Specialzed Accounting

Unit 2

Accounts of Banking Companies

Introduction

The banking business in India is covered by two main legislations – (1) Banking Regulation Act 1949 (2) The Reserve Bank of India Act 1934. The focus of governance is to ensure sound banking through regulation covering the opening of branches and maintenance of liquid assets. The corporate bodies doing the banking business in India are required to follow the provisions of the Banking Regulation Act. Before 1949, there was no special law to regulate banking companies. Further, the banking companies are also subject to Companies Act 2013 or 1956. The provisions of the BR act are in addition to the company law. If there is some specific law for a particular business, it will be largely governed by the specific act, but the other basic laws will also be applicable to the business. As similar to banking, there are separate acts for insurance business, electricity companies. Mostly the business is run by the corporate bodies, so the corporate law is compulsorily relevant for them.

Banking Companies

To understand the meaning of banking company, we are required to understand the meaning of two words- banking and company. The definitions of both the words are given in section 5 of the act:

- Banking means the accepting, for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order form or otherwise.
- Banking company means any company which transacts the business of banking in India.

Licensing of Banking Companies

In India, no company can carry on banking business unless it holds a license issued from RBI and such license may be issued subject to certain conditions as the RBI may think fit to impose in the case. Before granting a license to the company, the RBI may require to be satisfied by an inspection of the books of the company. Further, the following conditions are to be fulfilled strictly.

(a) The company is or will be in a position to pay its present or future depositors in full as their claims accrue.
(b) The affairs of the company are not being conducted in a manner detrimental to the interests of its present or future depositors.
(c) The general character of the proposed management of the company will not be prejudicial to the public interest or the interest of its depositors.
(d) The company has adequate capital structure and earning prospects.
(e) The public interest will be served by the grant of a license to the company to carry on banking business in India.

(f) The grant of license would be suitable for the monetary stability and economic growth of the area of operation of the company. The potential scope for expansion of banks already in existence in the area and other relevant factors would be examined before issuance of the license.
(g) Any other additional condition whichever is considered fit to be imposed by the RBI for carrying on banking business.

Forms of Business of Banking Companies

In addition to the business of banking, a banking company may engage in any one or more of the following forms of business:

(a) the borrowing, raising, or taking up of money; the lending or advancing of money
(b) the drawing, making, accepting, discounting, buying, selling, collecting, and dealing in bills of exchange, hundies, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates, scrips and other instruments and securities
(c) the granting and issuing of letters of credit, traveller's cheques, and circular notes
(d) the buying, selling and dealing in bullion and specie
(e) the buying and selling of foreign exchange including foreign bank notes
(f) the acquiring, holding, issuing on commission, underwriting and dealing in stock, funds, shares, debentures, debenture stock, bonds, obligations, securities and investments of all kinds
(g) the purchasing and selling of bonds, scrips or other forms of securities on behalf of constituents or others, the negotiating of loans and advances;
(h) the receiving of all kinds of bonds, scrips or valuables on deposit or for safe custody or otherwise; the providing of safe deposit vaults
(i) the collecting and transmitting of money and securities
(j) acting as agents for any Government 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
(k) acting as an attorney on behalf of customers
(l) contracting for public and private loans and negotiating and issuing the same
(m) the effecting, 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 the lending of money for the purpose of any such issue
(n) carrying on and transacting every kind of guarantee and indemnity business
(o) Managing, selling and realizing any property which may come into the possession of the company in satisfaction or part satisfaction of any of its claims
(p) Acquiring and holding and generally dealing with any property or any right, 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
(q) Undertaking and executing trusts
(r) Undertaking the administration of estates as executor, trustee or otherwise
(s) establishing and supporting or aiding in the establishment and support of associations, institutions, funds, trusts and conveniences calculated to benefit employees or ex-employees of the company or the dependents or connections of such persons; granting pensions and allowances and making payments towards insurance; subscribing to or

guaranteeing moneys for charitable or benevolent objects or for any exhibition or for any public, general or useful object

(t) the acquisition, construction, maintenance and alteration of any building or works necessary or convenient for the purposes of the company

(u) selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with all or any part of the property and rights of the company

(v) acquiring and undertaking the whole or any part of the business of any person or company, when such business is of a nature enumerated in this list

(w) doing all such other things as are incidental or conducive to the promotion or advancement of the business of the company

(x) any other form of business notified by the Govt. in the official gazette.

