JAGAT GURU NANAK DEV
PUNJAB STATE OPEN UNIVERSITY, PATIALA

(Established by Act No. 19 of 2019 of the Legislature of State of Punjab)

The Motto of the University

(SEWA)

SKILL ENHANCEMENT EMPLOYABILITY WISDOM ACCESSIBILITY

CERTIFICATE COURSE IN COMPUTER AIDED ACCOUNTING

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PREFACE

Jagat Guru Nanak Dev Punjab State Open University, Patiala, established in December 2019 by Act 19 of the Legislature of State of Punjab, is the first and only Open University of the State, entrusted with the responsibility of making higher education accessible to all especially to those sections of society who do not have the means, time or opportunity to pursue regular education.

In keeping with the nature of an Open University, this University provides a flexible education system to suit every need. The time given to complete a programme is double the duration of a regular mode programme. Well-designed study material has been prepared in consultation with experts in their respective fields.

The University offers programmes which have been designed to provide relevant, skill-based and employability-enhancing education. The study material provided in this booklet is self-instructional, with self-assessment exercises, and recommendations for further readings. The syllabus has been divided in sections, and provided as units for simplification.

The Learner Support Centres/Study Centres are located in the Government and Government aided colleges of Punjab, to enable students to make use of reading facilities, and for curriculum-based counselling and practicals. We, at the University, welcome you to be a part of this institution of knowledge.

Prof. G. S. Batra,
Dean Academic Affairs

CERTIFICATE COURSE IN COMPUTER AIDED ACCOUNTING

DIGITALIZED FINAL ACCOUNTS

COURSE III - DIGITALIZED FINAL ACCOUNTS

Learning Objectives:

1. The course provides an introduction to basic information and communication technology related to transaction execution, accounting and financial management.
2. The course also includes the accounting regulations and accounting organization, including IT security and internal control of accounting processes.
3. The course contributes to meeting the demands to become a authorized accountant.

Course Content:

Unit-I: Electronic data capture: using electronic data capture software to upload supplier receipts and customer invoices categorising expenses to the correct accounts code, ,reviewing and rectifying or resubmitting rejected documents submitting transactions to the linked cloud accounting general ledger.
Unit-– II Payroll. EPF liability, Filing of PF return, ESIC computation, tax computation, Profession tax liability
Unit – III SAP- Financial: ERP, Enterprise structure, Financial accounting, Bank accounting, Management of vendor and customer, Asset accounting
Unit IV: Final Accounts Meaning - Preparation of Trading Account – Profit and Loss Account – Balance Sheet – Closing Entries – Adjustment Entries – Provisions – Receipts and Payment Statement – Income and Expenditure Statement - Difference between Departments and Branches – Advantages – Special Features – Basis of Allocation and Apportionment of Expenses – Inter-departmental transfer at cost and sales price .
Unit –V: Corporate Banking Introduction – Bank Pass Book – Negotiable Instruments – Cheque – Discounting of Cheques –Cheque presentment – Cheque dishonored – Current Account – Overdraft – Cash credit – Bank-reconciliation Statement – Internet banking – RTGS – NEFT

References:

1. Financial Accounting by Mr.R.L.Gupta
2. Accounting for Business by Genesis

UNIT 1- ELECTRONIC DATA CAPTURE

STRUCTURE

1.0 Objectives

1.1 Introduction

1.2 Unit End Questions

1.3 References

1.0 OBJECTIVES

After completing this Students will be able to

- Define ERP
- Understand Management of vendor and customer
- Define financial accounting
- Explain asset accounting

1.1 INTRODUCTION

Electronic Data Capture (EDC is the medical abbreviation) is admittedly a fairly generic sounding term, but in the clinical trials field it actually means something fairly specific: using systems to collect clinical trial data in electronic form as opposed to paper form.

At Open Clinica, we are immersed in EDC all day, every day. However it's important to recognize that many participants in the field of clinical trials are still just getting their feet wet with EDC. So, here's a primer on the fundamentals of EDC.

What is an electronic data capture system?

Modern electronic data capture software is typically web-based and utilizes a thin client. Web-based means that the software runs entirely on a Web server (think Google.com), and thin client means that the only tool you need is an ordinary web browser (without any

cumbersome plug-ins) connected to the internet in order to access and utilize the EDC software (again, think Google.com).

Clinical trial data may be captured electronically at its source (called e-source), or in paper form and later transcribed into the EDC system.

What is electronic data capture used for?

Today, the majority of clinical trials being initiated use electronic data capture software. There are three primary categories of EDC software users: sites, sponsors, and CROs:

- Sites – A site refers to the entity that coordinates and collects data from the clinical trial patients, or subjects; usually a hospital or clinic. Nurses or other designated study "coordinators" employed by the site will typically be tasked with entering data into the study's EDC system. The site's Investigator—the physician in charge of the patient's care and patient's data–is responsible for reviewing and electronically signing the data.
- Sponsor – The sponsor of a clinical trial is the organization that "owns" the trial. Biopharma, device, and other life sciences companies must sponsor clinical trials in order to get their medical innovations approved by regulatory authorities (like the FDA) before they can go to market with their product. Sponsors may employ a variety of people who use the EDC system in various roles. Monitors working on behalf of the sponsor may visit the client sites for source data verification, reviewing data source documents and verifying the accuracy of corresponding data in the EDC system (with EDC software this "visit" is often virtual). Biostatisticians help plan for and analyze data collected. Typically heavy users of EDC software, data managers have the responsibility is to ensure the trial data is clean and usable. Among other tasks, they may submit requests for information (called "queries") to the sites to clarify and resolve data issues.
- CRO – A CRO, or contract research organization, is an entity that contracts with Sponsors to facilitate the planning and conduct of a clinical trial. In some trials, the CROs may effectively operate the trial on behalf of the sponsor. In other trials, they will take on only some of the key roles (data management, monitoring, analysis). In this regard, CROs may have many of the same types of EDC system users as sponsors. In academia, CROs are often called AROs (Academic Research Organizations), Clinical Trials Units, or Data Coordinating Centers. Their coordinating and management functions are much the same as their commercial counterparts.

In addition to the above types of EDC users, study patients may also contribute data to the EDC system, either directly through a specialized role in the software, or via a separate device and/or application that transmits data to the EDC system. The practice of patients entering data is called ePRO (electronic patient reported outcomes).

Why use electronic data capture software?

Today, the majority of new clinical trials use electronic data capture software. Some of the common motivations for using EDC include:

- Cleaner Data – EDC software is particularly good at enforcing certain aspects of data quality. Edit checks and source data verification programmed into the software can make sure data meets certain required formats, ranges, etc. before the data is accepted into the trial database.
- More Efficient Processes – EDC software can help guide the site through the series of study events, requesting only the data needed for the particular patient's circumstance at a particular time. It faculties the process of clarifying data discrepancies with tools for identifying and resolving data issues with sites, and can help reduce the number of in-person site visits required during a trial.
- Faster Access to Data – Web-based EDC systems can provide near real-time access to data in a clinical trial. This insight enables faster decision making, and can support adaptive trial designs.

Each of the above reasons for using EDC addresses issues of efficiency and productivity, and can therefore also reduce the cost of clinical trials.

What are the benefits of an EDC system?

Many research organizations are realizing the advantages of EDC over other methods and are leveraging new technologies to support clinical trials. An EDC system can help you achieve success in the following ways:

Quicker Access to Data. An EDC system can save a significant amount of time with real-time access to data and less time spent on query management. This also saves time at the end of a study, allowing quicker availability of the data for analysis. While it can take substantial time to initially learn how to use a specific system, some are so intuitive that only a few hours of training is required.

Data Security. An EDC system is hosted online with data entry completed on a web-based interface. Given the nature of the data collected in an EDC system, software vendors make sure the data is protected and backed up. Because each user account has designated permissions, most actions can only be carried out by certain roles.

Accuracy. EDC systems improve data quality. There are options to add constraints on a form that prevent inaccurate or illogical values from being entered. Using a computerized system enables legible entries and automatic calculations for cleaner data.

Organization. The use of an EDC system increases the efficiency of clinical trials due to its user-friendly navigation. Search options allow you to easily find and filter exactly what you need and store everything in one location with greater visibility while using less paper.

Cost-Effectiveness. Financially speaking, the cost of an EDC system ranges from free to expensive. Pricing varies, and some vendors charge for additional service and other fees. Purchasing an EDC system can seem like a large investment, but it should save money in the long run.

Compliance. An EDC must be compliant with regulatory requirements. A big one is 21 CFR Part 11. The software should have technical controls in place to ensure data integrity. To properly maintain an EDC system, standard operating procedures (SOPs) are essential to ensuring regulatory and organizational policies are met.

What are the common features of an EDC system?

Most software vendors are continually developing new enhancements to keep up with changes in the industry. While the bells and whistles vary from system to system, there is some functionality that you'll find in just about every EDC solution.

eCRF Designer. When creating eCRFs, there are design options to choose from that are meant to imitate paper forms. Forms are saved in a library and are often used across multiple protocols. This eliminates the need to recreate commonly used forms and promotes data standards. When building forms, edit checks can be programmed to help prevent invalid data from being entered. This ensures the values entered meet certain requirements.

Data Entry. After a protocol is set up in the system, the data collected is entered into the appropriate forms.

Query Management. An EDC system provides streamlined communication between monitors, data managers, and coordinators. Most systems have auto-generated queries and the ability to manually add queries. All queries need to be responded to and resolved by different roles before the data can be locked.

Data Export. Once you're ready to pull the data out of the system, there are easily accessible exports to extract patient data. Some systems have built-in metrics reporting that offers insights into the progress of a study.

1.2 Unit End Questions

A. Descriptive Questions

Long questions

1. What is an electronic data capture system?
2. What is electronic data capture used for?
3. Explain electronic data capture.
4. Define data export.
5. What are the common features of an EDC system?

Short questions

1. What are the benefits of an EDC system?
2. Define query management.
3. Why use electronic data capture software?
4. Define EDC.

B . Multiple Choice Questions

1. Business is said to be in a profit when

a. Expenditure exceeds income

b. Income exceeds expenditure

c. Income exceeds liability

d. Assets exceed expenditure

2. As per the accounting double-entry system, when expense increases, it is ___________.

a. No need to show as an accounting record.

b. Credited.

c. Debited.

d. Both (B) and (C).

3. What does the term “credit” mean in business?

a. agreement between a lender and a borrower

b. revenue a business earns from selling its goods

c. cost of operations that a company incurs to generate revenue

d. own with the expectation to provide a future benefit

4. When a Liability is decreased or reduced, it is registered on the

a. Debit side or left side of the account

b. Credit side or right side of the account

c. Debit side or right side of the account

d. Credit side or left side of the account

5. When there is an increase in capital by an amount, it is registered on the

a. Credit or right side of the account

b. Debit or left side of the account

c. Credit or left side of the account

d. Debit or right side of the account

Answer: 1. B, 2. C, 3. A, 4. A, 5. A

1.3 REFERENCES

Reference Books:

- "Enterprise Resource Planning: Concepts and Practice" by Vinod Kumar Garg and N. K. Venkitakrishnan
- "Enterprise Resource Planning" by Alexis Leon
- "ERP Demystified" by Alexis Leon
- "Implementing SAP ERP Financials: A Configuration Guide" by Vivek Kale

Web Resources:

- SAP Official Website: https://www.sap.com/
- Oracle ERP Cloud: https://www.oracle.com/cloud/erp/
- Microsoft Dynamics 365 ERP: https://dynamics.microsoft.com/en-us/erp/
- Infor ERP: https://www.infor.com/solutions/erp
- ERP Focus: https://www.erpfocus.com/

UNIT 2- PAYROLL

STRUCTURE

2.0 Objectives

2.1 Introduction

2.2 EPF liability

2.3 Filing of PF return

2.4 ESIC computation

2.5 Tax computation

2.6 Profession tax liability

2.7 Unit End Questions

2.8 References

2.0 OBJECTIVES

After completing this Students will be able to

- Define EPF
- Understand ESIC Computation
- Define tax computation
- Explain Profession tax liability

2.1 INTRODUCTION

Payroll is the compensation a business must pay to its employees for a set period or on a given date. It is usually managed by the accounting or human resources department of a company. Small-business payrolls may be handled directly by the owner or an associate.

Increasingly, payroll is outsourced to specialized firms that handle paycheck processing, employee benefits, insurance, and accounting tasks, such as tax withholding. Many payroll fintech firms, such as Atomic, Bitwage, Finch, Pinwheel, and Wagestream, are

leveraging technology to simplify payroll processes. These solutions pay employees with greater convenience and speed and provide digital payroll-related documents with innovative technology-enabled services required by the gig and outsourcing economy.

Payroll can also refer to the list of a company's employees and the amount of compensation due to each of them. Payroll is a major expense for most businesses and is almost always deductible, meaning the expense can be deducted from gross income lowering the company's taxable income.1 Payroll can differ from one pay period to another because of overtime, sick pay, and other variables.

KEY TAKEAWAYS

- Payroll is the compensation a business must pay to its employees for a set period and on a given date.
- The payroll process can include tracking hours worked for employees, calculating pay, and distributing payments via direct deposit or check.
- However, companies must also perform accounting and record-keeping, and set aside funds for Medicare, Social Security, and unemployment taxes.
- Companies can use professional services and outsource their payroll or use cloud-based software if they do not want to do it themselves.
- Calculating payroll involves many components and can be complex.

Understanding Payroll

Payroll is the process of paying a company's employees, which includes tracking hours worked, calculating employees' pay, and distributing payments via direct deposit to employee bank accounts or by check. However, companies must also perform accounting functions to record payroll, taxes withheld, bonuses, overtime pay, sick time, and vacation pay. Companies must put aside and record the amount to be paid to the government for Medicare, Social Security, and unemployment taxes.

Many companies use software solutions to manage their payroll. The employee inputs their hours through an API, and their pay is processed and deposited into their bank accounts.

Many medium- and large-size companies outsource payroll services to streamline the process. Employers track the number of hours each employee works and relay this information to the payroll service. On payday, the payroll service calculates the gross amount the employee is owed based on the number of hours or weeks worked during the pay period and the pay rate. The service deducts taxes and other withholdings from earnings and then pays the employees.

Special Considerations

Employers with gross sales of $500,000 or more per year are subject to the requirements of the Fair Labor Standards Act (FLSA) passed in 1938.23 This is a U.S. law that protects workers from certain unfair pay practices. The FLSA sets out various labor regulations, including minimum wages, requirements for overtime pay, and limitations on child labor. For example, FLSA rules specify when workers are considered on the clock and when they should be paid overtime.4

The law requires overtime—hours worked in excess of 40 hours per week—to be paid at one-and-a-half times the regular hourly rate. Some employees are exempt from the FLSA, and the Act does not apply to independent contractors or volunteers because they are not considered employees.4

Some hourly workers are not covered by the FLSA but are subject to other regulations. For example, railroad workers are governed by the Railway Labor Act, and truck drivers fall under the purview of the Motor Carriers Act.56

The FLSA also sets out how to treat jobs that are primarily compensated by tipping. In the case of tipped service workers, the employer must pay the minimum wage to the employee unless they regularly receive more than $30 per month from gratuities.

Advantages and Disadvantages of Using Professional Payroll Services

One major benefit of payroll services is their ability to produce a variety of reports that simplify accounting procedures and help companies ensure they are in compliance with legal and tax filing requirements. The payroll service may also maintain a record of how much vacation or personal time employees have used.

With respect to disadvantages, when companies outsource their payroll system, they must rely on individuals outside the business for accurate accounting. In the event of an error, the company's on-site personnel must deal with upset employees. Companies might also face tax penalties for errors made by the payroll service.

Another disadvantage is that payroll services are more expensive than running payroll in-house. The services may charge a set monthly fee or offer different payment structures for varying tiers of service. Because of their cost, payroll services may not be the best option for small companies with tight operating budgets.

Pros of Professional Payroll Services

- Access to a variety of reports

Simplified accounting and tax compliance

- Record of vacation time and personal time taken by employees

Cons of Professional Payroll Services

- Individuals outside the business are privy to financial and tax information.

Internal staff must still help employees with payroll problems.

- The company may face tax penalties due to errors by the payroll service.
- Payroll services can be expensive, which is a concern for small businesses.

As a business grows, its accounting needs become more complex. Larger firms may need to invest in a custom enterprise resource planning (ERP) system for their accounting and payroll functions.

Payroll Software Programs

In lieu of using specialized payroll services, some companies opt to rely on payroll software programs. Once the company purchases the software, there are no additional monthly fees. Software programs usually include printable tax forms and withholding tables.

In addition to financial savings, internal payroll systems help companies keep confidential financial information private. However, software programs can be time-consuming, which can pose a problem for small companies with few staff.

Small business owners benefit from accounting software because it helps them track accounts receivable and accounts payable, gauge their profitability, and prepare for tax season. A small business is one that can use out-of-the-box software without requiring extensive customizations. As a business grows, its accounting needs become more complex, and a custom enterprise resource planning (ERP) system is often needed.

There are many different types of cloud-based accounting software available for small businesses. The type of industry and number of employees are two factors that will dictate which accounting software is appropriate. For example, a freelancer would not need the same features in a piece of accounting software as a restaurant owner.

Investopedia conducted a review of payroll management and accounting software for small businesses and evaluated their cost, ease of use, features, integrations, and scalability. QuickBooks Online was considered the best overall software, while Xero was considered the best for micro-business owners. FreshBooks was best for service-based businesses, and QuickBooks Self-Employed was best for part-time freelancers, but Wave was the best free software.

How to Calculate Payroll Taxes

How you calculate payroll taxes will depend on your business and your local laws. However, here are some general guidelines provided by QuickBooks. The first step is to calculate your employees' gross pay.7

1. Calculate Your Employees' Gross Pay

You can determine an employee's gross pay using their pay rate and your scheduled pay periods. Most businesses will pay employees weekly, every two weeks, or monthly. To calculate an hourly employee's gross pay, multiply their hours worked in the pay period by their hourly pay rate. The formula is as follows:

Hourly rate x total hours worked in the pay period = gross pay

To calculate a salaried employee's gross pay, divide their annual salary by the number of pay periods in the year. The formula is as follows:

Yearly salary / number of pay periods in year = gross pay

For example. An employee makes $50,000 a year. Their company pays employees every two weeks for a total of 26 pay periods. Therefore, the employee's gross pay is $1,923.08.

2. Take Out Pre-Tax Deductions

After determining gross pay, you'll need to factor out deductions. These are tax deductions, but other pre-tax deductions may also apply. Pre-tax deductions include:

- 401(k) and some retirement plans
- Health insurance plans
- Health Savings Account (HSA) or Flexible Spending Account (FSA) contributions
- Some life insurance plans

3. Deduct Taxes (FICA, Unemployment, and Income Taxes)

Once you have taken out pre-tax deductions, the remaining pay is taxed. The FICA tax rate is 7.65%—1.45% for Medicare and 6.2% for Social Security taxes.8 Other tax rates will be determined by Federal, state, or local laws and your employee's W-4.

Calculate federal income taxes using IRS tax tables. Most often, you will pay federal taxes when you pay Social Security and Medicare taxes. Report all payments on IRS Form 941.9

Deduct the 7.65% FICA tax from the employee's gross pay. You, as the employer, must match each employee's contribution. The business submits both the employee's and the company's contributions to Social Security and Medicare.

For example, an employee earns $1,923 in gross pay for the latest pay period. To calculate the employee's Social Security tax contribution, multiply $1,923 by .062 to get $119.26. To calculate the employee's Medicare tax contribution, multiply $1,923 by .0145 to get $27.88.

In total, the employee's FICA tax contribution is $147.14 for the pay period, which the employer must match. In this case, the employer must pay $294.28 to the IRS. Half is a direct expense to the company, and the other half is withheld from the employee's paycheck.

Employers don't match income tax deductions, but they pay federal unemployment taxes. The IRS's Income Withholding Assistant will help you determine how much federal income taxes your employees owe.

4. Any Voluntary Deductions Must Be Taken From the Remaining Wages

These may include:

- Roth 401(k) contributions
- Life insurance plans
- Long-term disability insurance plans
- Wage garnishments
- Union dues

After all taxes and deductions, the remaining amount is how much the employee takes home on payday.

What is Payroll?

Payroll is a list of employees who get paid by the company. Payroll also refers to the total amount of money employer pays to the employees. As a business function, it involves:

1. Developing organization pay policy including flexible benefits, leave encashment policy, etc.
2. Defining payslip components like basic, variable pay, HRA, and LTA
3. Gathering other payroll inputs (e.g., organization's food vendor may supply information about the amount to be recovered from the employees for meals consumed)
4. The actual calculation of gross salary, statutory as well as non-statutory deductions, and arriving at the net pay
5. Releasing employee salary
6. Depositing dues like TDS, PF, etc. with appropriate authorities and filing returns

In short, we can say that payroll process involves arriving at what is due to the employees also called as 'net pay' after adjusting necessary taxes and other deductions.

The equation for calculating the net pay

Net pay = Gross income- gross deduction

Where,

Gross income or salary = All types of regular income + allowances + any one-time payment or benefit

Gross deduction = All types of regular deductions + statutory deductions + any one-time deductions

Fig.2.1 what is Payroll?

Payslips on excel can lead to slip ups

What are the Stages to Processing Payroll?

A payroll officer needs to do careful planning. There are always ongoing tasks that need attention and a constant need to monitor changes to withholdings, contribution to social security funds, etc. The entire process can be split into three stages, pre-payroll, actual payroll and post payroll activities.

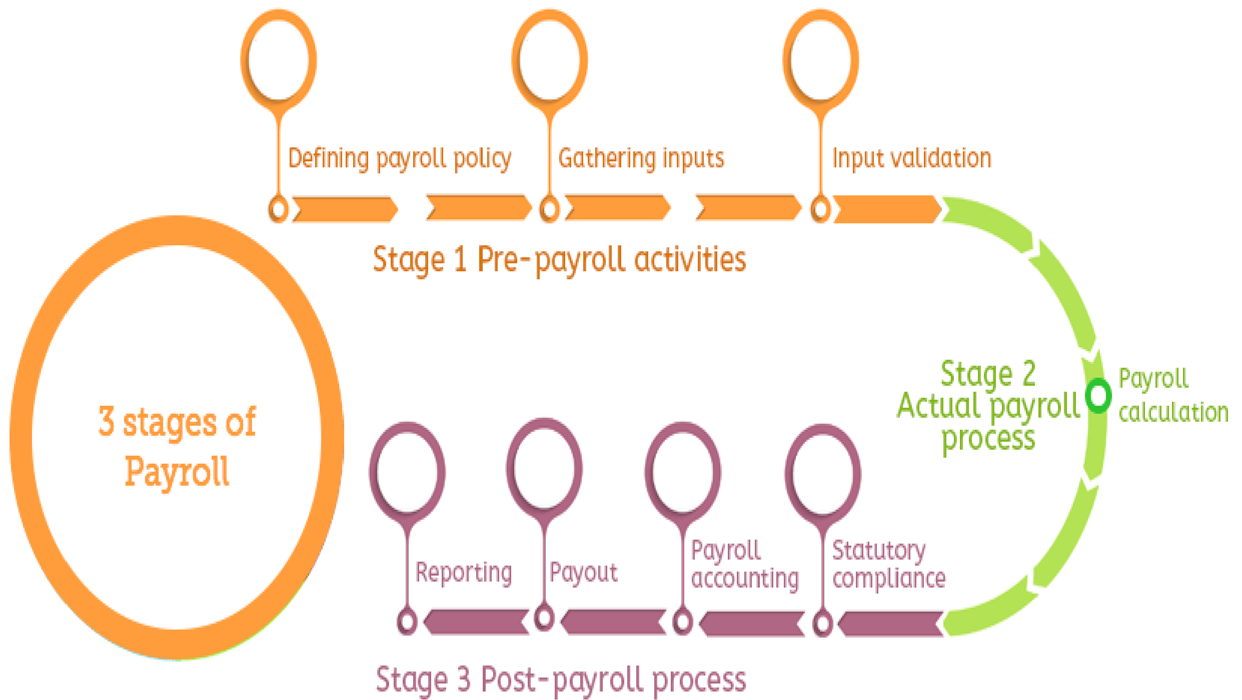

Fig 2.2 Stages to Processing Payroll

Pre-Payroll Activities

Defining Payroll Policy

The net amount to be paid is affected by multiple factors. The company's various policies such as pay policy, leave and benefits policy, attendance policy, etc. come into play at that time. As a first step, such policies need to be well defined and get approved by the management to ensure standard payroll processing.

Gathering Inputs

Payroll process involves interacting with multiple departments and personnel. There can be information like mid-year salary revision data, attendance data, etc.

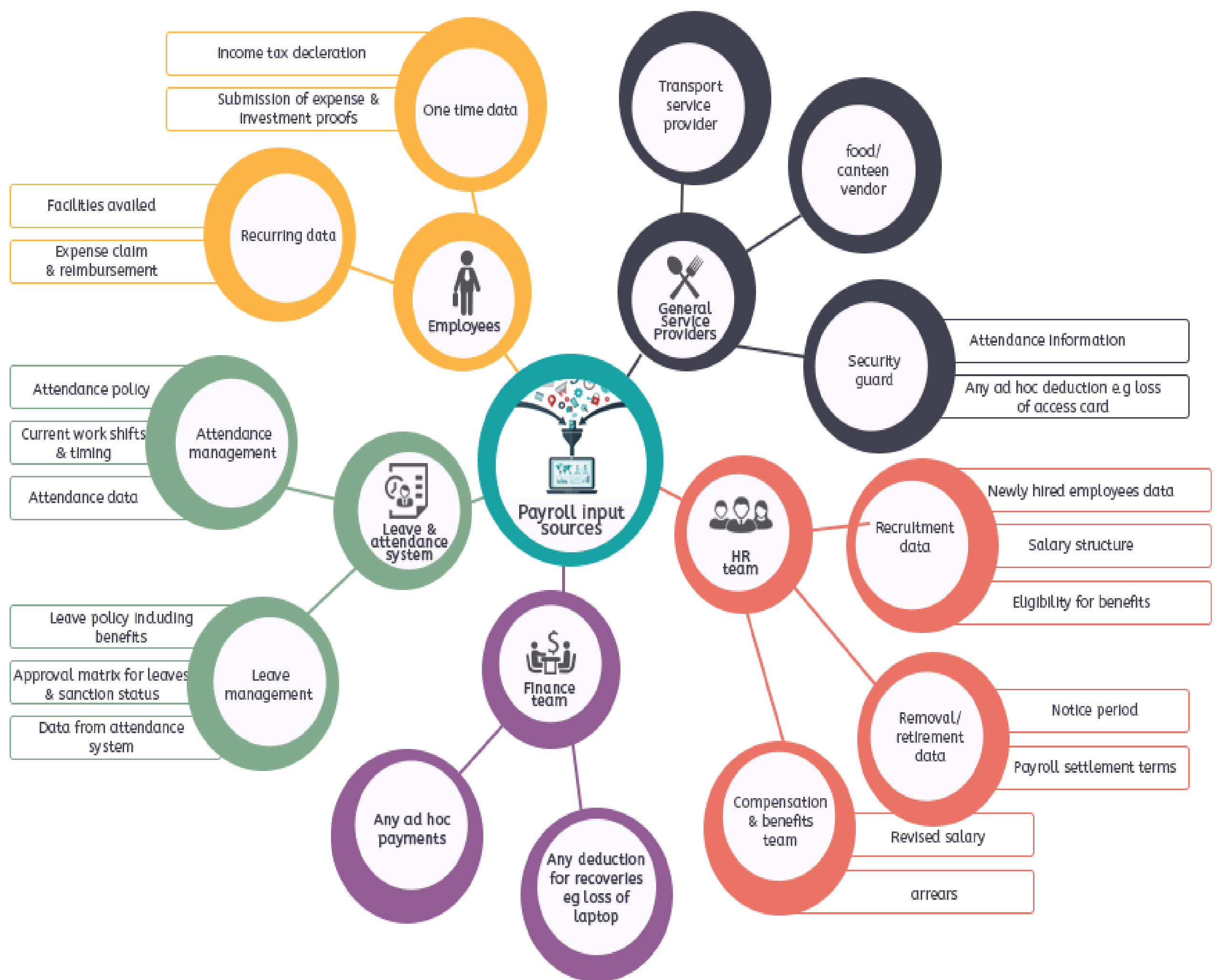

Fig.2.3 Pre-Payroll Activities

In smaller organizations, these inputs are received from a consolidated source or fewer teams. However, in a larger organization, the task of gathering data may look overwhelming. If you are using a smart payroll system having integrated features like leave and attendance management, employee self-service portal, etc. inputs collection process does not remain a problem.

Input Validation

Once inputs are received, you need to check for validity of the data concerning adherence to company policy, authorization/approval matrix, right formats, etc. You also need to ensure that no active employee is missed out and that no inactive employee records are included for salary payment.

Actual Payroll Process

Payroll Calculation

At this stage, the validated input data is fed into the payroll system for actual payroll processing. The result is the net pay after adjusting necessary taxes and other deductions. Once payroll process is over, it is always a good practice to reconcile the values and verify for accuracy to avoid any errors.

Post-Payroll Process

Statutory Compliance

All statutory deductions like EPF, TDS, ESI are deducted at the time of processing payroll. The company then remits the amount to the respective government agencies. The frequency can vary depending on the type of the dues. In most cases, payment of dues is made via challans. After all dues are paid return/report are filed. E.g., for filing PF return, ECR is generated and filed.

Payroll Accounting

Every organization keeps a record of all its financial transactions. Salary paid is one of the significant operating costs which has to be reported in the books of accounts. As part of payroll management, it is essential to check that all salary and reimbursement data is fed accurately into accounting/ERP system.

Payout

You can pay salary by cash, cheque or bank transfer. Typically organizations provide employees with salary bank account. Once you complete payroll, you need to ensure that company's bank account has sufficient funds to make the salary payment. Then you need to send a salary bank advice statement to the concerned branch. This statement is issued with particulars like employee id, bank account number, amount of wages, etc. If you are opting for a payroll management software that has employee self-service portal, you can easily publish the payslips and employees can log-in to their account and access the payslips.

Reporting

Once you complete payroll run for a particular month, finance and high management team may ask for reports such as department wise employee cost, location wise employee cost, etc. As a payroll officer, it becomes your responsibility to dig into the data and extract required information and share the reports.

Statutory Compliance in Indian Payroll

When you run payroll, being statutory compliant means that you are paying as per the applicable employment norms set by the central and state legislation. The common statutory

requirements that apply to Indian businesses include the provision for minimum wages, payment of overtime wages to workers, TDS deduction, contribution to social security schemes such as PF, ESI, etc.

While computing salary you need to consider all these deductions and contributions. Income tax is one such deduction. At the beginning of the year, the employee is asked to make a declaration about his additional incomes, tax saving investments, etc. called as 'income tax declaration.' Accordingly, employee's tax liability is calculated, and TDS is deducted.

Let's see how to calculate tax for any individual. In India, we have four tax brackets with an increasing tax rate.

Tax slabs for FY 2017-18, 18-19 and 19-20		
Income range	Tax rate	Tax amount
Up to Rs.2,50,000	-	No tax
Between Rs.5 lakhs and Rs.10 lakhs	20%	Rs.12,500+ 20% of income above Rs. 5 lakhs
Rs.12,500+ 20% of income above Rs. 5 lakhs	20%	Between Rs.5 lakhs and Rs.10 lakhs
Above 10 lakhs	30%	Rs.1,12,500+ 30% of income above Rs.10 lakhs

Based on above tax slabs, you can calculate monthly tax liability and deduct TDS. The TDS is then deposited monthly with the government, and a quarterly report of all deductions is also filed. Once you complete TDS returns for the fourth quarter, you can issue form 16 to employees. The employees use this form 16 as proof of tax deducted at the time of filing their individual income tax return.

Non-adherence with the statutory law can lead to hefty fines and penalties. That is why you need to be up to date on all tax and payroll statutory changes.

Challenges in Handling Payroll Management Process

The payroll process becomes challenging due to two main reasons.

The Requirement to stay Statutory Compliant

As mentioned before, non-adherence to statutory laws can lead to levy of fines and penalties and in the worst case may even threaten the existence of the business. Today there are some advanced payroll management software that automatically processes payroll in compliance with statutory laws.

Dependence on Multiple Payroll Inputs Sources

Before payroll can be processed, you need to get all the data together from sources such as attendance register, conveyance facility availed record, data from HR team like salary revision information, etc., making it a complicated process. For many years HR and payroll officers were managing payroll on excel sheets, but excel sheets have problems like dependency on excel formulas for salary calculation, complexity in adding and removing employees and other limitations like manual data entry, difficulty in extracting information, etc.

Various Methods Available to do Payroll for your Business

The possible options for running payroll can be

- Excel based payroll management
- Payroll outsourcing
- Using payroll software

Excel based Payroll Management

Many businesses who are at an initial stage of operations and have a handful of employees usually go for excel based payroll management.

Excel based payroll management involves doing payroll calculation on excel sheets using standard payroll calculation template. The mathematical formulas are set that help the payroll officer do the computation. While this method does not involve any cost, but it has its inherent limitations like

- High chances of clerical and mathematical errors as data is entered manually
- Difficulty in adding and removing employees from payroll list
- Chances of duplicate data and omission of entries at times
- Need to monitor tax updates and other statutory changes like PF, PT etc

Payroll Outsourcing

Outsourcing payroll means you want an external agency to take care of your payroll function. Many organizations who do not have a dedicated person for payroll go for this option. Based on their pay cycle, every month they provide employee salary information and other data such as attendance, leaves, reimbursement details, etc. to the payroll service provider. The service provider then computes payroll and also takes care of statutory compliance. Since payroll is a crucial function and businesses want to have full transparency and control over it, they often hesitate in outsourcing payroll.

Payroll Software

As discussed above, for running successful payroll, you need to ensure that payroll inputs are coming from every source in a timely and seamless manner. The intent of using software is to reduce the friction in getting the inputs. There are advanced payroll management software available in the market that not only automates payroll computation but also serve as a holistic leave and attendance management, HR management and employee self-service portal. Depending on the size of your business and use cases you can opt for an appropriate payroll software for your business.

Best Payroll Software for your Organization

The move from manual payroll system to automated one can save a lot of time. It not only helps in faster and accurate payroll processing but also keeps the employees, management and regulatory bodies happy.

There are some features that you should consider while selecting a payroll management software.

Ease of Operation

Payroll function can be very cumbersome. You should opt for a system which has comprehensive but straightforward workflows. If the software is intuitive, it reduces the need for software training and guidance. Also, make sure that the software provider is providing well-updated documentation so that you can access the information anytime as you may need.

Scalability

As organization size increases your software also need to serve you appropriately. The limitation can be in terms of employees data it process or in terms of the availability of features like leave and attendance management, reimbursement model, etc. The software offerings should be such that you can opt for advanced features at a reasonable price without much difficulty.

Employee Self-Service Module

One of the primary payroll input providers is the employee. He provides information such as income tax saving investment declaration, type of flexible benefit opted, etc. The interaction between the payroll officer and employee is usually very event-based. To understand the significance of ESS module let's assume a case of income tax declaration in two scenarios:

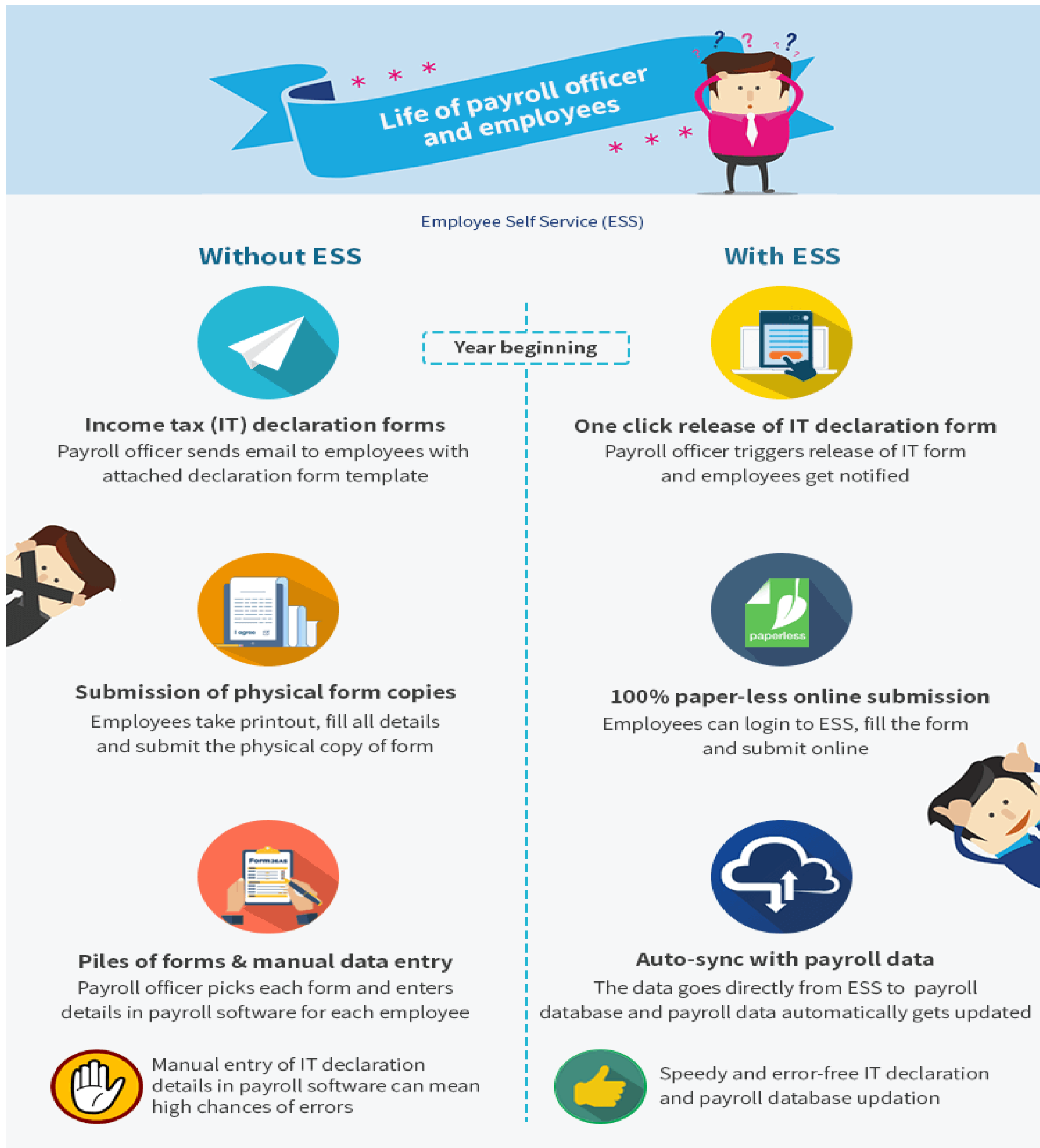

Fig.2.4 Employee Self-Service Module

So, we saw how a simple tool like employee self-service portal can reduce the manual intervention and automate payroll data collection for accurate tax computation.

Integration with Time, Attendance and Leave Management System

Time Management

Typically this module is used to track time spent on projects or specific activities. Consulting firms such as audit firms, specialist doctors, etc., who manage critical projects require a robust time management module for tracking time and at times this data may also be used for billing clients.

Attendance

While most small organization go for manual attendance system, medium and large organizations have started using smart automated tools such as biometric method, auto-tracking via system log-in, access cards, iris capture, etc. The data is stored in a system and linked to the payroll software that uses this data to calculate attendance days, overtime, etc. For seamless payroll processing, check that software supports attendance management and is configurable with access control machines.

Leave Management

In every organization, employees are entitled to take a certain number of leaves such as privilege or annual leave, casual leave, sick leave, holiday, etc.

If the software has leave management feature, HR can directly credit these leaves to the account of every eligible employee. As and when required, the employee can apply for leave through the system. A good system should also be able to define a workflow to notify the employee's manager for either approval or rejection. A robust payroll leave software with built-in leave management feature can help attain accurate payroll.

Integration with the Accounting System

Your accounting/ERP system needs to record every financial transaction including payroll information like department wise employee cost, individual payroll components like reimbursements, tax due and paid, etc. Some payroll solution have integration with accounting software via API(a way to push data directly from one software to another).

In the absence of such integration, the payroll officer needs to provide all transaction details to accounts department. The accountant then manually posts it in the form of journal entries in accounting/ERP software like Tally ERP, SAP, Quickbooks, etc. These integrations can help finance and payroll team work together and avoid any manual entry of data.

Cloud-Based Software over On-Premise Solutions

The payroll management automation space is transforming rapidly. The on-premise software solutions have become obsolete and businesses are going for cloud-based solutions due to their advantages.

Ability to Access the Data at Any Time and From Anywhere

If you use a cloud software, you do not need to be present in your office to be able to access your payroll data and employee data. You can login from anywhere at any time just like Gmail.

The Advantage over the Inherent Limitations of On-Premise Systems

The on-premise systems have their limitations like threat of data loss by fire, flood, etc. Also, the setup cost of these systems is huge and comes with an initial operation limit. Often the annual maintenance cost is quite high. Whereas, the cloud solutions are built on such technology, so you can always opt for an upgraded plan that supports higher level of operations at any time. Since cloud solutions have data center at multiple locations, even during incidences of fire, flood, etc. your data remains safe.

