferred inventory of $1000 to its branch office then below [journal entries](https://www.wallstreetmojo.com/journal-entry-examples/) will be passed in the books of Head office.



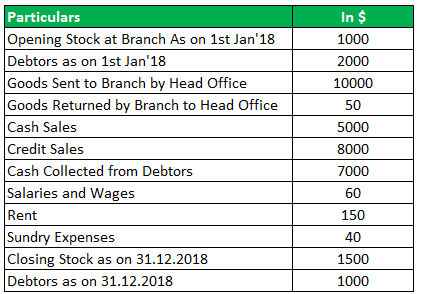
**#2 – Cash Remitted by Branch to Head office** – If Branch office remit cash of $500 to Head office.



**#3 – Head office Paid Expenses of Branch** – If Head office paid wages $500, Rent $ 400 & Salary $300 on behalf of the branch.



**Example: ABC Ltd. Company has it is branch office at Chennai and the following is the transaction between branch and Head office during the Year Jan’ 2018 – Dec’2019. In this example, the Head office is sending goods to the branch at the cost price.**



**Solution:**