Form 'A'
FORMAT OF BALANCE SHEET

Balance Sheet of ………….. (Name of the Banking Company) As on 31st March (Year)

Particulars	Schedule No.	As on 31.03. …. (Current Year)	As on 31.03. …. (Previous Year)
CAPITAL AND LIABILITIES			
Capital	1		
Reserves & Surplus	2		
Deposits	3		
Borrowings	4		
Other Liabilities & Provisions	5		
Total:			
ASSETS			
Cash and balances with RBI	6		
Balances with banks and money at call and short notice	7		
Investments	8		
Advances	9		
Fixed Assets	10		
Other Assets	11		
Total:			
Contingent Liabilities	12		
Bills for Collection			

Form 'B'
FORMAT OF PROFIT AND LOSS ACCOUNT

Profit & loss Account for the year ended 31st March (year)

Particulars	Schedule No.	Year ended on 31.03. …. (Current Year)	Year ended on 31.03. …. (Previous Year)
I. Income			
Interest earned	13		
Other income	14		

	Total:	
II. Expenditure		
Interest expended	15	
Operating expenses	16	
Provisions and contingencies		
	Total:	
III. Profit/Loss		
Net profit/loss (-) for the year		
Profit/loss (-) brought forward		
	Total:	
IV. Appropriations		
Transfer to statutory reserves		
Transfer to other reserves		
Transfer to Government/proposed dividend		
Balance carried over to balance sheet		
	Total:	

Minimum Capital & Reserve

The section 11 of the act lays down the following minimum limit of paid capital and reserves:

		(I) Banks Incorporated in India	Paid-up Capital & Total Reserves
(A)	(i)	A banking company incorporated in India having business offices in more than one states (Except Mumbai and Kolkata)	5 lakhs
	(ii)	A banking company incorporated in India having business offices in more than one states and having business offices in Mumbai or Kolkata or both	10 lakhs
		If all business offices of a banking company are in the same states and among them :	
(B)	(i)	Any office is in Mumbai or Kolkata	
		(for every business office situated at a place other than Mumbai or Kolkata, additional capital of 25,000 should be there limited to the maximum of 10 lakhs)	5 lakhs
	(ii)	If business office is in the state not in Mumbai or Kolkata	
		(For every additional office in the same district, 10,000 and for every office situated in other districts, 25,000 but paid-up capital and reserves of such bank need not be more than 5 lakhs)	1 lakh
		(II) Bank Incorporated Outside India	

	(i)	If they do not have any business office in Mumbai or Kolkata.	15 lakhs
	(ii)	If they have business office in Mumbai or Kolkata or in both.	20 lakhs

Banking companies carrying on business in India must see to it that:

(a) the subscribed capital is not less than half of the authorized capitals
(b) the paid-up capital is not less than half of the subscribed capital and
(c) the capital of the company consists of only or ordinary or equity shares

Further, the underwriting commission, or brokerage or discount on shares issued by a banking company cannot exceed 2.5 per cent of the paid-up value of the shares. A charge on unpaid capital cannot be created. No dividend can be declared unless expenses not represented by tangible assets have been completely written off.

BOOKS OF ACCOUNTS

The banks maintain some books, ledgers and registers for accounting and record keeping of the business transactions. The precise description of them is given hereunder:

Cash Book
This book gives the summary of the receiving cashier's counter cash book and paying cashier's counter cash book. The receipt counter keeps the details of each transaction like – serial number, depositor's name and amount received. Similarly, the payment counter keeps the details of each payment like- serial number, payee's name, amount paid, number of tokens. The record of the cash book must tally with the sum total of the counters cash books.

Cash Balance
The cash balance at the close of the day is written in the book which is duly signed by the cashier and the manager.

Day Book
The daybook is written by the cashier or accountant. It records day-to-day transactions relating to cash transfers and clearing etc. Its balancing is done on daily basis.

Current Account Ledger
It records the transactions of those customers who open current account. Generally, the bank does not pay interest on the balance of this account but a nominal charge is taken by the bank for rendering the services.

Savings Bank Ledger
It records the transactions of those customers who open savings account in the bank. The detailed description of the customer viz. name, address, occupation is recorded with an account number.

If there are many savings account ledgers, they are to be serially numbered.

Fixed Deposit Ledger

It contains transactions of those customers who have deposited their money into the bank for a fixed period. Generally, at the top of the account, depositor's name and address, rate of interest, period of deposit, the amount so deposited are to be recorded.

General Ledger

It is actually the key ledger of the accounting system of a bank. It contains the total amount in respect of all current accounts, total savings accounts, total loan accounts, total bills payable account, total expenses and total revenue accounts. Each ledger is kept under self balancing system. A trial balance can easily be prepared which helps to prepare the final account as well.

Besides the above ledgers overdue fixed deposit ledger, fixed deposit interest ledger, loan ledger, investment ledger may also be prepared.

Registers

In addition to the books and ledgers, few registers are maintained in a bank. The main registers are as under:

a) Bills for collection Register
b) Securities Register
c) Document Register
d) Standing Order Register
e) Cheques Dishonour Register
f) Draft Issue Register
g) Draft Payable Register
h) D.D. Register
i) Foreign Letters of Credit Register

CRR, SLR, Repo Rate & Reverse Repo Rate

The **CRR** is cash reserve ratio under which a certain percentage of the total bank deposits has to be kept in the current account with the RBI. Thus, the bank cannot lend the money to corporate or individual borrowers and bank cannot use the money for investment purposes. The bank does not earn anything on it.