2.2 EPF LIABILITY

As an employee working in a corporate set-up, there are several things one would like to know about the Employees Provident Fund (EPF). EPF is the main scheme under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952. The scheme is managed under the aegis of Employees' Provident Fund Organisation (EPFO).

It covers every establishment in which 20 or more people are employed and certain organisations are covered, subject to certain conditions and exemptions even if employ less than 20 persons each

EPF scheme, an employee has to pay a certain contribution towards the scheme and an equal contribution is paid by the employer. The employee gets a lump sum amount including self and employer's contribution with interest on both, on retirement.

As per the rules, in EPF, employee whose 'pay' is more than Rs 15,000 a month at the time of joining, is not eligible and is called non-eligible employee. Employees drawing less than Rs 15,000 a month have to mandatorily become members of the EPF. However, an employee who is drawing 'pay' above prescribed limit (currently Rs 15,000) can become a member with permission of Assistant PF Commissioner, if he and his employer agree.

1. Contribution by employer and employee: Contribution paid by the employer is 12 per cent of basic wages plus dearness allowance plus retaining allowance. An equal contribution is payable by the employee also. In case of establishments which employ less than 20 employees or meet certain other conditions as notified by the EPFO, the contribution rate for

both employee and the employer is limited to 10 percent.
For most employees of the private sector, it's the basic salary on which the contribution is calculated. For example, if the monthly basic salary is Rs 30,000, the employee contribution towards his or her EPF would be Rs 3,600 a month (12 per cent of basic pay) while the equal amount is contributed by the employer each month.

- It should, however, be noted that not all of the employer's share moves into the EPF kitty. Out of employer's contribution, 8.33% will be diverted to Employees' Pension Scheme, but it is calculated on Rs 15,000. So, for every employee with basic pay equal to Rs 15,000 or more, the diversion is Rs 1,250 each month into EPS. If the basic pay is less than Rs 15000 then 8.33% of that full amount will go into EPS. The balance will be retained in the EPF scheme. On retirement

2. Higher voluntary contribution by employee or Voluntary Provident Fund
The employee can voluntarily pay higher contribution above the statutory rate of 12 percent of basic pay. This is called contribution towards Voluntary Provident Fund (VPF) which is accounted for separately. This VPF also earns tax-free interest. However, the employer does not have to match such voluntary contribution.

3. Withdrawals from the EPF account
According to the EPF Act, for claiming final EPF settlement, one has to retire from service after attaining 55 years of age. The total EPF balance includes the employee's contribution and that of the employer, along with the accrued interest.
There is, however, a window to partially withdraw the amount for those nearing retirement. Anyone over 54 can withdraw up to 90 percent of the accumulated balance with interest. But what if someone decides to quit his job before reaching 55?
With effect from December 6, 2018, the employees can withdraw 75% of their EPF corpus after remaining unemployed for one month and balance 25% he is out of employment for 60 straight days or more. Prior to this, an employee can make such withdrawal only after remaining unemployed for more than 60 days.
To withdraw money, one may now use 'UAN based Form 19' and in effect bypass the employer signature requirement. This facility will be available to all those subscribers whose Universal Account Number (UAN) is activated and seeded with the KYC details like bank account and Aadhaar number. The claim can be submitted online on the Member e-Sewa portal.

4. Interest on account
The Interest in EPF is calculated on the basis of monthly running balance.

5. Universal Account Number (UAN)

UAN is allotted by EPFO. The UAN acts as an umbrella for the multiple Member IDs allotted to an individual by different establishments. The idea is to link multiple Member Identification Numbers (Member Id/PF Account number) allotted to a single member under single Universal Account Number.

UAN will help the member to view details of all the Member Identification Numbers (Member Id) linked to it. If a member is already allotted (UAN then he/she is required to provide the same on joining new establishment to enable the employer to in-turn mark the new allotted Member Identification Number (Member Id/PF account number) to the already allotted Universal Identification Number (UAN).

UAN has been made mandatory for all employees and will help in managing the EPF account and even PF transfer and withdrawals will become much easier than before. Remember, in most cases, the employer provides the UAN and the employee just has to get it activated by providing relevant KYC documents to the employer. So if you are changing jobs and already have a UAN, you need not get a new UAN from your new employer. It is a one-time permanent number which will remain the same throughout one's career.

When you join a new organisation, the first thing you should do is ask your employer for the 'New Form No. 11- Declaration Form' to furnish the existing UAN. If you don't have one, then just give your previous PF number along with the date of exit from your previous job.

6. The importance of five years of continuous service

Typically, in early and mid-years of their careers, employees tend to switch jobs. After leaving, they have two options with regard to their EPF. Either they can withdraw 75% of EPF corpus after waiting for one month if unemployed and make a complete withdrawal after remaining unemployed for two months or transfer the balance to the new employer.

The EPF withdrawal is not taxable if one has completed at least five years of continuous service. If one has switched jobs in less than five years but transferred the EPF to the new employer, it will be counted as continuous service. Someone, for instance, works for 1.5 years and then joins another organisation. He transfers his PF balance on to the new employer where he continues to work for 3.5 years. Taken together, it will be five continuous years of service for the employee. It is, therefor better to transfer your existing PF to your new employer.

7. Tax on early withdrawals

Withdrawing the PF balance without completing five continuous years of service has tax implications. The total employer's contribution amount along with the interest earned will get

taxable in the year of withdrawal. Also, the amount of deduction claimed under Section 80C on one's own contribution will be added to one's income in the year of withdrawal. In addition, the interest earned on one's own contribution will also be subject to tax.

The government had introduced Tax Deducted at Source (TDS) on PF withdrawals in order to discourage premature withdrawals and promote long-term savings. No tax is deducted if the employee withdraws PF after five years. Also, TDS shall not be applicable in case of PF transfer from one account to another. From June 1, 2016, for TDS, the threshold limit of PF withdrawal has been raised from Rs 30,000 to Rs 50,000. TDS will be applicable at the rate of 10 per cent provided PAN card is submitted.

With effect from April 1, 2020, interest will be taxable if an employee's own contribution in a financial year exceeds Rs 2.5 lakh. Interest will become taxable only on the excess portion.

8. Employees' Provident Fund Advances

Contributions towards Employees' Provident Fund (EPF) are meant to take care of one's post-retirement needs. But you don't have to wait till you retire to lay your hands on it. The EPFO allows one to access one's EPF even during the course of employment. Such withdrawals are treated as 'advances' and not loans.

Such advances are allowed only under specific situations - buying a house, repaying a home loan, medical needs, education or marriage of children, etc. Also, the amount that you can take as an advance will depend on the specific situation, the number of years of service, etc. As it's not a loan, one need not pay any interest on such advances. Unlike a loan, it is not necessary to repay the advance.

9. Availing advances

If you have your Know Your Customer (KYC) compliant UAN, which is activated and seeded to your bank account, you don't have to even go through your employer to get hold of your EPF. The UAN Based Form 31 (New) can be directly submitted to the EPFO. Else, you may fill in Form 31 and submit it to the EPFO through your employer. The claim can be submitted online on the Member e-Sewa portal, provided Aadhaar is linked to UAN.

The employee can take the advance for buying or building a house or buying a plot of land and even for construction of a house on a plot owned by the member. The advance can also be taken for repayment of the outstanding home loan, for self or family member's medical treatment, for the marriage of self/daughter/son/ brother/sister or for post matriculation education of son/daughter. With effect from March 27, 2020 two non-refundable advances can also be taken to meet the financial emergencies related to pandemic (e.g. Coronavirus).

10. Special advance scheme for housing

EPFO has allowed members i.e. the contributory employees of the provident fund (PF) scheme to use 90 percent of EPF accumulations to make down payments to buy houses and use their accounts for paying EMIs of home loans.

Under the new rules, an essential requirement for a PF member to withdraw one's PF money to buy a real estate property is that he or she has to be a member of a registered housing society having at least 10 members.

As a member, one can use the PF funds for an outright purchase, as a down payment for a home loan, for buying plots, for the construction of a house. The transactions can be made through central government, state government and even from a private builder, promoters or developers. Only those members who have completed 3 years as a PF member will be eligible for this scheme.

Any employee in India receives the salary after the employer deducts a certain amount of money as of PF(Provident Fund). One might feel that they are not able to spend their cash-in-hand. However, when a person wants to retire from their job, Employee Provident Fund EPF is one of the main contributions helpful for their living. The Ministry of Labour regulates EPF schemes in India.

What is an Employee Provident Fund?

Employee Provident Fund EPF is one of the popular savings schemes launched under the supervision of the Government of India. The Ministry of Labour regulates EPF schemes in India. It is the main scheme under the Employee Provident Fund and Miscellaneous Provisions Act,1952. Employee Provident Fund Organisation(EPFO) manages this savings scheme.

This scheme aims to build a sufficient retirement corpus for an individual. It inculcates the habit of saving money for the salaried class employee. The fund includes monetary contributions from both employer and employee. Each of them has to contribute 12% of the employee’s basic salary (Basic + Dearness allowance) towards this fund every month. Once an individual retires, they receive the entire contribution(of both employee and employer) as a lump sum with interest. The rate of return earned is fixed, which is set by EPFO. Also, the interest accrued is tax-free.

The government of India has mandated contribution in this scheme. Thus, as the government manages it, it is considered to be a low- risk investment.

What is PF Account Number?

Every company registered with the EPFO will assign a Provident Fund (PF) account number to their employees. The PF number is an alphanumeric code. It represents the state, regional office, establishment, and PF member code. The PF trust manages the PF number. The PF number is not unique and changes when an employee changes jobs. While a Universal Account Number (UAN) is a unique number allotted to PF members. Every time an employee changes jobs, their PF account number changes. However, the UAN number remains the same.

Monthly Contribution – Employer and Employee

As mentioned above, both employer and employee have an equal contribution towards the employee provident fund. The actual amount to EPF contribution is calculated based on the employee's basic salary and dearness allowance. For most employees, the PF contribution is 12% of the basic salary. The below is the given details of employee and employer contribution towards EPF:

Employee's contribution towards EPF

The employer deducts 12% of the employee's salary (basic + dearness allowance) directly every month for a contribution towards EPF. This entire contribution goes to the EPF account of the employee.

Employer's contribution towards EPF

Similarly, the employer also contributes 12% of the employee's salary towards EPF. But, the employer's contribution has the following categories.

EPF Contribution Rate 2022

Category	Percentage of contribution (%)
Employees Provident Fund	3.67%
Employee Pension Scheme (EPS)	8.33%
Employee's Deposit Link Insurance Scheme (EDLIS)	0.5%
EPF Admin Charges	1.1%
EDLIS Admin Charges	0.01%

However, in certain circumstances, EPF contribution can be 10%. For instance, this can imply in the following cases –

If a company has less than 20 employees

The company incurs losses that are more than its entire net worth

If a company is associated with beedi, jute, brick, guar gum or coir industry

The contribution can also vary in the case of women employees. In the union budget 2018-2019, new women employees can make an EPF contribution of 8% instead of 12%. This

privilege is only for the first three years of employment. The primary reason for this revision was:

To enable women for higher take-home pay

To encourage companies to hire more women to bridge the gap

Even though a woman employee contributes 8% towards EPF, the employer has to maintain its EPF contribution at 12%. Well, an employee can also add more than 12% towards EPF. This is the Voluntary Provident Fund (VPF).

It is important to note that EPF will continue to be active as long as you are a salaried employee. If you switch jobs, it is paramount to update your EPF information with your new employer to continue their contribution.

Employee Provident Fund Interest Rate

The current interest rate for EPF for the FY 2021-22 is 8.10% p.a.. This interest rate is calculated every month and then transferred to the Employee Provident Fund accounts every year on 31st March. The interest earned on EPF is exempted from tax.

This rate is pre-decided by the Government of India(GOI) along with the Central Board of Trustees(CBT). CBT regulates the Act. The interest rate which is announced by GOI stays valid for a financial year, i.e. starting from 1st April of one year to 31st march year ending of next year.

If there is no contribution in the EPF account consecutively for three years, then the account becomes inactive or dormant. Even in such instances, the interest is paid on the EPF account until the employee retires. However, for retired employees, the interest is not paid on inoperative accounts. The interest earned on inoperative accounts is taxable as per the employee's tax slab rate.

Subsequently, the employer's share contributed towards the Employee Pension Scheme(EPS) does not accrue interest. However, a member is eligible to receive its pension only after the age of 58.

Employee Provident Fund Tax Implication

The contributions made in EPF are tax exempt. This fund falls under the EEE Exempt-Exempt-Exempt taxation regime. This means that no tax is levied at the time of contribution, accrual of interest and withdrawal at the time of maturity if it is within a specific limit. However, there are rules and exceptions to be checked.

Employer Contribution

Employer's contribution towards EPF is tax exempted up to a certain limit. As per the new budget 2020, it has proposed a new limit towards the employer's contribution.

As per the new proposal, the employer's contribution to EPF, National Pension Scheme and superannuation fund on an aggregate basis should not exceed Rs.7.5 lakh in the financial year. Suppose, if the aggregate amount exceeds the proposed limit, then the additional amount is taxable in the hands-on employee.

Employee Contribution

Employee's contribution towards EPF and interest is exempted from tax. One can claim tax deduction under section 80C up to a limit of 1.5 lakhs. If the amount from PF is withdrawn at maturity, then no tax has to be paid. However, suppose the employee withdraws any partial amount due to any emergencies. In that case, the amount will be taxable to the employee.

Tax on Withdrawal

EPF balance withdrawal is considered to be tax-free. As per the rule, there are certain exceptions based on the number of years of employment.

Before five years

Suppose the employee has not completed a consecutive five years of service. In that case, the amount withdrawn is taxable in the hands of the employee in the year of receipt. The amount may remain tax-free in the following two exceptions.

Firstly, if the employment is terminated due to an employee's ill health, the employer has discontinued its business or any other reason for withdrawal which is beyond the control of the employee. In such a scenario, the EPF amount withdrawn before five years of employment is considered to be tax-free in the hands of the employee.

Secondly, suppose the employee changes his employer in less than five years. In that case, the employee can transfer his PF account balance for the existing employer to the new employer. In this case, the PF balance remains tax-free.

Therefore, it is always suggestible to transfer the PF balance while changing jobs to avoid any taxation.

After five years

Suppose the employee has completed a consecutive five years of service. In that case, the amount withdrawn is tax-free in the hands of the employee in the year of receipt.

Otherwise

Suppose the EPF withdrawal amount is less than Rs.50,000 before completion of 5 years of service, in such instances. In that case, the individual has to pay tax on the EPF withdrawal amount if he falls in the taxable bracket(based on this tax slab rate).

Suppose the EPF withdrawal amount is more than Rs.50,000 before completion of 5 years of service, in such instances. In that case, TDS (Tax Deducted at Source) is deducted. If PAN card is furnished, then 10% TDS is charged. If PAN card is not submitted, then TDS is at the maximum marginal tax rate. However, No TDS if Form 15G/15H is submitted.

EPF Withdrawal

Every month a certain amount is deposited in the PF account. This amount keeps earning interest and forms a large corpus. At the end of the employment, a substantial amount is collected in the EPF account to help an individual to meet their financial needs during their retirement period.

When an individual retires at the age of 58, 100% of the corpus can be withdrawn. If a person has attained an age of 54 or above, one can withdraw 90% of its EPF corpus before one year of its retirement. Even though EPF is considered to be a retirement savings scheme, funds can be withdrawn in case of certain exceptions.

Premature Withdrawal on an emergency

Premature PF withdrawals are also allowed in case of financial emergencies. One can withdrawal only after a period of 5 years of completion of service. In the following examples where one can avail partial withdrawal:

Voluntary Provident Fund

Voluntary Provident Fund(VPF) is another simplified version of the traditional provident fund. It is another savings scheme for building a retirement corpus. It is also known as the Voluntary Retirement Fund. Only salaried employees are eligible to invest in this scheme.

Meaning and Scheme

As the name suggests, VPF is a voluntary contribution from the employee towards their provident fund account. In this scheme, it is not mandatory for a 12% contribution by the employee towards their provident fund. However, employees can do it voluntarily. An employee can also contribute up to 100% of their basic salary and dearness allowance in this scheme. The employer does not need to contribute to this scheme; it solely depends on the employer's choice for any additional contribution.

The interest of VPF is similar to the EPF scheme. The rate of interest of VPF is decided by the Government of India every year. Employers or employees do not need to contribute to this fund. Also, this fund has a lock-in period of 5 years. In case, the contributor wishes to withdraw money(fully or partially) before completion of 5 years; then this amount is subject to taxation.

Withdrawal

Generally, when an employee retires or resigns from a job, the entire amount in the fund is payable. In case of the untimely death of the account holder, the nominee can claim the amount in VPF. The main benefit of this fund is that it allows withdrawals anytime.

Furthermore, VPF also allows partial withdrawal as loans. In case of any unforeseen financial circumstances, employees can withdraw from their VPF account. For instances, some of the reasons can be –

Payment of loans

Wedding

Children education

Medical emergency

Purchase of new house/land

Payment for housing loan

However, if one withdraws the amount before five years, then it is taxable in the hands of the employee. Vice-versa, if one withdraws the amount after five years, the taxation is the same as EPF. Similarly, it falls under the EEE taxation regime. However, the exemption is only up to a limit of INR 1.5 lakhs under Section 80C only.

Find: PPF Vs VPF which is better?

Benefits of Employee Provident Fund (EPF)

The EPF scheme is one of the most popular and largest saving schemes in India for all salaried class employees. The following are a list of benefits of this scheme –

Tax saving scheme

The investment amount and the interest income are exempt from tax. The amount accumulated also remains tax-free if withdrawn after completion of 5 years. However, in case of premature(before five years) withdrawal, it will be taxable in the hands of the employee.

Capital appreciation

The Government of India fixes the interest rate of this scheme. The contribution to this fund happens monthly. Thus, it is not a burden to the employee to make a lump sum investment at once. As the money and interest keep adding, the compounding effect creates a vast corpus at the retirement age.

Retirement corpus

In the long run, this scheme helps to build a sufficient retirement corpus. This corpus helps the retired employee to have a sense of financial security and independence.

Financial Emergency

This accumulated fund can be used for any unforeseen events that occur in life. The employee can partially withdraw from this fund for any exceptional cases.

Unemployment

If the employee loses his job, this fund can be used to meet his expenses. One can withdraw 75% of the accumulated fund after one month of unemployment. The remaining 25% of the fund can be withdrawn after two months of unemployment.

Death

In case of death of the employee, the accumulated EPF fund amount is transferred to the nominee to help the family in difficult times.

Easy Access

The Universal Account Number(UAN) provides easy access to the employees to their PF account via the EPF member portal. They can transfer their PF account whenever they change jobs.

Explore Government Schemes

Ways to Check EPF Balance

The government of India has made it very easy for the employees to check their EPF account balance. One can do a balance check of their EPF account through various ways. Following are the different ways to check EPF claim status:

1. Umang App

The Umang(Unified Mobile Application for New-age Governance) app has been launched by the Government of India to drive mobile governance in India. It provides a single platform for all Indian citizens to access various e-government services.

Besides, this app helps in checking your EPF balance through UAN Number. One can view their EPF passbook, raise a claim (E.g., withdrawal of PF amount) and track EPF claims. One can register on the app by getting a one-time password sent to their respective mobile number. Also, through this app the EPF claim status can be tracked. It is essential to link Aadhaar card to Umang App and UAN Number.

2. Missed Call

Any member can do a balance check of their EPF account by giving a missed call to 011-22901406 from their registered mobile number. Importantly, to avail this service, one has to

link their UAN number with their KYC details, i.e. Aadhaar card or Pan Card or Bank Account details such as account number, ifsc code, etc.

Few things to keep in mind –

One should have a UAN compulsorily.

UAN should be activated

One should give their correct mobile number at the UAN portal. If the mobile number has been changed, the same has to be updated on the UAN site.

One should call from their registered mobile number only.

After a missed call, one will receive an SMS from AM-EPFOHO. EPFO sends a reply to the missed call as an SMS. This SMS contains the following details of the EPF account –

UAN Number

PF Number

Name

Date of Birth

EPF Balance

Last PF Contribution

3. Text SMS

If the UAN is registered with EPFO, then you can send an SMS to 7738299899 from your registered mobile number for checking your EPF balance. The message has to be sent in this format – "EPFOHO <UAN> <LAN>". The first three letters of the preferred language have to be written followed after UAN. (E.g., MAR for choosing the Marathi language). This facility is available in 10 languages. They are English (default), Hindi, Punjabi, Gujarati, Marathi, Kannada, Telugu, Tamil, Malayalam, and Bengali. EPFO sends the details on SMS as per its records.

4. Employees Provident Fund Organisation EPFO Website

Employees Provident Fund Organisation EPFO is the largest social security organization of India. It was formed by the Government of India. EPFO plays a significant role in helping its members in different ways.

It has its website where members can register with their UAN number. One can check their PF passbook balance of their EPF account online. One can download or print their EPF passbook. The following are the steps to verify your PF balance –

Visit the EPFO website – www.epfindia.gov.in.

Click on 'Our Services' and select 'For Employees'

Click on 'Services' and choose the 'Member Passbook' option.

Type the UAN and password to view passbook

It is important to note that the employer has activated UAN. Though the EPFO provides the UAN, the employer needs to verify and activate it to access the EPF account online.

Explore NPS vs EPF

What are the documents required needs for EPF registration?

The documents required by employees to register for EPF scheme are:

ID proof (Aadhaar Card/ PAN Card)

Bank A/c number with IFSC code

Voluntary application

Explore Tax saving investments under Section 80C

Tax Saving Fixed Deposit

Public Provident Fund (PPF)

National Pension Scheme (NPS)

National Savings Certificate (NSC)

Sukanya Samriddhi Yojana (SSY)

ELSS fund (tax saving fund)

To check their tax liability while filing income tax returns, one can use an income tax calculator.

Scripbox Income Tax Calculator helps in checking if there is any additional scope to save more tax so that investors can get maximum tax benefits on their investments. Scripbox's Income Tax Calculator, helps investors to derive maximum benefits by suggesting tax saving investments. They can claim the same while filing income tax returns.

What is a composite claim?

A composite claim is a combination of different forms, used for the withdrawal of money from EPF offline. This EPF form combines Form 19, Form 10C, and Form 31. Individually, Form 19 is for PF final settlement (claim form); Form 10C is for pension withdrawal, and form 31 is for partial PF withdrawals.

However, suppose an individual has its UAN linked with an Aadhaar card and bank account. In that case, they can submit this single form directly to EPFO without employer attestation. Similarly, if UAN is not linked to Aadhaar card and bank account, then employer attestation is required on the form.

Conclusion

EPF comes under Employee Provident Fund and Miscellaneous Provisions Act,1952. EPF is an excellent saving scheme for building a sufficient retirement corpus for salaried employees.

Over the career time, one shifts a job multiple times. But, the benefit of this scheme is added continuously under UAN. EPF can be a good investment plan as it also comes with tax benefits. It ensures higher earnings and improves savings for employees in the long-term.

However, there are certain limitations, as well. There can be a better investment plan or alternative, which is an ELSS fund (tax saver fund). ELSS fund is a type of equity funds that helps investors get inflation-beating returns for retirement. With tax-saving and lower lock-in period high returns, this tax saver fund attracts many investors.

2.3 PF RETURN FILING

To promote the attitude of savings amongst the employees and also to benefit them during retirement a social security system of Provident fund was introduced. Contributions towards the PF are made by both the employer as well as the employee every month. The contribution made towards the PF can be only drawn by the employee only during the time of his or her employment, but there are a few exceptions.

The employers that have PF registration have to file the PF returns monthly. The PF return filings are to be completed by the 25th of each month. Here we will talk about the various forms used for PF return filing in detail. The employers can easily file the PF return through the Unified portal.

Form 2

Form 2 is filed as a declaration and nomination under the Flagship scheme of the Employment Provident Fund and the Employment Family Pension Scheme. Form 2 must be filed by the employees who are joining the establishment. This form is to be submitted with Form 5. Form 2 is divided into 2 different parts.

Part A

Part A of Form 2 deals with nominating the recipients of the EPF balance of the particular account holder, in the event of his or her death. This part of the form must include the following details:

- Name
- Address
- Relationship with the subscriber
- Age

- Sum of the money that is to be paid to the nominee
- Guardian Details (In case the nominee is a minor)

This Part has to be signed or needs to have a thumb impression to be made at the end of the section.

Part B

The details of the nominee as already mentioned in Part A should also be included in Part B. Additionally, the details of the members who are eligible to receive the children/ widow pension must be furnished.

This Part again must be signed duly or a thumb impression has to be made at the end of the section.

Form 5

Form 5 is a monthly report that contains the details of the employees who are newly enrolled in the provident fund scheme. Form 5 must include the following details:

- Organization's Name
- Address of the Organization
- Code of the organization
- Account number of the Employee
- Name of the employee
- Middle Name (Husband/Father)
- Date of birth of the employee
- Date of joining
- Track record of the work.

The form is to be filed and stamped by the employer with the date of filing mentioned on it.

Form 10

It is a monthly report that includes the details of the employees who have ceased to be a part of the scheme on the given month. Form 10 includes the following details.

- Account Number
- Name of the employee
- Name of the father or the husband
- Date of leaving the service
- Reason for leaving service.

Form 10 must be filed and stamped by the employer with the filing date of the form.

Form 12A

This Form 12 A is a report that contains the payment details that are contributed to the account of the respective employee in a particular month.

Annual PF Return Filing

The annual returns are to be filed by the 30th of April in a given year. The forms that are utilized for filing the annual PF returns are

- Form 3A
- Form 6A

Form 3A

The Form 3A depicts the month-wise contribution to the subscriber or members and the employers towards the Employee Provident Fund and the Employee Pension Fund in a year. The data is calculated by every member who is a part of the scheme. Additionally, the scheme will include the following details

- Account Number
- Name of the subscriber
- Name of the father or the husband
- Name and address of the establishment
- The statutory rate of contribution
- Voluntary contribution in case if there is any.
- Form 3A must contain the signature and the seal of the employer.

Form 6A

Form 6A is a consolidated annual contribution statement that includes details about the annual contribution of each member of the establishment. The Form has to include the details as they are enumerated below:

- Account number
- Name of the members of the subscriber
- Wages, retaining allowance if there is any, and the D.A that includes the cash value of the food concession that is paid during the currency period.
- The amount of contribution that is deducted from the wages.
- Employer’s contribution (Both EPF and Pension)
- Refund of the advances
- Rate of the higher voluntary contribution (If there is any)
- Remarks

Besides this, the following details should also be included in the amount remitted column:

- The month of the contribution

- The remitted contribution that includes the refund of the advances
- EDLI Contribution
- Pension Fund Contribution
- Administrative charges
- Aggregate contributors.

2.4 ESIC COMPUTATION

The Employee State Insurance ("ESI") is a contributory fund that has contributions both from the employer and employee and enables Indian employees to take part in a self-financed, healthcare, insurance fund.
The scheme is managed by the Employee State Insurance Corporation which is a government body, and it is governed by the ESI Act 1948. The ESI is the largest integrated need-based social insurance scheme for employees. It protects the employees in times of uncertain and unfortunate events. The scheme provides both cash benefits and healthcare.

All non-seasonal factories having 10 or more employees are covered under ESI. All the establishments that are covered under the Factory Act and Shops and Establishments are also eligible for ESI. The units that have 10 or more employees or are located in the scheme-implemented areas are covered under this Act.
Although the establishments are covered under the Act, not all employees are covered under the Act. So, what is the eligibility criteria for employees? All employees whose monthly income that is excluding overtime, bonus, leave encashment does not exceed Rs.21,000 are covered under this Act.

Wages as per the ESI Act

The contributions (employee and employer) are made basis on the wages paid to the employees. Some of the inclusions and exclusions from the wage component are as follows:

Inclusions	**Exclusions**
Basic Pay	Entertainment Allowance
Dearness Allowance	Retrenchment Compensation
City Compensatory Allowance	Encashment of leave and

	gratuity
House Rent Allowance	Deduction of health insurance
Incentives (including sales commission)	Tax Deductions
Medical Allowance	–
Meal allowance	–
Any other special allowances	–
Attendance and Overtime Payments	–

Computation of ESI

The rates of the ESI contribution are calculated on the wages paid. Currently, the employee contribution is 0.75% of wages paid/payable, and employer contribution is 3.25% of wages paid/payable.

Total ESI Contribution = Employer's Contribution + Employees Contribution

Let us say Mr Hard Working with wages of Rs.18,000 work in a factory unit. The contribution will be as follows:

Employee Contribution – 0.75%*18,000 = 135

Employer Contribution – 3.25%*18,000 = 585

So a total contribution of Rs.720 will be made. The onus of deducting the contribution and depositing the same is on the employer. The employer must deposit the amount within 15 days of the end of the calendar month in which the deduction is made. The same can be deposited online or to authorised designated branches of SBI or other designated branches.

Employee State Insurance Contribution Collection

An employer is responsible for paying his contribution for each employee and deducting employee contributions from wages bills. Furthermore, the employer must pay the contributions to the Corporation within 15 days of the last day of the calendar month in which the contributions are due.

The Corporation has authorised certain SBI branches and a few other banks to accept payments on its behalf.

Contribution Period and Benefit Period

The concept of contribution period covers the employee in the event of the wages increasing from the threshold limit of Rs.21,000.

Let us continue with the above example, say Mr Hard Working was earning wages of Rs.18,000 till June 2020, the wages increase to Rs.22,000 from July 2020. The contribution period is 1 st April 2020 – 30th September 2020 and hence the deduction will continue on the revised salary up to September and he will be eligible for the benefit up to 30th June of the following year.

Similarly, say an employee Mr Diligent earns a wage of Rs.20,000 till October 2020 and from next month he earns Rs.23,000. The deduction must continue on the revised salary up to 31st March 2021 and he will be eligible for the benefit up to December 2021.

Name	Salary Revision	Contribution Period	Benefit Period
Mr Hard Working	July 2020	1 st April 2020 – 30th September 2020	1st January to June 2021
Mr Diligent	Nove mber 2020	1st October to 31st March 2021	1st July to 31st December

Hence ESI contribution must be made by both employee and employer and the benefits help the employee in unfortunate circumstances.

What are the Advantages of Being an ESIC Member?

The advantages of signing up for this Employees' State Insurance Scheme (ESIC) are numerous. Here are a few examples:

- Sickness benefits at a rate of 70% (in the form of pay) will be paid in the event of any certified illness lasting for a maximum of 91 days in any year.
- An employee's and his family's medical coverage.
- Pregnant women are entitled to maternity leave (paid leaves).
- If an employee dies on the job, 90% of their pay is paid to their dependents every month for the rest of their lives.
- The same rules apply in the event of an employee's disability.
- Expenses associated with the funeral.
- Medical expenses for the elderly.

Returns Registration and Filing of ESI in Salary

Employers who are required to register under the Employee State Insurance Act of 1948 ("Act") must take the following steps:

- An employer must maintain all papers on hand in case they are needed.
- After that, an employer must file Form 1, which is available on the ESIC website in PDF format.

Note: ESIC will double-check all of the information and assign a 17-digit unique number. All filings require this one-of-a-kind number.

Documents Required for Registration of ESI in Salary

The following documents are required for obtaining registration of an ESI member to get an ESI salary:

- Address proof of the business
- PAN card of the business
- Details of all partners, directors, and shareholders
- A license under the Factories Act or Shop Establishment Act
- Details of all employees and their salary structure
- Bank details
- Documents such as partnership deed, Articles of association, and Memorandum in case of company.

How to Check Claim Status Of ESI Online?

Below are the steps mentioned to check the ESI claim status online:

- Open the UMANG App or you can download it on your smartphone.
- Enter the IP number or the ESIC Insurance Number and click on 'Get OTP'.
- Enter the OTP that will be sent to the reference phone number and click on 'Submit'.
- Now select 'Claim Status' under the services section.
- If you have made any claims, you will be able to see the status or you use the advanced search to find the details.

Consequences of Employee Contribution Non-Payment or Late Payment

- The amount deducted from an employee's pay as an employee contribution is considered to have been entrusted to the employer. As a result, the employer is more responsible for ensuring that the contribution is deposited with ESI in salary.
- Non-payment or late payment of an employee's contribution deducted from his or her wages is a punishable offence under the ESI Act.

- Non-payment, late payment, or falsifying payments are punishable by up to two years in prison and a Rs 5,000 fine under the ESI Act.

Consequences for Employers When ESI in Salary is Delayed

If an employer fails to contribute within the time limit established in the rule, they will be subject to simple interest at the rate of 12% per year for each day of delay or default in payment.

Frequently Asked Questions

What are wages under the ESI Act?

As per the ESI Act, wages are the remuneration paid or payable in cash to an employee. It includes any payment to an employee during authorised leave, strike, or lock-out, which is not illegal or layoff. It also includes other additional remuneration, if any, paid at intervals not exceeding two months. However, it does not include any contribution paid by the employer to any pension fund or provident fund, travelling allowance, gratuity payable or any sum paid to the person employed to defray special expenses entailed on him by the nature of his employment.

What is the contribution under the ESI Act?

Currently, the employee's contribution rate is 0.75% of their wages, and the employer's contribution rate is 3.25% of the wages paid/payable for the employees. The employees who receive a daily average wage of up to Rs.176 are exempt from paying their share of contribution. However, the employers will contribute their share in respect of the employees having a wage of up to Rs.176 per day.

What are the benefits for which ESI contribution can be claimed?

The ESI contributions cover the following benefits-

- Medical benefits
- Sickness benefit
- Maternity benefit
- Disablement benefit, including temporary disablement benefit and permanent disablement benefit
- Dependant's benefit
- Funeral expenses

What is disablement under ESI Act?

Disablement is a condition resulting from employment injury. When the injury renders the insured person temporarily incapable of doing his/her work and necessitating medical treatment, it is considered temporary disablement. When the disablement reduces the employee earning capacity, it is a permanent partial disability. When the disablement totally deprives the insured person of the capacity of doing any work, it is a permanent total disability.

What is the mode of payment of the ESI contribution?

The employer needs to file monthly contributions online through the ESIC portal for all its employees after duly registering them. The employer must file the employee wise number of

days for which wages are paid. The ESIC has facilitated the payment of ESI contributions online via the payment gateway of 58 banks in addition to the SBI. The total amount of contribution of all the employees for each month is to be deposited in any branch of the SBI by the online generation of a challan through the ESIC portal using the employers' credentials.

2.5 PROFESSIONAL TAX

What is Professional Tax and Professional Tax Slab Rate in India?

Professional Tax is a Tax which is levied by the State on the Income earned by way of profession, trade, calling or employment. This form of tax was first levied in India in the year 1949 and the power to levy Professional Tax has been given to the States by way of Clause (2) of Article 276 of the Constitution of India.

This Tax is levied based on slab rates depending on the Income of the Individual. This Tax is just like Income Tax except for the fact that Income Tax is collected by the Central Govt and Professional Tax is collected by the State Government. When this tax was first introduced in India, the maximum limit on the tax to be collected was Rs. 250. However, this limit was raised from Rs. 250 to Rs. 2500 in the year 1988.

For the past few years, State Governments have been requesting the Parliament to raise this ceiling from Rs. 2500 to Rs. 7500. However, their request has not been accepted and the maximum amount of Professional Tax that can be levied by any State is Rs. 2,500 only.

Any amount paid as Professional Tax to the State Govt. is allowed as a deduction under Section 16 of the Income Tax Act and Income Tax on the Balance Amount is levied as per the Income Tax Slab Rates in force.

In case of Salaried and Wage earners, the Professional Tax is liable to be deducted by the Employer from the Salary/Wages and the Employer is liable to deposit the same with the state government. In case of other class of Individuals, this tax is liable to be paid by the person himself.

Professional Tax in India is collected by some state governments themselves while in several other states which have active Panchayats, the local bodies themselves levy and this tax. Every person liable to pay this Tax (either on his own behalf or on behalf of its employee) shall apply for Professional Tax Registration in the prescribed form with the prescribed authority.

As the states have been empowered to levy and collect this Tax, different states levy Professional Tax as per Different Slab Rates. The Professional Tax Slab Rates in some of the major states in India are given below:-

1. Maharashtra
2. New Delhi
3. Karnataka
4. West Bengal
5. Madhya Pradesh
6. Tamil Nadu
7. Andhra Pradesh
8. Gujarat

1. Professional Tax in Maharashtra

Professional Tax in Maharashtra is governed by the Maharashtra State Tax on Professions, Trades, Callings and Employment Act, 1975 which came into effect from 1st April 1975. The Professional Tax Slab Rates on Salary and Wages in Maharashtra are as follows:-

Monthly Salary	Amount payable in Maharashtra
Less than Rs. 7500	Nil
Rs. 7501 to Rs. 10000	Rs. 175 pm
Rs. 10001 & above	Rs. 200 pm except for the month of Feb Rs. 300 for the month of Feb

Different Slab Rates have been prescribed for different class of Individuals by the Maharashtra State Govt. and the above slab rates are only for Salaried Individuals and Wage Earners.

For all other class of Individuals, Maharashtra State Govt has prescribed different slab rates and the Individual is himself liable to pay this Tax. For a detailed list of Slab Rate in Maharashtra on different class of Individuals refer this list.

The Maharashtra State Govt has also announced a composition scheme under which any person liable to make payment to the Maharashtra State Govt @ Rs. 2500 p.a. can make a onetime lump-sum payment in advance of Rs. 10,000 and his liability for the next 5 years would be discharged.

The Interest levied for late payment of this Tax in Maharashtra is 1.25% per month and the Maharashtra State Authority may also impose penalty @ 10% of the Total Tax due. Forms for *Registration and Payment of Professional Tax* can be downloaded from here.

2. Professional Tax in New Delhi

In December 2004, the Municipal Corporation of Delhi (MCD) tried to enforce professional tax on those residing and working in New Delhi. However, this proposal was rejected by the Standing Committee of the MCD. And therefore, this Tax is not levied in New Delhi.

3. Professional Tax in Karnataka

Professional Tax in Karnataka is levied under the Karnataka Tax on Professions, Trade, Callings and Employment Act, 1976. *Professional Tax Slab Rates in Karnataka on Salary* and Wage earners are as follows:-

Monthly Salary	Amount payable in Karnataka
Less than Rs. 15,000	Nil
Rs. 15,000 & above	Rs. 200 per month

Different Slab Rates in Karnataka have been prescribed for different class of Individuals and the above slab rates are only for Salary/ Wage earners. For detailed list on the slab rates of different class of Individuals in Karnataka refer this list.

For late payment of Professional Tax in Karnataka, Interest @ 1.25% per month would be levied and a maximum penalty of 50% of the Total Amount due may also be levied by the Karnataka authority. The Forms for Registration and for payment of this tax can be downloaded from here.

4. Professional Tax in West Bengal

Professional Tax in West Bengal is governed by the West Bengal State Tax on Professions, Trades, Callings and Employment Act, 1979. The Professional Tax Slab Rates in West Bengal with effect from 01/04/2013 on Salary & Wage earners are as follows:-

Monthly Salary	Amount payable in West Bengal
Less than Rs. 8500	NIL
Rs. 8501 to Rs. 10000	Rs. 90 pm
Rs. 10001 to Rs. 15000	Rs. 110 pm
Rs. 15001 to Rs. 25000	Rs. 130 pm
Rs. 25001 to Rs. 40000	Rs. 150 pm
Rs. 40001 & above	Rs. 200 pm

The above slab rates in West Bengal are only applicable to Salaried and Wage earners. For slab rates in West Bengal on other class of Individuals, refer this list.

The *Forms for Registration and Payment of this tax in West Bengal* can be downloaded from here. In case of any delay in depositing this Tax with the West Bengal Govt, Interest @ 1% pm would be levied. The West Bengal govt may also levy penalty @50% of the Total Amount Due.

5. Professional Tax in Madhya Pradesh

Professional Tax in Madhya Pradesh (MP) is levied by the Madhya Pradesh Vritti Kar Adhiniyam, 1995. As per Notification No. 174 dated 31/03/2012 published in the MP Gazette, the following Slab Rates would be applicable in Madhya Pradesh on salaried income wef 1st April 2012 onwards

Monthly Salary	Amount payable in Madhya Pradesh
Less than Rs. 12500	Nil
Rs. 12500 to Rs. 14999	Rs. 125 pm
Rs. 15000 & above	Rs. 208 from April to Feb & Rs. 212 in March

For slab rates on other class of individuals, refer this list.

6. Professional Tax in Tamil Nadu

Professional Tax in Tamil Nadu is levied under the Town Panchayats, Municipalities & Municipal Corporations Rules 1988. The Slab Rates in Tamil Nadu on salaried income are as follows:-

Monthly Salary	Amount payable in Tamil Nadu
Less than Rs. 3500	Nil
Rs. 3501 to Rs. 5000	Rs. 16.66 pm
Rs. 5001 to Rs. 9000	Rs. 40
Rs. 9001 to Rs. 12500	Rs. 126.67 pm
Rs. 12501 & above	Rs. 182.50 pm

7. Professional Tax in Andhra Pradesh

Professional Tax in Andhra Pradesh is levied under the Andhra Pradesh Tax on Professions, Trades, Callings and Employment Act 1987. The Slab Rates in Andhra Pradesh on Salary/ Wage earners are as follows:-

Monthly Salary	Amount payable in Andhra Pradesh
Up to Rs. 15000	Nil
Rs. 15001 to Rs. 20000	Rs. 150 pm
Rs. 20,000 & above	Rs. 200 pm

8. Professional Tax in Gujarat

Professional Tax in Gujarat is governed by the Gujarat Panchayats, Municipalities, Municipal Corporations and State Tax on Professions, Traders, Callings and Employment Act 1976. The Slab Rates in Gujarat are as follows:-

Monthly Salary	Amount payable in Gujarat
Less than Rs. 5999	Nil
Rs. 6000 to Rs. 8999	Rs. 80 per month
Rs. 9000 to Rs. 11999	Rs. 150 per month
Rs. 12000 & above	Rs. 200 per month

The above professional tax slab rates are salary/ wage earners. For other class of Individuals refer this list.

If you are employed and earn a regular salary, you are required to pay professional tax. You must have seen the term professional tax in the salary slips that you receive every month. It is written below your gross salary, allowance, and HRA.

Professional tax is a deduction that is deducted from your gross salary along with TDS, EPF and any other deduction.

However, this tax doesn't mean that it is levied only if you are in professional practice such as a doctor, lawyer etc. If you earn a salary, you are eligible to pay this tax. Before moving further let us see what professional tax is.

What is Professional Tax?

Professional tax is a direct tax that is deducted from your gross salary by your employer.

This tax is levied by the state government and thus can vary depending on the state you live in. The maximum limit of which you can be charged is Rs 2500.

The tax is calculated based on the slabs. Each state can have different salary slab rates for the calculation of professional tax. Andhra Pradesh, Maharashtra, Gujarat are some of the states where this tax is applicable.

What Kind of Professionals must Apply for Professional Tax in India?

Tax season is fast approaching and everyone, especially first time taxpayers, are preparing themselves. For first time taxpayers, there is a lot to learn and figure out, and it might even get overwhelming at times. The taxes you pay depend mainly on your occupational status, and the amount of money you have earned in the year. Today, we have a look at professional tax, which is actually not just for professionals.

Statewise Professional Tax Slabs

Professional slab rate varies from state to state. Some of the states which currently impose a professional tax in India are West Bengal, Maharashtra, Gujarat, Andhra Pradesh, Kerala, Tamil Nadu, Karnataka, Bihar, Assam, Madhya Pradesh etc.

Professional Tax in West Bengal

Salary per month	**Tax**
Up to Rs.10,000	0
Rs.10,001 to Rs.15,000	Rs.110
Rs.15,001 to Rs.25,000	Rs.130
Rs.25,001 to Rs.40,000	Rs.150
More than Rs.40,000	Rs.200

Professional Tax in Maharashtra

Salary per month	**Tax**
Till Rs.7,500 (men)	NA
Till Rs.10,000 (women)	NA
Rs.7,501 to Rs.10,000	Rs. 175
Rs.10,000+	Rs. 200 (300 for the last month)

Professional Tax in Karnataka

Salary per month	**Tax**

Up to Rs.14,999	NA
15,000+	Rs. 200

Professional Tax in Andhra Pradesh

Salary per month	**Tax**
Up to Rs.15,000	NA
Rs.15,001 to Rs.20,000	Rs. 150
Rs.20,000+	Rs. 200

Professional Tax in Tamil Nadu

Salary per month	**Tax**
Up to Rs.3,500	NA
Rs.3,5001 to Rs.5,000	Rs. 22.5
Rs.5,001 to Rs.7,500	Rs. 52.5
Rs.7,501 to Rs.10,000	Rs. 115
Rs.10,001 to Rs.12,500	Rs. 171
Above Rs.12,500	Rs. 208

Professional Tax in Telangana

Salary per month	Tax
Up to Rs. 15,000	NA
Rs. 15,000 to Rs. 20,000	Rs. 150
Rs. 20000+	Rs. 200

Professional Tax in Kerala

Salary per month	Tax
Up to Rs. 1999	NA
Rs. 3,000 to Rs. 4,999	Rs. 20
Rs. 3,000 to Rs. 7,499	Rs. 30
Rs. 5,000 to Rs. 7,499	Rs. 50
Rs. 7,500 to Rs. 9,999	Rs. 75
Rs. 10,000 to Rs. 12,499	Rs. 100
Rs. 12,500 to Rs. 16,666	Rs. 125
Rs. 16,667 to Rs. 20,833	Rs. 166
Rs. 20,834+	Rs. 208

Applicability of Professional Tax

Professional tax does not mean that only people who practice a profession need to pay it. It applies to other sections as well. Here is the list of the parties that are required to pay Professional tax.

1. Companies and Business Firms

2. Limited Liability Partnerships (LLP)

3. Corporations

4. Co-op Societies and Associations

5. Hindu Undivided Family

6. Clubs

7. Lawyers and Legal practitioners

8. Contractors

9. Architects

10. Engineers

11. Insurance agents

12. Chartered Accountants (CA)

13. Company Secretary (CS)

14. Surveyors

15. Tax consultants

16. Management consultants

17. Doctors and other medical representatives

How does Professional Tax Work?

Like every direct tax formula, Professional Tax in India has its formula and the slab rate is set by the individual state or union territory. According to Article 246 of the Constitution, only Parliament has power to frame laws for subjects on the Union List that includes tax on income.

However, in case of the State and Concurrent lists, the state can make it optional to levy professional tax in India. This tax is deductible from your taxable income. Thus most of the Indian states and union territories levy professional tax since it is a source for their revenue. Professional tax in India is collected by the Commercial Tax Department of the respective state.

Who is Responsible to Collect and Pay Professional Tax?

For employees, their employer is responsible for deduction and payment of professional tax to their respective State Government as per the rate slab, and also for registering and obtaining professional tax registration certificates. Individuals involved in freelance occupations without employees also need to register for this tax, as per the slab provided by the state government.

Do keep in mind, professional tax is subject to exemptions provided by respective states to specific categories.

What is the Maximum Limit for Professional Tax in India?

Although the tax is levied depending upon the income of the individual, the maximum amount any State can levy as Professional Tax is restricted to Rs. 2,500.

How to Pay Professional Tax?

Professional Tax is a direct tax that is not levied by the central government. It is a state-levied tax. Thus, the payment also differs with different states.

However, in general, professional tax can be paid via both online and offline modes. You need to visit the relevant state's official website for payment of professional tax. For example, if you reside in West Bengal you need to log in to their official website: http://wbprofessiontax.gov.in/

Exemptions in Professional Tax

Though every individual who receives a regular income (salary) is required to pay the Professional Tax, some individuals are exempt from it. So, if you fall under the categories mentioned below, you do not need to pay Professional Tax.

a) Member of Force (Governed by Army, Air Force, Navy Act)

b) An individual suffering from mental or physical disability. Disability can be blindness, deafness, etc.

c) Parent of a child suffering from a disability

d) Charitable hospitals are present in places that come under below taluk level.

e) Badli workers (temporary workers that are employed in a factory)

f) Individual running an educational institute

g) A foreign individual who has been employed by the relevant state

h) Any individual of above 65 years

i) Women who are solely engaged as agents under the Government's Mahila Pradhan Kshetriya Bachat Yojana

Professional Tax Deduction

Yes, there is deduction available of professional tax paid under Section 16 of Income Tax Act, 1961

Consequences of Violation of Professional Tax Regulation

Each state has its own penalty rates for failure to register for professional tax in time and delay in filing the returns. There is also a penalty for missing the due date, which again depends on the state legislation.

For example: In Maharashtra, penalty for late registration is Rs 5/day. There is also an interest of 1.25%/month for late payment, a 10% penalty on the tax amount in the case of non-payment/delay of professional tax, and a penalty of Rs.1000 –2000 for late return-filing.

2.6 Unit End Questions

A. Descriptive Questions

Long questions

1. Define EPF.
2. Define tax computation.
3. List the steps of filing of PF return.
4. Discuss Exemptions in Professional Tax.

Short questions

1. Explain the concept profession tax liability.
2. Describe tax computation.
3. Explain in detail the steps filing of PF return.
4. Discuss ESIC computation.
5. Define EPF and its liability.

B . Multiple Choice Questions

1. Bank advice letter send to ___________
    a. Employee
    b. Normal Bank a/c
    c. Master Bank
    d. None of the above
2. In PayChek to create holiday we have to create __________ first
    a. Employee
    b. Location

c. Emolument

d. All the above

3. There are _______ salary components by default in PayChek.

a. 10

b. 14

c. 20

d. 9

4. If the house of the employee is situated at Mumbai the HRA is ______ of the salary
    a. 40%
    b. 45%
    c. 50%
    d. 20%
5. In Paychek to create employee we have to press________ button
    a. Add
    b. Insert
    c. New
    d. None of the above

Answers: 1. C, 2. B, 3. B, 4. C, 5. C

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UNIT 3- SAP- FINANCIAL ACCOUNTING

STRUCTURE

3.0 Objectives

3.1 Introduction

3.2 ERP

3.3 Enterprise structure

3.4 Financial accounting

3.5 Bank accounting

3.6 Management of vendor and customer

3.7 Asset accounting

3.8 Unit End Questions

3.9 References

3.0 OBJECTIVES

After completing this Students will be able to

- Define ERP
- Understand Management of vendor and customer
- Define financial accounting
- Explain asset accounting

3.1 INTRODUCTION

SAP Financial Accounting (FI) collects and stores business transactions in a way that satisfies external reporting requirements. Due to online integration within itself and with other modules, it allows managers to assess the financial position of the company in real time. It handles financial relations with vendors and customers, such as booking receivables

and payables, sending and collecting payments, issuing dunning notices and account statements. Interface with banks (processing outgoing and incoming payments, posting bank statements) is also done within this module.

Financial Accounting in SAP consists of:

- General Ledger Accounting (FI-GL) - the core of FI and of financials in general, providing the basic financial reports such as balance sheet, P&L statements or data for VAT returns. Due to its importance in the whole financial reporting structure, all "general settings" that are shared by all submodules (e.g., organizational structures, document types or posting periods) are described under this heading.
- Accounts Receivable (FI-AR) - all financial relations with customers
- Accounts Payable (FI-AP) - all financial relations with vendors
- Asset Accounting (FI-AA, formerly known as "Asset Management" FI-AM) - supports acquisition, depreciation and retirement of fixed assets
- Bank Accounting - processing of bank statements

It is online integrated with:

- Controlling (CO) - all postings to P&L or certain fixed asset accounts that are created as cost elements are automatically updated on cost center, internal order or profitability segment reports in controlling and can be further processed from there (settled, allocated etc.). On the other hand, allocations within controlling that cross FI organizational structure (e.g., bookings across profit centers or segments) can be online or periodically transferred back to FI.
- Logistics - all material movements that are relevant for accounting (goods receipts, sales, scrapping, etc.) are online updated in accounts. The same holds about vendor invoices, as soon as they are posted. Sales invoices can be generated online or in batch.
- Project System and Investment Management (PS-IM) - data are updated online in the same way as for Controlling.

The term "business language" refers to accounting. An essential area of accounting is financial accounting. Financial accounting involves documenting, categorising, and summarising financial transactions as well as creating business-related statements in accordance with generally accepted accounting principles and practises. In addition to giving information on the overall operational outcomes of the company, it is primarily meant to assist all parties outside of its operating responsibility, such as shareholders and creditors.

Concept of financial accounting: Financial accounting, broadly speaking, is the disclosure of data about a company or other sort of organisation so that management or staff can evaluate its financial development and future outcomes. In order to state the financial position (balance sheet) as of the end of the period and to determine the results (profit or loss) of business operations during the specific time, financial accounting is used.

Financial accounting is based upon the accounting equation.

Assets = Liabilities + Owners' Equity

This mathematical formula has to balance. Assets are important resources that belong to the company in this case. They are the product of previous transactions or occurrences and reflect a likely future economic advantage. The firm's current liabilities are its debts. These are likely future losses of financial compensation that stem from previous transactions or events. Owners' equity denotes the owners' remaining stake in the company's assets. A different name for owners' equity is residual interest. Owners can directly invest in the company or run it at a profit and reinvest the earnings.

Financial accounting is explicitly described as incorporating the rules and practises to express financial information about a company in management literature. Those with advanced understanding of financial accounting can use this data to make important decisions based on how the firm is considered to be doing financially. These choices could be made while assessing career prospects, making financial loans or credit decisions, or purchasing or selling stock.

3.2 ENTERPRISE RESOURCE PLANNING (ERP)

Enterprise resource planning (ERP) is a platform companies use to manage and integrate the essential parts of their businesses. Many ERP software applications are critical to companies because they help them implement resource planning by integrating all the processes needed to run their companies with a single system.

An ERP software system can also integrate planning, purchasing inventory, sales, marketing, finance, human resources, and more.

- ERP software can integrate all of the processes needed to run a company.
- ERP solutions have evolved over the years, and many are now typically web-based applications that users can access remotely.

- Some benefits of ERP include the free flow of communication between business areas, a single source of information, and accurate, real-time data reporting.
- There are hundreds of ERP applications a company can choose from, and most can be customized.
- An ERP system can be ineffective if a company doesn't implement it carefully.

What Does ERP Do?

ERP applications also allow the different departments to communicate and share information more easily with the rest of the company. It collects information about the activity and state of different divisions, making this information available to other parts, where it can be used productively.

ERP applications can help a corporation become more self-aware by linking information about production, finance, distribution, and human resources together. Because it connects different technologies used by each part of a business, an ERP application can eliminate costly duplicates and incompatible technology. The process often integrates accounts payable, stock control systems, order-monitoring systems, and customer databases into one system.

How Does It Work?

ERP has evolved over the years from traditional software models that made use of physical client servers and manual entry systems to cloud-based software with remote, web-based access. The platform is generally maintained by the company that created it, with client companies renting services provided by the platform.

Businesses select the applications they want to use. Then, the hosting company loads the applications onto the server the client is renting, and both parties begin working to integrate the client's processes and data into the platform.

Once all departments are tied into the system, all data is collected on the server and becomes instantly available to those with permission to use it. Reports can be generated with metrics, graphs, or other visuals and aids a client might need to determine how the business and its departments are performing.

A company could experience cost overruns if its ERP system is not implemented carefully.

Benefits of Enterprise Resource Planning

Businesses employ enterprise resource planning (ERP) for various reasons, such as expanding, reducing costs, and improving operations. The benefits sought and realized between companies may differ; however, some are worth noting.

Improves Accuracy and Productivity

Integrating and automating business processes eliminates redundancies and improves accuracy and productivity. In addition, departments with interconnected processes can synchronize work to achieve faster and better outcomes.

Improves Reporting

Some businesses benefit from enhanced real-time data reporting from a single source system. Accurate and complete reporting help companies adequately plan, budget, forecast, and communicate the state of operations to the organization and interested parties, such as shareholders.

Increases Efficiency

ERPs allow businesses to quickly access needed information for clients, vendors, and business partners. This contributes to improved customer and employee satisfaction, quicker response rates, and increased accuracy rates. In addition, associated costs often decrease as the company operates more efficiently.

ERP software also provides total visibility, allowing management to access real-time data for decision-making.

Increases Collaboration

Departments are better able to collaborate and share knowledge; a newly synergized workforce can improve productivity and employee satisfaction as employees are better able to see how each functional group contributes to the mission and vision of the company. Also, menial and manual tasks are eliminated, allowing employees to allocate their time to more meaningful work.

ERP Weaknesses

An ERP system doesn't always eliminate inefficiencies within a business or improve everything. The company might need to rethink how it's organized or risk ending up with incompatible technology.

ERP systems usually fail to achieve the objectives that influenced their installation because of a company's reluctance to abandon old working processes. Some companies may also be reluctant to let go of old software that worked well in the past. The key is to prevent ERP projects from being split into smaller projects, which can result in cost overruns.

Employing change management principles throughout the ERP life cycle can prevent or reduce failures that compromise full implementation.

ERP Solutions Providers

Some familiar names are leaders in ERP software. Oracle Corp. (ORCL) originally supplied a relational database that integrated with ERP software developed by SAP (SAP) before entering the broader enterprise market in a big way in the early 2000s.1 Microsoft (MSFT) has long been an industry leader, with many customers using multiple software applications from the company.2

As cloud-based solutions have grown in popularity in recent years, the traditional ERP industry leaders have seen challenges from upstarts such as Bizowie and Workwise.34

ERP Examples

Fulton & Roark

Men's grooming product maker Fulton & Roark successfully implemented enterprise resource planning to better track inventory and financial data. Like many other businesses, the North Carolina company used spreadsheets to track inventory and accounting software to record financial data.5

As the company grew, its processes lagged. Their antiquated inventory tracking system did not account for changing costs, and the accounting software could not record the metrics needed for key financial statements. These breakdowns created manual processes, which further compromised time and resources.5

To eliminate unnecessary processes and centralize work, they chose the Oracle NetSuite ERP system. Immediately, Fulton & Rourk was better able to identify accounting errors related to inventory, eliminate costs from employing third parties to evaluate their financial records, and better report financial positions.6

Cadbury

Cadbury, a global confectioner and maker of the popular chocolate Cadbury egg, also successfully implemented an ERP system. The company had thousands of systems but could not keep pace with its rapid growth and used ineffective warehouse management systems.7

It implemented a system that integrated its thousands of applications, standardized processes, and restructured warehouse management systems—breaking down silos for seamless, integrated coordination of work.8

What Is the Importance of Enterprise Resource Planning?

Enterprise resource planning software offers single-system solutions that integrate processes across the business. These applications allow users to interact within a single interface, share information, and enable cross-functional collaboration. They increase productivity, collaboration, and efficiency.

What Are the 5 Components of ERP?

The components of an ERP system depend on the organization's needs. However, there are key features that each ERP should include. Generally, packages include finance, human resource, logistics and manufacturing, supply chain management, and customer relationship management.

What Are the Types of ERP?

Generally there are three deployment options for ERP systems; Cloud-based, on-premise, and a hybrid of the two. Within these options, a business can choose from hundreds of types such as finance, supply chain management, and human resource management.

What Are the 2 Main ERP Applications?

Which ones are the main applications depends on the business and the industry it operates in. Most companies can benefit from supply chain management, logistics, and financial applications to help them streamline their operations and expenses.

The Bottom Line

Enterprise resource planning (ERP) manages and integrates business processes through a single system. With a better line of sight, companies can better plan and allocate resources. Without ERP, companies tend to operate in silos, with each department using its own disconnected system.

ERP systems promote the free flow of communication and sharing of knowledge across an organization, the integration of systems for improved productivity and efficiencies, and increased synergies across teams and departments. However, moving to an ERP system will be counterproductive if the company's culture does not adjust to the change and the company does not review how the structure of its organization can support it.

Why is ERP important for business?

While there’s no all-up solution for every business process, ERP technology is getting better and better at bringing processes together. After your processes, systems, and data are connected, you’ll get the business intelligence, acceleration, and adaptability you need to start optimizing your operations.

Here are three ways an ERP system can improve your business:

1. **Drive optimal performance.** With solutions that use AI, you’ll access insights that enhance your decision making and reveal ways to improve operational performance going forward.

2. **Accelerate operational impact.** By connecting processes and data, you'll bring more visibility and flexibility to employees, helping them take action quickly and deliver more value across the business.
3. **Ensure business agility.** Many ERP solutions are built to adapt to your needs and grow with you, helping you proactively prepare for—and readily respond to—any operational disruption or market change

.

What business functions can be optimized with ERP?

An ERP system can cover many core functions across your organization—helping break down the barriers between the front office and back office while offering the ability to adapt your solution to new business priorities. Some of the key business functions include:

Commerce

Today's retailers face many challenges, and an ERP system can deliver a complete, omnichannel commerce solution that unifies back-office, in-store, and digital experiences. Customers get a more personalized and seamless shopping experience through AI recommendations, while retailers increase employee productivity, help reduce fraud, and grow their business.

Finance

Modern ERP increases profitability while driving compliance. It offers dashboards and AI-driven insights that give an overview of your finances to help you tap into the real-time information anytime and anywhere. It should also cut down on entering information manually by automating daily tasks and include tracking abilities that help with your business's regulatory compliance.

Human resources

Modern solutions offer ways to manage company data and streamline employee management tasks like payroll, hiring, and other duties. You'll be in a better position to help retain, recruit, and empower employees while also tracking employee performance and to help you identify HR problems before they happen.

Manufacturing

This ERP capability improves business communication, automates daily processes through robotic process automation, and offers manufacturers the ability to fulfill customer needs and manage resources by accessing real-time data. It also optimizes project management, cost management, and production planning.

Supply chain

If your company is still entering information by hand and trying to track down inventory in your warehouse, you can save time and money by automating these processes with ERP. Modern supply chain solutions also offer dashboards, business intelligence, and even Internet of Things (IoT) technology to help you get a handle on your inventory management.

Three signs that you need ERP software

If you're reading this and struggling with your legacy system, you might be wondering if this is the right time to make a change. Here are some signs that you need new ERP software:

1. **The basics aren't letting you grow:** Perhaps you've been doing fine with basic tools, but if your current software is putting limits on your market expansion and ability to grow on a global scale, it may be time for a better ERP system that is flexible enough to allow for growth.
2. **You're dealing with disparate systems:** As technology changes, you're noticing that your disparate systems don't work well together. You may notice that your new accounting software isn't compatible with your old HR system, and you're tired of wasting time and resources trying to stitch a solution together.
3. **You can't meet customer expectations:** If your staff and customers are mobile and your system isn't accommodating them, it's time to invest in one that meets everyone's needs. Giving your staff the tools they need to succeed and investing in meeting your customers' expectations can help you maintain your competitive edge.

Three ERP implementation challenges for businesses

Despite all the options out there, some companies are still hesitant about implementing ERP. There could be many reasons why, but where there's a challenge, there's a solution.

Choosing the right ERP solution.

You don't have to find the perfect software solution to fix everything. ERP should be able to take the best of the business processes you're using now and bring them together under one system that allows everyone in your organization to view the same information. This is why choosing the right technology partner is important.

Affording the cost of an ERP system.

A solution doesn't have to be an all-or-nothing implementation. Software solution modules can be purchased separately according to your business needs. This will help your team ease into the implementation piece of ERP, and it'll save you from having to invest in a major software renovation without knowing whether the functions you're adding will pay off.

Integrating new ERP software with existing software.

As we mentioned, any ERP solution you choose should work with what you're using now but also include features that can help in your future growth. For instance, if the software you have mostly handles the financial, supply chain, and manufacturing sides of your business, you may want to look for a solution that brings in a strong business intelligence component.

3.3 ENTREPRISES STRUCTURE

SAP FI enterprise structures are the bedrock of the financial solution; without them, you couldn't integrate and configure your program.

So if you've decided to make the switch to Financial Accounting with SAP, it's important to understand the basics of the program. After all, without that background info, running SAP FI wouldn't do you much good.

What is an Enterprise Structure?

SAP defines the enterprise structure as "the definition of specific organizational units that together represent your company's business units and divisions." Enterprise structures are the bedrock of the SAP FI solution; without them, you couldn't integrate and configure your program. You couldn't run SAP FI at all.

So which enterprise structures do you need in order to run SAP FI? Let's take a look at them.

Company and Company Codes

A company is defined by SAP as "an organizational unit in accounting that represents a business organization according to the requirements of commercial law in a particular country." This is the highest level of organization for accounting. To get the idea—Alphabet, which oversees many, many businesses such as Google and Calico, could be considered a company. Each of these subsidiary businesses, all doing their own things while united under Alphabet's organization, is assigned a *company code*. These identifiers help differentiate each entities' finances among the large corporate pot.

Company codes are usually assigned to legally independent companies, but sometimes are assigned to legally dependent companies if they are operating abroad with external reporting requirements.

Credit Control Area

The credit control area serves as the main hub where decisions on customer credit are made. It specifies and checks the limit for each individual customer in both accounts receivable and sales and distribution.

This can be done in one of two ways: a *decentralized* approach or a *central management* approach. In the former, a separate area is assigned to each company code. This allows credit to be awarded within a singular relationship.

But sometimes a customer will be involved with multiple company codes. This is where the central management approach comes into play. This combines all the different iterations of

the same customer within different company codes into one control area, streamlining the credit checking and assigning process.

Segments

Segments are divisions of a company that create revenue. Per GAAP and IFRS, you must be able to provide a balance sheet at the segment level. By identifying segments in SAP FI, you can easily create the necessary financial statements for external reporting requirements.

Profit Center

While segments are used for external reporting, *profit centers* are internal units. They allow better controlling because you can follow the money in each unit and assign responsibility in accordance with results. Likewise, profit centers that are doing poorly are easier to identify and correct because their inefficiencies aren't easily masked by the surplus of a well-performing group.

Business Areas

Though not as popular as they were in the past, *business areas* still play an important role in the internal identification of separate areas of responsibility. Similar to segments, business areas build out the balance sheet required by external forces. Under the New G/L, however, business areas and segments are considered so similar that one can be used in place of the other. Segments get the nod.

Functional Areas

Functional areas allow you to assign costs to specific areas within the business—things like administration, sales, production, and so on. From there, it's easy to create profit and loss statements for each aspect of the business, allowing you to dig in and figure out where costs are bleeding and where you can make more.

Financial Management Area

Financial management (FM) areas are units that look at the business from a cash budget management and funds management perspective. Company codes are assigned to FM areas, which in turn create the reports.

Enterprise structure is the organization structure as represented in SAP system. Enterprise structure is the basis for the configuration of other parameters. It's primarily defined with three primary domain areas and is very similar to the finance organization structure used in an organization or sales organization structure used in SAP.

- Finance & Controlling
- Sales and Distribution
- Logistics

Finance and controlling

Following are the elements of FICO related Enterprise structure

- Operating Concern
- Controlling area
- Company code
- Credit control area

Sales and Distribution

SD related enterprise structure defined under the company code is.

- Sales organization
- Distribution channel
- Division
- Sales offices
- Sales group

Logistics

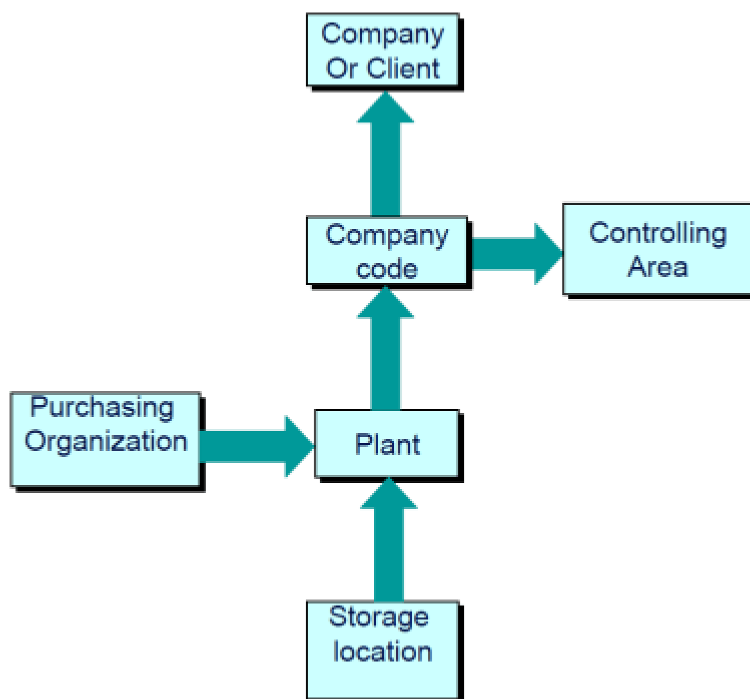


Fig.3.1 Logistics

Logistics related enterprise structure defined under the company code are

- **Plants** – Plant describes the place where the production activities are performed or goods and services are provided. It is attached to the company code.
- **Storage locations** – It represents the physical area within a plant where the materials are stored. It is attached to a plant.

- **Purchase organizations** – It is responsible for procuring material and services, negotiation of price with the vendor. It can be assigned to company code to make it company specific or assigned to plant to make it plant specific
- **Purchasing group** – Represents a buyer or group of buyer responsible for certain purchasing activities.

Financial Organisation Structure

Organization unit is the highest level in the ERP system hierarchy. Specifications or data which shall be valid for all ERP organizational units in all applications are entered at the client level, eliminating the need to enter this information more than once (e.g. exchange rates). Each client is a self-contained unit which has separate master records and a complete set of tables and data. Users must enter a client key and have a user master record in the client in order to log on to the system.

Controlling Area

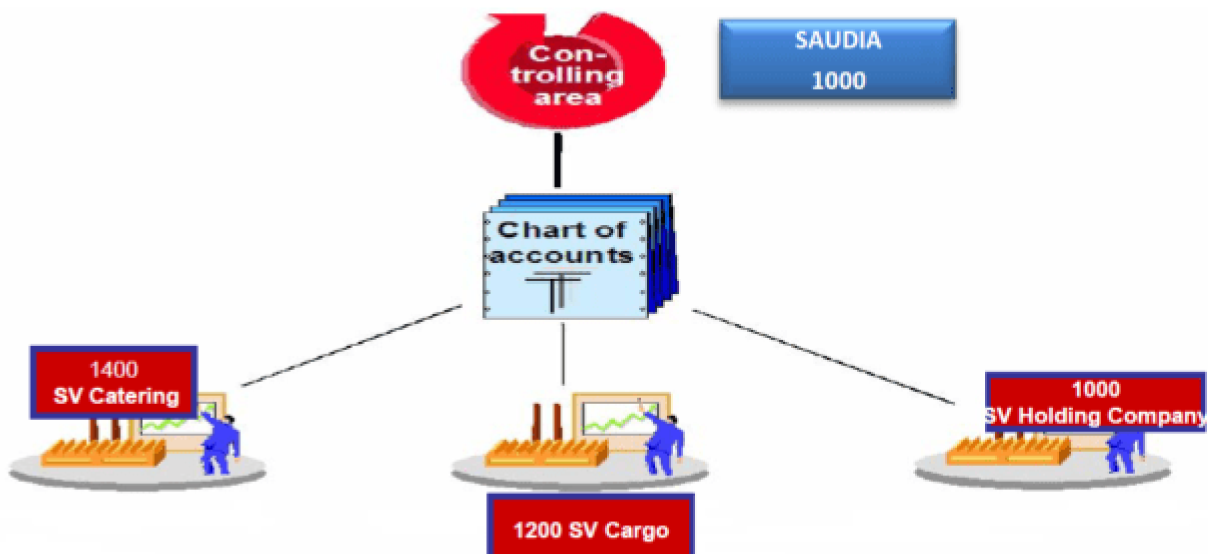


Fig.3.2 Controlling Area

The controlling area identifies a self-contained organizational structure for which costs and revenues can be managed and allocated. It represents a separate unit of cost accounting. One or more company codes can be assigned to a controlling area, which enables you to carry out cross-company code cost accounting between the assigned company codes. However, this is only possible if the assigned company codes and the controlling area all use the same operating chart of accounts.

Company Code

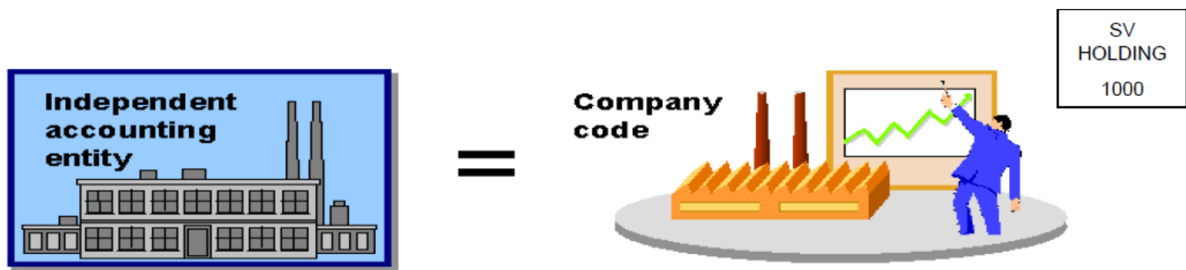


Fig.3.3 Company Code

A company code is an independent accounting entity (the smallest organizational element for which a completely self-contained set of accounts can be drawn up). An example is a company within a corporate group. It has a unique, four character key. The general ledger is kept at the company code level and is used to create the legally required balance sheets and profit and loss statements.

- A company code designation is required for every financially based transaction entered into R/3. This is done either manually or automatically by deriving the company code from other data elements.
- Company code is assigned to a chart of accounts (COA) which can be used by multiple companies provided they have the same basic account requirements

Chart of Accounts

The chart of accounts is a variant which contains the structure and the basic information about general ledger accounts.

- You define the chart of accounts with a 4 character identifier.
- You define the components of the chart of account, e.g. language, length of the G/L account number.
- The length of the G/L account number can be from 1 to 10 digits.
- The chart of accounts has to be assigned to every company code which would like to create accounts based on the defined structure.

Cost Controlling Objects

The controlling area contains CO objects that take on various functions within Controlling. such as:

- Internal orders
- Cost objects
- Networks
- Projects
- Cost centers

Fiscal Year

All company codes must be assigned to a fiscal year period.

Creating a Sales Organisation Structure

This is the highest level of the hierarchy and is, therefore, set up first. The company example used here has just one sales organization. Once this sales organization is defined, it can then be assigned to the company code. The different ways products are marketed are then configured by defining the various distribution channels. Once these distribution channels are defined, they are then assigned to the appropriate sales organization. Groupings of materials, referred to as divisions, are then created. These divisions (grouping of materials) are then linked to the sales organization. After the three areas (sales organization, distribution channel, and division) are linked, a sales area is created. Now that the entire sales area is formed, it can be used in the crucial pricing decisions made later.

Creating a Sales Organization

From the IMG Screen: Enterprise structure -> Definition -> Sales and Distribution -> Define, Copy, Delete, Check Sales Organization

Start by double-clicking the Define sales organization line or selecting it and clicking Choose. At the next screen, click the New entries button.

Enter the following:

- Sales Organization: SO_ _
- Description of Sales Organization Name
- Address text name ADDRESS_SENDER
- Letter header text: ADDRESS_HEADER
- Footer lines text: ADDRESS_FOOTER
- Greeting text name: ADDRESS_SIGN
- Sales Org. calendar: US
- Rebate proc. Active: Make sure this box is checked

Click the Address button or hit Shift+F5, on this screen enter the following:

- Postal Code/City: 86011, Flagstaff (Sales Organization zip code and city)
- Country/Region: US, AZ (Country and State)
- Language: English

Click Save, then click Enter.

Assigning New Sales Organization to Company Code

From the IMG Screen: Enterprise structure -> Assignment -> Sales and Distribution -> Assign Sales Organization to Company Code

From the initial screen, scroll down if necessary and double click your company code. One the screen that appears, check the unassigned sales organization(s) for your company, then click enter.

Review all new assignments then click Save. The above screen shows the assignment. Your sales organization has now been assigned to your company code.

Definition of Distribution Channels

From the IMG Screen: Enterprise structure -> Definition -> Sales and distribution -> Define, Copy, Delete, Check Distribution Channel

Double click Define distribution channel or select the line and click Choose. Click the New entries button, then enter your distribution channels as shown:

Distr. Channel-Name

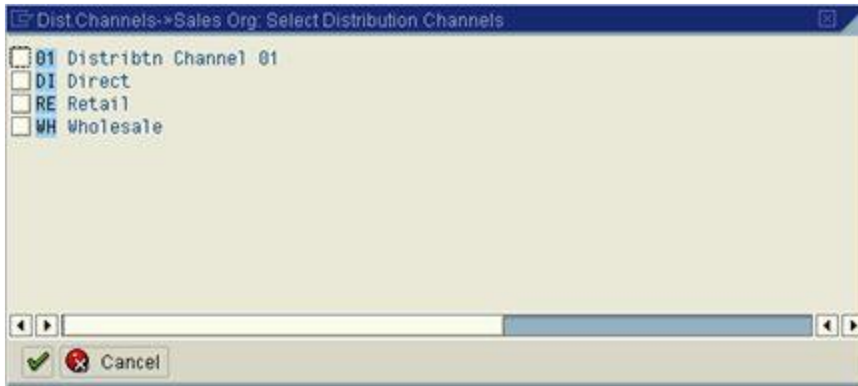
- DI- Direct
- WH-Wholesale
- RE-Retail

Click Save to record the new definitions, review entries.

Linking Sales Organization to Distribution Channels

From the IMG Screen: Enterprise structure -> Assignment -> Sales and distribution -> Assign distribution channel to sales organization

At this screen, find the sales organization you created and assigned to your company code. Double click your sales organization or select that line and click Assign, this will bring up a screen listing all of the distribution channels that are available to your sales organization. This list should include the channels that were just set up and any that existed in the system previously.

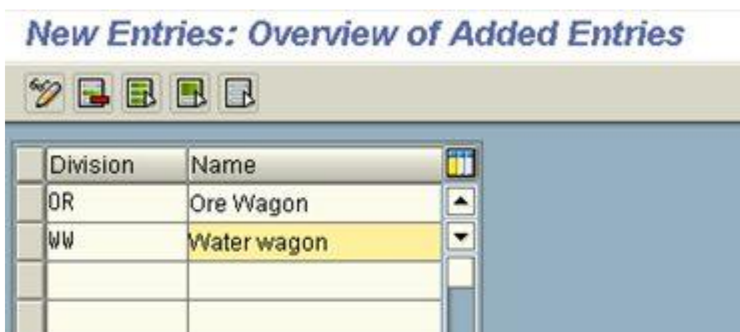


Check the channels that were created in the section above: DI, WH, and RE. Now click Enter. Once you have returned to the first screen, scroll up and review the assignments just made. Click Save before exiting to record the assignment changes.

Defining Divisions

From the IMG Screen: Enterprise structure -> Definition -> Logistics general -> Define, Copy, Delete, Check Division

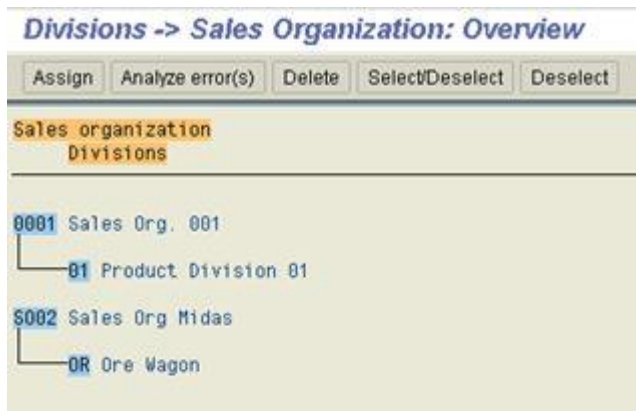
Double-click Define Division, or select the line then click the Choose button. On the very next screen, click the New entries button. On this screen, create your new divisions, then click Save.



Assigning Divisions to Sales Organizations

From the IMG Screen: Enterprise structure -> Assignment -> Sales and distribution -> Assign division to sales organization

From this screen, double-click your sales organization, or select it and click the Assign button. Check the relevant divisions created in the previous step to accept, then click enter. Scroll up to review the assignments, they should look similar to the following screen, now click Save to keep new assignments.



Setting up the Sales Areas

From the IMG Screen: Enterprise structure -> Assignment -> Sales and distribution -> Set up sales area

From this screen, double-click your sales organization, or select it and click the Assign button. Select the distribution channels individually, then select the sales area that needs to be assigned to that distribution channel. Review the entries, they should look similar to those set up to the right. Click Save once all the selections and assignments have been made.

3.4 FINANCIAL ACCOUNTING

Financial accountancy is directed by both local and international accounting standards. Generally Accepted Accounting Principles is the standard framework for guidelines for financial accounting used in any given jurisdiction. It encompasses the standards, conventions and rules that accountants follow in recording and summarising and in the preparation of financial statements. Conversely, International Financial Reporting Standards

is a set of international accounting standards stating how particular types of transactions and other events should be reported in financial statements.