The **SLR** is statutory reserve ratio under which a certain percentage of total bank deposits has to be invested in specified securities predominantly Central Govt. or State Govt. securities. As the money goes into investment as Govt. securities, it earns some amount of interest on the investment.

The **Repo Rate** is a rate at which banks borrow from RBI for short period up to 7 or 14 days but predominantly overnight. The RBI manages this repo rate which is the cost of credit for a bank. This becomes a floor below which the short-term interest rates do not go. The higher the repo rate means the cost of short-term money is high. The lower the repo rate means the cost of short-term money is low. The higher repo rate may slow down the economy growth and lower the repo rate may enhance economy growth.

The **Reverse Repo Rate** is a rate which the RBI offers to banks when they deposit their surplus cash with the RBI for shorter periods. In other words, it is the rate at which the RBI borrows from the commercial banks. When bank have excess funds but do not have any other lending or investment options, they deposit the surplus funds with the RBI and earn interest on the deposited funds.

The reverse repo rate has an inverse relationship with the money supply in the economy. During high levels of inflation in the economy, the RBI increase the reverse repo rate which encourages the banks to park more funds with the RBI to earn higher returns on idle cash.

P & L ACCOUNT AND BALANCE SHEET OF BANKING COMPANIES

Every banking company is required to prepare its annual accounts in accordance with section 29 of the BR Act.

(a) The final accounts must be prepared in the forms set out in the third schedule to the act or as near there to circumstances admit.
(b) The final accounts must be signed by the manager or principal officer of the company and at least three directors of the company.
(c) The accounts and balance sheet together with the auditor's report should be published in the prescribed manner. Three copies of the same must be furnished as returns to the RBI within three months from the end of the accounting period.
(d) The banking company shall send to the Registrar of Joint Stock Companies three copies of profit and loss account and balance sheet and of the auditor's report.

Accounts for General Insurance Companies

Meaning of General Insurance

Insurance contracts that do not come under the ambit of life insurance are called general insurance. The different forms of general insurance are fire, marine, motor, accident, and other miscellaneous non-life insurance. The tangible assets are susceptible to damages and a need to protect the economic value of the assets is needed. For this purpose, general insurance products are bought as they provide protection against unforeseeable contingencies like damage and loss of the asset. Like life insurance, general insurance products come at a price in the form of premium.

Features of General Insurance Companies:

a) General Insurance policy is a contract of indemnity in which the insurer agrees to reimburse only the actual loss suffered subject to the average clause.
b) General Insurance contract is for a short period usually a year.
c) The subject matter is any physical property, assets, ship or cargo etc.
d) General insurance has only the element of protection and not the element of investment.
e) Insurable interest on the subject matter must be present both at the time of effecting policy as well as when the claim falls due.
f) General insurance is a contract of indemnity. The insured can claim only the actual amount of loss from the insurer.
g) General insurance does not have any surrender value or paid-up value.
h) In case of general insurance, business profit is determined after making provision for unexpired risks.
i) Loss is measurable in case of general insurance.

Final Accounts of General Insurance Companies

Final accounts 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).

1. Revenue Account: A separate Revenue Account (Form B-RA) is prepared for each type of business e.g., fire, marine etc. It records the incomes and expenses of a particular business and profit/loss is transferred to Profit and Loss Account.

2. Profit and Loss Account: (Form B-PL) Besides, profit/loss of different business, it records incomes and expenses of general nature and it shows how the profit has been appropriated. Its balance is shown in the Balance Sheet.

3. Balance Sheet: (Form B-BS) It records various assets and liabilities of the General Insurance Companies.

It must be observed that difference in revenue account does reveal profit or loss of business. The revenue account is closed by transfer to respective fund account viz., fire fund, marine fund etc. Ascertainment of profit under General Insurance Business. General insurance policies are normally issued for short terms renewable every year.

Reserve for Unexpired Insurance: 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.

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).