Financial accounting process

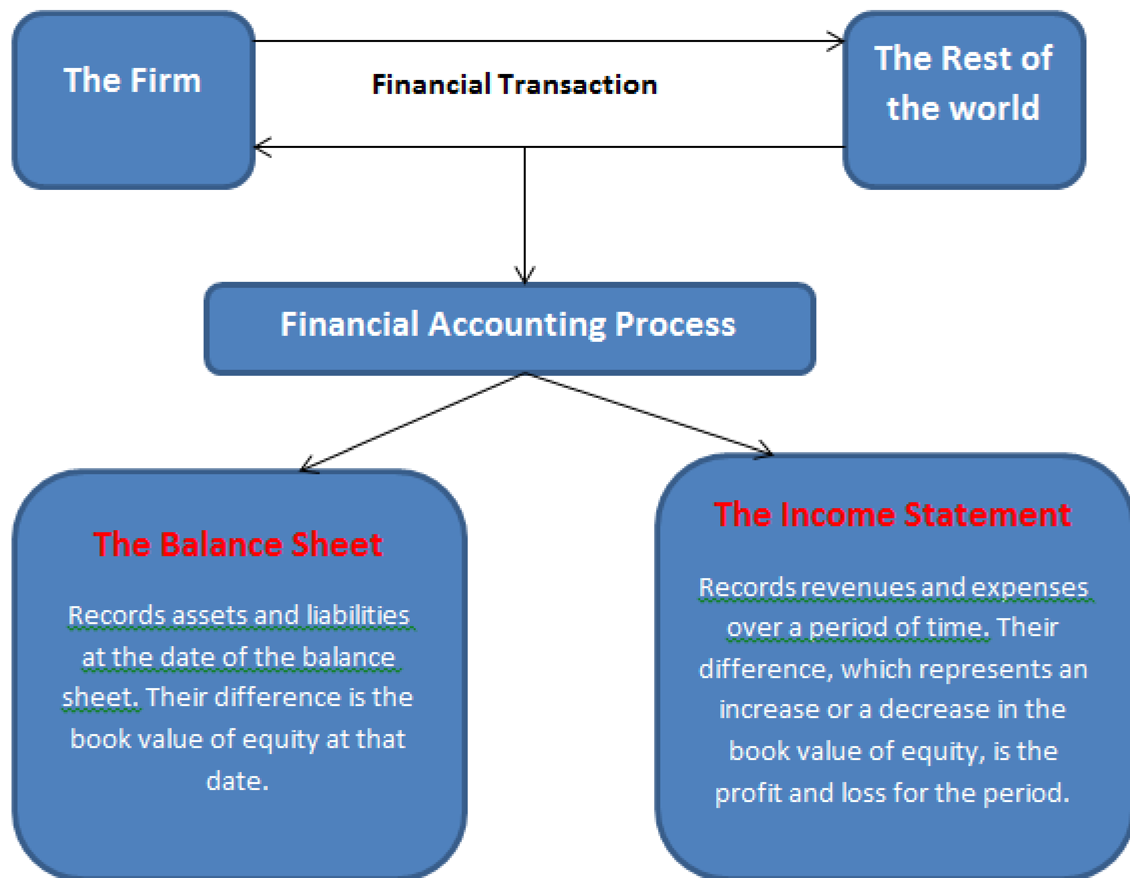


Fig.3.4 Financial accounting process

Basic features of financial accounting are as under:

Relevance: Financial accounting is decision-specific. It must be possible for accounting information to influence decisions. This trait is important for developing statements.

Materiality: Information is material if its error or misstatement could influence the economic decisions of users taken on the basis of the financial statements.

Reliability: Accounting must be precise or unbiased. It should be capable to be relied upon by managers. Often information that is highly relevant isn't very reliable, and vice versa.

Understandability: Accounting reports should be clearly understood to accountant and by those at whom the information is aimed.

Comparability: Financial reports from different periods should be comparable with one another in order to derive meaningful conclusions about the trends in an entity's financial performance and position over time. Comparability can be ensured by applying the same accounting policies over time.

Scope of financial accounting: Financial accounting systems primarily provide external decision makers with categorised and summarised information about the operation of a firm. It gives data on how businesses are doing, including if they are profitable. Preparing a profit and loss account and balance sheet for reporting to owners and outside parties is the primary goal of financial accounting (Bhar, 1976). By creating general purpose reports, it aims to provide relevant information that will aid creditors, investors, and other users in making wise financial and investment decisions. These reports serve a broad purpose by providing data on management performance so that it may be evaluated for resource use and business operations. (Jawahar Lal, 2009).

Financial statements, such as a profit and loss account, are the final result of the financial accounting system and provide decision makers with useful information. The concept of a double entry system is the foundation for the accounting methods used in financial accounting. In terms of the monetary units of the community in which it functions, financial accounting measures general business transactions, economic resources, financial responsibilities, and changes in them (Jawahar Lal, 2009). Financial statements are used by management for internal purposes. While making decisions that have an impact on a company's financial situation, they analyse financial statements. (Kimuda, 1986).

Importance of finance accounting: Financial accounting is crucial for all business types. The value of financial accounting can frequently go undetected by small business owners. The documenting of transactions is useful in financial accounting. Also called as bookkeeping, this accounting function. Financial accounting is used by small businesses to log transactions in the ledger of the organisation. Due to the double-entry technique used in financial accounting, each transaction has an impact on two accounts, which reflect the two sides of a transaction.

Accounting practises are used by all small business owners to maintain track of their operations. The ledger is used for this. Double-entry accounting is used in finance. As both sides of any transaction are impacted, this is nothing new. The double-entry system thus has an impact on two accounts. This offers a systematic and transparent approach to the business's operations. Financial accounting is very advantageous in this regard. Financial accounting is used to transmit information to third parties. These are persons who are interested in business operations but are not directly involved in the firm. This is accomplished by distributing the company's financial statements to third parties. These are the final outcomes of the way business was done.

There are good reasons to explain the value of financial accounting. Financial accounting is essential for sharing information with others inside the company as well. We refer to them as internal users. Organizations can benefit from financial accounting because it gives small-business owners the tools to analyse their rivals and assess potential investment opportunities. For every business, financial accounting regulations apply. Since every organisation employs the same approach of analysis, comparing one company to another is made simpler for business owners. Small business owners can obtain a ratio of the businesses and use this ratio to contrast competitors because it is a common method of analysis.

Advanced Financial Accounting, in conjunction with social and economic development, financial accounting for the original content to supplement, extend, and develop an accounting, that is intrinsic in the use of financial accounting methods, financial accounting does not include the existing business, as well as objective changes in the economic environment, some of the special business to generate new ideas to reflect the accounting and supervision of accounting. Intermediate financial accounting and accounting concepts work together to produce a full financial accounting system.

Drawbacks of Finance Accounting

The fact that financial accounting allows for multiple approaches is its primary drawback. Accounting is undoubtedly founded on concepts and adheres to "generally accepted accounting principles," but there are multiple principles that might be used to treat every given item. This enables different approaches to be used within the bounds of generally accepted accounting standards.

Second, even if financial accounting adheres to the rule of objectivity, estimates must be made, which entails the use of judgement. In order to record some events, estimates must be made. Future estimates cannot be expected to be precise, and impartiality suffers as a result.

Financial accounting also has the flaw of ignoring crucial non-monetary data. Only transactions and events that can be valued in money are considered in financial accounting. Even if they are significant, non-monetary transactions and events are overlooked, or not documented.

Information provided by financial accounting is not timely. The purpose of financial accounting is to provide data in the form of statements (such as a balance sheet and profit and loss account) for a given time frame, often one year. Hence, only a post-mortem analysis of the past can be done because the information is of historical importance. In order for management to plan and take remedial action, the company needs timely information often.

Comprehensive analysis is not provided by financial accounting. The data provided by financial accounting is actually an agglomeration of the financial transactions that took place throughout the year. Of course, it makes it possible to examine the overall effects of business activities over the duration of the accounting period. The cost, sales, and profit of each product must be known in order for the business to operate properly, but financial accounting does not offer this level of product-specific knowledge.

Financial accounting does not reveal the present value of the business. In financial accounting, the position of the business as on a particular date is shown by a statement known as balance sheet. In balance sheet the assets are shown on the basis of going concern concept. Therefore, it is presumed that business has comparatively longer life and will continue to exist indefinitely, hence the asset values are going concern values. The realised value of each asset if sold today cannot be identified by studying the balance sheet.

To summarize, financial accounting are basically, financial statements means of communicating financial information to parties outside the business organization. Financial accounting is a subsection of accounting in which money is seen as a device to gauge financial performance. Financial accounting includes the monitoring and controlling of the flow of money into and out of a company. Those flows are documented on financial statements such as the balance sheet, income statement and cash flow statement which provide insightful information to external parties who have a vested interest in the company's performance. This includes lenders and investors. Various studies have shown that financial accounting is a system that amasses, processes and reports information about an entity's performance (i.e. profit or loss), its financial position (i.e. assets, liabilities and shareholders' equity) and changes in financial position. Main intent of financial accounting is preparation of general purpose financial statements, which are financial statements meant for use by stakeholders, external to the entity, who do not have any other means of getting such information.

What are the three fundamental concepts of accounting?

To be able to do accounting, you should understand some of its central concepts. The 3 fundamental concepts of accounting are:

Accruals concept

The accruals concept states that revenues can be recognised only when they are earned, and expenses, when assets are used. This means that businesses do not have to go by cash value when they recognise profits, losses and revenue. For example, if your company sells a product, the value of that product will have to factor in additional costs like customer support

and logistics, and not just the cost of production. It is general practice among auditors to verify that a company's financial statements are prepared following the accruals concept.

Going concern concept

In accounting, it is always assumed that a business remains in operation in future time periods. Expenses and revenue may be pushed to future periods, depending on the situation. For example, companies can defer debt amounts (or portions of it) to their next financial quarters, under the assumption that they will be operational in the future. Without the going concern concept, all potential future expenses will have to be accounted for in the current period and this can make it difficult for businesses to function, especially if they rely on credit/loans to function.

Economic entity concept

The economic entity concept maintains that business transactions be kept separate from the business owner's personal transactions. Auditors have to verify that there is no mixing of business and personal transactions in a company's financial records. If any person, including the owner, uses company funds for their own personal transactions, it is considered embezzlement of funds, which has legal and professional ramifications.

What are the basics of accounting?

To understand the basics of accounting, it is important to look at its three main components and the terminology related to these components. The basic components of accounting are:

Records

Companies must identify a clear approach to record-keeping, before they begin the accounting process. They have to set up some basic accounts in which to store information. Accounts fall into the following classifications:

- **Assets:** These refer to resources or items that the company owns. Assets have future economic value that can be measured and can be expressed in monetary terms. Examples of a company's assets include investments, cash, inventory, accounts receivable, land, supplies, equipment, buildings and vehicles.
- **Liabilities:** These refer to the legal financial obligations or debts that companies incur during business operations. Liabilities can be limited or unlimited. They are settled over time through the transfer of economic benefits such as money, services or goods. Recorded on the right side of a company's balance sheet, liabilities include any payable amounts, loans, mortgages, earned premiums, deferred revenues and accrued expenses.

- **Equity:** Equity, also known as shareholder's equity, refers to the amount of money that a company must return to its shareholders after all of its assets are liquidated and all of its debt is paid off. Equity is calculated by subtracting a company's total assets to its total liabilities.
- **Expenses:** Expenses refer to the costs of operations that businesses incur to generate revenue. Common expenses include employee wages, payments to suppliers, equipment depreciation and factory leases.
- **Revenue:** Revenue refers to the income that a company generates from its normal business operations. It includes deductions and discounts for returned products. Revenue is the gross income figure from which costs are subtracted to determine net income.

Transactions

The accountant is responsible for generating a number of business transactions, while others are forwarded to the accountant from other departments of a company. As part of these transactions, they are recorded within the accounts mentioned in the first point. Some crucial business transactions include:

- **Sales:** These are transactions in which products/services are transferred from buyers to sellers for cash or credit. Sales transactions are recorded in the seller's accounting journal (a document that contains a summary of the transaction) as a credit to the sales account and a debit to cash or accounts receivable. Sales typically involve the creation of an invoice to be sent to the customers, detailing the amount that the customer owes.
- **Purchases:** These are transactions that businesses require in order to obtain materials and services necessary to accomplish their goals. Purchases made in cash are recorded as a debit to the inventory account and a credit to cash. If the purchase is made with a credit account, the credit entry would be recorded in the accounts payable account and the debit entry would be recorded in the inventory account. Purchases often involve the issuance of purchase orders and disbursement of supplier invoices.
- **Receipts:** These are the transactions that refer to a company getting paid for providing services or goods to customers. The receipt transaction is recorded in the journal for the seller as a credit to accounts receivable and a debit to cash.
- **Employees' compensation:** This requires information about the number of hours that employees spent at paid labour, which is then used to generate tax deductions, gross wage information and other deductions, which result in net pay to employees.

Financial statements

Once all the company's transactions related to an accounting period have been completed, the accountant consolidates the information stored in the accounts and sort it into three documents that are collectively called financial statements. These statements include:

- **Income statement:** This document contains information about the company's revenues and deducts all expenses incurred to determine the net profit or loss for the reporting period. It measures the ability of a company to expand its customer base and operate efficiently.
- **Balance sheet:** This document contains information about a company's assets, liabilities and equity as of the end of the reporting period. It shows the financial position of an organisation as of a point in time and is carefully reviewed to determine an organisation's ability to pay its bills.
- **Statement of cash flows:** This document contains information about the uses and sources of cash during the reporting period. It's especially useful when the amount of net income that appears on the income statement is different from the net change in cash during the reporting period.

What are the five basic principles of accounting?

These are five basic principles of accounting that are important:

Revenue principle

The revenue principle, also called the ‘revenue recognition principle', determines when accountants may record transactions as revenue in their books. It states that businesses earn revenue when customers gain legal possession of a service or product, and not at the point of cash transaction between the company and the customer.

Expense principle

The expense principle is similar to the revenue principle, but it deals with expenditure. The principle determines when an accountant can record a transaction as an expense in their books. It states that expenses occur when businesses accept the services or goods of another entity, regardless of when they may be billed for it.

Matching principle

The matching principle states that a company should match all its revenue items with a corresponding expense item. For example, if your company makes garments, you should account for the cost of production, like fabric, dyes, threads, equipment and labour, and match it with the revenue the company earn when a customer purchases that product at a given price. Businesses who follow the revenue, expense and matching principle are said to operate under accrual accounting methods.

9 Accounting Principles

Here are 9 accounting principles you must know before stepping into the accounting industry:

Monetary unit principle

The monetary unit principle states that all business transactions must be in terms of money and Indian currency (₹). Money is the common unit used for recording business transactions such as capital, assets and liabilities. A business cannot report its assets as three buildings, two machines or one brand name. That is why the monetary unit stresses reporting only those transactions that you can express in monetary terms. However, you may record other types of transactions separately. The principle assumes that the purchasing power of money remains unchanged with time. This principle does not give importance to the concept of inflation.

For example, your organisation purchased a building worth ₹20 lakhs in 2012. Due to inflation, the building costs ₹40 lakhs in 2016. You cannot reflect the same in your accounts as per the monetary unit principle.

Going concern principle

The going principle assumes that a business is likely to continue its activities for an indefinite period. It means that the organisation will not liquidate and will not be dissolved. Because of this principle, accountants can treat some items as assets instead of expenses because the business will operate and reap benefits from the asset in the future as a going concern.

For example, accountants report purchases of machinery as an asset instead of an expense because, as per the going concern principle, the organisation will continue in the foreseeable future. This helps the accountant allocate the cost of the machinery over its useful life.

The going concern principle is beneficial for investors, as it gives assurance that they will receive a return on their investment. The absence of going concern accounting principle will ensure that organisations report their expenses without deferring them.

Dual aspect of the duality principle

The duality principle of accounting suggests that every business should record its transactions in two separate accounts. Each transaction has an equal and opposite impact on the business. This concept is the foundation of double-entry bookkeeping and essential for creating financial reports. The equation of the dual aspect principle is:

Assets = Liabilities + Equity

The principle explains that there will be both a credit and debit for the same amount when a transaction occurs. For example, when organisations purchase computers and laptops through cheques, the accountant considers the transaction's two-fold effect. The credit side is owning machinery and the debit side is the reduction in the bank balance.

This accounting principle helps auditors find out potential loopholes and errors in the financial statements.

Cost principle

The cost principle states that a business should record its assets at the purchase price and not the market price. The purchase price includes the installation and transportation charges.

For example, if an organisation purchases a piece of cosmetic manufacturing machinery for ₹2,00,000 and spends ₹2,000 on installation and ₹800 on transportation, the machinery's purchase price would be ₹2,02,800. If the same machinery's current market price is ₹5,00,000, the accounting books will still reflect ₹2,02,800 as the purchase price.

As the cost principle deals with cost in the past, the purchase price is known as the historical cost. So, the cost principle implies that if organisations pay nothing for acquiring the assets, they cannot include the asset in their financial statement. For this reason, goodwill appears in the financial statements only when organisations pay the price for this intangible asset.

Realisation principle

The realisation principle states that a business should record the revenue from any business transaction only when realised. According to this principle, a business earns revenue when the organisation gives its goods and services to a customer through cash or some asset in exchange. In short, the realisation accounting principle states that revenue is realised when a business earns it and not when it collects the revenue.

For example, a SaaS company receives an order for supplying software worth ₹4,00,000. The company supplies SaaS software worth ₹1,00,000 by 31st December 2021 and the rest of the order they supply in January 2021. The 2020 revenue for the SaaS company would be ₹1,00,000 because merely getting an order is not revenue until the goods or services reach the customer.

Accrual principle

One of the essential principles of accounting is the accrual principle. It states that a business must record the transactions during the accounting period in which they occur, irrespective of when the business receives the cash flow for the transaction. In short, a business must record the accrued income in the period in which it arises rather than the subsequent period in which the business will receive the income. Similarly, a business must record the accrued expenses in the accounting period in which it occurs rather than the period in which the business receives the payment.

Furthermore, this accounting principle advocates that a business must show all the prepaid expenses in the accounting period in which the business pays for it. The accrual accounting

principle is essential because it ensures that expenses match the revenue in an accounting period.

For example, utility companies in India usually bill customers once a month for their service, whether it is electricity, water or gas. The company's accountant records the revenue when it bills the customer at the end of the month, even though the customer will submit the payment in the subsequent month.

Matching principle

The matching principle directs that a business should report expenses on the income statement for the accounting period in which the business earned its related revenue. So, once the revenue becomes receivable, the business should allocate it to an appropriate accounting period with the accrual principle's help. If the business postpones the revenue to the next accounting period due to some circumstances, it should postpone the expenses to that accounting period.

For example, if a jewellery store spends ₹1,80,000 on social media marketing in 2018 with marketing strategies likely to benefit three accounting periods, 2018, 2019 and 2020, then in such a case, only ₹60,000 is an expense incurred in 2018. The accountant will report the remaining amount in 2019 and 2020.

Consistency principle

Applying the consistency principle would mean that once a business adopts an accounting principle or method, they must follow this method or principle for all their accounting periods until an alternative method or principle comes into the market.

The consistency principle is beneficial for auditors, as it helps in comparing financial results from different accounting periods. Maintaining consistency in bookkeeping is imperative to avoid confusion and give insight into how a business reports specific numbers and information on its financial statement. For example, if a retail store uses the last-in, first-out (LIFO) method for reporting financial statements of 2018, they cannot switch to the first-in, first-out (FIFO) method in 2019.

Full disclosure principle

Applying the full disclosure principle means that accountants include all the relevant and necessary information in the financial statements. The information could be how a business maintains the financial records and how the business operates. This principle ensures that users, investors, creditors and readers of the financial information receive no misleading information. A business should include all necessary details like disclosing the accounting method and non-monetary transactions, among other information.

ACCOUNTING CONCEPTS & CONVENTIONS

In drawing up accounting statements, whether they are external "financial accounts" or internally-focused "management accounts", a clear objective has to be that the accounts fairly reflect the true "substance" of the business and the results of its operation.

The theory of accounting has, therefore, developed the concept of a "true and fair view". The true and fair view is applied in ensuring and assessing whether accounts do indeed portray accurately the business' activities.

To support the application of the "true and fair view", accounting has adopted certain concepts and conventions which help to ensure that accounting information is presented accurately and consistently.

Accounting Conventions

The most commonly encountered convention is the "historical cost convention". This requires transactions to be recorded at the price ruling at the time, and for assets to be valued at their original cost.

Under the "historical cost convention", therefore, no account is taken of changing prices in the economy.

The other conventions you will encounter in a set of accounts can be summarised as follows:

Monetary measurement

Accountants do not account for items unless they can be quantified in monetary terms. Items that are not accounted for (unless someone is prepared to pay something for them) include things like workforce skill, morale, market leadership, brand recognition, quality of management etc.

Separate Entity

This convention seeks to ensure that private transactions and matters relating to the owners of a business are segregated from transactions that relate to the business.

Realisation

With this convention, accounts recognise transactions (and any profits arising from them) at the point of sale or transfer of legal ownership - rather than just when cash actually changes hands. For example, a company that makes a sale to a customer can recognise that sale when the transaction is legal - at the point of contract. The actual payment due from the customer may not arise until several weeks (or months) later - if the customer has been granted some credit terms.

Materiality

An important convention. As we can see from the application of accounting standards and accounting policies, the preparation of accounts involves a high degree of judgement. Where decisions are required about the appropriateness of a particular accounting judgement, the "materiality" convention suggests that this should only be an issue if the judgement is

"significant" or "material" to a user of the accounts. The concept of "materiality" is an important issue for auditors of financial accounts.

Accounting Concepts

Four important accounting concepts underpin the preparation of any set of accounts:

Going Concern

Accountants assume, unless there is evidence to the contrary, that a company is not going broke. This has important implications for the valuation of assets and liabilities.

Consistency

Transactions and valuation methods are treated the same way from year to year, or period to period. Users of accounts can, therefore, make more meaningful comparisons of financial performance from year to year. Where accounting policies are changed, companies are required to disclose this fact and explain the impact of any change.

Prudence

Profits are not recognised until a sale has been completed. In addition, a cautious view is taken for future problems and costs of the business (the are "provided for" in the accounts" as soon as their is a reasonable chance that such costs will be incurred in the future.

Matching (or "Accruals")

Income should be properly "matched" with the expenses of a given accounting period.

Key Characteristics of Accounting Information

There is general agreement that, before it can be regarded as useful in satisfying the needs of various user groups, accounting information should satisfy the following criteria:

Understandability

This implies the expression, with clarity, of accounting information in such a way that it will be understandable to users - who are generally assumed to have a reasonable knowledge of business and economic activities

Relevance

This implies that, to be useful, accounting information must assist a user to form, confirm or maybe revise a view - usually in the context of making a decision (e.g. should I invest, should I lend money to this business? Should I work for this business?)

Consistency

This implies consistent treatment of similar items and application of accounting policies

Comparability

This implies the ability for users to be able to compare similar companies in the same industry group and to make comparisons of performance over time. Much of the work that goes into setting accounting standards is based around the need for comparability.

Reliability

This implies that the accounting information that is presented is truthful, accurate, complete (nothing significant missed out) and capable of being verified (e.g. by a potential investor).

Objectivity

This implies that accounting information is prepared and reported in a "neutral" way. In other words, it is not biased towards a particular user group or vested interest

Accounting Equation

The accounting equation is the basic element of the balance sheet and the primary principle of accounting. It helps the company to prepare a balance sheet and see if the entire enterprise's asset is equal to its liabilities and stockholder equity. It is the base of the double-entry accounting system.

Double-entry accounting is a system that ensures that accounting and transaction equation should be equal as it affects both sides. Any change in the asset account, there should be a change in related liability and stockholder's equity account. While performing journal entries accounting equation should be kept in mind.

How to calculate the Accounting Equation?

The accounting equation on the basis of a balance sheet can be calculated as.

- The business total assets should be located on the balance sheet for a particular period
- The liabilities of a company should be listed separately in the balance sheet and calculated
- The total liability and total stockholder's equity should be added
- The total liabilities and equity will equal the company's asset

The Formula for the Accounting Equation

Assets = Liabilities + Shareholder's Equity

Example of Accounting Equation:

1. For the budgetary year, leading retailer ABC firm incorporated the following points on its balance sheet:

Total assets: ₹190 crore

- Total liabilities: ₹130 crore

Total shareholders' equity: ₹60 crore

If we evaluate the accounting equation (Liabilities + Equity), we arrive at (₹130Cr + ₹50Cr) = ₹190 crore, which equals to the calculation of the assets submitted by the company.

2. An organisation ABC wish to buy a ₹500 manufacturing machine using cash. This deal will result in debt of (-₹500) for equipment and (+₹500) as a credit to cash. Therefore, the accounting equation will be.

Assets	=	Liabilities	+	Shareholder's Equity
+500				
-500				
0	=	0	+	0

Double-Entry Accounting (Bookkeeping)

In double-entry accounting or bookkeeping, total debits on the left side must equal total credits on the right side. That's the case for each business transaction and journal entry. As a result, the financial statements are in balance.

The monthly trial balance is a listing of account names from the chart of accounts with total account balances or amounts. Total debits and credits must be equal before posting transactions to the general ledger for the accounting cycle.

Double-entry bookkeeping started being used by merchants in Italy as a manual system during the 14th century.

Accounting software is a double-entry accounting system automatically generating the trial balance. The trial balance includes columns with total debit and total credit transactions at the bottom of the report.

Expanded Accounting Equation

The expanded accounting equation lengthens the basic accounting equation (Assets = Liabilities + Shareholders' Equity). It shows items within the shareholders' equity section of the balance sheet in the formula.

The expanded accounting equation is:

Total Assets = Total Liabilities + CC +/- AOCIL + BRE + R – E – D – SR

Where terms from the Shareholder's Equity section of the balance sheet include:

CC is Contributed Capital

AOCIL is Accumulated Other Comprehensive Income (Loss)

BRE is Beginning Retained Earnings

R is Revenue

E is Expenses

D is Dividends (paid)

SR is Stock Repurchases

In this expanded accounting equation, CC, the Contributed Capital or paid-in capital, represents Share Capital. AOCIL is added for income or subtracted for loss. Retained Earnings is Beginning Retained Earnings + Revenue – Expenses – Dividends – Stock Repurchases.

Accumulated Other Comprehensive Income (Loss), AOCIL, is a component of shareholders' equity besides contributed capital and retained earnings. AOCIL includes unrealized gains or losses on available for sale securities, foreign currency translation gains or losses, and pension plan-related items, including gains or losses, prior pension service costs, and credits.

Share repurchases are called treasury stock if the shares are not retired. Treasury stock transactions and cancellations are recorded in retained earnings and paid-in-capital. The journal entry depends on transaction specifics.

Share capital consists of preferred stock, if any, and common stock. Retained Earnings is computed as Beginning Retained Earnings plus year-to-date additions to Retained Earnings (from Revenue minus Expenses = Net Income) minus Dividends paid minus Share Repurchases.

For EAE, you'll still need the Balance Sheet. Note that you'll also need the Income Statement and possibly the detailed Statement of Stockholders' Equity.

Not all companies will pay dividends, repurchase shares, or have accumulated other comprehensive income or loss.

What is Accounting Process?

The primary objective of financial accounting is to record financial transactions to arrive at the results of the operations of the business during a year. This is done by preparing financial statements, *i.e.* Profit and Loss Account and Balance Sheet at the end of the year. For preparing these **financial statements**, a business transaction has to pass through a number of stages in the accounting process. This means when a business transaction occurs, the process begins to record the transaction in the account books.

The accounting process is a series of steps that begin with a transaction taking place and ends with closing of the account books at the end of the year. Because the complete sequence of accounting procedure is repeated in the same order during each accounting year, it is also referred to as accounting cycle.

2. Steps in Accounting Process

The main steps in the accounting process are described in Fig. 3.1. These steps are:

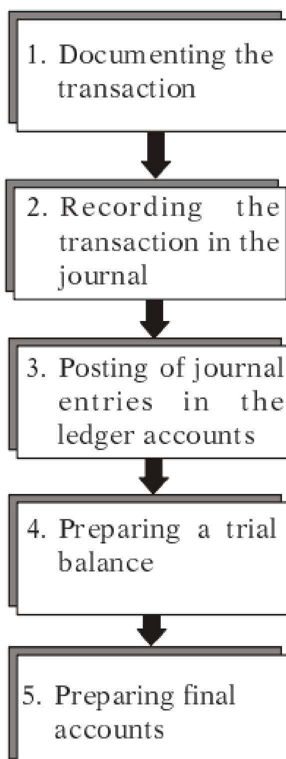
1.

    1. Source documents
    2. Journal
    3. Ledger
    4. Trial balance
    5. Final accounts

Of these five steps, first four steps are discussed in this chapter and the last step i.e. final accounts is discussed in a subsequent chapter.

3. Source Documents

The starting point in the accounting process is to record the transaction on the basis of a documentary evidence. This means that the origin of a transaction is the source document. In other words, source document is the voucher or written evidence on the basis of which transactions are recorded in the books of account. Such voucher may be generated within the business or may flow into the business from outside. Examples of vouchers are pay-in-slips of the bank deposit, cash memos, bills, invoices, rent receipts, order received, etc. These documents are the foundation of all accounting records.



There should be some documentary evidence (voucher) of each transaction. These documents reveal that transactions have occurred and initiate the accounting process.

On the basis of documentary evidences, the accountant makes a record of a transaction in journal in chronological order. Journal is a subsidiary book.

Information given in journal is then entered in ledger. This is known as posting. Ledger is a principal book having a set of accounts.

The equality of debits and credits in the ledger accounts is verified by preparing a trial balance at the end of the period.

Profit and Loss Account and Balance Sheet are the two basic financial statements, also known as final accounts, which are prepared from information given in the trial balance.

4. Journal in Accounting Process

Journal is a book of first entry. It is a preliminary book to provide a chronological record of transactions in which each transaction is recorded with relevant supplementary information. Journal is known as a book of original entry because the transactions are first recorded in journal and it is from this record that various accounts are posted in the ledger. Journal is also known as subsidiary book or day book. The process of recording transactions in journal is known as journalising.

A standard form of a journal is given below:

Journal

Date	*Particulars*	*L.F.* *(Ledger Folio)*	*Amount*	
			Debit `	*Credit* `

Journal has the following five columns:

1. Date This column records the date when transaction is entered in journal.

2. Particulars In this column the accounts to be debited and credited are entered. The name of the account to be debited is written first and in the next line, the account to be credited is written preceded by the word 'To'. A brief explanation of the transaction known as 'Narration' is also given below the account to be credited. (see Illustration 3.1)

3. L.F. i.e. Ledger Folio means the page numbers of the ledger in which these accounts appear in the ledger.

4. Debit (Dr) Amount In this column, amount to be debited is entered.

5. Credit (Cr) Amount In this column, amount to be credited is entered.

4.1 Recording in Journal

The transactions in journal are recorded on the basis of rules of debit and credit of double entry system. All financial transactions are classified into three categories:

(***i***) transactions relating to persons,

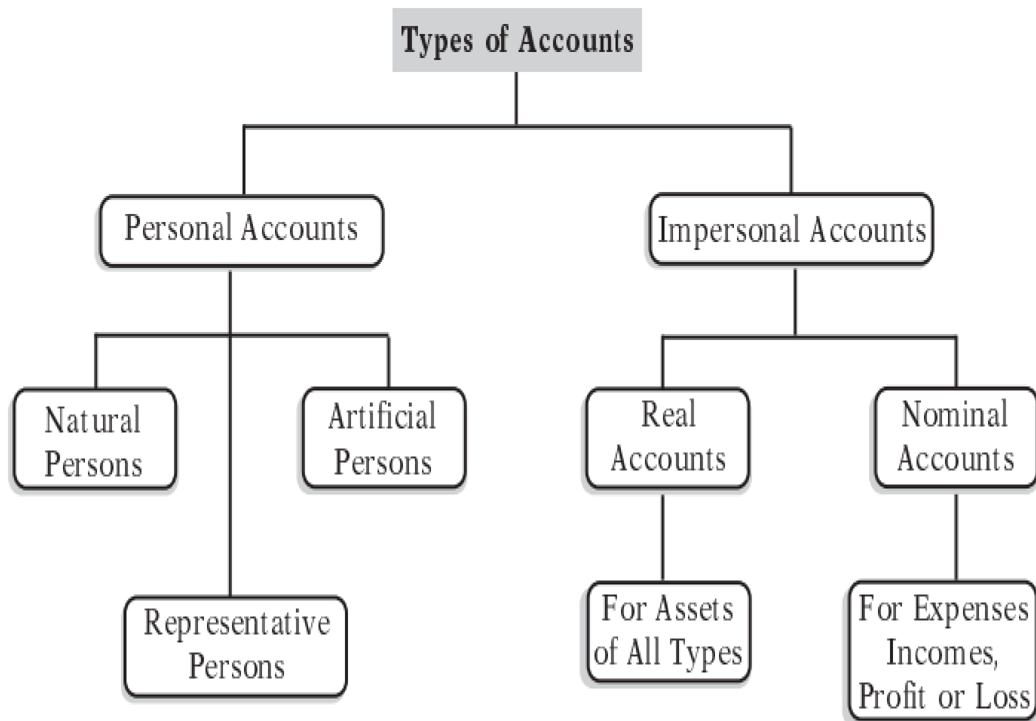
(***ii***) transactions relating to business assets and properties, and

(***iii***) transactions relating to business expenses and incomes.

On the basis of this classification of transactions, accounts are classified as explained below.

4.2 Types of Accounts

There are three types of accounts, *i.e.*, personal, real and nominal.



Types of Accounts

Note: *One should know that short form of account is written as a/c.*

(***a***) ***Personal Accounts:*** This includes:

(***i***) *Accounts of natural persons, e.g.*, debtor's a/c, creditor's a/c, Ram's a/c, etc.

(***ii***) *Accounts of artificial persons* and body of persons e.g., partnership firm's a/c, company's a/c, bank a/c, club's a/c, insurance company's, etc.

(***iii***) *Representative personal accounts* When an account represent a certain person, it is called representative personal account. For example, if salary of 10 employees has not been paid, the total amount due to these employees will be added and shown under one common account called 'salaries outstanding a/c', but in the books the names of employees will appear. Therefore, salaries outstanding a/c is a personal account because it represents certain persons. Similarly, insurance prepaid a/c, rent outstanding a/c, interest accrued a/c, etc. are personal accounts.

(***b***) ***Real Accounts*****:** These are accounts of things tangible or intangible, *e.g.*, furniture a/c, cash a/c, goodwill a/c, patent rights a/c, machinery a/c, land and building a/c, etc.

(***c***) ***Nominal Account:*** These are accounts of expenses (and losses) and incomes (and gains), *e.g.*, interest paid a/c, wages a/c, interest earned a/c, commission a/c, rent a/c, discount a/c, profit on sale of old machine a/c, etc.

4.3 Nominal Account v. Personal Accounts

Generally there is a confusion regarding some of nominal accounts and personal accounts. A simple rule is that when a prefix or suffix is added to a nominal account, it becomes a personal account. For example, wages a/c is a nominal a/c but wages outstanding a/c is a personal a/c. Similarly, rent a/c and insurance a/c are nominal accounts but rent paid in advance a/c and unexpired insurance a/c are personal accounts.

Golden Rules of Debit and Credit		
(*a*) *Personal Account*:	**Debit** the receiver.	**Credit** the giver.
(*b*) *Real Account*:	**Debit** what comes in.	**Credit** what goes out.
(*c*) *Nominal Account*:	**Debit** the expenses and losses.	**Credit** the gains and incomes.

5. Compound Journal Entries

Sometimes two or more transactions of the same nature take place on the same date. Instead of passing a separate entry for each transaction, a combined entry (known as compound entry) may be passed to record all these transactions. Such compound entries may be of three types:

1. One account to be debited and two or more accounts to be credited.

2. Two or more accounts to be debited and one account to be credited

3. Two or more accounts to be debited and two or more accounts to be credited.

Ledger

6. Ledger in Accounting Process

The ledger is a set of accounts. In other words, the book which contains various accounts is known as ledger. It may be a bound book or a set of loose leaf pages or punched cards. Each account is opened on a separate page or card in the ledger.

A ledger has the following columns :

Dr.	**Name of the Account**	*Cr.*

Dr.				**Name of the Account**		*Cr.*	
Date	*Particulars*	*Journal Folio (JF)*	*Amount* `	*Date*	*Particulars*	*Journal Folio (JF)*	*Amount* `

6.1 Points to be noted in the ledger

1. Every account in the ledger has a name which is written at the top of the account.

2. Ledger account is divided in two equal parts. The left side part is known as debit (Dr.) side and the right side is known as credit (Cr.) side.

3. JF column denotes the page (folio) number on which journal entry of this transaction has been recorded.

6.2 Distinction between Journal and Ledger

The main points of distinction between journal and ledger are as under :

6.2.1 Subsidiary Book and Principal Book

Journal is a subsidiary book. It is also called a book of original entry or first entry. Ledger is the principal book, also known as a book of second entry. In other words, journal an original record while ledger is a derived record.

6.2.2 Chronological and Analytical Record

Journal is a chronological record of day-to-day business transactions while a ledger is an analytical record of these transactions.

6.2.3 Narrations

Journal entries are supported by narrations to help in properly understanding the entries. Ledger entries are not supported by narrations.

6.2.4 Balancing

Journal is not balanced while ledger accounts are balanced.

6.3 Ledger Posting

The process of transferring the debits and credits from the journals to the ledger accounts is called posting. Each amount listed in the debit column of the journal is posted by entering it on the debit side of the account in the ledger and each amount listed in the credit column of the journal is posted to the credit side of the ledger account. The following sequence is used for posting to ledger:

(i) Open (or locate) in the ledger the first account named in the journal entry.

(*ii*) Enter in the debit column of the ledger account the amount of the debit as shown in the journal. It is customary to write 'To' on the debit side with the name of the account and 'By' on the credit side with the name of the account.

(*iii*) Enter the date of the transaction in the date column of the ledger account.

(*iv*) Enter in journal folio column the number of the journal page from which the entry is being posted.

(*v*) The recording of the debit in the ledger account is now complete. Return to the journal and enter in the ledger folio column, the number of the ledger page to which the debit was posted.

(*vi*) Repeat the above five steps for the credit side of the journal entry.

Example. (Data is assumed)

Journal Entry

Date 2013	*Particulars*	*L.F.*	*Dr.* `	*Cr.* `
Jan. 1	Cash Account … Dr. To Sales Account (Goods sold to R. C. & Co. on cash basis)	1 14	840	840

The two ledger accounts affected by this entry are:

1. Cash Account

2. Sales Account

These two accounts will appear in the ledger as follows :

Dr.			Cash Account			Cr.	
Date 2013	*Particulars*	*Journal Folio*	*Amount* `	*Date*	*Particulars*	*Journal Folio*	*Amount*
Jan. 1	To Sales	10	840				

Dr.				Sales Account		Cr.	
Date	*Particulars*	*Journal Folio*	*Amount* `	*Date* 2013	*Particulars*	*Journal Folio*	*Amount* `
				Jan. 1	By Cash	10	840

6.4 Balancing of Ledger Accounts

Balancing is the process of equalising the two sides of an account. After posting has been completed, the difference between the totals of debit and credit sides is ascertained. This is known as balancing of accounts. If the total of the debit side is more than that of credit side, it is said to have a debit balance and vice versa, if credit side total is more than that of debit side, it is a case of credit balance. The difference between the two is placed on the shorter side by writing "To or By Balance c/d" so that the two sides become equal. Thus the total of the bigger side is written on both sides. In the next period, the account will start with the balance as "To or By Balance brought down". This is written on the side which has a bigger total.

If the totals of the two sides are equal, the account is said to be in balance.

7. Trial Balance in Accounting Process

When all ledger accounts have been prepared and balanced off, a list of all debit balances and credit balances is prepared. In double entry system, the debits must be equal to credits. In other words, the total of the debit balances must be equal to the total of the credit balances. The proof of the equality of debit balances and credit balances is called a 'Trial Balance'. Thus a trial balance may be defined *as* '*a two-column schedule listing the balances of all the accounts as they appear in the ledger. The debit balances are listed in the left hand column and the credit balances in the right hand column'.* The total of the two columns should agree. If the debit side and credit side of the trial balance are equal, it is proved that the account books are arithmetically correct. But it is not a conclusive proof that there no errors.

Objectives

The main objectives of preparing a trial balance are follows:

1. To test the arithmetic accuracy. When a trial balance agrees, it is taken as a proof that double entry of all transactions is complete and arithmetically the books of account are correct. But it should not be taken as a conclusive proof that there no errors because certain errors are not disclosed by trial balance.

2. To detect errors. When the total of the debit balances is not equal to the total of the credit balances, it means that there are certain errors.

3. To provide data for preparing financial statements. Profit and Loss Account and Balance Sheet are prepared on the basis of trial balance data and additional information.

Solution

Debit and Credit Items in Trial Balance

Debit Balances	**Credit Balances**
Personal Accounts	**Personal Accounts**
Bank	Capital
Sundry debtors	Bank (overdraft)
Drawings	Sundry creditors
Loan (given)	Loan (taken)
Prepaid insurance or other expenses	Outstanding wages or other expenses
Real Accounts	**Real Accounts**
Opening stock	Sales
Purchases	Purchases returns
Sales returns	**Nominal Accounts**
Plant	Discount received
Furniture Cash	Dividend received

Goodwill	Commission received
Investments Other fixed assets	Interest received and other incomes received
Nominal Accounts	Provisions and reserves
Wages, salaries, bad debts and other expenses and losses	

Cash Book

Cash is an essential medium of conducting transactions taking place in a business and needs to be recorded for maintaining proper bookkeeping of the transactions. Cash is a current asset, and examples of cash transactions can be bank overdraft, money orders, demand deposits.

This leads to the need for maintaining all cash transactions in one place for the business and necessitates the use of a cash book.

Cash Book definition

Cash book is a special type of book that is only concerned with the recording of cash transactions of an organisation. It performs the dual role of both journal and a ledger for all the cash transactions taking place in a business organisation.

A cash book records all the cash receipts on the debit side and all the cash payments of the organisation on the credit side.

Features of Cash Book

Cash book has the following features:

1. Acts as both a journal and a ledger.
2. Can be used as an alternative to a cash account for recording transactions.
3. It follows the dual entry system of accounting (i,e. Debit and credit side in cash book).
4. The debit side should be identical to the credit side.
5. Cash book should always have a debit balance.

Types of Cash Book

There are four types of cash books used for accounting purposes. Let us have a look at the types of cash books.

1.Single column cash book

2.Double column cash book

3.Triple column cash book

4. Petty cash book

Single column cash book: Single column cash book is also called a simple cash book. It presents entries for cash received (receipts) on the left side or debit side and cash payments on the right hand side or credit side.

The bank transactions and the discounts that are given for transactions will be featured in separate ledger accounts in case of single-column cash books.

Cash books are updated on a daily basis in some business firms. The most striking feature of a cash book is that it can never have a credit balance. It should always show a debit balance.

Double Column cash book: In a double column cash book, there is an additional column that is reserved for the discounts. Therefore, in a double-column cash book, also known as two-column cash book, the cash receipts and transactions are recorded in one column while the second column records discounts received and discounts provided.

Discount being a nominal account the discount provided is placed on the debit side of the cash book while discount received is placed on the credit side of the cash book.

At the end of the accounting period, both the columns are balanced, and the closing balances are transferred appropriately.

Triple column cash book: In a triple column cash book, the two columns are similar to the double column cash book. While the additional column is for bank transactions.

Due to the advances in the banking industry, most firms deal in cheques and therefore, the presence of a bank column in a cash book is helpful in understanding the transactions properly.

Petty cash book: Petty cash book, as the name suggests, is for very small transactions that take place in an organisation. Such transactions can occur in a day and are repetitive in nature, which can put undue load on the general cash book. For this reason, it is maintained separately.

Examples of such transactions are: stationery, postage, food bills, etc.

Advantages of Cash Book

Cash book offers the following advantages:

1.It offers easy verification of cash by matching the balance in the cash book with actual cash in hand and is therefore helpful in identifying mistakes in the entry.

2.It helps in creating a regular record of transactions date wise for the convenience of accounting personnel.

3. As it is maintained date wise, any cash payments or the transaction can be correctly traced back in the cash book.

4. It is helpful in detecting any cash frauds in the organisation.

5.It helps in saving time and labour by reducing the workload

Special Purpose Books

Special Purpose Books are a set of journals that record transactions only of a particular nature. Examples of these books are Cash Book, Purchases Book, Sales Book, Sales Returns Book, Purchase Returns Book, Bills Payable Book, Bills Receivable Book and Journal Proper. These are subsidiary books that help to record entries of a similar nature more accurately and efficiently. The different types of Special Purpose Books are as follows:

Purchases Book – Purchases Book (Journal) is a book of original entry. It records transactions related to the credit purchases of items that a firm deals with for its business. The cash purchases get recorded in the Cash Book. The credit purchases for items that the firm will not resell don't get recorded in the Purchases Book. For Example, if a firm deals in spare parts for vehicles, it will only record the credit purchases of items directly related to those spare parts in the Purchases Books. It will not record the credit purchase of unrelated items like furniture in the book. Those items will get recorded in the main journal or 'Journal Proper'.

Sales Book – Sales Book (Journal) is a book of original entry. It records transactions related to the credit sales of items that a firm deals with. The cash sales get recorded in the Cash Book. The credit sales for items unrelated to the business don't get recorded in the Sales Book. For Example, if a firm deals in tyres, it will only record the credit sales of items directly related to those tyres in the Sales Books. It will not record the credit sales of unrelated items like computers in the book. Those items will get recorded in the main journal or 'Journal Proper'.

Purchase Returns Book – The Purchase Returns Book (Journal) records transactions related to the return of goods purchased by the firm. Sometimes the goods that the firm purchases from suppliers get sent back to them because they were defective, damaged or not as per the order's specifications. The firm also prepares a debit note for this transaction and sends it to the supplier.

Sales Returns Book – The Sales Returns Book (Journal) records transactions related to the return of goods sold by the firm. Sometimes the goods that a firm sells to customers are sent back by them because those items were defective, damaged or not as per the order's

specifications. The firm also prepares a credit note for this transaction in favour of the customer.

Bills Payable Book – The Bills Payable Book (Journal) records the details of bills payable for the firm. The accountants will debit the individual accounts of the entities with the corresponding amount, which gets recorded in the Bills Payable Book. It is the money that the firm owes its creditors and has to pay back that amount within a stipulated period.

Bills Receivable Book – The Bills Payable Book (Journal) records the details of bills receivable for the firm. The accountants will credit the individual accounts of the entities with the corresponding amount, which gets recorded in the Bills Receivable Book. It is the money that the firm will receive from its creditors and has to receive that amount within a stipulated period.

Cash Book – Cash Book (Journal) records the cash and bank transactions of a business. It fulfils the purpose of both a journal and a ledger for cash inflows and outflows related to the firm's operations.

Journal Proper – A Journal Proper records all other transactions which do not find a place in these subsidiary books. Some of the transactions recorded in these books are related to opening entries, transfer entries, rectification entries, adjustment entries, and other miscellaneous entries that do not get recorded anywhere else.

Conclusion

These Special Purpose Books or Subsidiary Books are essential for a firm to keep track of the business activities taking place in the organisation. It is also beneficial for preparing Ledger Accounts, Trial Balance and Financial Statements.

Bank Reconciliation Statement

Bank Reconciliation Statement is a record book of the transactions of a bank account. This statement helps the account holders to check and keep track of their funds and update the transaction record that they have made. Bank Reconciliation statement is also known as bank passbook. The balance mentioned in the bank passbook of the statement must tally with the balance mentioned in the cash book. In the statement, all the deposit will be shown in the credit column and withdrawals will be shown in the debit column. However, if the withdrawal exceeds deposit it will show a debit balance (overdraft).

Importance of Bank Reconciliation Statement

Generally while making a comparison between the company's cash book and bank balance, the balance does not tally. Therefore, it is important to determine the cause for the difference and display them in the bank reconciliation statement and then tally the two balances. The

bank reconciliation statement helps in explaining the differences in the amount between the company's cash book and bank balance. The cash book and the bank passbook differences are caused by:

- The difference in timing recording the transactions: The difference in timing can be caused by many factors which are:
  - Bank-issued cheque but not yet deposited for payment
  - Paid cheque in the bank but yet not cleared
  - Bank made direct debit from the customer's side
  - Cheque/ amount deposited directly to the bank account
  - Dividends and Interest collected by the bank
  - Bank made direct payment from the customer's side
  - Cheques deposited/bills discounted dishonoured
- Errors made by the company or by the bank: In a few occasions, the error in two balances can be made from the bank side or in the company's cash book. Few errors are as follows:
  - Errors made while registering the transaction by the company
  - Errors made while registering the transaction by the bank

Types of Bank Reconciliation Statement

The Bank Reconciliation Statement can be prepared in 2 ways:

- Documenting of bank reconciliation statement without adjusting the cash book balance.
- Filing of bank reconciliation statement after adjusting the cash book balance.

Steps to Prepare Bank Reconciliation Statement:

  - First, the date on which the statement is recorded is mentioned.
  - After which the balance displayed in the cash book is mentioned in the statement. Sometimes, the balance mentioned in the passbook can also be mentioned.
  - The deposited cheques which are not collected are deducted.
  - Then the cheques issued but the deposited for payment, but amount directly deposited in the bank account are recorded
  - All the transactions like overdraft interest, amount debited by the bank but not recorded in the cash book, cheques and bills dishonoured are deducted.
  - All the credits and profit collected by the company and directly deposited in the bank is added.

- Adjustments of errors are made
- Now the balance between the cash book and statement should be equal or the same.

3.5 BANK ACCOUNTING

Bank is an institution that provides a great variety of financial services. At their most basic, banks hold money on behalf ofcustomers, which is payable to the customer on demand, either by appearing at the bank for a withdrawal or bywriting a check to a t hird party.

Meaning and definitions of bank:

A bank is a commercial institution, licensed to accept deposits and acts as a safe custodian of the spendable funds of its customers. Banks are concerned mainly with the functions of banking, i.e., receiving, collecting, transferring, buying, lending, investing, dealing, exchanging and servicing (safe deposit, custodianship, agency , trusteeship) money and claims to money both domestically and internationally. The principal activities of a bank are operating current accounts, receiving deposits, taking in and paying out notes and coins, and making loan

Different types of Bank:

There are various types of banks and they can be divided into some of thefollowing categories:

Savings banks: These banks function with the intention to culminate saving habits among people, especially those who belong to low income groups or those who are salaried. The money these people deposit in the banks are invested in securities, bonds etc. These days, many commercial banks perform the dual functions of savings bank. The postal department is also in a way a saving bank.

Commercial banks: These banks function to help the entrepreneurs and businesses. They give financial services to these businessmen like debit cards, banks accounts, short term deposits, etc. with the money people deposit in such banks. They also lend money to businessmen in the form of overdrafts, credit cards, secured loans, unsecured loans and mortgage loans to businessmen.

The commercial banks can be further classifies as: public sector bank, private sector banks, foreign banks and regional banks.

1. **The public sector banks** are owned and operated by the government, who has a major share in them. The major focus of these banks is to serve the people rather earn profits. Some examples of these banks include State Bank of India, Punjab National Bank, Bank of Maharashtra, etc.
2. **The private sector banks** are owned and operated by private institutes. They are free to operate and are controlled by market forces. A greater share is held by private players and not the government. For example, Axis Bank, Kotak Mahindra Bank etc.
3. **The foreign banks** are those that are based in a foreign country but have several branches in India. Some examples of these banks include; HSBC, Standard Chartered Bank etc.
4. **The regional rural banks** were brought into operation with the objective of providing credit to the rural and agricultural regions and were brought into effect in 1975 by RRB Act. These banks are restricted to operate only in the areas specified by government of India. These banks are owned by State Government and a sponsor bank.
5. **Cooperative banks**: These banks are controlled, owned, managed and operated by cooperative societies and came into existence under the Cooperative Societies Act in 1912. these banks are located in the urban as well in the rural areas. Although these banks have the same functions as the commercial banks, they provide finance to farmers, salaried people, small scale industries, etc. and their rates of interest of interest are lower.
6. **Investment banks**: These are financial institutions that provide financial and advisory assistance to their customers. Their clients can be individuals, businesses, or government organizations. They assist theircustomers to raise funds when required. These banks act as the underwriters for their customers when they want to raise capital by issuing securities. In some cases, they also help their customers to issue securities.
7. **Specialized banks:** These provide unique services to their customers. Some such banks include foreign exchange banks, development banks, industrial banks, export import banks etc. These banks also provide huge financial support to businesses and various kinds projects and traders who have to import or export their goods or services.
8. **Central bank:** The central bank is also called the banker's bank in any country. In India, the Reserve Bank of India is the central bank. The Federal Reserve in USA and the Bank of England in UK function as the central bank. This bank makes various monetary policies, decides the rates of interest, controlling the other banks in the country, manages

the foreign exchange rate and the gold reserves and also issues paper currency in a country.

Various types of bank account:

Bank Accounts are classified into four different types.

Current Account

1) Savings Account:

2) Recurring Deposit Account:

3) Fixed Deposit Account:

Current Account: Current account is mainly for business persons, firms, companies, public enterprises etc and is never used for the purpose of investment or savings.These deposits are the most liquid deposits and there are no limits for number of transactions or the amount of transactions in a day. While, there is no interest paid on amount held in the account, banks charge certain service charges, on such accounts. The current accounts do not have any fixed maturity as these are on continuous basis accounts.

Savings Account: Savings Account is meant for saving purposes. Any individual either single or jointly can open a savings account. Most of the salaried persons, pensioners and students use Savings Account. The advantage of having Savings Account is Banks pay interest for the savings. The saving account holder is allowed to withdraw money from the account as and when required.

The rate of interest ranges between 4% to 6% per annum in India. There is no restriction on the number and amount of deposits. But withdrawals are subjected to certain restrictions. Some banks recommend to maintain a minimum amount to keep it functioning.

Recurring Deposit Account: Recurring deposit account or RD account is opened by those who want to save certain amount of money regularly for a certain period of time and earn a higher interest rate. In RD account a fixed amount is deposited every month for a specified period and the total amount is repaid with interest at the end of the particular fixed period.

Fixed Deposit Account:In Fixed Deposit Account (also known as FD Account), a particular sum of money is deposited in a bank for specific period of time. Its one time deposit and one time take away (withdraw) account. The money deposited in this account cannot be withdrawn before the expiry of period. However, in case of need, the depositor can ask for closing the fixed deposit prematurely by paying a penalty. The penalty amount varies with banks. A high interest rate is paid on fixed deposits. The rate of interest paid for fixed deposit varies according to amount, period and also from bank to bank.

A.Types Of Bank Deposit Customers

Banks open accounts for various types of customers like individuals, partnership firm, Trusts, companies, etc. While opening the accounts, the banker has to keep in mind the various legal aspects involved in opening and conducting those accounts, as also the practices followed in conducting those accounts. Normally, the banks have to deal with following types of deposit customers.

Individuals:

The depositor should be properly introduced to the bank and KYC norms are to be observed. Introduction is necessary in terms of banking practice and also for the purpose of protection under section 131 of the Negotiable Instruments Act. Usually, banks accept introductions from the existing customers, employee of the bank, a locally well-known person or another bank.

A joint account may be opened by two or more persons

Non-resident individuals (NRIs)

Non-Resident Indian means, a person, being a citizen of India or a person of Indian origin residing outside India. A person is considered Indian Origin when he or his parents or any of his grand parents were Indian National.

Various Types of NRI Accounts:

- Ordinary Non-resident Rupee Accounts (NRO Accounts);
- Non-Resident (External) Rupee Accounts (NRE Accounts);
- Non-resident (Non-Repatriable) Rupee Deposits (NRNR Accounts); and
- Foreign Currency (Non-Resident) Accounts (Banks) Scheme (FCNR (B) Accounts).

While NRO and NRE accounts can be kept in the form of current, savings bank, recurring deposit or term deposit accounts, deposits under NRNR and FCNR (B) schemes can be kept only in the form of term deposits for periods ranging from six months to three years.

Joint Hindu Family (JHF):

Joint Hindu Family (JHF) (also known as Hindu Undivided family) is a legal entity and is unique for Hindus. It has perpetual succession like companies; but it does not require any registration. The head of JHF is the Karta and members of the family are called co-parceners. The JHF business is managed by Karta.\

Partnership firms:

A partnership is not a legal entity independent of partners. It is an association of persons. Registration of a partnership is not compulsory under Partnership Act. However, many banks insist on registration of a partnership. In any case, ie stamped partnership deed or Partnership letter should be taken when an account is opened for a partnership. The partnership deed will contain names of the partners, objective of the partnership, and other operational details, which should be taken note of by the bank in its dealings.

Joint stock companies:

A company is registered under companies Act has a legal status independent of that of the share-holders. A company is an artificial person who has perpetual existence with limited liability and common seal. Memorandum and Articles of Association, Certificate of Incorporation, Resolution passed by the Board to open account, name and designations of persons who will operate the account with details of restriction placed on them are the essentials documents required to openan account.

Clubs, Societies and Associations:

The clubs, societies, association etc., may be unregistered or registered. Account may be opened only if persons of high standing and reliability are in the managing committee or governing body. Copy of certificate of registration and Copy of bye- law, certified to be the latest, by the Secretary/President are required to be obtained and also a certified copy of the resolution of the Managing Committee/Governing body to open the bank account and giving details of office bearers etc., to operate the account.

Trust Account:

Trusts are created by the settler by executing a Trust Deed. A trust account can be opened only after obtaining and scrutinizing the trust deed. The Trust account has to be operated by all the trustees jointly unless provided otherwise in the trust deed. A trustee cannot delegate the powers to other Trustees except as providedfor in the Trust Deed. A cheque favoring the Trust shall not be credited to the personal account of the Trustee.

Various Kinds Of Services:

Banks offer many different channels to access their banking and other services:

- Automated teller machines
- A branch in a retail location
- Call centre
- Mail: most banks accept cheque deposits via mail and use mail to communicate to their customers, e.g. by sending out statements

- Mobile banking is a method of using one's mobile phone to conduct banking transactions
- Online banking is a term used for performing multiple transactions,payments etc. over the Internet
- Relationship managers, mostly for private banking or business banking,often visiting customers at their homes or businesses
- Telephone banking is a service which allows its customers to conduct transactions over the telephone with automated attendant, or when requested, with telephone operator
- Video banking is a term used for performing banking transactions or professional banking consultations via a remote video and audio connection. Video banking can be performed via purpose built banking transaction machines (similar to an Automated teller machine), or via avideo conference enabled bank branch clarification
- DSA is a Direct Selling Agent, who works for the bank based on acontract. Its main job is to increase the customer base for the bank.

Bank Pass Book:

Passbook or Bank Statement is a copy of the account of the customer as it appears in the bank's books. When a customer deposits money and cheques into his bank account or withdraws money, he records these transactions in the bank column of his cashbook immediately.

Correspondingly, the bank records them in the customer's account maintained in its books. Then they are copied in a passbook and given to the customer. With the computerization of banking operations, bank statements (in lieu of passbook) are issued to the customer's periodically.Thus passbook is a record of the banking transactions of a customer with a bank. All entries made by a customer in his cashbook (bank column) must be entered by the bank in the passbook.

Bank loan:

Bank loans are the easiest source of availing finance. A bank loan is an extensionof credit by a bank to a customer or business; it has to be paid along with interest.

Features of Bank Loans:

Bank loans have the following characteristics:

1. It is a short-term source of finance.
2. A bank loan may be either secured or unsecured

depending upon thecircumstances.

3. The interest charged by the bank on such a loan may be either fixed or variable.

4. If mortgage loan is to be obtained, the borrower has to pay a number of fees such as title searching fees, application fees, inspection fees, etc.

A bank loan offers the following advantages:

1. They can be easily procured.
2. They can be used for short-term as well as medium-term financing.
3. Interest paid on a bank loan is a tax deductible expenditure.

2.9 Banker-Customer Relationship:

Banking is a trust-based relationship. There are numerous kinds of relationship between the bank and the customer. The relationship between a banker and a customer depends on the type of transaction. Thus the relationship is based on contract, and on certain terms and conditions.

These relationships confer certain rights and obligations both on the part of the banker and on the customer. However, the personal relationship between the bankand its customers is the long lasting relationship. Some banks even say that they have generation-to-generation banking relationship with their customers.The banker customer relationship is fiducially relationship. The terms and conditions governing the relationship is not be leaked by the banker to a third party.

Classification of Relationship:

The relationship between a bank and its customers can be broadly categorized in to General Relationship and Special Relationship.

If we look at **Sec 5(b)** of Banking Regulation Act, we would notice that bank's business hovers around accepting of deposits for the purposes of lending. Thus the relationship arising out of these two main activities is known as General Relationship. In addition to these two activities banks also undertake other activities mentioned in Sec.6 of Banking Regulation Act. Relationship arising out of the activities mentioned in Sec.6 of the act is termed as special relationship.

General Relationship:

Debtor-Creditor: When a 'customer' opens an account with a bank, he fills in andsigns the account opening form. By signing the form he enters into an agreement/contract with the bank. When customer deposits money in his account the bank becomes a debtor of the customer and customer a creditor. The money so deposited by customer

becomes bank's property and bank has a right to use the money as it likes. The bank is not bound to inform the depositor the manner of utilization of funds deposited by him. Bank does not give any security to the depositor i.e. debtor. The bank has borrowed money and it is only when the depositor demands, banker pays. Bank's position is quite different from normal debtors.

Banker does not pay money on its own, as banker is not required to repay the debt voluntarily. The demand is to be made at the branch where the account exists and The debtor has to follow the terms and conditions of bank said to have been mentioned in the account opening form. Though the terms and conditions are not mentioned in the account opening form, but the account opening form contains a declaration that the terms and conditions have been read and understood or has been explained. In fact the terms and conditions are mentioned in the passbook, which is issued to the customer only after the account has been opened.

2. Creditor–Debtor: Lending money is the most important activities of a bank. The resources mobilized by banks are utilized for lending operations. Customer who borrows money from bank owns money to the bank. In the case of any loan/advances account, the banker is the creditor and the customer is the debtor.The relationship in the first case when a person deposit money with the bank reverses when he borrows money from the bank. Borrower executes documents and offer security to the bank before utilizing the credit facility.

In addition to opening of a deposit/loan account banks provide variety of services, which makes the relationship more wide and complex. Depending upon the type of services rendered and the nature of transaction, the banker acts as a bailee, trustee, principal, agent, lessor, custodian etc.

Special Relationship:

1. Bank as a Trustee:

As per **Sec. 3** of Indian Trust Act, 1882

' A "trust" is an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner.' Thus trustee is the holder of property on behalf of a beneficiary.

As per **Sec. 15** of the 'Indian Trust Act, 1882 'A trustee is bound to deal with the trust-property as carefully as a man of ordinary prudence would deal with such property if it were his own; and, in the absence of a contract to the contrary, a trustee so dealing is not responsible for the

loss, destruction or deterioration of thetrust-property.’ A trustee has the right to reimbursement of expenses (Sec.32 of Indian Trust Act.).

In case of trust banker customer relationship is a special contract. When a person entrusts valuable items with another person with an intention that such items would be returned on demand to the keeper the relationship becomes of a trustee and trustier. Customers keep certain valuables or securities with the bank for safekeeping or deposit certain money for a specific purpose (Escrow accounts) the banker in such cases acts as a trustee. Banks charge fee for safekeeping valuables

Lessor and Lessee:

Sec.105 of ‘Transfer of property Act 1882’ defines lease, Lessor, lessee, premiumand rent. As per the section

“A lease of immovable property is a transfer of a right to enjoy such property, made for a certain time, express or implied, or in perpetuity, in consideration of a price paid or promised, or of money, a share of crops, service or any other thing ofvalue, to be rendered periodically or on specified occasions to the transferor by
the transferee, who accepts the transfer on such terms.”

Accounting of banking companies:.

Banking activities undertaken by banks include personal banking (non-business customers), commercial Banking (small and medium-sized business customers) and corporate banking (large international and multinational corporations).

According to Charles J. Woelfel:

A complete banking service would comprehend a variety of functions, including any of the following:

(1) Receive demand deposits and pay customers' cheques drawn against them, and operate automated teller machines (ATM);

(2) Receive time and savings deposits, issue negotiable orders of withdrawal, and pay interest thereon, as well as provide automatic transfer service (A TS) for funds from serving accounts to cover cheques;

(3) Discount notes, acceptances and bills of exchange;

(4) Supply credit to business firms with or without security, issue letters of credit and accept bills drawn thereunder;

(5) Transfer money at home and abroad;

(6) Make collections and facilitate exchanges;

(7) Provide custodianship for securities and other valuables;

(8) Provide personal loans, credit and services to individuals, and lend or discount customer installment receivables of vendors;

(9) Act in a fiduciary capacity for individuals, as well as establish commontrust funds;

(10) Provide corporate trust services (stock transfer agent, registrar, payingagent, escrow agent, and indenture trustee);

(11) Act as factors and engage in equipment leasing;

(12) Deal in Government securities and underwrite general obligations of state and municipal securities;

(13) Invest in government and other debt securities;

(14) Act as fiscal agent or depository for the Central Government, states and subdivisions of states;

(15) Provide miscellaneous services such as place orders in securities for customers; act as insurance agent of incidental to banking transactions; serve as finder to bring buyers and sellers together; act as travel agent and issue letters of credit and traveler's cheques; provide club accounts and other special purpose accounts; act as agent for accepting service of legal process of incidental I normal banking or fiduciary transactions of the bank; act as pay role issuer; establish charitable foundations, invest in small business investment corporations and bank service corporations; deal in foreign exchange; buy and sell gold bullion under license from the Treasury Department, and foreign coin; provide domestic and international correspondent banking services, etc.

2.10 Subsidiary Books:

These include the following:

(i) Personal Ledger The bank maintains separate ledgers for different types ofaccounts, such as,

(a) Current Accounts Ledger,

(b) Savings Bank Accounts Ledger,

(c) Fixed Deposit Accounts Ledger,

(d) Recurring Deposit Accounts Ledger, etc.

Entries are made in these ledgers directly from the vouchers.

(ii) Investments Ledger Accounts of all investments are kept in this ledger.

Memorandum Books

In addition to the subsidiary books, a bank maintains various other books to facilitate its works, which do not form a part of double entry system. Some ofthese are:

(i) Receiving Cashier's Counter Cash Book

(ii) Paying Cashier's Counter Cash Book

(iii) Cash Balance Book.

Principal Books of Account

Cash Book and General Ledger are the principal Books of Account of any bank. Cash Book records all cash transactions and General Ledger contains Control Account of all subsidiary ledgers and different Assets am Liabilities Account. In the general ledger, accounts are arranged in such a manner that a Balance Sheetcan be easily prepared.

Final Accounts

According to Section 29 of the Banking Regulation Act, 1949, every banking company is required to prepare with reference to that year a Balance Sheet and .a Profit and Loss Account as on the last working day ofthe year in the 'Form A' and 'Form B' respectively set out in the 'Third Schedule' or as near thereto as circumstances admit.

Balance Sheet

With effect from 19th March, 1992, the Balance Sheet of a bank is to be preparedas per the new form. In the new form, assets and liabilities are shown vertically along with the figures of year. In the top section capital and liabilities" are shown and in the bottom section, assets are shown.

THE THIRD SCHEDULE

(See Section 29)

Form 'A'

FORM OF BALANCE SHEET

Balance Sheet of.....

Balance Sheet as on 31st March.....

	Schedule	As on31.3.	As on31.3.
Capital and liabilities Capital	 1		

Reserves & Surplus	2		
Deposits	3		
Borrowings	4		
Other Liabilities and	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			

('000 omitted)

FORM OF PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH

	Sch edu	Year ended	Year ended 31.3
I. Income			
Interest earned	13		
Other Income	14		
Total			
II.Expenditure			
Interest Expended	15		
Operating Expenses	16		
Provision and contingencies			

	Total		
III. Profit /Loss Net Profit/(Loss) for the year Profit/(Loss) brought forward			
	Total		
Transfer to statutory reserve Transfer to other reserve Proposed Dividend Balance carried forward to Balance sheet			

Note: 1.The total income includes income of foreign branches at Rs _______

2. The total expenditure includes expenditure of foreign branchesat Rs______

3. Surplus / Deficit of foreign branches Rs ________

SCHEDULES: Details of all schedules are in below:

A> Capital and Liabilities

1. **Capital**
2. **Reserve and Surplus:** It includes Capital Reserve, Security Premium, Revenue and other Reserve and. Profit and Loss Account balance.
3. **Deposits:** It includes Demand deposits, Savings bank deposits and term deposits.
4. **Borrowings:** It includes Borrowings from Reserve Bank of India, other banks, institutions and agencies.
5. **Other Liabilities and Provisions:** It includes Bills payable, inter-office adjustments (net), interest accrued, provision for bad debts, provision for taxation.

B> Assets

6. **Cash and Balances with Reserve Bank of India:** Cash in hand (including foreign currency notes); and balances with Reserve Bank of India are shown under this item.

7. **Balances with Banks and Money at Call and Short Notice:** Balances with banks; money at call and short notice are shown under this item. Money at call is refundable at 24 hour's notice and money at short notice is refundable at 7day's notice.

8. **Advances:** Bills purchased and discounted, cash credit, overdrafts and loanspayable on demand; and term loans are shown under this item.

9. **Fixed Assets:** Premises, other fixed assets (including furniture and fixtures)are shown under this item.

10. **Other Assets:** Inter- office adjustments, interest accrued, tax paid in advance, stationery and stamps, non-banking assets acquired in satisfaction of claims are shown under this item

11. **Contingent Liabilities:** It is shown by way of a footnote. It represents liabilities not provided in the Balance Sheet.

Profit and Loss Account:

Profit and Loss Account of a banking company is also prepared in vertical form. 'Form B' of the Third Schedule of the Banking Regulation Act, 1949 is to be used for preparing Profit and Loss Account. It is divided into four sections:

I. Income;

II. Expenditure;

III. Profit/Loss; and

IV. Appropriations.

C> Income:

The schedules of Income are:

12. **Interest Earned**: It includes interest/discount on advances/bills, income on

investments, interest on balances with RBI etc. It should be noted that according to the new form, bad debts and provision for bad debts, other provisions are not to be deducted from the interest earned. For greater transparency in accounts, these items are shown as separate items in the Profit and Loss Account.

13. **Other income**: It includes commission, exchange and brokerage, profit on sale of investments, profit on revaluation of investments, profit on sale of land, building and other assets, profit on exchange transaction, and income earned by way of dividends from subsidiaries, etc.

D> Expenditure

14. **Interest expended:** Interest paid on deposits, interest on RBI borrowings; interest on interbank borrowings, etc., are shown under this item.

15. **Operating expenses :** Salaries and wages of staff; rent, rates and taxes; printing and stationery; advertisement; depreciation on banks' properties; director's fees; auditor's fees; law charges; postage; repairs; insurance; etc., are shown under this item.Third item of this section is provisions and contingencies. Provision for bad debts, provision for taxation and other provisions are shown under this item.

Profit/Loss

In this section, profit/loss for the current year (difference between income and expenditure explained above) and brought forward profit/loss are shown.

Appropriations

In this section, amount transferred to statutory reserve as per Section 17; amount transferred to other reserve; proposed dividend, etc., are shown. The balance is transferred to the Balance Sheet.

3.6 MANAGEMENT OF VENDORS AND CUSTOMERS

VENDOR MANAGEMENT

Vendor relationship management (VRM) is deepening the buyer-supplier relationships to achieve a mutually beneficial goal and establish trust. An efficient vendor relationship management process can deliver a number of key benefits from quality increments and improved total cost of ownership (TCO) to new innovations and a much smoother flow of data.

Top 3 successful vendor relationship strategies

Successful vendor relationships require quite a bit of planning and hard work. Here are three vendor relationship management strategies that can be used to maximize the value of supplier relationships:

1. Communicate often

Poor communication is at the heart of most business failures. The inability to convey or receive important information from your suppliers can end up shaking the very foundations of your vendor management process.

Corporate buyers need to communicate with their vendors frequently in order to transmit their requirements effectively and get a better understanding of their suppliers' capabilities.

2. Build partnerships

The key to efficient vendor management is moving out of a transactional relationship and into a strategic supplier-buyer relationship model. The first step of the process is treating your suppliers as valuable partners.

Rather than just disclosing the pre-defined KPIs with your suppliers, involve them in key strategic vendor management decisions like setting clear objectives for the relationship.

This will not only allow you to tap into their expertise but also offer other benefits like increased trust, preferential treatment, and more.

3. Create a win-win situation

Running after short-term cost savings will cost your organization more in the long run and make a substantial impact on the quality. So, rather than squeezing your suppliers to cut down the cost, take some time to study and understand your vendor's business.

Negotiation should be based on good faith and value rather than resorting to strong-arm tactics. Objectives of the partnership should be structured in a way that offers equal opportunity for profitability and strengthens both businesses.

Best practices in vendor relationship management

Procurement teams need to look for best practices and try implementing them to lower the total cost of ownership and improve the efficiency of their supplier management process.

Here are three vendor relationship management or vendor performance management best practices.

1. Measure performance

Organizations with the best vendor relationship process have an elaborate system to measure the performance of their vendors. Scorecards, vendor ratings, and vendor performance reviews are used to hold vendors accountable for their performance.

2. Share risk

Uncertainty in the supply chain paves the way for a number of risks like price volatility, demand fluctuations, and more. Carefully designed vendor contracts reduce the amount of uncertainty, by enabling risk-sharing.

3. Build trust

A truly effective vendor relationship management process is built on a foundation of trust. Buyers who ensure that their vendors are financially and emotionally invested in the relationship have a good chance of winning the trust of their vendors in a relatively short period of time.

How a comprehensive procurement solution improves your vendor relationship process

Vendor relationship management isn't restricted to managing an up-to-date database of your vendors and communicating with them regularly. In fact, this process is actually designed to help you know your vendors better, making them an active partner in your business operations. In addition to supplier information management, managing vendors involves things like efficient vendor onboarding, transparent vendor performance reviews, robust risk mitigation, and more.

Manual vendor management tools such as paper forms and spreadsheets cause a number of disruptions like delayed payments, missed discounts, lost opportunities for savings, and strained vendor relationships.

Cloud-based procurement software like Kissflow Procurement Cloud makes the vendor management process smooth and consistent. Kissflow offers accurate, advanced insights on contract compliance, expense management, and operational performance reporting. Running your vendor management through Kissflow helps you evaluate your vendors by offering you proper visibility into the process. Here are some other advantages:

Quick vendor screening

Retrieve and verify supplier data like business reports, financial and credit risk data

Real-time collaboration

Instantly confirm goods receipt notices (GRNs), goods return ship notices, and more

All data in one place

Access all POs, PRs, contracts, and confidential vendor payment information, all in one place

Easy vendor enrolment

Collect key vendor information to screen them based on reputation, past performance, and more

Corrective actions

With sub-par supplier performance, initiate corrective action plans (SCAR) or offboard them

Rate contracts

Incorporate rate contracts; enforce contract pricing when catalog prices are raised

What is a vendor management process? What are the steps involved in vendor management?

Simply put, vendor management process is the set of directives to shortlist, onboard, and engage with vendors.

Essentially, it involves 7 steps.

1. Assess the vendor
2. Establish goals
3. Negotiate a contract
4. Onboard the vendor
5. Monitor their performance
6. Communicate regularly
7. Reward their performance

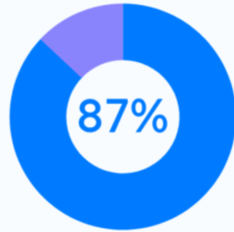
Let’s look at each of these steps in detail.

1. Assess the vendor

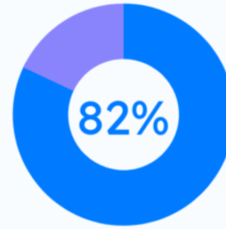
Before onboarding any merchant, assess them for the quality of their product, time to supply, pricing, network, and reliability.

You’ll be surprised to know that 87% of organizations have encountered a disruptive incident with a vendor in last three years. In fact, 82% of companies aren’t sure if they’ve identified all third-party risks.

Vendor risks



organizations have encountered a disruptive incident with vendor



organizations are not completely aware of third-party risks

Many organizations use scorecards for examining their vendors. For example, out of 100, they allot 10 points for quality, 40 points for pricing, 20 points for supply time, etc.

The goal of analyzing your suppliers is to vet them for a long-term relationship. It's important to identify if they can consistently deliver the promised output and quality.

2. Establish goals

To meet your sales goals, set up clear objectives for your vendors as well. More importantly, comprehend your business process in the utmost detail. It will help you structure and define clear performance metrics.

Convey your expectations and build a mutual understanding with your vendors. With strategic inputs, your vendors will be able to forecast your needs and maintain their inventory accordingly.

3. Negotiate a contract

To cultivate a relationship with your vendors, recognize and acknowledge their business objectives. For this, author a legitimate contract that is beneficial for both parties.

Negotiating too much for prices and restricting the profit margin of your vendor can hamper the quality of the product. To avoid that, plan the terms of the contract in such a way that they are mutually profitable.

4. Onboard the vendor

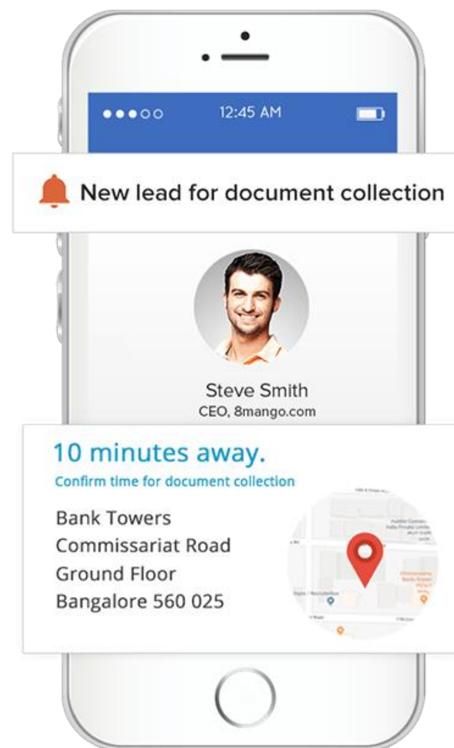
When your organization and the vendor land at mutually beneficial grounds, Sign the contract and onboard the vendor.

The onboarding process involves guiding the vendor into your company's network. A good vendor onboarding process guarantees the commencement of a smooth relationship.

Learn more about building an optimal vendor onboarding process through this webinar:

However, if you're new, vendors may not know about your platform. In this case, you'll have to build a team to go door-to-door and educate vendors about your platform.

But there's one more thing that fast-growing marketplaces do. They employ field employees and use vendor onboarding tools to educate + onboard vendors in one go. For example, leading marketplaces like Amazon Pay, Meesho, and Dunzo use LeadSquared's mobile app for onboarding vendors on the go.



5. Monitor your vendor's performance

After conveying your expectations, you expect your vendors to work as per the indicated standards of contract. But most of the time, the situation is far from ideal.

You need to constantly monitor your merchants and ensure that they are working at their highest potential.

The vendors who perform exceptionally well are called as strategic vendors. Take their perspective while establishing new vendor policies or changing the current ones.

6. Communicate regularly with your vendors

On average, U.S. retail operations have a supply chain accuracy of only 63%. This can result in significant delays and re-stocking issues. For example, 34% of businesses have shipped an order late due to selling a product that wasn't in stock.

It is possible to avoid such instances through regular communications with vendors about their stock, supply-network, and more. Many organizations hold gatherings and forums to talk about vendor issues. Here, vendors are guided and are provided with tips to improve.

7. Reward your vendors

Vendors see themselves as a part of the organization when you reward them for their performance. Organizing reward campaigns motivates your vendors and establishes a healthy competition among them. Vendor performance is beneficial for your company in the long run.

The importance of vendor management for the success your organization

Your success depends on your vendors' success. And there is only one way to build good relations with vendors. That's through effective vendor management. It helps you:

- **Catch up with the market trends:** You can inform your vendors about an ascending demand in the market. Subsequently, you can also advise them to maintain their inventory to satiate the soaring need in the marketplace.
- **Leverage the opportunity to improve:** Strategic meetings helps your vendors improve consistently. It gives them an opportunity to learn from other vendors and improve. At the same time, you can also learn from your vendors. For instance, their challenges. And provide appropriate solutions or tweak your processes to suit their needs.
- **Build long-term relationships:** For a long-term association with vendors, it is essential to ensure that they are accomplishing their business goals. To that effect, vendor management assists them in realizing their goals by measuring their performance and providing inputs to increase their sales.
- **Provide better quality of products:** The ultimate goal of vendor management is to provide a standard quality of products and services in a stipulated time and minimal cost. A proper vendor management process helps you ensure that the product quality and customer expectations are always met.

  The above points clearly show why vendor management is important for the growth of your organization. However, setting up a process is just one piece of the puzzle. Executing it properly is a completely different ball game. In the next section, we will discuss how technology can help you ramp up your process.

Vendor management tools: how technology gives you an advantage

Software tools make it easy to onboard and manage vendors. When I say vendor, I talk about the entire conglomeration of suppliers, merchants, driving partners, and sellers. But before we discuss the benefits of using tools, a quick look at the features of an ideal vendor management software.

Feature	Impact
Activity log	You will need to understand how well your vendor interacts with your platform. Tracking activities will help you achieve that.

Centralized data repository	Having a central repository for all vendor-related information, compliance documents, self-help documents, contracts, etc. make it easy to access and use the information as and when needed.
Communication	Your software should support communication through more than one channel, allow bulk messaging, and easy information exchange.
Onboarding	The onboarding module in your vendor-facing software should allow application, document collection, verification, and connect the verified vendor with your organization's workflows.
Payments	The software should either provide payment functionalities or integrate with payment gateways.
Performance tracking	Tracking vendor's every move is important to reduce risk and help them make more sales.
Self-service portal	A vendor portal to upload documents, access transactions, and more.

Capture inquiries and perform screening

A lot of times you'll receive business inquiries from sellers. Here, two main functions come into play:

1. Capture inquiry into your central system,
2. And assign the request to your team for verification and onboarding

Now, a lot of inquiries you receive might not fit your vendor selection criteria. Sometimes, it could be the region they operate in, or sometimes it could be the scale they're not able to meet. Manually vetting them could be time consuming.

Vendor onboarding software qualifies leads based on predetermined criteria. It ensures a high-quality funnel and prevents you team wasting time on non-serious merchants.

Automate your processes

Simple processes like application, document collection, etc. can be automated. For instance, you can provide self-serve portals to increase merchant self-listing. Again, you can automate tasks like document collection through vendor portals.

You can also use your merchant management software to map vendors to your team members for vendor verification, onboarding, and other operational tasks.

Another use case of merchant management software is—automate engagement campaigns. As mentioned above, you need to communicate regularly and stay in touch with your vendors to keep them engaged. You can use software tools to ask for their feedback, send tips to increase sales, product and marketing updates, etc.

Equip you teams with smart tools

If your process requires field visits for your teams, tools like mobile CRM comes in handy. Your team can carry field visits with ease and update the vendor status through the app itself.