Form B-RA
Name of the Insurer:
Registration No. and Date of Registration with the IRDA
Revenue Account for The Year Ended 31st March, 20…
Policyholders' Account (Technical Account)

No.	Particulars	Schedule	Current Year	Previous Year

1	Premium Earned (Net)	1		
2	Profit/Loss on sale/Redemption of Investments			
3	Other (to be specified)			
4	Interest, Dividend & Rent – Gross			
	Total (A)	2		
1	Claims Incurred (Net)	3		
2	Commission	4		
3	Operating Expenses related to Insurance Business			
	Total (B)			
	Operating Profit/Loss from Fire/Marine/ Miscellaneous Business C = (A-B)			
	APPROPRIATIONS			
	Transfer to Shareholders' Account			
	Transfer to Catastrophe Reserve			
	Transfer to Other Reserves (to be specified)			
	Total (C)			

Form B-PL
Name of the Insurer:
Registration No. and Date of Registration with the IRDA
Profit and Loss Account for The Year Ended 31st March, 20…
Shareholders' Account (Non-technical Account)

No.	Particulars	Schedule	Current Year	Previous Year
1	**Operating Profit / (Loss)**			
	(a) Fire Insurance			
	(b) Marine Insurance			
	(c) Miscellaneous Insurance			
2	**Income from Investments**			
	(a) Interest, Dividend & Rent – Gross			
	(b) Profit on sale of Investments			
	Less: Loss on sale of Investments			
3	**Other Income (To be specified)**			
	Total (A)			
4	**Provisions (Other than taxation)**			
	(a) For diminution in the value of investments (Net)			
	(b) For doubtful debts			
	(c) Others (To be specified)			
5	**Other Expenses**			
	(a) Expenses other than those related to Insurance Business.			
	(b) Bad Debts written off.			
	(c) Others (to be specified)			
	Total (B)			
	Profit before tax Provision for			

	Taxation Profit after tax **Appropriations** *(a)* Interim dividends paid during the year *(b)* Proposed final dividend *(c)* Dividend distribution tax *(d)* Transfer to reserves/other account (to be specified) Balance of Profit/Loss brought forward from last year Balance Carried forward to the Balance Sheet			

Re-Insurance

In general insurance there are risks which, because of their magnitude or nature, one insurance company cannot afford to cover, e.g. aviation insurance. Generally, in such cases, an insurance company insures the whole risk itself and lays off the amount it has accepted to other insurance of reinsurance companies, retaining only that much risks which it can absorb.

A reinsurance transaction may thus be defined as an agreement between a ‘ceding company’ and a ‘reinsurer’ whereby the former agrees to ‘cede’ and the latter agrees to accept a certain specified share of risk or liability upon terms as set out in the agreement. A ‘ceding company’ is the original insurance company which has accepted the risk and has agreed to ‘cede’ or pass on that risk to another insurance company or a reinsurance company. It may however be emphasized that the original insured does not acquire any right under a reinsurance contact. In the event of loss, therefore, the insured’s claim for full amount is against the original insurer.

In other words, if an insurer is not willing to bear the whole of the risk, it reinsures itself. Some risk retains with some other insurer. This is called as reinsurance. Both re-insurer and original insurer share the premium and risk in the same proportion and decided by them earlier.

Double insurance

Double insurance is the insuring of an individual, dependent, or personal property by two or more insurance companies. Such dual insurance allows those with coverage to claim the full amount from the policies; however, the total claim cannot exceed the actual loss or cost associated with the underwritten subject of the policies. Insurance companies are law bound to honour double insurance policies, but the recipient of such policies must satisfy certain eligibility requirements. Underwriters of double insurance policies have the ability to reject or appeal certain claims based on deception or unjust enrichment. Consequently, it is important that individuals insurable under double insurance have an understanding of the independent insurance policies that comprise their dual coverage and know the process for claims and payouts.

Surrender Value:

The term surrender value indicates the value that we receive from the insurance issuer after we surrender the policy before maturity. Surrender, here, means termination or cancellation of the life policy or returning the policy to the insurance company before the stipulated time. The policy no longer exists after the company clears off the payment to the policyholder. There can be a number of reasons behind surrendering our policy. One of the most common reasons is inability to pay the premiums. The policyholders often feel they have chewed more than they can swallow. Surrendering our policy means we will not have to pay premiums any further. When we terminate a policy, the company pays us certain amount because we have paid premiums in the previous years of which a portion has been used to cover risk, and another portion has been used as an investment. The investment portion with its increased value will be returned to us after deducting some termination charges. We might even get some bonus as well. This amount is known as the surrender value. However, keep in mind that the surrender value factor plays a key role in minimising the bonus.

Paid-up Value:

It may occur that we do not want to pay the premiums of the policy, but you want to keep the policy. The insurance companies have a solution for this one too. The insurance company will offer us an option where we can have our policy, but the company will have no premium expectations from us. But there is a catch in this. The assured sum of the policy when it was taken will be reduced considerably. This is done through a calculation called paid-up process. The calculated amount is known as the paid-up value. Formula to calculate the above two:

1. $Surrender\ Value\ = [\{(Number\ of\ premiums\ paid/number\ of\ payable\ premiums) \times Assured\ Sum\ of\ money\} + total\ bonuses] \times Surrender\ value\ factor$
2. $Paid - up\ Value\ = (Number\ of\ premiums\ paid/total\ number\ of\ payable\ premiums) \times assured\ sum\ of\ money$