Some of the benefits of using mobile CRM for field teams are:

- Share automated day plans to your team based on the leads assigned to them
- Give meeting recommendations
- Track if your team are at the right location and interacting with the right vendors
- Collect documents and onboards vendors on the fly

Track your vendors' performance

There are two main reasons why you should keep an eye on your vendor activities.

1. Mitigate risks like vendors supplying faulty products, not delivering on time, etc.
2. Identify top sellers, best-selling products, and more

Merchant management tools make it easy to track your vendors. You can utilize this information to motivate sellers who are trying hard to succeed on your platform. Data-driven insights through software will also help you make informed business decisions.

These are just some of the many benefits of using software to manage your vendor-related processes. And companies have realized success and fast growth with these tools. I would like to share the story of Meesho, India's leading reseller marketplace, who improved its vendor onboarding efficiency by 70% through technology.

CUSTOMER MANAGEMENT

Taking care of customers pays off. Companies that establish tight connections with clients on average experience **better financial results**.

According to **PwC**, around ⅔ of buyers say that a positive customer care experience largely determines their **loyalty** to the brand. Moreover, **32% of customers** will completely stop interaction with the beloved brand if a negative experience happens just once!

It seems that a good customer management system is an essential competitive advantage for companies that want to prosper in the market. Let’s see what you can do to achieve it.

What is customer management?

Customer management is the process of managing the company's relationships with potential and existing customers.

The term is closely related to **customer relationship management**, which is software that helps you manage all your company's interactions with prospects and customers, organize the data, and align your inner business processes.

Although some may use the terms interchangeably, customer management is not only about measurements, numbers, and sales predictions. To build an authentic relationship, not an occasional dialogue, the company has to:

Create a brand identity and develop key messages

Yes, positioning is a duty of the marketing department, but it's important to transform a brand book into a reference point for external communication for every single employee. Otherwise, there will be a strong disconnect between what the company claims and what it does when managing customers.

Set an external communication policy

Before building any relationships, it's vital to answer these questions: How should your sales reps or PR specialists speak to third parties? Who are authorized spokespersons to speak on behalf of your brand? What pieces of information are to be disclosed?

Write briefs and create templates for the sales team

Although all departments may somehow interact with clients, customer management is mainly a sales reps' task. Remember, your company's reputation is not set in strategies. It's shaped by day-to-day communication with your prospects.

Invest in personnel

Since relationships exist between people, a human factor here is key. If truth be told, few people can and are willing to build social connections.

Think of it as a talent — to withstand dialogue pauses, show perseverance, step aside from time to time, be polite and diplomatic, and not to appear rude or sycophant. Without getting the right people in the right seats, customer management simply can't happen.

Use good software

Face it: in the 21st century, there are hardly any routine jobs that employees can perform as efficiently and quickly as computers. **CRM systems** offer a variety of automation opportunities and become vital personal assistants that bring customer management to the next level.

With CRM tools, you can customize messages, create personalized offers, send reminders, prepare reports, share data, forecast, and much more.

Finding (or creating) perfect CRM software takes time and money. However, once you succeed, get ready to profit from:

- Better alliance of sales and marketing efforts
- Individualized and personalized offers
- Shortened customer journey
- More precise **buyer personas** & key account profiles
- Reduced bounce rate
- Improved client retention & **CLV**.

How to conduct customer experience management?

A good customer management strategy is the one that gives answers to not only a *"How?"* question but *"Why?"* as well:

- Why may a customer give preference to our product or service?
- Why do they prefer whichever communication channel?
- Why was the client satisfied/unsatisfied with the purchase? etc.

The *"The customer is never wrong"* principle should be taken as a basis when it comes to dialogue with the client. To achieve this, one should stick to some essential recommendations.

Set up data collection and storage

Typically, a CRM software system will be enough to cover all data needs. Always give preference to the tools with pre-designed **integration options** and API.

Still, the program you use is not as important — if you don't have a budget to buy expensive licenses, use free tools like Excel, Google Sheets, or SQL. Once you decide to invest in a CRM solution, here's our shortlist to consider:

- Zendesk
- Snov.io (with its integrations)
- HubSpot
- Pipedrive
- Salesforce
- Zoho
- Salesmate.

Create a customer journey map

A customer journey is what shows the **POCs** with buyers and directly refers to establishing relations with them. Use inputs from marketers and CRM statistics to create a detailed customer journey map. Mark down 5 conventional decision-making stages and write down the communication goal at every single step.

CUSTOMER JOURNEY MAP

Example of an online grocery store

www.columbiaroad.com

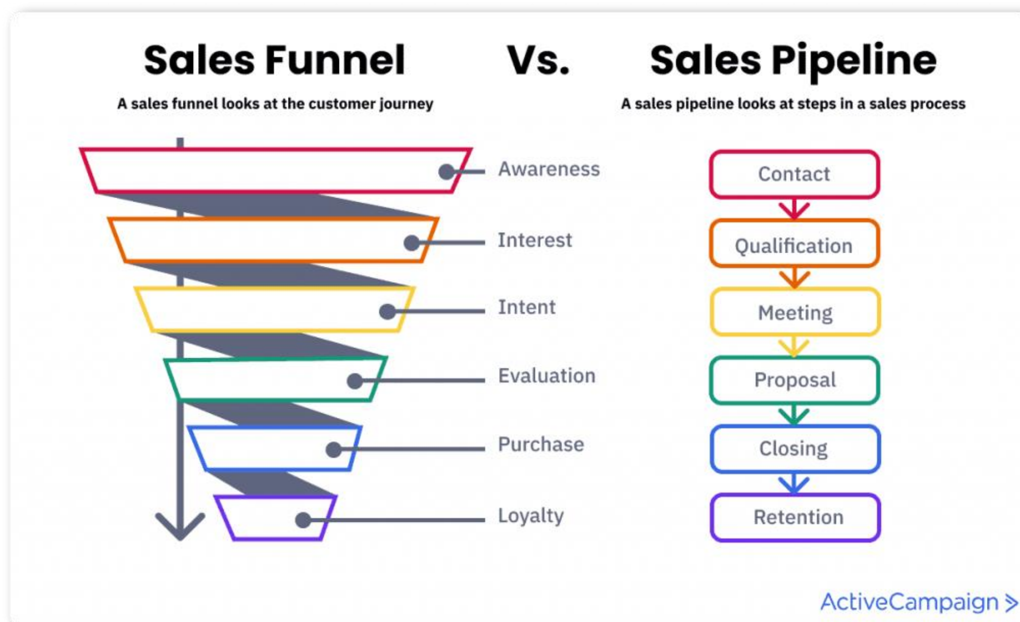
STAGE	AWARENESS	CONSIDERATION	DECISION		DELIVERY & USE			LOYALTY & ADVOCACY	
CUSTOMER ACTIVITIES	Hear from friends, see offline or online ad, read from newspapers	Compare & evaluate alternatives	Add groceries to shopping cart	Make an order	Receive or pick up on order	Contact customer service	Enjoy groceries	Order again and/or order more	Share experience
CUSTOMER GOALS	No goals at this point	Find the best solution to buy food	Find and select products easily, get inspired	Order effortlessly	Receive or pick up an order effortlessly and when needed	Get help if problems appear, request for refund	Have the right and good quality ingredients	Repeat good customer experience	Share feelings, give feedback
TOUCHPOINTS	Word of mouth, traditional media, social media	Word of mouth, website, brick & mortar store, social media		Website, app, order confirmation email	Delivery service, packing, messages (email, SMS, phone call)	Phone, email, chat	Food products, packages, other materials		Word of mouth, social media
EXPERIENCE	Interested, curious	Requires effort but excited	Excited	"Payment is painful"	Requires effort, happy when received	Frustrated	Satisfied	"This is easy"	"I have to share this"
BUSINESS GOAL	Increase awareness and interest	Increase number of website visitors	Increase shopping cart value & conversion rate	Increase online sales and conversion rate	Deliver on time and minimise the delivery window	Increase customer service satisfaction, minimise waiting time	Make products to match expectations	Increase retention rate and order value and/or frequency	Turn customers into advocates, turn negative experiences into positive
KPIs	Number of people reached	New website visitors	Shopping cart value, conversion rate	Online sales, conversion rate	On time delivery rate, average delivery window	Customer service success rate, waiting time	Product reviews	Retention rate, order value and frequency	Customer satisfaction
ORGANISATIONAL ACTIVITIES	Create marketing campaigns and content both offline and online, PR	Create marketing campaigns and content both offline and online	Optimise grocery shopping experience	Optimise online purchase funnel, order handling	Picking & delivery	Organise customer service	Develop products & product range	Target marketing, make re-ordering easy, upselling and/ or cross-selling	Manage feedback and social media, develop sharing / inviting possibilities
RESPONSIBLE	Marketing & Communications	Marketing & Communications	Online development, Customer service	Online development, warehouse, logistics	Warehouse, logistics	Customer service	Product development, purchasing	Marketing, online development	Customer service, online development
TECHNOLOGY SYSTEMS	CRM, analytics, programmatic buying platform, social media	CRM, analytics, CMS, marketing automation	CRM, analytics, CMS, ecommerce platform, PIM	CRM, analytics, CMS, ecommerce platform, PIM, inventory system, marketing automation	CRM, analytics, order & delivery system, marketing automation	CRM, analytics, help desk, ticketing system, chat	CRM, analytics, vendor management system, PIM	CRM, analytics, marketing automation, ecommerce platform	CRM, analytics, marketing automation, ecommerce platform, social media analytics

An example of how the map may look like: Each stage includes defined goals and touchpoints

You can also use different communication channels for each stage, say, give preference to emails on the awareness stage and social media and paid ads to target **prospects** on the consideration stage.

Create & adjust sales pipelines

After you've outlined your **sales funnel**, it's time to add details to a sales pipeline. Here's the difference between the two: a sales funnel looks at the customer journey, while a sales funnel looks at the steps in a sales process.



Source

Evaluate customer journeys to identify low and high points and failures to set expectations. Then match this information with the ongoing sales process to find & fix the bottlenecks.

Improve user experience

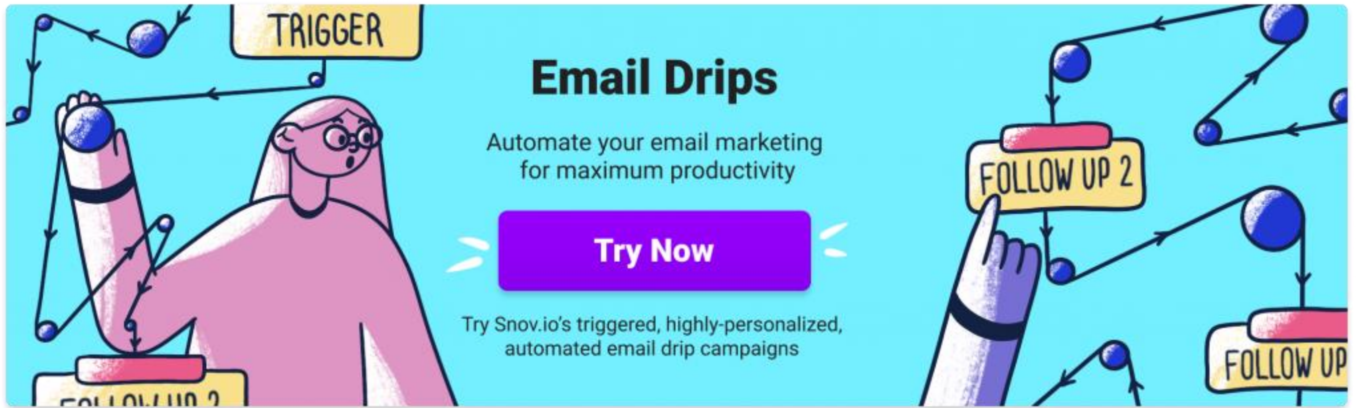
Be proactive. Test **UX** hypotheses to enhance customer satisfaction with what you offer and gain a good reputation.

Here's a simple example. People spend most of their time with smartphones in their hands. And when it comes to services, in most cases, prospects look for a quick answer. If you run a delivery business, these two facts can serve as a reason to experiment with AI and **chatbots** instead of investing more in the land-based support team.

Automate relationship management

The problem with customer management usually occurs when scaling up. If you have hundreds and thousands of contacts, use helpful tools to automate communication and keep customization at its highest level.

For example, you can try drip email campaign constructor from Snov.io to create and adjust mailing sequences and be on time with relevant content. Or try other marketing automation tools, like Marketo, ActiveCampaign, Leadfeeder, to conduct omnichannel communication with customers.



The business environment is changing rapidly, so customer management needs to be revised from time to time. Noticeable changes in sales **KPIs** and new communication approaches that market leaders begin to use may indicate it's time to evolve and rebuild the system.

3.7 ASSET ACCOUNTING

Asset accounting focuses on the recording and reporting of financial information related to a company's **balance sheet financial statement**. The balance sheet reports all assets of a business. Accountants must accurately report this information because assets represent a portion of the total wealth or economic improvements made by the company. The balance sheet assets are broken out in two groups: current and fixed. Each group contains specific items with values determined using Generally Accepted **Accounting Principles** (GAAP).

Current assets are the first items reported on the balance sheet under asset accounting.

Current assets are the first items reported on the balance sheet under asset accounting. These items include cash and cash equivalents, **inventory**, accounts receivables and short-term marketable securities. Asset accounting values these items at current **market value** since this information is readily available and the items can be quickly bought or sold on the open market. Current assets may also represent the items used by a company to generate sales from normal business operations. The second group of assets on the balance sheet includes the fixed assets of a company.

Fixed assets are items held for long-term use by the company. Companies may have several fixed assets depending on the size and type of operations of the business. According to GAAP guidelines, asset accounting must divide up fixed assets according to one of three groups: intangible, tangible or investments.

Is Amazon actually giving you the best price? This little known plugin reveals the answer.

Intangible assets include goodwill, patents, copyrights and trademarks. These items are valued using accounting measurements set forth by GAAP. The business industry or sector may allow companies to values these items differently, depending on the type if intangible asset. The next group of fixed assets on the balance sheet is **tangible assets**.

Tangible assets include the traditional items or land, buildings, machinery, vehicles, fixtures and computer equipment. Asset accounting usually records these items at historical cost and depreciates this value over a set amount of time. GAAP usually allows companies to choose a **depreciation** method consistent with the type of asset reported among several business industries or sectors. When reporting these fixed assets for tax purposes, accountants must use the Modified Accelerated Cost Recovery System (MACRS) to report depreciation on annual tax filings. Asset accounting must keep two separate depreciation schedules when depreciating fixed assets.

The final group of balance sheet fixed assets is investments held by the company. These items are classified as held-to-maturity, available for sale and long-term investments. Asset accounting reports these items at the current market value. This means accountants must review the investment market to determine how much these items could be sold for at current market rates. Adjustments are then made to these fixed assets to increase or decrease the book value of the asset.

What is Asset Accounting in SAP

SAP Asset Accounting is also called as sub ledger accounting, it is one of the important sub-module of SAP financial accounting (SAP FICO) module. Asset Accounting in SAP (FI-AA) is used for managing and supervising the fixed assets of an organization. The main purpose of asset accounting is to extract the exact values of the fixed assets owned by the company on a particular date.

SAP FI-AA components

The important components SAP financial accounting asset accounting are

- Traditional Asset accounting
- Preparation for consolidation
- Information system
- Processing leased assets

Important fundamentals of Asset Accounting

Fixed assets are assets used for running a business enterprise, where the fixed assets are used for more than one year.

The cost of using asset and the wear and tear in the asset is called as depreciation, where the depreciation is accounted at the end of accounting period.

The total value of assets are charged to profit & loss accounts over life cycle of asset.

Initially you need to configure company code in financial accounting, then you need to assign chart of depreciation to company code.

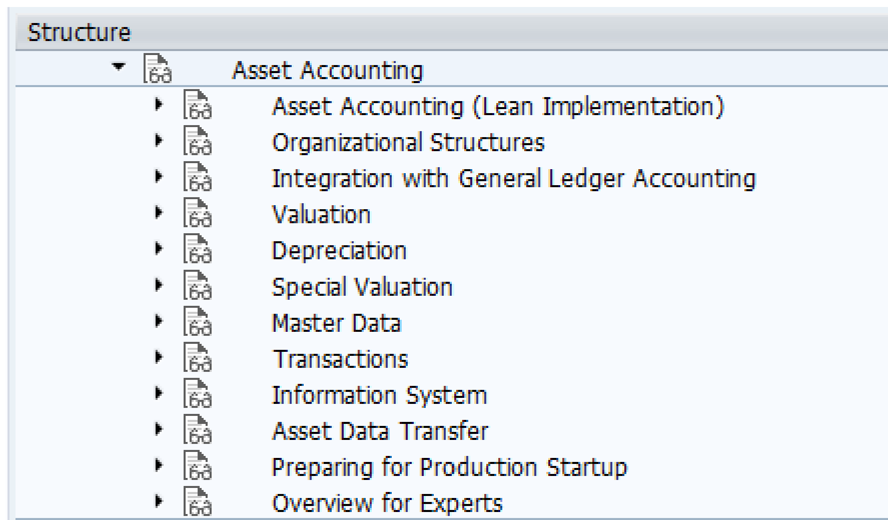
The values of assets from the date of purchase and to its final termination will be updated in SAP system.

Important configuration of Asset Accounting in SAP

The first step of configuration of asset accounting in SAP is ensuring that country specific template is available or not. If the organization is small with low assets, then we can go for the configuration through the asset accounting lean implementation method. Otherwise we can go for regular implementation method.

Configuration steps

The important configurations of SAP FI – AA are as follows.



3.8 Unit End Questions

A. Descriptive Questions

Long questions

1. What do you mean by bank? State the different types of bank.
2. Discuss the different types of bank account.
3. Describe the various kinds of bank customer in India.
4. What is pass book, what are the features of it?
5. Define bank loan highlights the advantages and disadvantages of it.

Short questions

1. Classify the numerous types of bank securities
2. Distinguish between pledge hypothecation and mortgage.
3. Clarify the different types of books maintained by the bank.
4. Establish the relation between banker and customers.
5. how the accounting of banking companies are maintained.

B . Multiple Choice Questions

1. ERP is combination of _________ and __________.

   a. technology, assessment
   b. assessment, management
   c. management, technology
   d. technology, business process

2. In EPR information technology integrates with companies ________ to achieve its ultimate goal.

a. business ethics
b. business processes
c. management
d. resources

3. ___________ utilizes software applications for scheduling production processes.

a. Manufacturing requirement planning
b. Materials requirement planning
c. Inventory management and control
d. Enterprise resource planning

4. On which of the following is the ERP system based?

a. Database and Software design

b. Database and Processes

c. Processes and Software design

d. Database

5. Which of the following departments does the effective utilization, up-dation and integration of updated information?

a. Information technology department

b. Management information system department

c. Quality assurance department

d. Information processing

3.9 REFERENCES

Reference Books:

- "Enterprise Resource Planning: Concepts and Practice" by Vinod Kumar Garg and N. K. Venkitakrishnan
- "Enterprise Resource Planning" by Alexis Leon
- "ERP Demystified" by Alexis Leon
- "Implementing SAP ERP Financials: A Configuration Guide" by Vivek Kale

Web Resources:

- SAP Official Website: https://www.sap.com/
- Oracle ERP Cloud: https://www.oracle.com/cloud/erp/
- Microsoft Dynamics 365 ERP: https://dynamics.microsoft.com/en-us/erp/
- Infor ERP: https://www.infor.com/solutions/erp
- ERP Focus: https://www.erpfocus.com/

UNIT 4 - FINAL ACCOUNTS OF SOLE PROPRIETOR AND PARTNERSHIP FIRM

STRUCTURE

4.0 Objectives

4.1 Introduction

4.2 Trading Account and Profit and Loss Account

4.3 Balance Sheet

4.4 Closing Entries

4.5 Adjustment Entries

4.6 Provisions

4.7 Receipts and Payment Account

4.8 Income and Expenditure Account

4.9 Departments and Branches

4.10 Basis of Allocation and Apportionment of Expenses

4.11 Inter-departmental transfer at cost and sales price

4.12 Unit End Questions

4.13 References

4.0 OBJECTIVES

After completing this Students will be able to

- Define Balance sheet
- Understand preparation of Trading Account
- Define provisions
- Explain Inter-departmental transfer at cost and sales price

4.1 INTRODUCTION

Final accounts are an integral part of a financial accounting year for every business. In other words, it is the end product of the accounting process carried out the whole year. These need to be prepared by every business on or by the 31st of March every financial year as it marks the end of the year.

Meaning of Final Accounts

Final accounts refer to the accounts prepared by a business entity at the end of every financial year. The final accounts depict a clear and accurate financial position of the entity. This information is of use to the management, investors, owners, shareholders, and also to other users of such information.

The final accounts of an entity consists of the following accounts:

1. Manufacturing and Trading Account
2. Profit and Loss Account
3. Balance Sheet
4. Profit and Loss Appropriation account

The trial balance forms the basis for the preparation of the final accounts. Further, these are audited by the internal as well as external auditors, usually the Chartered Accountants. Thus, these need to be prepared in a fair and transparent manner.

Manufacturing Account

Manufacturing entities need to prepare a Manufacturing account before preparing the Trading Account. It determines the Cost of goods sold.

Format of Manufacturing Account

Particulars	Units	Amount		Particulars	Units	Amount
To Raw material consumed:				By By-products at net realizable value		
Opening inventory				By Closing Work-in-Process		
Add: Purchases				By Trading A/c		
Less: Closing inventory				**Cost of production**		
To Direct Wages						
To Direct expenses						
Prime cost						
To Factory overheads:						
Royalty						
Hire charges						

To Indirect expenses:						
Repairs & Maintenance						
Depreciation						
Factory cost						
To Opening Work-in-process						

Trading Account

It is prepared after the manufacturing account by the manufacturing industries. However, in case of trading concerns, it is the first account that is prepared. It determines the gross profit or gross loss of an entity resulting from the trading activities. Trading activities refer to the buying and selling activities of a business.

Opening stock, Purchases (less returns) and Direct expenses are written on the debit side of the Trading account while Closing Stock and Sales (less returns) are written on the credit side of the Trading account. When the credit side exceeds the debit side, it shows Gross Profit and if the debit side exceeds the credit side, it shows Gross Loss.

The gross profit or loss is transferred to the Profit and Loss A/c. The closing entries are as follows:

For Gross Profit

Trading A/c Dr.

To Profit and Loss A/c

For Gross Loss

Profit and Loss A/c Dr.

To Trading A/c

Sample Trading Account

Trading Account

Particulars	Amount	Particulars	Amount
To opening stock	–	By sales (less returns)	–
To purchases (less returns)	–	By closing stock	–
To fuel and power	–	By gross loss (transfer to P & L A/C)	–
To wages	–		
To carriage inwards	–		
To freight and octroi	–		
To direct expenses			
To gross profit (transfer to P & L A/C)	–		

Profit and Loss Account

The profit and loss account determines the net profit or net loss of the business for the accounting period. It begins with the balance carried down from the Trading Account. The revenues and expenses that are indirect or that do not form a part of the Trading account, form a part of the Profit and Loss Account. When the credit side of the Profit and Loss Account exceeds the debit side, it shows net profit and vice-versa.

The net profit or loss is then shown as an addition or deduction respectively, from the Capital account in the Balance Sheet.

Some expenses that form a part of the Profit and Loss Account are:

1. Sales Tax
2. Provisions

3. Maintenance
4. Administrative Expenses
5. Selling and Distribution Expense
6. Depreciation
7. Freight and carriage on sales
8. Wages and Salaries

Some revenues that appear on the credit side of the Profit and Loss Account are Commission received, Discount received, profit obtained on sale of assets, etc.

Closing Entries for Net Loss or Net Profit are as follows:

For Net Loss

Capital A/c – Dr.

To Profit and Loss A/c

For Net Profit

Profit and Loss A/c Dr.

To Capital A/c

Format for Profit and Loss Account

Profit & Loss Account

Particulars	**Amount**	**Particulars**	**Amount**
To gross loss		By gross profit	
To salaries		By rent received	
To rents and taxes		By discounts earned	
To travelling expenses		By interests earned	
To stationary/printing expenses		By bad debts recovered	
To postage		By commissions earned	

To audit & legal charges		By dividends received	
To telephone expenses		By income from other sources	
To insurance premium		By Net Loss (transferred to Capital A/C)	
To marketing/advertisement			
To interest paid			
To discount allowed			
To sundry expenses			
To carriage outwards			
To bad debts			
To depreciation			
To loss by fire/theft			
To any other expenses			
To net profit (transferred to Capital A/C)			

Balance Sheet

The balance sheet is a statement showing the total assets, total liabilities and the capital of the business. It shows the financial position of the business on the last day of the financial year i.e. 31st March.

The assets are on the Right-hand side of the Balance sheet while Capital and liabilities are on the Left-hand side. The total assets need to be equal to the total liabilities and capital for the Balance sheet to match.

Format of Balance Sheet

Balance Sheet

Balance Sheet

Liabilities	**Amount**	**Assets**	**Amount**
Capital (Less: drawings Add: profit)		Land and building	
Reserves and surplus		Plant and machinery	
Outstanding expenses		Furniture	
Loans		Stock	
Trade creditors		Sundry debtors	
Bills payable		Bills receivable	
		Misc. investments	
		Cash in hand	

Total	xx	Total	xx

Adjustments in Final Accounts

When the books are maintained as per the accrual basis of accounting, the incomes and expenses need to be recorded on an accrual basis. This implies that an income earned in the current financial year whether received or not and an expense incurred for the current financial year whether paid or not needs to be accounted for in the current financial year. This gives rise to the adjustments in final accounts. The adjustments always appear outside the Trial Balance.

Some common adjustments:

- Closing Stock
- Outstanding Expenses
- Prepaid or Unexpired Expenses
- Accrued or Outstanding Income
- Income Received In Advance or Unearned Income
- Depreciation
- Bad Debts
- Provision for Doubtful Debts
- Provision for Discount on Debtors
- Manager's Commission
- Interest on Capital
- Goods Distributed among Staff Members for Staff Welfare
- Drawing of Goods for Personal Use
- Abnormal or Accidental Losses

4.2 TRADING AND PROFIT AND LOSS ACCOUNT

A business needs to prepare a trading and profit and loss account first before moving on to the balance sheet. Trading and profit and loss accounts are useful in identifying the gross profit and net profits that a business earns.

The motive of preparing trading and profit and loss account is to determine the revenue earned or the losses incurred during the accounting period.

The trading and profit and loss account are two different accounts that are formed within the general ledger. The two parts of the account are:

1. Trading Account

2. Profit and Loss Account

Trading account is the first part of this account, and it is used to determine the gross profit that is earned by the business while the profit and loss account is the second part of the account, which is used to determine the net profit of the business.

Let us know more about these accounts in detail

1. Trading Account

Trading account is used to determine the gross profit or gross loss of a business which results from trading activities. Trading activities are mostly related to the buying and selling activities involved in a business. Trading account is useful for businesses that are dealing in the trading business. This account helps them to easily determine the overall gross profit or gross loss of the business. The amount thus determined is an indicator of the efficiency of the business in buying and selling.

The formulae for calculating gross profit is as follows:

Gross profit = Net sales – Cost of goods sold

Where

Net sales = Gross sales of the business minus sales returns, discounts and allowances.

The trading account considers only the direct expenses and direct revenues while calculating gross profit. This account is mainly prepared to understand the profit earned by the business on the purchase of goods.

Items that are seen in the debit side include purchases, opening stock and direct expenses while credit side includes closing stock and sales.

Closing entries for Gross Loss or Gross Profit

The following entries are passed

In case of Gross Loss

Profit and Loss A/c Dr.

To Trading A/c

In case of Gross Profit

Trading A/c Dr.

To Profit and Loss A/c

Preparing Trading Account

Trading account is prepared by closing all the temporary purchases and revenue accounts and making adjustments in the inventory accounts by the use of a closing journal entry

For the following question, prepare a trading account

Particulars	Amount	Particulars	Amount
Sales	2,05,000		
Sales returns	15,000		
Purchases	49,000		
Purchases returns	3000		
Opening inventory	8000		
Closing inventory	30,000		
Trading Account	1,500		

The format of trading account after passing the closing entry is as follows:

Dr.	**Trading Account for the year ended**		**Cr.**
Sales returns	15,000	Sales	205,000
Purchases	49,000	Purchase returns	3,000
Beginning inventory	8,000	Ending inventory	9,000
Balance c/d	145,000		
Total	**217,000**	**Total**	**217,000**
		Balance b/d	145,000

In this example, all accounts are closed and transferred to the trading account. The credit entry of 1,45,000 is the gross profit for the period.

2. Profit and Loss Account

Profit and loss account shows the net profit and net loss of the business for the accounting period. This account is prepared in order to determine the net profit or net loss that occurs during an accounting period for a business concern.

Profit and loss account get initiated by entering the gross loss on the debit side or gross profit on the credit side. This value is obtained from the balance which is carried down from the Trading account.

A business will incur many other expenses in addition to the direct expenses. These expenses are deducted from the profit or are added to gross loss and the resulting value thus obtained will be net profit or net loss.

The examples of expenses that can be included in a Profit and Loss Account are:

1. Sales Tax
2. Maintenance
3. Depreciation
4. Administrative Expense
5. Selling and Distribution Expense
6. Provisions
7. Freight and carriage on sales
8. Wages and Salaries

These appear in the debit side of Profit and Loss Account while Commission received, Discount received, profit obtained on sale of assets appear on the credit side.

Net profit can be determined by deducting business expenses from the gross profit and adding other incomes obtained

Net profit = Gross profit – Expenses + Other income

Closing Entries for Net Loss or Net Profit:

i. In case of Net Loss

Capital A/c – Dr.

To Profit and Loss A/c

ii. In case of Net Profit

Profit and Loss A/c -Dr.

To Capital A/c

Trading and Profit and Loss Account Format

Trading and Profit and Loss Account format is represented separately as follows:

Format for Trading Account

Trading account for the year ended………..

To opening stock	xxx	By Sales xxxx	
To purchases xxxx		Less returns xx	
Less returns xxx		--------	xxxx
-------------	xxxx	By closing stock	xxx
To Direct expenses:		By gross loss (if loss)	xxx
Carriage inward	xxx		
Freight	xxx		
Octroi	xxx		
Dock dues	xxx		
Excise duty	xxx		
Royalty	xxx		
Motive power	xx		
Coal, gas, water	xxx		
Factory expenses	xxx		
To Gross Profit (if profit)	xxx		
	xxxxx		xxxxx

Format for Profit and Loss Account

Profit & Loss Account
(For the year ended...)

Dr. Particulars	Amount	Particulars	Cr. Amount
To Gross loss b/d	Xxx	By Gross Profit b/d	Xxx
To Salaries	Xxx	By Discount Received	Xxx
To Office rent, rates and taxes	Xxx	By Commission Received	Xxx
To Printing & stationery	Xxx	By Bank Interest	Xxx
To Telephone expenses	Xxx	By Rent received	Xxx
To Postage & telegram	Xxx	By Dividend on shares	Xxx
To Discount Allowed	Xxx	By Interest earned on debentures	Xxx
To Insurance	Xxx	By Profit on sale of asset	Xxx
To Audit Fees	Xxx	By Net loss	Xxx
To Electricity charges	Xxx		
To Repairs & renewals	Xxx		
To Depreciation	Xxx		
To Advertisement	Xxx		
To Carriage Outwards	Xxx		
To Bad Debts	Xxx		
To Provision for Bad debts	Xxx		
To Selling commission	Xxx		
To Bank Charges	Xxx		
To Interest on loans	Xxx		
To Loss on sale of asset	Xxx		
To Net Profit	Xxx		
	xxx		xxx

Difference between Trading and Profit and Loss Account

The following points of difference exist between the Trading and Profit and Loss Account

Parameters	Trading Account	Profit and Loss Account
Meaning	Trading account used to find the gross profit/loss of the business for an accounting period	Profit and loss account or Income statement is used to find the net profit/loss of the business for an accounting period
Timing	Trading Account is prepared first and then profit and loss account is prepared.	Profit/Loss Account is prepared after the trading account is prepared.
Purpose	For knowing the gross profit or gross loss of a business	For knowing the net profit or net loss of a business
Stage	It is the first stage in the creation of the final account.	it is the second stage in the creation of the final account.
Dependency	It is not dependent on trial balance	It is dependent on trading account
Transfer of Balance	The balance in the form of Gross loss or Gross Profit of the trading account will be transferred to the Profit and Loss Account	The balance in the form of Net loss or Net Profit of the profit and loss account will be transferred to the Balance Sheet

4.3 BALANCE SHEET

The Balance Sheet is a statement that shows the financial position of the business. It records the assets and liabilities of the business at the end of the accounting period after the preparation of trading and profit and loss accounts

'Not-for-Profit' Organisations design Balance Sheet for determining the financial position of the establishment. The preparation of the balance sheet is on the same pattern as of the trade entities. It depicts liabilities and assets as during the end of the year. Assets are depicted on the right-hand side, whereas the liabilities are depicted on the left-hand side.

However, there will be a General Fund or Capital Fund in place of the Capital and the surfeit or deficit as per Income and Expenditure A/c which is either deducted from or added to the capital fund, as the scenario may be. It is a common practice to add some of the subsidised items like entrance fees, legacies and life membership fees precisely in the capital fund.

Fig.4.1 Balance sheet

Features of Balance Sheet:

The features of a balance sheet are as follows:

- It is regarded as the last step in final accounts creation
- It is a statement and not an account
- It consists of transactions recorded under two sides namely, assets and liabilities. Assets are placed in the left hand side, while the liabilities are placed on the right hand side
- The total of both side should always be equal
- The balance sheet discloses financial position of the business
- It is prepared after trading and profit and loss account is prepared.

All the above are mentioned balance sheet items are also known as characteristics of the balance sheet.

Importance of Balance Sheet:

Balance sheet analysis can say many things about a company's achievement. Few essential factors of the balance sheet are listed below:

- Creditors, investors, and other stakeholders use this financial tool to know the financial status of a business.
- It is used to analyse a company's growth by comparing different years.

- While applying for a business loan, a company has to submit a balance sheet to the bank.
- Stakeholders can find out the business accomplishment and liquidity position of a company.
- Company's balance sheet analysis can detect business expansion and future expenses.

Also Read: What is the difference between Fixed Assets and Current Assets?

What is the purpose of balance sheet?

The main purpose of the balance sheet is to show a company's financial status. This sheet shows a company's assets and liabilities, along with the money invested in the business. This statement is required to analyze the financial status information for several consecutive periods. Generally, investors and creditors look at the balance sheet of the company to understand how effectively a company will use its resources and how much it can give in return. Though the balance sheet can be prepared at any time, it is mostly prepared at the end of the accounting period. The balance sheet can be created at any time. However, it is often prepared at the end of the financial year.

How to prepare a Balance Sheet?

Below are the steps mentioned to prepare a balance sheet?

1. **Compose a trial balance-** It is a regular report included in any accounting programme. If it is a manual mode, then create a trial balance by transferring every general ledger account's ending balance to a spreadsheet.
2. **Arrange the trial balance-** It is important to arrange the initial trial balance to assure that the balance sheet similar to the relevant accounting structure. While using adjusting entries to adjust the trial balance all the entry should be completely recorded so the auditors can understand why it was made.
3. **Discard all expense and revenue accounts-** The trial balance includes expenses, revenue, losses, gains, liabilities, equity, and assets. Delete all from the trial balance except equity, liabilities, and assets. However, the deleted accounts are used to create an income statement.
4. **Calculate the remaining accounts-** In this stage, sum up all the trial balance account used to create a balance sheet. The typical line items used in the balance sheet are:
    - Cash
    - Accounts receivable
    - Inventory
    - Fixed assets
    - Other assets

- Accounts payable
- Accrued liabilities
- Debt
- Other liabilities
- Common stock
- Retained earnings

5. **Validate the balance sheet-** The total for all assets recorded in the balance sheet should be similar to the liabilities and stockholders' equity accounts.
6. Present in the required balance sheet format.

Balance Sheet Format:

The balance sheet of a company will look like the image given below.

Balance Sheet of .... As at............

Liabilities	**Rs.**	**Assets**	**Rs.**
		Fixed Assets:	
Capital:		Good will	
Opening Balance xxxx		Land	
Add: Net Profit xxxx		Building	
(Less: Net Loss)		Plant & Machinery	
Less: Drawings xxxx		Furniture & Fixtures	
Long-term Liabilities:		Investment:	
Loan		Current Assets:	
Current liabilities:		Closing stock	
Income received-in-advance		Accrued income	
Sundry Creditors		Prepaid expenses	
Outstanding Expenses		Sundry Debtors	
Bills Payable		Bills Receivable	
Bank Overdraft		Cash at Bank	
		Cash in Hand	

What is Reserve in Balance Sheet:

A *reserve* is a retained earnings secured by a company to strengthen a company's financial position, clear debt & credits, buy fixed assets, company expansion, legal requirements,

investment and other plans. These are usually done to save the cash from being used in other purposes. Reserve funds do not have any legal restrictions so that the company can use it for any purpose. For instance: Let's consider company ABC has to suspend one of its products and release refunds to its buyers over the periods of six months.

To make sure that the company has enough money to give refunds, a balance sheet reserve of ₹1,00,000 is created. As customers demand refunds, Company ABC reduces the ₹1,00,000 reserve. Especially insurance companies regularly create balance sheet reserves to make sure they have sufficient funds to pay out claims. The reserves usually meet the expense of applications that have been registered but not yet paid. Balance sheet reserves are registered as liabilities on the balance sheet.

Consolidation of Balance Sheet:

A consolidated balance sheet shows both the liabilities and assets of a parent company along with its subsidiaries in one document, without any specific mention about which item is associated with which company. A consolidated financial statement is issued by a company whenever it acquires 50 per cent of controlling stake or business in another company. For example: If an organization has ₹1 million as assets and buy subsidiaries for ₹400,000 and ₹300,000, assets respectively. In this scenario, the consolidated balance sheet will reflect ₹1.7 million as an asset.

While recording the consolidated balance sheet, it's essential to modify the subsidiaries assets figures so that they indicate the accurate market value. Also, the parent company revenue should not be included in this sheet because the net change is ₹0.

How to Prepare Consolidated Balance Sheet?

To prepare a consolidated balance sheet first name the document, it's subsidiary and date at the head of the sheet. In the left-side column, create a section for assets, liabilities, and equity. All the numbers included in the sheet should match with the worksheet's consolidated trial balances. After including the numbers from your worksheet, review the consolidated balance sheet.

The total assets, liabilities, and equity should be similar to the parent company. Lastly, add subsidiary and delete all the duplicate items.

NUMERICAL EXAMPLE OF FINAL ACCOUNTS

1. From the following balances taken from the books of Simmi and Vimmi Ltd. for the year ending March 31, 2017, calculate the gross profit.

	(₹)
Closing Stock	**2,50,000**
Net sales during the year	

40,00,000

Net purchases during the year

15,00,000

Opening stock

15,00,000

Direct expenses

80,000

Trading account as on March 31, 2017 A/c

Dr.

Cr.

Expenses/Losses

Amount

₹

Revenues/Gains

Amount

₹

To Opening Stock

15,00,000

By Net Sales

40,000

To Net Purchases

15,00,000

By Closing Stock

2,50,000

To Direct Expenses

80,000

To Gross Profit

11,70,000

42,50,000

42,50,000

2. **Operating profit earned by M/s Arora & Sachdeva in 2016-17 was ₹ 17,00,000. Its non-operating incomes were ₹ 1,50,000 and non-operating expenses were ₹ 3,75,000. Calculate the amount of net profit earned by the firm.**

The formula for computing the operating profit is giving as

Operating Profit

=

Net Profit + Non-Operating Expenses – Non-Operating Incomes

⇒ ₹ 17,00,000

=

Net Profit + ₹ 3,75,000 – ₹ 1,50,000

⇒ ₹ 17,00,000

=

Net Profit + ₹ 2,25,000

⇒ Net Profit

=

₹ 17,00,000 – ₹ 2,25,000

=

₹ 14,75,000

3. **The following are the extracts from the trial balance of M/s Bhola & Sons as on March 31, 2017**

Account Title

Debit

₹

Credit

₹

Opening Stock

2,00,000

Purchases

8,10,000

Sales

10,10,000

10,10,000

10,10,000

(Only relevant items)

Closing Stock as on date was valued at ₹ 3,00,000.

You are required to record the necessary journal entries and show how the above items will appear in the trading and profit and loss account and balance sheet of M/s Bhola & Sons.

Books of M/s Bhola & Sons

Journal

Date

Particulars

L.F.

Debit

Amount

₹

Credit

Amount

₹

2017

Mar 31

Trading A/c

Dr

10,00,000

To Opening Stock A/c

2,00,000

To Purchases A/c

8,10,000

(Being the balances from the opening stock and purchases accounts transferred to the Trading A/c)

Mar 31

Sales A/c

Dr.

10,10,000

Closing Stock A/c

Dr.

3,00,000

To Trading A/c

13,10,000

(Being the balances from the sales and closing stock A/c transferred to the Trading A/c)

Mar 31

Trading A/c

Dr.

3,00,000

To Profit and Loss A/c

3,00,000

(Being the balance from the Trading Account i.e. Gross proit transferred to the Profit and Loss A/c)

Trading A/c of M/s Bhola & Sons as on March 31, 2017

Dr.

Cr.

Expenses/Losses

Amount

₹

Revenues/Gains

Amount

₹

To Opening Stock

2,00,000

By Sales

10,10,000

To Purchases

8,10,000

By Closing Stock

3,00,000

To Gross Profit

3,00,000

3,10,000

3,10,000

Balance Sheet of M/s Bhola & Sons as on March 31, 2017

*Only relevant data is shown.

Liabilities

Amount

₹

Assets

Amount

₹

Closing Stock

3,00,000

4. The following trial balance is extracted from the books of M/s Ram on March 31, 2017. You are required to prepare trading and profit and loss account and the balance sheet as on date :

Account Title

Amount

₹

Account Title

Amount

₹

Debtors

12,000

Apprenticeship premium

5,000

Purchases

50,000

Loan

10,000

Coal, gas and water

6,000

Bank overdraft

1,000

Factory wages

11,000

Sales

80,000

Salaries

9,000

Creditors

13,000

Rent	**4,000**
Capital	**20,000**
Discount	**3,000**
Advertisement	**500**
Drawings	**1,000**
Loan	**6,000**
Petty	**500**
Sales return	**1,000**
Machinery	**5,000**
Land and building	**10,000**
Income tax	**100**
Furniture	**9,900**

Trading and Profit and Loss account of M/s Ram for the year ended March 31, 2017

Dr.

Cr.

Expenses/Losses	**Amount ₹**	**Revenues/Gains**	**Amount ₹**
To Purchases			

50,000

By Sales

80,000

To Coal, gas and water

6,000

Sales return

(1,000)

79,000

To Factory wages

11,000

To Gross profit c/d

12,000

79,000

79,000

To Salaries

9,000

By Gross profit b/d

12,000

To Rent

4,000

By Apprenticeship premium

5,000

To Discount

3,000

To Advertisement

500

To Net profit

500

17,000

17,000

Balance sheet of M/s Ram as on March 31, 2017

Liabilities

Amount

₹

Assets

Amount

₹

Capital

20,000

Machinery

5,000

Net Profit

500

Land and Building

10,000

20,500

Furniture

9,900

Drawings

(1,000)

Loan (Lent)

6,000

Income tax

(100)

19,400

Debtors

12,000

Loan (Borrowed)

10,000

Petty cash

500

Creditors

13,000

Bank Overdraft

1,000

43,400

43,400

4.4 CLOSING ENTRY

A closing entry is a journal entry that is made at the end of an accounting period to transfer balances from a temporary account to a permanent account.

Companies use closing entries to reset the balances of temporary accounts − accounts that show balances over a single accounting period − to zero. By doing so, the company moves these balances into permanent accounts on the balance sheet. These permanent accounts show a company's long-standing financials.

Temporary Accounts

Temporary accounts are accounts in the general ledger that are used to accumulate transactions over a single accounting period. The balances of these accounts are eventually used to construct the income statement at the end of the fiscal year.

The income statement is a financial statement that is used to portray a company's financial performance and activities over a single fiscal year. It is for this reason that the date line in the annual income statement is written as "Year ended."

Below is an example of Amazon's 2017 annual income statement. You can see that for the date, it is written as "Year ended December 31, YYYY".

AMAZON.COM, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share data)

	Year Ended December 31,		
	2015	2016	2017
Net product sales	$ 79,268	$ 94,665	$ 118,573
Net service sales	27,738	41,322	59,293
Total net sales	107,006	135,987	177,866
Operating expenses:			
Cost of sales	71,651	88,265	111,934
Fulfillment	13,410	17,619	25,249
Marketing	5,254	7,233	10,069
Technology and content	12,540	16,085	22,620
General and administrative	1,747	2,432	3,674
Other operating expense, net	171	167	214
Total operating expenses	104,773	131,801	173,760
Operating income	2,233	4,186	4,106
Interest income	50	100	202
Interest expense	(459)	(484)	(848)
Other income (expense), net	(256)	90	346
Total non-operating income (expense)	(665)	(294)	(300)
Income before income taxes	1,568	3,892	3,806
Provision for income taxes	(950)	(1,425)	(769)
Equity-method investment activity, net of tax	(22)	(96)	(4)
Net income	$ 596	$ 2,371	$ 3,033
Basic earnings per share	$ 1.28	$ 5.01	$ 6.32
Diluted earnings per share	$ 1.25	$ 4.90	$ 6.15
Weighted-average shares used in computation of earnings per share:			
Basic	467	474	480
Diluted	477	484	493

See accompanying notes to consolidated financial statements.

Source: Amazon.com

As mentioned, temporary accounts in the general ledger consist of income statement accounts such as sales or expense accounts. When the income statement is published at the end of the year, the balances of these accounts are transferred to the income summary, which is also a temporary account.

The income summary is used to transfer the balances of temporary accounts to retained earnings, which is a permanent account on the balance sheet.

Income Summary

The income summary is a temporary account used to make closing entries.

All temporary accounts must be reset to zero at the end of the accounting period. To do this, their balances are emptied into the income summary account. The income summary account then transfers the net balance of all the temporary accounts to retained earnings, which is a permanent account on the balance sheet.

Permanent Accounts

Permanent accounts are accounts that show the long-standing financial position of a company. Balance sheet accounts are permanent accounts. These accounts carry forward their balances throughout multiple accounting periods.

To understand this better, we can look at an account such as inventory. Below is an excerpt from Amazon's 2017 annual balance sheet.

AMAZON.COM, INC.

CONSOLIDATED BALANCE SHEETS
(in millions, except per share data)

	December 31,	
	2016	**2017**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 19,334	$ 20,522
Marketable securities	6,647	10,464
Inventories	11,461	16,047
Accounts receivable, net and other	8,339	13,164
Total current assets	45,781	60,197
Property and equipment, net	29,114	48,866
Goodwill	3,784	13,350
Other assets	4,723	8,897
Total assets	$ 83,402	$ 131,310

Source: amazon.com

Learn to read financial statements in CFI's free reading financial statements course!

The balance sheet captures a snapshot of a company at a given point in time. By looking at this balance sheet, we can observe the following:

1. On December 31, 2016, Amazon reported $11,461 million of inventory. This amount was carried forward into the beginning of 2017.
2. On December 31, 2017, Amazon posted $16,047 million of inventory.
3. Amazon increased its inventories by $4,586 million in 2017 to come to the balance it reported on December 31, 2017.

By looking at it this way, we can see how Inventory is a permanent account that carries forward balances through multiple accounting periods.

Example of a Closing Entry

Below are examples of closing entries that zero the temporary accounts in the income statement and transfer the balances to the permanent retained earnings account. This is done using the income summary account.

1. Close Revenue Accounts

Clear the balance of the revenue account by debiting revenue and crediting income summary.

Date	Accounts	Debit	Credit
2017			
Dec. 31	Revenue	$ 100,000	
	Income summary		$ 100,000

2. Close Expense Accounts

Clear the balance of the expense accounts by debiting income summary and crediting the corresponding expenses.

Date	Accounts	Debit	Credit
2017			
Dec. 31	Income summary	$ 92,000	
	Cost of goods sold		$ 55,000
	Depreciation expense		5,000
	Rent expense		15,000
	Wages expense		15,000
	Interest expense		2,000

3. Close Income Summary

Close the income summary account by debiting income summary and crediting retained earnings.

Date	Accounts	Debit	Credit
2017			
Dec. 31	Income summary	$ 8,000	
	Retained earnings		$ 8,000

4. Close Dividends

Close the dividends account by debiting retained earnings and crediting dividends.

Date	Accounts	Debit	Credit
2017			
Dec. 31	Retained earnings	$ 4,000	
	Dividends		$ 4,000

Additional Resources

Thanks for reading CFI's closing entry guide. Corporate Finance Institute has other resources that will help you expand your knowledge and advance your career! Check out the links below:

- Accounting Fundamentals
- Introduction to Corporate Finance
- Accounting Equation
- Linking the Financial Statements

4.5 ADJUSTMENT ENTERIES

Adjusting entries are changes to journal entries you've already recorded. Specifically, they make sure that the numbers you have recorded match up to the correct accounting periods.

Journal entries track how money moves—how it enters your business, leaves it, and moves between different accounts.

Here's an example of an adjusting entry: In August, you bill a customer $5,000 for services you performed. They pay you in September.

In August, you record that money in accounts receivable—as income you're expecting to receive. Then, in September, you record the money as cash deposited in your bank account.

To make an adjusting entry, you don't literally go back and change a journal entry—there's no eraser or delete key involved. Instead, you make a new entry amending the old one.

For example, going back to the example above, say your customer called after getting the bill and asked for a 5% discount. If you granted the discount, you could post an adjusting journal entry to reduce accounts receivable and revenue by $250 (5% of $5,000).

Making adjusting entries is a way to stick to the matching principle—a principle in accounting that says expenses should be recorded in the same accounting period as revenue related to that expense.

In the accounting cycle, adjusting entries are made prior to preparing a trial balance and generating financial statements.

Why make adjusting entries?

When you make an adjusting entry, you're making sure the activities of your business are recorded accurately in time. If you don't make adjusting entries, your books will show you paying for expenses before they're actually incurred, or collecting unearned revenue before you can actually use the money.

So, your income and expenses won't match up, and you won't be able to accurately track revenue. Your financial statements will be inaccurate—which is bad news, since you need financial statements to make informed business decisions and accurately file taxes.

One more thing: Adjusting journal entries are essential for depreciating assets. Which is important for reporting tax deductions and balancing your books.

Who needs to make adjusting entries?

If you do your own accounting, and you use the accrual system of accounting, you'll need to make your own adjusting entries.

If you do your own accounting and you use the cash basis system, you likely won't need to make adjusting entries.

No matter what type of accounting you use, if you have a bookkeeper, they'll handle any and all adjusting entries for you.

Spread sheets vs. accounting software vs. bookkeepers

Adjusting entries will play different roles in your life depending on which type of bookkeeping system you have in place.

If you do your own book keeping using spread sheets, it's up to you to handle all the adjusting entries for your books. Then, you'll need to refer to those adjusting entries while generating your financial statements—or else keep extensive notes, so your accountant knows what's going on when they generate statements for you.

If you use accounting software, you'll also need to make your own adjusting entries. The software streamlines the process a bit, compared to using spread sheets. And it will likely generate financial statements for you. But you're still 100% on the line for making sure those adjusting entries are accurate and completed on time.

If you have a bookkeeper, you don't need to worry about making your own adjusting entries, or referring to them while preparing financial statements. They'll do both for you.

If you don't have a bookkeeper yet, check out Bench—we'll pair you with a dedicated bookkeeping team, and give you access to simple software to track your finances.

Fig.4.2 Spread sheets vs. accounting software vs. bookkeepers

The five types of adjusting entries

If making adjusting entries is beginning to sound intimidating, don't worry—there are only five types of adjusting entries, and the differences between them are clear cut. Here are descriptions of each type, plus example scenarios and how to make the entries.

1. Accrued revenues

When you generate revenue in one accounting period, but don't recognize it until a later period, you need to make an accrued revenue adjustment.

Example scenario

Your business makes custom tote bags. In February, you make $1,200 worth for a client, then invoice them. The client pays the invoice on March 7.

You incurred expenses making the bags—cost of materials and labor, workshop rent, utilities—in February. To accurately reflect your income for the month, you need to show the revenue you generated. (Remember: Revenue minus expenses equals income.)

First, you make an adjusting entry, moving the revenue from a "holding account" (accrued receivables) to a revenue account (revenue.) Then, on March 7, when you get paid and deposit the money in the bank, you move the money from revenue to cash.

Example adjusting entry

In your general ledger, the adjustment looks like this. First, during February, when you produce the bags and invoice the client, you record the anticipated income.

For the sake of balancing the books, you record that money coming out of revenue.

Date	Account	Debit	Credit
Feb. 27	Accrued receivables	$1,200	
Feb. 27	Revenue		$1,200

Then, when you get paid in March, you move the money from accrued receivables to cash.

Date	Account	Debit	Credit
March 7	Accrued receivables		$1,200
March 7	Cash	$1,200	

2. Accrued expenses

Once you've wrapped your head around accrued revenue, accrued expense adjustments are fairly straightforward. They account for expenses you generated in one period, but paid for later.

Example scenario

Suppose in February you hire a contract worker to help you out with your tote bags. You agree in advance to pay them $400 for a weekend's work. However, they don't invoice you until early March.

Example adjusting entry

In February, you record the money you'll need to pay the contractor as an accrued expense, debiting your labor expenses account.

Month	Account	Debit	Credit
February 21	Accrued expenses		$400

Month	Account	Debit	Credit
February 21	Labor expenses	$400	

In March, when you pay the invoice, you move the money from accrued expenses to cash, as a withdrawal from your bank account.

Month	Account	Debit	Credit
March 1	Accrued expenses	$400	
March 1	Cash		$400

3. Deferred revenues

If you're paid in advance by a client, it's deferred revenue. Even though you're paid now, you need to make sure the revenue is recorded in the month you perform the service and actually incur the prepaid expenses.

Example scenario

Over the years, you've become well-respected in the tote bag community. You're invited to speak at the annual Tote Symposium, in Lodi, California.

The conference showrunners will pay you $2,000 to deliver a talk on the changing face of the tote bag industry. They pay you in January, after you confirm you'll be attending. You'll speak at the conference in March.

Example adjusting entry

First, record the income on the books for January as deferred revenue. You'll credit it to your deferred revenue account for now.

Date	Account	Debit	Credit
January 6	Cash	$2,000	
January 6	Deferred revenue		$2,000

Then, in March, when you deliver your talk and actually earn the fee, move the money from deferred revenue to consulting revenue.

Date	Account	Debit	Credit
March 7	Deferred revenue	$2,000	
March 7	Consulting revenue		$2,000

4. Prepaid expenses

Prepaid Expenses work a lot like deferred revenue. Except, in this case, you're paying for something up front—then recording the expense for the period it applies to.

Example scenario

You rent a new space for your tote manufacturing business, and decide to pre-pay a year's worth of rent in December.

In December, you record it as prepaid rent expense, debited from an expense account.

Account	Debit	Credit
Prepaid rent expense	$12,000	
Cash		$12,000

Then, come January, you want to record your rent expense for the month. You'll move January's portion of the prepaid rent from an asset to an expense.

Account	Debit	Credit
Rent expense	$1,000	
Prepaid rent		$1,000

5. Depreciation expenses

When you depreciate an asset, you make a single payment for it, but disperse the expense over multiple accounting periods. This is usually done with large purchases, like equipment, vehicles, or buildings.

At the end of an accounting period during which an asset is depreciated, the total accumulated depreciation amount changes on your balance sheet. And each time you pay depreciation, it shows up as an expense on your income statement.

The way you record depreciation on the books depends heavily on which depreciation method you use. It's a pretty complex operation involving large sums. Considering the amount of cash and tax liability on the line, it's smart to consult with your accountant before recording any depreciation on the books. To get started, though, check out our guide to small business depreciation.

4.6 PROVISIONS

While studying the balance sheet, students often might have noticed an entry known as provisions, which was listed on the liabilities side of a balance sheet. This article will help you in understanding the concept of a provision in accounting and the need for the creation of such a provision.

Provision Definition

Provisions in accounting refer to the amount that is generally put aside from the profit in order to meet a probable future expense or a reduction in the asset value although the exact amount is unknown.

Provision cannot be seen as savings, but it can be regarded as a way of recognising any upcoming or future liabilities.

Most of the time, provision is treated as a reserve, but reserve and provision are not interchangeable. A provision is set up to cover probable future liabilities while a reserve is a part of the profit that is set aside for assisting the company's growth and expansion.

Provisions in Accounting

It is stated in the matching principle that it is mandatory to report all expenses incurred in a financial year along with the revenue earned. This is essential as it will become misleading if cost belonging to a certain year is recorded in previous or future balance sheets.

Provisions, therefore, balance the current year balance to become more accurate by ensuring expenses are included along with revenues in the same accounting period.

Examples of Provisions in accounting

Bad debt is one of the most common types of provisions. It is calculated to cover the cost of debts that are expected to remain unpaid during an accounting period.

The other examples of provisions are

1. Doubtful debts
2. Depreciation
3. Pension
4. Restructuring liabilities
5. Income taxes
6. Guarantee (product warranties)

Requirements for creating provision

A provision can be created due to a number of factors. However, there are certain requirements that must be met before a financial obligation can be considered as a provision.

The following requirements are mentioned below:

1. The organisation should perform a detailed amount of regulatory measurement for the obligation, and it should be performed by the management.
2. An obligation must be determined as such, it is probable to occur, but not certain to occur. It should have more than 50% chance of occurring.

3. The obligation must result in a decrease in the financial position of the business.

Accounting Treatment of Provision

Accounting treatment of provision can be understood with the example of presenting a written off bad debt in the account books.

Bad debt expense A/c Dr 50000

To Bad debt provision A/c 50000

4.7 RECEIPT AND PAYMENT ACCOUNT

Receipt and payment account functions as a summary of cash payments and receipts of an organisation during an accounting period. It provides a picture of the cash position of a Not-for-Profit organisation. It does not differentiate between the receipts and payments, whether they are of capital or revenue in nature and records all cash and bank transactions of both capital and revenue nature.

Receipt and payment account does not include any non-cash transactions such as depreciation. The Receipt and payment account is prepared at the end of an accounting period.

Receipt and Payment Account format

Receipt and Payment Account format is presented below:

Receipts and Payments Account
for the period ending on

Dr. | | | | | *Cr.*

Receipts		*Rs.*	*Payments*		*Rs.*
To Balance b/d :			By Balance b/d (Bank overdraft)		xxx
Cash	xxx		By Annual Sports Expenses		xxx
Bank	xxx	xxx	By Salaries & Wages		xxx
To Subscription :			By Rent, Rates & Taxes		xxx
for previous year	xxx		By Insurance		xxx
for current year	xxx		By Furniture		xxx
for next year	xxx	xxx	By Sports Equipments		xxx
To Entrance Fees		xxx	By Books & Periodicals		xxx
To Donation for Building		xxx	By Audit Fees		xxx
To General Donations		xxx	By Printing & Stationery		xxx
TO Life Membership Fees		xxx	By Honorarium		xxx
To Legacy		xxx	By Bank Charges		xxx
To Grant from Govt.		xxx	By Postage & Telegrams		xxx
To Contribution for Annual Dinner		xxx	By Water & Electricity		xxx
			By Conveyance & Travelling		xxx
To Rent		xxx	By Sundry Expenses		xxx
To Receipt on Annual Sports		xxx	By Annual Dinner Expenses		xxx
To Sale of Old Sports Materials		xxx	By 10% Investments		xxx
To Sale of Old Magazines		xxx	By Balance c/d:		xxx
To Sundry Receipts		xxx	Cash	xxx	
To Balance c/d (Bank overdraft)		xxx	Bank	xxx	xxx
		xxx			xxx

Features of Receipt and Payment Account

Below mentioned are some of the features of Receipt and Payment Account :

1.It does not include any transactions that are not cash or bank items.

2.It shows all cash payments and receipts without making any difference between capital and revenue

3. Receipt and Payment Account starts with the opening balance of cash and bank and ends with ending balance of cash and bank

4. It is prepared on the last day of the accounting period of the business organisation.

5. All cash and cheque receipts are recorded in the debit side while all cash and cheque payments are recorded on the credit side.

EXAMPLE

1. Prepare Receipt and Payment Account of Geeks Organisation from the following information given:

1. Opening balance on 1.4,2021

- Cash in Hand ₹36,400
- Bank overdraft ₹9,020

2. Subscriptions:

- 2020-21 ₹32,000
- 2021-22 ₹1,15,500
- 2022-23 ₹17,500

3. Expenses made by Organisations during the year ₹30,900(including ₹1,600 salary unpaid on 31.3.2021 and ₹2,200 salary unpaid on 31.3.2022) for Salary,₹2,350 for Postage and Stationery,₹5,600 for Electricity charges,₹7,070 on purchase of periodicals and ₹950 on advertisement.

4. Incomes of the Organisation during the year ₹1,900 for sale of old newspaper,₹8,500 for interest on investment,₹11,000 for Donations.

5. ₹4,200, which were bad debts in the year 2019-20, realized 75% from his state this year.

6. Grants of ₹4,030 and Legacies of ₹7,770 received.

7. Purchased furniture for ₹25,555.

8. ₹28,080 received on account of donations for building.

9. The Organisation received ₹96,400 as Entrance Fees and ₹1,30,500 as Life Membership fees.

10. ₹27,00 was paid as Audit fees for this year's audit of books of accounts and ₹18,405 for Rates and Taxes.

11. Closing Balance of Cash at Bank was ₹1,66,600.

Solution:

Geeks Organisation
Receipts and Payment Account
(for the year ended on 31.3.2022)

Dr. | **Cr.**

Receipts		Amount (₹)	Payments		Amount (₹)
To Balance on b/d:			By Bank Overdraft (Opening Balance)		9,020
Cash in Hand		36,400	By Furniture		25,555
To Donations for Building		28,080	By Sundry Expenses:		
To Sundry Receipts:			Salary	30,900	
Sale of Old Newspapers	1,900		Postage and Stationery	2,350	
Interest on Investment	8,500		Electricity Charges	5,600	
Donations	11,000	21,400	Purchase of Periodicals	7,070	
To Entrance Fees		96,400	Advertisement	950	46,870
To Bad Debts Recovered		3,150	By Audit fees		27,000
To Grants		4,030	By Rates and Taxes		18,405
To Legacies		7,770	By Balance b/d:		
To Subscriptions:			**Cash in Hand (Balancing figure)**	**59,280**	
2020-21	32,000		Cash at Bank	3,06,600	3,65,880
2021-22	1,15,500				
2022-23	17,500	1,65,000			
To Life Membership Fees		1,30,500			
Total		**4,92,730**	**Total**		**4,92,730**

2. From the following information of GFG Club, prepare Receipts and Payment Account for the year ending on 31st March, 2022. Cash at Bank at the year end was ₹1,97,300. Find Cash in Hand at the year ending:

1. Balance on 1st April,2021:

- Cash at Bank ₹83,200
- Cash in Hand ₹27,000

2. Subscriptions received ₹64,200 (including ₹11,100 for 2020-21 and ₹16,300 for 2022-23)

3. Special Subscriptions for Governor’s Party ₹49,000

4. Sundry Receipts:

- Locker rent ₹31,500
- Sale of Old Newspapers ₹1,750
- Profit from Entertainment ₹22,800
- Rent realized from Club Hall ₹35,500
- Interest received from Investment ₹8,000

5. Sundry Payments:

- Salaries ₹28,000 (₹6,500 includes for 2020-21)
- Postage and Stationery ₹2,020
- Electricity charges ₹1,765
- Purchase of Library Books ₹30,200
- Expenses on Dance and Socials ₹1,980

6. Life Membership Fees ₹12,630 and Entrance fees ₹1,590 of the club

7. Investments purchased by the Organisation worth ₹20,000

8. Honorarium paid by the Organisation ₹3,050

Solution:

GFG Club
Receipts and Payments Account
Dr. **(for the year ended on 31st March,2022)** **Cr.**

Receipts		Amount (₹)	Payments		Amount (₹)
To Balance b/d:			By Sundry Payments:		
Cash at Bank	83,200		Salaries(₹6,500 included for 2020-21)	28,000	
Cash in Hand	27,000	1,10,200	Postage and Stationery	2,020	
To Subscriptions:			Electricity charges	1,765	
2020-21	11,100		Expenses on Dance and Socials	1,980	
2021-22	36,800		Purchase of Library books	30,200	63,965
2022-23	16,300	64,200	By Investments		20,000
To Special Subscription for Governor's Party		49,000	By Honorarium		3,050
To Sundry Receipts:			By Balance c/d:		
Locker rent	31,500		Cash at Bank	1,97,300	
Sale of old newspapers	1,750		**Cash in Hand**	**52,855**	2,50,155
Profit on Entertainment	22,800				
Rent from Club Hall	35,500				
Interest received from Investment	8,000	99,550			
To Life Membership Fees		12,630			
To Entrance Fees		1,590			
Total		**3,37,170**	**Total**		**3,37,170**

4.8 INCOME AND EXPENDITURE ACCOUNT

The income and expenditure account is prepared by the non-trading entities to determine surplus or deficit of income over expenditures for a particular time frame. The accumulated or accrual concept of accounting is rigidly pursued while preparing income and expenditure a/c of non-trading concerns. It is prepared as a portion of final accounts of non-trading entities and is equal to the profit and loss account outlined by for-profit business entities.

INCOME AND EXPENDITURE ACCOUNT
for the year ended ....

Dr. Cr.

Expenditure	₹	Income	₹
To Consumable Materials	×××	By Subscriptions	×××
To Honorarium	×××	By Grants Received	×××
To Salary and Wages	×××	*(for General Purposes)*	
To Repairs	×××	By Entrance Fees	×××
To Expenses Paid on Specific Show	×××	*(To the extent not capitalized)*	
(Any cultural events)	×××	By General Donations	×××
To Entertainment Expenses	×××	By Interest on deposits	×××
To Printing and Stationery	×××	By Dividends	×××
To News Papers and Periodicals	×××	By Collection for Specific Show	×××
To Postage	×××	*(Any Cultural events)*	
To Upkeep of Lawns	×××	By Profit on Sale of Fixed Assets	×××
To Rent	×××	By Locker's Rent	×××
To Municipal Taxes	×××	By Cloak Room Rent Received	×××
To Insurance	×××	By Hall Rent Received	×××
To Loss on sale of Fixed Asset	×××	By Receipts from Sale of	×××
To Depreciation on Fixed Assets	×××	Newspapers and Magazines	
To Audit Fees	×××	By Miscellaneous Incomes	×××
To Miscellaneous Expenses	×××	By Deficit*	×××
To Surplus *	×××	*(Excess of Expenditure over*	×××
(Excess of Income over Expenditure)	×××	*Income)*	
	×××		×××

Features of Income and Expenditure Account

Below mentioned are the characteristic features of Income and Expenditure Account :

- Income and expenditure account presented by non-trading entities are much like the profit and loss a/c presented by trading entities.
- It is prepared by stringently following the fundamentals of the double-entry system of bookkeeping or accounting.
- It is always prepared during the end of the period which normally comprises of 1 year.
- It decides the surplus or deficit of income over expends of the non-trading entities for the particular year.
- The surplus or deficit from the income and expenditure account is moved to the capital fund a/c.
- The Income and expenditure account of only revenue nature are incorporated in this account. Any income and expenditure of capital nature are not comprehended.
- It is prepared by accountants chosen by the enterprise's management and is audited by an independent auditor.
- It does not begin with the opening balance, and it follows back the incomes received and expenditures incurred by the non-trading entities during the financial year.
- The accumulated or accrual concept of accounting is rigidly pursued when it is prepared.

In our daily life, we do calculate and keep track of the record of our monthly income against all the expenses. Similarly, business individuals follow this task of calculating and keeping

track of their income and expenditure. This income and expenditure account is prepared for tracking the income and expenses of the business to know the surplus earned and deficit incurred in a period. Without this account, it would be havoc knowing where the money flowed at the end of the business cycle.

In this context, we are going to take up the discussion of what exactly an income and expenditure account is, what item comes in this account, and other such important aspects that will be dealt with here.

What is an Income and Expenditure Account?

An Income and Expenditure Account is the detailed summary of every income and expense incurred by an organization in a specific financial year. Prepared on an accrual basis, this account records every income and expense in a particular year, irrespective of whether they are clear or not. Outlined by non-trading entities, this account distinguishes capital from revenue and takes only the latter into account.

Typically, these are nominal accounts, which outline an organization's final accounts and are similar to that of profit and loss accounting by a business entity. These accounts primarily serve to find the surplus or deficit balance of an organization, taking both current income and expenses into account.

Surplus and Deficit Balance of an Income and Expenditure Account

When the revenue generated by a non-trading or non-profitable organization exceeds the total expenditure incurred in a financial year, the Income & Expenditure account shows a surplus balance. It is usually termed as excess income over expenditure. Contrastingly, if the revenue generated by an organization falls short of its annual expenditure, the format of the Income and Expenditure account shows a deficit balance. Be its surplus or deficit, only its closing balance is taken into consideration.

Format of an Income and Expenditure Account

Like any accounting method, an Income and Expenditure account has its specific format accompanied by its formula. This format has the following features:

- The name of this institution is mentioned at the top, followed by its heading of Income and Expenditure account.
- The financial year for which this account has been created must be mentioned too.

- Typically, these have 4 columns with 2 on the left for expenditure, while those on its right for income.
- The first column contains expenditure details while the following column notes these expense amounts.
- The third column lists every income along with its following column mentioning income amounts
- These second and fourth columns mention total expenditure and income in a financial year.

This format is vital since it effectively ensures that the Income and Expenditure formula is utilized in the simplest ways to calculate results. Total expenditure is subtracted from total income to find out surplus or deficit. In the event of a negative answer, it indicates a deficit while it is vice versa if there is a profit. The following table illustrates an Income and Expenditure account format.

Following is a Model of Income and Expenditure Account

Income and Expenditure Account for the Year Ended……….

Expenditure (Dr.)	**INR**	**Income (Cr.)**	**INR**
To Consumable materials	Xxx	By Subscriptions	xxx
To Honorarium	Xxx	By Grants received	xxx
To Salary and Wages	Xxx	By Entrance fees	xxx
To Repairs	Xxx	By General donations	xxx
To Entertainment expenses	Xxx	By Interest on deposits	xxx
To Printing and Stationery	Xxx	By Dividends	xxx
To Postage	Xxx	By Collection for shows and events	xxx

To Housing rent	Xxx	By Profit of sale of fixed assets	xxx
To Municipal Tax	Xxx	By Rent received	xxx
To Insurance	Xxx	By Receipts of sales	xxx
To Depreciation of fixed assets	Xxx	By Miscellaneous incomes	xxx
To Audit fees	Xxx		
To Miscellaneous	Xxx		
To surplus (excess of Income over Expenditure)	Xxx	By deficit (excess of Income over Expenditure)	xxx

Basic Features of an Income and Expenditure Account

Vital features of an Income and Expenditure Account are as follows:

1. Similar to profit and loss accounts maintained by business entities, an Income & Expenditure account helps non-trading organizations to keep a note of their generated revenue.
2. These accounts typically outline one year and are taken into account when the fiscal year concludes.
3. This accounting method is primarily based on a double-entry system of accounting that records both outgoing expenses and incoming revenues.
4. These accounts are used to deduce the surplus or deficit incurred by an organization at the end of a certain period.
5. The surplus or deficit recorded in an Income and Expenditure account is moved to a Capital fund account when this account is closed.

6. An Income & Expenditure account only takes into consideration revenues and expenses. Such an account does not record any capital-based income or expenditure of an organization.
7. While these accounts are generally prepared by internal accountants of a non-trading organization, these are audited independently by external auditors.
8. Such an account does not begin with its opening balance. Usually, they follow back every income with expenditure through a concerned financial year.
9. As a nominal account, the Income and Expenditure account format debits all expenses and losses, while crediting every income. Prepared on an accrual basis, this includes every paid and received amount along with those that await clearance.

How to prepare an Income and Expenditure Account?

Understanding the format for an Income & Expenditure account along with its formula is not adequate to prepare them. These steps below detail an outline on how to create such an account:

1. Collection of receipts and payment accounts of a non-trading enterprise whose Income and Expenditure account is to be created.
2. Opening and closing balances about this receipt and payment account should be ignored. Additionally, every payment of previous years' expenses, as well as that of the future, should also be ignored. Capital payments of this current year are also omitted.
3. Every receipt about the previous year's revenue along with that of the upcoming years should be omitted from the listing. Additionally, capital revenue for this current year is also ignored.
4. The current year's revenues should be listed, including both expenditures and incomes. Depreciation of fixed assets related to revenue should also be taken into consideration. Additionally, profit or loss on sales of assets is also taken into account as long as they are not a part of this organization's capital revenue.
5. Both the total expenditure and total income should be calculated. Net differences between these 2 suggest if a non-trading enterprise has a surplus or deficit balance.

With numerous vital concepts, formats, and formulae being a part of the curriculum, students should go through related topics too. Along with study material on these topics, Vedantu also offers live classes which can be especially helpful in clearing difficult concepts. So, why wait? Go for it today to take a step towards academic excellence.

EXAMPLE

1. **The Receipt and Payment Account of Harimohan charitable institution is given:**

Receipt and Payment Account for the year ending March 31, 2015

Receipts

Amount

₹

Payments

Amount

₹

Balance b/d

Furniture

3,000

Cash at Bank

22,000

Investments

55,000

Cash in Hand

8,800

Advance for building

20,000

Donations

16,000

Charities

60,000

Subscriptions

50,200

Salaries

10,400

Endowment fund

60,000

Rent and Taxes

4,000

Legacies

12,000

Printing

1,000

Interest on Investment

3,800

Postage

300

Interest on Deposits

800

Advertisements

1,100

Sale of old newspapers

500

Insurance

4,800

Donation for building

16,000

Balance c/d:

Legacy for building

12,000

Cash at bank

32,000

Cash in hand

10,500

2,02,100

2,02,100

Prepare the Income and Expenditure Account for the Year ended on March 31, 2015 after considering the following:

(i)

Liabilities to be provided for are:

Rent ₹ 800; Salaries ₹ 1,200; advertisement ₹ 200.

(ii)

₹ 2,000 due for interest on investment was not actually received.

Books of Harimohan Charitable Institution

Income and Expenditure Account

for the year ending March 31, 2015

Dr

Cr

Expenditure

Amount

₹

Income

Amount

₹

To Charities A/c

60,000

By Donations A/c

16,000

To Salaries A/c

10,400

By Subscriptions A/c

50,200

Outstanding Salaries

1,200

11,600

By Legacies A/c

12,000

To Rent and Taxes A/c

4,000

By Interest on Investment A/c

3,800

Outstanding Rent

800

4,800

Accrued Interest

2,000

5,800

To Printing A/c

1,000

By Interest on Deposits A/c

800

To Postage A/c

300

By Sale of old newspapers A/c

500

To Advertisements A/c

1,100

Outstanding Advertisement Expenses

200

1,300

To Insurance A/c

4,800

To Surplus A/c

(Excess of Income over Expenditure)

1,500

85,300

85,300

Note: The payments for Furniture, Investments and Advance for building are capital in nature. So, they are not entered in the Income and Expenditure Account. Similarly, the Cash at Bank, Cash in Hand, Endowment Fund, Donation for building, Legacy for building are receipts which are capital in nature. So, they are not entered in the Income and Expenditure Account.

2. **Following is the information given in respect of certain items of a Sports Club. Show these items in the Income and Expenditure Account and the Balance Sheet of the Club:**

	₹
Sports Fund as on 1.4.2015	**35,000**
Sports Fund Investments	**35,000**
Interest on Sports Fund	**4,000**
Donations for Sports Fund Investment	**15,000**
Sports Prizes awarded	

10,000

Expenses on Sports Events

4,000

General Fund

80,000

General Fund Investments

80,000

Interest on General Fund Investments

8,000

Books of Sports Club

Income and Expenditure Account

for the year ending March 31, 2016

Dr **Cr**

Expenditure	Amount ₹	Income	Amount ₹
		By Interest on General Fund Investments	8,000

Balance Sheet of Sports Club

for the year ending March 31, 2016

Liabilities	Amount ₹	Assets	Amount ₹
Sports Fund	35,000	Sports Fund Investments	35,000
Interest on Sports Fund			

4,000

General Fund Investments

80,000

39,000

Donations for Sports Fund

15,000

54,000

Sports Prizes awarded

(10,000)

44,000

Expenses on Sports Events

(4,000)

40,000

General Fund

80,000

4.9 BRANCH AND DEPARTMENT

A branch is a segment of a business company located outside the head office. Department is a different functional area within the business organization. The purpose of Branch is to business expansion and to face competition. The purpose of the Department is to improve operational activities and business performance. Branches are the outcome of tough competition and the expansion of a business. Departments are the result of fast human life.

Followings are the main differences between branch and department:

Basis of difference	Branch	Departmental
1. place	Branch are established by separating them from the head office	Departments are run by attaching them with the main organization under a single roof.
2. Geography	Branches are geographically separated.	Departments are not separated rather existed under a same roof.
3. objective	Branches are the outcome of touch competition and expansion of business	Department are the result of fast human life.
4. Types	Branches are different types like dependent, independent and foreign.	There is no such classification in department because all are common under the same roof.
5. Common cost	Allocation of branch common expenses does not arise.	Allocation of departmental common expenses is a touch job.
6. reconciliation	Reconciliation is necessary for final result of departments.	No reconciliation is necessary because there is a central account division.

(a) Branches are separated from the main organization. Departments are attached to the main organization under a single roof.

(b) Branches are geographically classified (like different branch offices in different cities of the country). Departments are technically classified such as the production department, finance department, personnel department, etc.

(c) Branches are the outcome of tough competition and the expansion of the business. Departments are the result of fast human life.

(d) The chief executive who is to keep a constant watch over the departments supervises closely and controls effectively. Control is practically un-practicable in the case of a far-off branch since it is not possible for the Head Office to keep a constant watch.

(e) Branches are geographically separated. Departments are not separated rather existed under the same roof.

(f) A department is a technical area of an office which is under the same premises while the branch is an extension of the office with more or less the same features.

(g) Branches are of different types like dependent, independent and foreign. There is no such classification in the department because all are common under the same roof.

(h) The allocation of branch common expenses does not arise. The allocation of departmental common expenses is a tough job.

(i) Departmental trading with their Head Office is conducted under the same roof although each department deals with a separate line of activity. Branch trading is conducted in different parts of the country under the Head Office dealing with usually the same line of activity.

(j) To find out the net result of the organization, the reconciliation of different branch account is the main job. In departmental accounting, no reconciliation is necessary because there is a central account division.

The main dissimilarities or difference between branch and department can be pointed out as follows:

Branch Vs. Department

1. Meaning

Branch: A segment of a business company located outside the head office

Department: Different functional area within the business organization

2. Classification

Branch: Branches are geographically classified (like different branch offices in different cities of the country)

Department: Departments are technically classified such as production department, finance department, personnel department etc.

3. Location

Branch: Separate location from head office

Department: Within the head office

4, Purpose

Branch: Purpose of business expansion and to face competition

Department: To improve operational activities and business performance

5. Accounting

Branch: Branch accounting system is maintained

Department: Departmental accounting system is maintained

Distinction Between Branch And Department

(Comparison Chart)

Basis For Difference	**Branch**	**Department**
Introduction	Outlet or segment of a organization located outside the main office	Functional area of the company within the organization
Classification	Geographically classified	Technically classified
Location	Outside the head office	Within the head office
Purpose	Business expansion, providing better services etc.	Improve organizational efficiency
Accounting System	Branch accounting	Departmental accounting

4.10 BASIS OF ALLOCATION AND APPORTIONMENT OF EXPENSES

Departmentalization can be understood as a process of creating departments such as machining, personnel, fabrication, maintenance, stores, accounts, etc., in an organization, for the purpose of allocation and apportionment of overheads in a convenient way. The term **allocation of cost** is concerned with the complete cost items, whereas the **apportionment of the cost** is all about the proportion of cost items.

Based on the relation of the cost item with the cost center or unit, to which it is imposed, the cost item is allocated or apportioned and not as per the nature of the expense.

Take a read of this article excerpt, in which you can find the fundamental differences between allocation and apportionment of cost.

Comparison Chart

BASIS FOR COMPARISON	COST ALLOCATION	COST APPORTIONMENT
Meaning	Allocation of cost, implies the entire distribution of the overhead item to the departments on a logical basis.	Apportionment of cost refers to distribution of various overhead items, in proportion, to the department on a logical basis.
Represents	It represents that part of cost attribution, which charges a particular cost to a cost unit.	It represents that part of cost attribution, which shares cost among multiple cost units, in the proportion of expected benefit received.
Distribution	Directly assigned to the department.	Proportionately assigned to different departments.
Application	When the overhead belongs to a specific department.	When the overhead belongs to different departments.

Definition of Cost Allocation

Cost Allocation, as the name suggest, is the direct allotment of cost to the traceable cost object. It is the process of associating the expenses incurred, to different departments of the organization.

When a particular cost item is easily recognizable with a cost unit, i.e. product, or cost center, then these costs are charged to the concerned cost center or unit, and the process is called as cost allocation. In finer terms, it is the full-fledged distribution of an overhead item to the department, rationally.

Therefore, a process, in which there is an outright charging of whole cost items to the concerned cost center, is termed as cost allocation. The two factors responsible for cost allocation are:

- Respective cost unit or cost center, causing the overhead to be incurred.
- Definite amount of cost is to be calculated.

For instance: Salary paid to the employees of the maintenance department, can be allocated to that department.

Definition of Cost Apportionment

When the cost items cannot be outrightly charged to or accurately traceable to a particular cost center, then such items of cost are prorated amongst various cost objects, on an equitable basis, this process is known as cost apportionment. It is the distribution of different items of cost in proportions to the cost unit or cost center on a suitable basis.

In simple terms, the expenses which are unallowable are dispersed over multiple departments, is known as apportionment.

For instance: Wages paid to the head of the factory, rent of factory, electricity, etc. cannot be charged to a particular department, then these can be apportioned amongst various departments.

The basis for apportionment of costs is determined after proper examination of the relationship between the base and different variables. It is important to predetermine an appropriate basis for apportionment, which guarantees the equitable share of common overheads for the departments. The basis should be periodically reviewed, to improve the accuracy. It is based on the principles of:

- Service Rendered
- Survey or Analysis Method
- Ability to bear
- Efficiency

Key Differences Between Cost Allocation and Cost Apportionment

The difference between cost allocation and cost apportionment can be drawn clearly on the following grounds:

1. Allocation of cost means a process in which the entire amount of overhead is charged to a specific cost center. On the contrary, Apportionment of cost can be understood as the distribution of proportions of cost items to the cost unit, i.e. product or service or the cost center.
2. Allocation of the cost is possible only when the cost is recognized as particularly imputable to a specific cost center. Conversely, apportionment of the cost is needed when the cost cannot be allocated to a particular cost center. Instead, the cost is shared by two or more cost centers, as per the expected benefit received.
3. As allocation of overhead is a sheer process of departmentalization of expenses, the overheads are directly assigned to the department. In contrast, cost apportionment involves the proportionate distribution of cost to different departments, on a reasonable basis.
4. Cost allocation is applied when the overhead is associated with a particular department. As against this, cost apportionment is applied when the overhead is related to various departments.

4.11 INTER DEPARTMENTAL TRANSFER PRICING / TRANSFER COST

Transfer prices are almost inevitably needed whenever a business is divided into more than one department or division

In accounting, many amounts can be legitimately calculated in a number of different ways and can be correctly represented by a number of different values. For example, both marginal and total absorption cost can simultaneously give the correct cost of production, but which version of cost you should use depends on what you are trying to do.

Similarly, the basis on which fixed overheads are apportioned and absorbed into production can radically change perceived profitability. The danger is that decisions are often based on accounting figures, and if the figures themselves are somewhat arbitrary, so too will be the decisions based on them. You should, therefore, always be careful when using accounting information, not just because information could have been deliberately manipulated and presented in a way which misleads, but also because the information depends on the assumptions and the methodology used to create it. Transfer pricing provides excellent

examples of the coexistence of alternative legitimate views, and illustrates how the use of inappropriate figures can create misconceptions and can lead to wrong decisions.

When transfer prices are needed

Transfer prices are almost inevitably needed whenever a business is divided into more than one department or division. Usually, goods or services will flow between the divisions and each will report its performance separately. The accounting system will usually record goods or services leaving one department and entering the next, and some monetary value must be used to record this. That monetary value is the transfer price. The transfer price negotiated between the divisions, or imposed by head office, can have a profound, but perhaps arbitrary, effect on the reported performance and subsequent decisions made.

Price charged by individual entities for goods or services supplied to one another in multi-department, multi-office, or multinational firms. Transfer price policy is generally aimed at:

(1) evaluating financial performance of different business units (profit centers) of a conglomerate, and/or to

(2) shift earnings from a high tax jurisdiction to a low-tax one. Tax authorities usually frown upon transfer pricing aimed at tax avoidance and insist that each internal part of the firm deals with the other on 'arm's length' (market price) basis.

What is a Transfer Price?

A transfer price is the price at which divisions of a company transact with each other. Transactions may include the trade of supplies or labor between departments. Transfer prices are used when individual entities of a larger multi-entity firm are treated and measured as separately run entities.

Also known as "transfer cost".

BREAKING DOWN 'Transfer Price

In managerial accounting, when different divisions of a multi-entity company are in charge of their own profits, they are also responsible for their own "Return on Invested Capital". Therefore, when divisions are required to transact with each other, a transfer price is used to determine costs. Transfer prices tend not to differ much from the price in the market because one of the entities in such a transaction will lose out: they will either be buying for more than the prevailing market price or selling below the market price, and this will affect their performance.

Transfer pricing is the value placed on goods and services exchanged between affiliates or divisions within a company. The transactions are not truly at arm's length, and therefore do not represent a market price for the goods or services provided. Because the organization may

want to properly measure efficiency, productivity, or profitability at the division level, transfer prices must be established when one part of a company does business with another.
The need to track exchanges can occur for a variety of reasons. For example, a company might want to keep track of how its resources are consumed by various user groups. By charging other departments for use of resources i.e. services, the company can rationally allocate the cost to the area utilizing those services (and responsible for the expense). An obvious side effect of such a policy is that users may think twice about using these services, thereby limiting unnecessary demands.
Beyond the question of staff department charge-backs are the issues of: interdepartment or intercompany transfers of product or services that ultimately will be sold to third parties, and the allocation of costs between subsidiaries. A common example is where one division manufactures a product and another sells it. Although the parent company's goal may be to report true profitability at each level, the management teams responsible at the plant and at the sales office will have opposing agendas, with the former arguing for relatively high transfer prices and the latter lobbying for lower transfer prices.
The best rule to follow is to let market prices be the guide; the factory would "sell" to the sales division at a price they could receive if selling to a third-party distributor. That way the manufacturing results are judged based on profits from market price transactions combined with manufacturing efficiency and know-how, while the sales division is tracked on how well they are able to manage the interplay of market forces on demand and pricing. This criterion is known as the "Basic Arm's Length Standard (BALS)" and is the preferred standard by which transfer prices are set.
Another important issue concerning transfer pricing arises with respect to income tax jurisdiction. Companies with international or interstate operations will often have separate subsidiaries in each jurisdiction, sometimes for legal and/or political reasons. The affiliates will likely be subject to differential tax rates in the various jurisdictions in which they do business. In these cases, the transfer price issue becomes the concern of an interested third party—the tax authorities. Here the motivation would be to shift profits from a high tax-rate location to a lower one; this can be easily accomplished by manipulating the transfer prices. Obviously the Internal Revenue Service is aware of this practice, and will challenge inappropriate transfer prices in the course of audits. Section 482 of the Internal Revenue Code was written to set tax rules and guidelines for acceptable transfer pricing and cost allocations between affiliates.

Transfer pricing within multinational corporations (MNCs) can be fairly complex, requiring different strategies for different transactions and markets. Foreign tax systems, exchange controls, and competition all need to be taken into account. Where two countries, such as the United States and Canada, might have similar substantive laws but differing compliance and reporting rules, companies might use advance pricing agreements (APAs) to ensure compliance. An APA defines an acceptable transfer price calculation method before being implemented, thus avoiding problems with a transfer price audit.

Transfer pricing is the setting of the price for goods and services sold between controlled (or related) legal entities within an enterprise. For example, if a subsidiary company sells goods to a parent company, the cost of those goods paid by the parent to the subsidiary is the transfer price. Legal entities considered under the control of a single corporation include branches and companies that are wholly or majority owned ultimately by the parent corporation. Certain jurisdictions consider entities to be under common control if they share family members on their boards of directors. Transfer pricing can be used as a profit allocation method to attribute a multinational corporation's net profit (or loss) before tax to countries where it does business. Transfer pricing results in the setting of prices among divisions within an enterprise.

In principle, a transfer price should match either what the seller would charge an independent, arm's length customer, or what the buyer would pay an independent, arm's length supplier. While unrealistic transfer prices do not affect the overall enterprise directly, they become a concern for government taxing authorities when transfer pricing is used to lower profits in a division of an enterprise located in a country that levies high income taxes and raise profits in a country that is a tax haven that levies no (or low) income taxes.

Profit allocation

The term "transfer pricing" covers the setting, analysis, documentation, and adjustment of charges made between related parties for goods, services, or use of property (including intangible property) via separate accounting for each related party. Transfer prices among divisions of an enterprise should reflect allocation of resources among such components. The transfer prices are supposed to be set at arm's length prices − similar to charges between unrelated parties.

How Transfer Pricing Techniques Improve Profitability

There are five transfer pricing techniques a corporation can choose from to improve profitability of not only business unit level, but the corporate-wide level. Each of the technique has strengths and weaknesses that, any incorrect transfer pricing can cause

considerable dysfunctional purchasing behaviour and could suffer profitability on corporate-wide level—thus selecting the most suitable transfer pricing techniques is critical.

First, here s a quick comparison of the five transfer pricing techniques, each shows four variables: profitability enhancement, performance review process required, ease of use and common problems.

What is Transfer Pricing, When Is It Important?

Simply put, transfer pricing is a task of determining prices at which products (or could be components) will be sold between divisions (or department or business units) in a corporation. It is most common in vertically integrated companies, where each division in succession produces a component that is a necessary part of the product being created by the next division in line.

So, if an organization sells its own products internally—from one division to another—then transfer pricing is important.

Let us take a look at each transfer pricing techniques and how each technique can be used to improve profitability in the corporate-wide level.

Technique#1. Using External Market Price

Using external market price as transfer pricing technique is the most common. Under this approach, the selling division matches its transfer price to the current market rate. By doing so, a company can achieve four goals:

- Goal#1. Maximize profits – A company can achieve the highest possible corporate-wide profit. This happens because the selling division can earn just as much profit by selling all of its production outside of the company as it can by doing so internally—there is no reason for using a transfer price that results in incorrect behavior of either selling externally at an excessively low price or selling internally when a better deal could have been obtained by selling externally.
- Goal#2. Profit center structure – Using the market price allows a division to earn a profit on its sales, no matter whether it sells internally or externally. By avoiding all transfers at cost, the senior management group can structure its divisions as profit centers, thereby allowing it to determine the performance of each division manager.
- Goal#3. Simplified information sources – The market price is simple to obtain—it can be taken from regulated price sheets, posted prices, or quoted prices, and applied directly to all sales. No complicated calculations are required, and arguments over the correct price to charge between divisions are kept to a minimum.

- Goal#4. Outside shopping – A market-based transfer price allows both buying and selling divisions to shop anywhere they want to buy or sell their products. For example, a buying division will be indifferent as to where it obtains its supplies, for it can buy them at the same price, whether that source is a fellow company division or not. This leads to a minimum of incorrect buying and selling behavior that would otherwise be driven by transfer prices that do not reflect market conditions.

However, market prices are not always available. This happens when the products being transferred do not exactly match those sold on the market, or if they are intermediate- level products that have not yet been converted into final products, so there is no market price available for them.

Another problem with market-based pricing is that there must truly be an alternative for a selling division to sell its entire production externally. This is a common problem for specialty products, where the number of potential buyers is small, and their annual buying needs are limited in size. A final issue is that market-based pricing can drive divisions to sell their production outside of the company.

Technique#2. Using Adjusted Market Pricing

Adjusted market pricing involves price setting in order to simplify transfer prices and adjust for the absence of sales-related costs. For example, if market prices vary considerably by the unit volume ordered, there may be a broad range of transfer prices in use, which can be very complicated to track.

A single adjusted market price can be used instead, which is based on the average shipment or order size. If a buying division turns out to have purchased in significantly different quantities from the ones that were assumed at the time prices were set, a company can retroactively adjust transfer prices at the end of the year; or it can leave the pricing alone and let the divisions do a better job of planning their inter-divisional transfer volumes in the next year.

As another example, there should be no bad debts when selling between divisions, as opposed to the occasional losses incurred when dealing with outside firms; accordingly, this cost can be deducted from the transfer price.

The same argument can be made for the sales staff, whose services are presumably not required for interdepartmental sales. However, these price adjustments are subject to negotiation, so more aggressive division managers are more likely to resist reductions from their market-based prices while those managing the buying divisions will push hard for

excessively large price deductions. The result may be pricing anomalies that do not yield the optimum profit for the company as a whole.

Technique#3. Using Negotiated Transfer Prices

The managers of buying and selling divisions can negotiate a transfer price between themselves, using a product's variable cost as the lower boundary of an acceptable negotiated price and the market price (if one is available) as the upper boundary. The price that is agreed on, as long as it falls between these two boundaries, should give some profit to each division, with more profit going to the division with better negotiating skills.

The method has the advantage of allowing division managers to operate their businesses in a more independent manner, not relying on preset pricing. It also results in better performance evaluations for those managers with greater negotiation skills.

However, it also suffers from these flaws:

- Sub-optimal behavior – If the negotiated price excessively favors one division over another, the losing division will search outside the company for a better deal on the open market and will direct its sales and purchases in that direction; this may result in sub-optimal company-wide profitability levels.
- Negotiation time – The negotiation process can take up a substantial proportion of a manager's time, not leaving enough for other management activities. This is a particular problem if prices require constant renegotiation.
- Brokered deals – Interdivisional conflicts over negotiated prices can become so severe that the problem is kicked up corporate headquarters, which must step in and set prices that the divisions are incapable of determining by themselves.

For all these reasons, the negotiated transfer price is a method that is generally relegated to special or low-volume pricing situations.

Technique#4. Using Contribution Margin

What if there is no market price at all for a product? A company then has no basis for creating a transfer price from any external source of information, so it must use internal information instead.

One approach is to create transfer prices based on a product's contribution margin. Under this pricing system, a company determines the total contribution margin earned after a product is sold externally and allocates this margin back to each division, based on their respective proportions of the total product cost.

There are several good reasons for using this approach, which:

- Converts a cost center into a profit center – By using this method to assign profits to internal product sales, divisional managers are forced to pay stricter attention to their profitability, which helps the overall profitability of the organization.
- Encourages divisions to work together – When every supplying division shares in the margin when a product is sold, it stands to reason that it will be much more eager to work together to achieve profitable sales rather than bickering over the transfer prices to be charged internally. Also, any profit improvements that can be brought about only by changes that span several divisions are much more likely to receive general approval and cooperation under this pricing method, since the changes will increase profits for all divisions. These arguments make the contribution margin approach popular as a secondary transfer pricing method, after the market price approach.

Despite its useful attributes, there are a number of issues with it that a company must guard against in order to avoid behavior by divisions that will lead to less-than optimal overall levels of profitability. The contribution margin approach:

- Can increase assigned profits by increasing costs – When the contribution margin is assigned based on a division's relative proportion of total product costs, the divisions will realize that they will receive a greater share of the profits if they can increase their overall proportion of costs.
- Must share cost reductions – If a division finds a way to reduce its costs, it will receive an increased share of the resulting profits that is in proportion to its share of the total contribution margin distributed. For example, if Division A's costs are 20% of a product's total costs and Division B's share is 80%, then 80% of a $1 cost reduction achieved by Division A will be allocated to Division B, even though it has done nothing to deserve the increase in margin.
- Requires the involvement of the corporate headquarters staff – The contribution margin allocation must be calculated by somebody, and since the divisions all have a profit motive to skew the allocation in their favor, the only party left that can make the allocation is the headquarters staff. This may increase the cost of corporate overhead.
- Results in arguments – When costs and profits can be skewed by the system, there will inevitably be arguments between the buying and selling divisions, which the corporate headquarters team may have to mediate. These issues detract from an organization's focus on profitability.

The contribution margin approach is not a perfect one, but it does give companies a reasonably understandable and workable method for determining transfer prices. It has more problems than market-based pricing but can be used as an alternative or as the primary approach if there is no way to obtain market pricing for transferred products.

Technique#5. Using Cost-Plus Method

The cost-plus approach is an alternative when there is no market from which to determine a transfer price. This method is based on its name—just accumulate a product's full cost and add a standard margin percentage to the cost; this is the transfer price. This approach has the singular advantage of being very easy to understand and calculate, and can convert a cost center into a profit center, which may be useful for evaluating the performance of a division manager.

The cost-plus method's flaw is that the margin percentage added to a product's full cost may have no relationship to the margin that would actually be used if the product were to be sold externally. If a number of successive divisions were to add a standard margin to their products, the price paid by the final division in line—the one that must sell the completed product externally—may be so high that there is no room for its own margin, which gives it no incentive to sell the product. Because of this issue, the cost-plus method is not recommended in most situations.

Five Transfer Pricing Techniques Summarized

A comparison of five transfer pricing methods can be summarized as follows:

1. Market Pricing

- Profitability Enhancement: Creates highest level of profits for entire company.
- Performance Review: Creates profits centers for all divisions.
- Ease of Use: Simple applicability.
- Problems: Market prices not always available; may not be large enough external market; does not reflect slight reduced internal selling costs; selling divisions may deny sales to other divisions in favor of outside sales.

Adjusted Market Pricing

- Profitability Enhancement: Creates highest level of profits for entire company.
- Performance Review: Creates profits centers for all divisions.
- Ease of Use: Requires negotiation to determine reductions from, market price.
- Problems: Possible arguments over size of reductions; may need headquarters' intervention.

Negotiated Prices

- Profitability Enhancement: Less optimal result than market-based pricing, especially if negotiated prices vary substantially from the market.
- Performance Review: May reflect manager negotiating skills more than division performance.
- Ease of Use: Easy to understand but requires substantial preparation for negotiations.
- Problems: May result in better deals for divisions if they buy or sell outside the company; negotiations are time consuming; may require headquarters' intervention.

Contribution Margins

- Profitability Enhancement: Allocates final profits among cost centers; divisions tend to work together to achieve large profit
- Performance Review: Allows for some basis of measurement based on profits, where cost center performance is only other alternative.
- Ease of Use: Can be difficult to calculate if many divisions involved.
- Problems: A division can increase its share of the profit margin by increasing its costs; a cost reduction by one division must be shared among all divisions; requires headquarters' involvement.

Cost Plus

- Profitability Enhancement: May result in profit build up problem, so that division selling externally has no incentive to do so.
- Performance Review: Poor for performance evaluation, since will earn a profit no matter what cost is incurred.
- Ease of Use: Easy to calculate profit add-on.
- Problems: Margins assigned do not equate to market-driven profit margins; no incentive to reduce costs.

Words of Caution

A company must set its transfer prices at levels that will result in the highest possible levels of profits, not for individual divisions but rather for the entire organization. Otherwise a division may enjoy maximum profit while the corporate-wide level does not.

For example, if a transfer price is set at a product's cost, the selling division would rather not sell the product at all, even though the buying division can sell it externally for a profit that more than makes up for the lack of profit experienced by the division that originally sold it the product. The typical division manager will select the product sales that result in the highest level of profit only for his or her division, since the manager has no insight (or interest) in the financial results of the rest of the organization.

Only by finding some way for the selling division to also realize a profit will a company have an incentive to sell its products internally, thereby resulting in greater overall profits.

An example of such a solution is when a selling division creates a by-product that it cannot sell but that another division can use as an input for the products it manufactures. The selling division scraps the by-product, because it has no incentive to do anything else with it. However, by assigning the selling division a small profit on sale of the byproduct, it now has an incentive to ship it to the buying division. Such a pricing strategy assists a company in deriving the greatest possible profit from all of its activities.

Another factor is that the amount of profit allocated to a division through the transfer pricing method used will impact its reported level of profitability—therefore the performance review for that division and its management team.

If the management team is compensated in large part through performance-based bonuses, its actions will be heavily influenced by the profit it can earn on inter-company transfers. For example, an excessively low transfer price will result in low production priority for that item, as long as the selling division has some other product available that it can sell for a greater profit.

Finally, altering the transfer price used can have a dramatic impact on the amount of income taxes a company pays, if it has divisions located in different countries that use different tax rates.

Companies that are frequent users of transfer pricing must create prices that are based on a proper balance of the goals of overall company profitability, divisional performance evaluation, and (in some cases) the reduction of income taxes. The attainment of all these goals by using a single transfer pricing method should not be expected. Instead, focus on the attainment of the most critical goals, while keeping the adverse effects of not meeting other goals at a minimum. This process may result in the use of several transfer pricing methods, depending on the circumstances surrounding each inter-divisional transfer.

4.12 Unit End Questions

A. Descriptive Questions

Short questions

1. Define closing entries
2. What do you mean by provisions?

3. List the entries in P/L account.
4. Discuss about income and expenditure statement.
5. List the point of department and branch.

Long questions

1. Explain in detail receipts and payment statement.
2. Describe closing and adjustment entries.
3. Explain Inter-departmental transfer at cost and sales price
4. Explain in detail the difference between department and branch.
5. Explain how to prepare trading account and P/L account.

B . Multiple Choice Questions

1. Business is said to be in a profit when

   a. Expenditure exceeds income

   b. Income exceeds expenditure

   c. Income exceeds liability

   d. Assets exceed expenditure

2. As per the accounting double-entry system, when expense increases, it is ___________.

   a. No need to show as an accounting record.

   b. Credited.

   c. Debited.

   d. Both (B) and (C).

3. What does the term "credit" mean in business?

   a. agreement between a lender and a borrower

   b. revenue a business earns from selling its goods

   c. cost of operations that a company incurs to generate revenue

   d. own with the expectation to provide a future benefit

4. When a Liability is decreased or reduced, it is registered on the

   a. Debit side or left side of the account

b. Credit side or right side of the account

c. Debit side or right side of the account

d. Credit side or left side of the account

5. When there is an increase in capital by an amount, it is registered on the

a. Credit or right side of the account

b. Debit or left side of the account

c. Credit or left side of the account

d. Debit or right side of the account

Answer: 1. B, 2. C, 3. A, 4. A, 5. A

4.13 REFERENCES

Reference Books:

- "Enterprise Resource Planning: Concepts and Practice" by Vinod Kumar Garg and N. K. Venkitakrishnan
- "Enterprise Resource Planning" by Alexis Leon
- "ERP Demystified" by Alexis Leon
- "Implementing SAP ERP Financials: A Configuration Guide" by Vivek Kale

Web Resources:

- SAP Official Website: https://www.sap.com/
- Oracle ERP Cloud: https://www.oracle.com/cloud/erp/
- Microsoft Dynamics 365 ERP: https://dynamics.microsoft.com/en-us/erp/
- Infor ERP: https://www.infor.com/solutions/erp
- ERP Focus: https://www.erpfocus.com/

UNIT 5 CORPORATE BANKING

STRUCTURE

5.0 Objectives

5.1 Introduction

5.2 Bank Pass Book

5.3 Negotiable Instruments

5.4 Cheque

5.5 Discounting of Cheques

5.6 Cheque presentment

5.7 Cheque dishonoured

5.8 Current Account

5.9 Overdraft

5.10 Cash credit

5.11 Bank-reconciliation Statement

5.12 Internet banking

5.13 RTGS

5.14 NEFT

5.15 Unit End Questions

5.16 References

5.0 OBJECTIVES

After completing this Students will be able to

- Define Bank pass book
- Understand Bank reconciliation statement
- Define Current account
- Explain NEFT

5.1 INTRODUCTION

Corporate banking is a subset of business banking that involves a range of banking services that are offered only to corporates. The services include the provision of credit, cash management facilities, etc.

Fig.5.1 Corporate Banking

Corporate Banking Services

1. Credit

Loans and related credit products are offered to corporate customers. Credit facilities form the largest share of profits for commercial banks. The interest rates imposed on the loans are significantly high due to the amount of risk prevalent in lending to corporate customers.

2. Treasury services

Treasury services are used by companies to manage their working capital requirements. Such services are extremely important for multinational companies as they facilitate currency conversion.

3. Fixed asset requirement financing

Fixed asset requirement financing services are important for corporates involved in capital-intensive industries such as transportation, information technology, and heavy machinery manufacturing. Banks facilitate customized loans and lease agreements for the purchase of equipment, machinery, etc.

4. Employer services

Commercial banks also provide services such as the selection of retirement plans and healthcare plans, as well as payroll facilities, for employees.

5. Commercial services

Banks also provide services such as portfolio analysis, leverage analysis, debt and equity restructuring, analyses of real assets, etc. Other services that are of importance to corporate clients include asset management services and underwriters for initial public offering (IPOs), etc.

The services are undertaken by the investment banking arm of the commercial bank. Investment banking and corporate banking were separated under the provisions of the Glass-Steagall Act.

Characteristics of Corporate Banking

1. Clientele

A bank’s business banking unit usually serves small to middle-sized businesses and large conglomerates.

2. Authority

A company’s corporate banking accounts can only be opened after obtaining consensus from the board of directors of the company. It means that they must be authorized by an official vote or a corporate resolution. The company’s treasurer usually opens corporate accounts.

3. Liability

Since companies are recognized as separate legal entities under the law, all contents of corporate accounts are the property of the company and not of the individual board members. It means that there is a certain degree of independence to corporate accounts. It also indicates that the personal creditors of the board of directors are not entitled to the contents of the corporate account of a company.

4. Credit rating

The conduct or functioning of the corporate account forms part of the credit history of the company. It affects the valuation and share prices of the company, the interest rates applicable to loans extended to the company, etc.

5. Bankers

Corporate banking requires a degree of expertise in the industry. Thus, corporate bankers are extremely well paid. JP Morgan Chase, Bank of America Merrill Lynch, and Goldman Sachs are some of the largest commercial banks in the world.

5.2 BANK PASSBOOK

Banking has come a long way over the years. With the ubiquity of mobile wallets and banking apps, most of us never set foot inside a bank anymore. But what are your options if you prefer a more traditional approach? A passbook savings account might be worth considering.

What is a passbook?

A bank passbook is a physical notebook held by bank account holders. It records on paper the details of all banking transactions, including elements such as:

- Debits
- Credits
- Loans
- Fixed deposits
- Recurring deposits

While most banks now offer paperless alternatives to the old-fashioned passbook, you can still find some accounts with a passbook attached. For example, a passbook savings account comes both with a physical notebook to record transactions, as well as competitive interest rates.

How does a passbook work?

A bank passbook is simply a physical log of your transactions, but what type of information should be recorded?

For debit transactions, you'd include all details about payments including payee name, method of payment, and name of the bank making a transfer. You'd also record all direct debit and pay order information, as well as details about self-payments to other accounts.

Similarly for credit transactions, you'd use your passbook to keep track of deposit interest, receipts from third parties, and cash deposits. Any loan-related details would go here as well including the mode of payment.

Essentially, passbooks hearken back to a pre-internet form of banking when you'd need to meticulously keep paper-based records in the absence of computers and SMS alerts. Bank customers would use a cheque book and passbook to balance their accounts.

Can **you open a passbook savings account?**

If the idea of visiting a bank branch in person and recording your details by hand is appealing, you can still find institutions offering passbook savings accounts. However, today there is more technology involved than in the past. The bank will keep track of your transactions and interest rates through its computer system, whether or not you choose to hold a physical passbook in hand. In fact, some banks offer a digital passbook instead to facilitate electronic transactions.

What **are passbook apps?**

You may have seen the term 'passbook' also used in relation to mobile apps and wallets. For example, Apple Wallet is also called Passbook. However, this goes a step beyond the

traditional meaning of a passbook by also allowing users to store cards, coupons, event tickets, and boarding passes in a central location.

In addition to Apple Passbook, there are several informal passbook apps offered by banks. These work the same way as a physical paper version, showing a record of transactional details. Most banking apps could be looked at as the replacement for the old-fashioned passbook, allowing you to facilitate transactions and record their details without the need to visit the bank in person.

Passbook **savings account pros and cons**

If you enjoy the old-school aspect of recording your transactions on paper, a passbook savings account might be a good option for you. Here's a look at the main pros and cons.

Advantages:

- A physical notebook makes it easy to see all your transactions and balance at a glance.
- Passbook savings accounts can help children learn about banking.
- Fees and interest rates are often favourable.

Disadvantages:

- You won't be able to enjoy the convenience of online banking in some cases.
- Customers might have to visit the bank in person.
- Your selection might be limited to small, regional banks.

While a passbook savings account won't be for everyone, digital passbook apps offer a good middle ground for those who like the traditional aspects of a passbook but still want to take advantage of modern technology.

5.3 NEGOTIABLE INTRUMENT

A negotiable instrument is a document that guarantees payment of a specific amount of money to a specified person (the payee). It requires payment either upon demand or at a set time and is structured like a contract.

Fig.5.2 Negotiable Instrument

Features of Negotiable Instruments

The term "negotiable" in a negotiable instrument refers to the fact that they are transferable to different parties. If it is transferred, the new holder obtains the full legal title to it.

Non-negotiable instruments, on the other hand, are set in stone and cannot be altered in any way.

Negotiable instruments enable its holders to either take the funds in cash or transfer to another person. The exact amount that the payor is promising to pay is indicated on the negotiable instrument and must be paid on demand or at a specified date. Like contracts, negotiable instruments are signed by the issuer of the document.

Types of Negotiable Instruments

There are many types of negotiable instruments. The common ones include personal checks, traveler's checks, promissory notes, certificates of deposit, and money orders.

1. Personal checks

Personal checks are signed and authorized by someone who deposited money with the bank and specify the amount required to be paid, as well as the name of the bearer of the check (the recipient).

While technology has led to an increase in the popularity of online banking, checks are still used to pay a variety of bills. However, a limitation of using personal checks is that it is a relatively slow form of payment, and it takes a long time for checks to be processed compared to other methods.

2. Traveler's checks

Traveler's checks are another type of negotiable instrument intended to be used as a form of payment by people on vacation in foreign countries as an alternative to the foreign currency.

Traveler's checks are issued by financial institutions with serial numbers and in prepaid fixed amounts. They operate using a dual signature system, which requires the purchaser of the check to sign once before using the check and a second time during the transaction. As long as the two signatures match up, the financial institution issuing the check will guarantee payment to the payee unconditionally.

With traveler's checks, purchasers do not have to worry about carrying large amounts of foreign currency while on vacation, and banks provide security for lost or stolen checks.

With technological advancement in the last few decades, the use of traveler's checks has gone into decline as more convenient ways of making payments abroad have been introduced. There are also security concerns associated with traveler's checks, as signatures can be forged, and the checks themselves can also be counterfeit.

Today, many retailers and banks do not accept traveler's checks due to the inconvenience of the transactions and fees charged by banks to cash them. Instead, traveler's checks have been mostly replaced with debit and credit cards as methods of payment.

3. Money order

Money orders are like checks in that they promise to pay an amount to the holder of the order. Issued by financial institutions and governments, money orders are widely available, but differ from checks in that there is usually a limit to the amount of the order – typically $1,000.

Entities who need more than $1,000 need to purchase multiple orders. Once the money orders are bought, the purchaser fills in the details of the recipient and the amount and sends the order to that person.

Money orders contain relatively little personal information compared to checks with just the names and addresses of the sender and recipients and not any personal account information.

International money orders are also a popular way of sending money abroad nowadays since money orders do not need to be cashed in the country of issuance. As such, they enable a simple and quick method of transferring money.

4. Promissory notes

Promissory notes are documents containing a written promise between parties – one party (the payor) is promising to pay the other party (the payee) a specified amount of money at a certain date in the future. Like other negotiable instruments, promissory notes contain all the

relevant information for the promise, such as the specified principal amount, interest rate, term length, date of issuance, and signature of the payor.
The promissory note primarily enables individuals or corporations to obtain financing from a source other than a bank or financial institution. Those who issue a promissory note become lenders.
While promissory notes are not as informal as an IOU, which merely indicates that there is a debt, it is not as formal and rigid as a loan contract, which is more detailed and lists out the consequences if the note is not paid and other effects.
5. Certificate of Deposit (CD)
A certificate of deposit (CD) is a product offered by financial institutions and banks that allows customers to deposit and leave untouched a certain amount for a fixed period and, in return, benefit from a significantly high interest rate.
Usually, the interest rate increases steadily with the length of the period. The certificate of deposit is expected to be held until maturity when the principal, along with the interest, can be withdrawn. As such, fees are often charged as a penalty for early withdrawal.
Most financial institutions, including banks and credit unions, offer CDs, but the interest rates, term limits, and penalty fees vary greatly. Interest rates charged on CDs are significantly higher (around three to five times) than those for savings accounts, so most people shop around for the best rates before committing to a CD.
CDs are attractive to customers not only because of the high interest rate but also of their safe and conservative nature, as the interest rate is fixed throughout the course of the term.

5.4 CHEQUE

A cheque is a financial document that orders a bank to pay a particular amount of money from a person's account to another individual's or company's account in whose name the cheque has been made or issued. The cheque is utilised to make safe, secure, and convenient payments. It serves as a secure option since hard cash is not involved during the transfer process; hence the fear of loss or theft is minimised.
A cheque may be issued against a current account or a savings account. Every bank cheque has a **cheque number, MICR and IFSC code**. Under this mode of fund transfer, there are three parties involved in the on-track movement of money through a written paper source.

Parties to a Cheque

There are three parties to cheque –

- **Drawer**– The person who draws the cheque, i.e., signs and orders the bank to pay the sum.
- **Drawee**– The bank on which the cheque is drawn or who is directed to pay the specified sum written on the cheque.
- **Payee**– The beneficiary, i.e., to whom the amount is to be paid.

Apart from the above mentioned parties, there are two more parties to a cheque:

- **Endorser**: When a party transfers his right to take the payment to another party, he/she is called an endorser.
- **Endorsee**: The party in whose favour, the right is transferred, is called endorsee.

Sometimes, the drawer and the payee can be the same person, when the drawer writes a self-cheque.

Features of Cheque

- A cheque is an unconditional order
- It is always drawn on a particular bank
- A signature on the exchequer is a mandate and should be only done by the maker
- The amount is always a certain sum of money in one's account
- A cheque is always payable on demand
- A cheque's payment is always in cash or account transfer
- The cash amount is to be paid to the person mentioned therein, or order, or the bearer

Types of Cheque

1. **Bearer Cheque:** This type of cheque can be encashed by the bearer (person carrying/bearing the cheque) on presentation before the authorised bank. Banks do not require authorisation to be permitted to make payment from the issuer for these cheques.
2. **Blank cheque**– A blank cheque is the one that has the sign of the issuer and no other details are filled in it. It possesses high risk because if someone finds it, the person can issue the cheque to themselves.
3. **Order Cheque:** This type of cheque can be encashed only by the payee, that is, the person whose name has been written on the cheque.
4. **Open Cheque:** This is an uncrossed cheque that can be encashed at any bank and the payment can be made to the person bearing the cheque. It can also be transferred from

the original payee to a different payee. The issuer is required to put his signature on both the front and back of the cheque.

5. **Crossed Cheque:** Cheque: Also known as the account payee cheque. On the top left corner of the cheque, it has the words ''account payee'' written enclosed in two parallel lines. These lines ensure that the payment is made only to the person whose name is written on the cheque and hence are the safest types of cheques to issue.
6. **Post-dated Cheque:** This type of cheque has a later date of being encashed and can be used to meet a future financial obligation. Even if these are presented to the bank by the bearer immediately, the payment is processed by the bank only on the date mentioned on the cheque. These cheques are valid for up to 3 months from the date of issuance.
7. **Stale Cheque:** Three months past the date of issuance, a cheque is past its validity and is called a stale cheque. No money can be withdrawn using such stale cheques.
8. **Banker's Cheque:** A banker's cheque is issued by the bank and guarantees payment.
9. **Self Cheque:** A self-cheque has the word 'self' written in the drawee column and can only be drawn at the issuer's bank.
10. **Traveller's Cheque:** This type of cheque can be used by foreigners on a vacation in place of hard cash. These are issued by one bank and can be encashed in the form of currency at a different bank in a foreign location/country. Traveller's cheques don't have an expiry date and can be used at later date.

How to Cancel a Cheque

To cancel a cheque, you just need to strike two lines across the cheque and write the word "**CANCELLED**" across it. You don't need to sign the cancelled cheque. It only works as proof that you have an account in the bank. There is the account holder's name, branch name and address, account number, and MICR Code on the cheque which is enough to submit as proof.

Purpose of a Cancelled Cheque

As all the primary details of your bank account are present in a cancelled cheque, it helps a verifier/auditor to confirm these details of yours. Moreover, a Cancelled Cheque doesn't necessarily require your signature on it, so there aren't any security issues which you should be concerned about when you submit your bank cheque as proof of your financial identity.

- **While borrowing loans**: You are required to submit cancelled cheques to banks when you apply for a loan such as a car loan, home loan, personal loan, or loan against

property with them. A cancelled cheque is considered proof of your bank account with the prospective lender bank.

- **When investing in the market**: When you are investing in the stock market such as the National Stock Exchange or the Bombay Stock Exchange, the service provider will ask you for your cancelled cheque.
- **Organizations usually ask for cancelled cheques**to verify a person's banking and financial profile. This is because through a single cancelled cheque they acquire all the usually required details of verification for your bank account.
- **When you buy mutual funds**yourself or through a third party agency as per government rules, you need to provide a cancelled cheque as proof of your bank account to the seller so that any funds and derivatives which are received through your mutual funds transactions are credited in your bank account directly. As aforementioned, whenever a credit has to happen in your bank account, a cancelled cheque is required by the creditor to verify the account first.

What is Cross Cheque?

A crossed cheque is any cheque which is **crossed with two parallel lines**. The lines can be drawn either across the whole cheque or through the top left-hand corner. What does it signify? It simply means that the specific cheque can only be deposited straightway into a bank account and **cannot be instantly encashed by a bank or any credit institution**. This ensures a level of security to the payer since it requires the funds to be handled through a collecting bank.

Different ways to Cross a Cheque

Cross cheque focuses on the instruction given by the drawer (maker) of the particular cheque to the drawee bank. This instruction demands to pay the cheque at the counter of the bank, but with a strict direction to pay it to a person who offers it through a banker. What is the purpose of crossing? Crossing makes it possible to trace the person to whom the amount/payment has been made. In India, there are various crossing tools to safeguard cheque payments such as:

General Crossing

This type of cheque crossing requires two parallel transverse lines. There isn't any restriction on putting these parallel lines on a specific area on the cheque, but they can be drawn anywhere. Usually, it is advisable to put it on the top left corner of the cheque. The usefulness or significance of this crossing is that the cheque should essentially be paid only to the banker.

Special Crossing

Special Crossing cheque does require the name of the banker. The effect of this type of crossing is that the cheque should be funded only to the banker to whom it is crossed. It is a reminder to all the people that a special crossing cannot be changed into a general crossing.

Not Negotiable Crossing

In this type of cheque crossing variety, the paper document needs to contain the words 'not negotiable'. Moreover, the cheque can be crossed specially or generally. What is the effect of this crossing? The cheque remains non-negotiable (transferrable) as well as the title of the transferee will not be better than the title of the transferor.

Uncrossing a Cheque

- If you are now familiar with the cross cheque meaning, then clearly there is no way the payee can uncross the cheque. Furthermore, the cheque is considered non-transferable, which means it cannot be transported to a third party. However, the only action which is allowed is for the payee to deposit the cheque in an account that he/she holds with their name.
- Therefore, the payer can uncross the cheque by lettering "Crossing Cancelled" across the front side of the cheque. However, such an action isn't recommended since it eliminates the protection the payer initially had in place.

Advantages and Disadvantages of Cheque

Advantages of a Cheque

- It is safer and more convenient to carry around than cash
- It is a negotiable instrument which can be endorsed in favour of a third party.
- It can be easily traced if lost

Limitations of a Cheque

- Payments through cheque may be sometimes refused since it is not legal tender money
- Individuals who do not possess a bank account cannot use cheques
- Depositing a cheque into your bank account requires you to visit the bank and is time-consuming

What do you mean by Cheque Leaf

A cheque leaf, commonly known as a Cheque, is a tool which is used to transfer funds from one bank account to another. A bundle of cheque leaves attached is a Cheque book which is provided by the bank to its customers.

- A cheque was developed to conduct **safe and secure financial transactions**.
- Cheques enable you to **transfer large amounts of money**from one bank account to another without the requirement of a physical transfer.

Positive Pay System

- A positive pay system has been introduced to reduce fraud which occurs due to tampering and increase customer safety in cheque payments
- The process involves reconfirming the details of large value cheques, that is, cheques exceeding Rs. 50,000. The cheque is honoured if the details match, the discrepancy is flagged in case there is a mismatch.

How to Apply for a New Cheque Book?

There are various ways in which you can apply for a new chequebook using any of the following means given below:

- **Internet Banking:** You can log in to your bank's internet banking account and request a cheque book by mentioning details like your account number and mailing address. The cheque book is then delivered to the address linked to your bank account.
- **Mobile Application:** You can simply log in to your bank's mobile app and request a cheque book.
- **ATM:** You can also apply for a cheque book through an ATM by simply following the steps given below:

1. Visit your bank's ATM and insert your debit card
2. Enter your PIN and choose the 'issue new cheque book' option
3. Click on 'Submit'
4. Once your request is submitted, your chequebook will be sent to your address

- **Branch Visit:** You can also visit your bank branch and request a new chequebook

Things to Keep in Mind when Writing a Bank Cheque

- Omit the words 'OR BEARER' and Add 'A/C Payee' at the top left corner of the cheque. This ensures that no one apart from the individual in whose favour this cheque is drawn can acquire the stated amount
- Avoid leaving spaces between the words PAY and the Name of the Receiver and also between the name and surname. This practice is important since it doesn't offer anyone a chance to fill in the alphabet before or after the name to claim the money.
- Always write 'ONLY' after mentioning the amount in words in the 'RUPEES' column by using the symbol '/-'at the end
- Ensure there is no sort of overwriting. It means, that no scribbling or cancellation of text would be entertained by the banks
- Fill in the correct date. A cheque without a date permits anyone to put any date and pull-out cash using the bank cheque at their will. Further, a cheque with a post- or pre-

date is another issue that can lead to dishonouring of the cheque. Moreover, a wrongly written date, for example, the wrong year or a month would also lead you to a problem

- Make sure you do not hand over a cheque without the presence of the date, amount of cheque in numbers and words and the Payee's name
- Keep your signature clear and if needed, sign twice to ensure that the cheque is not bounced due to a signature mismatch
- Further, mention the credit card number, mobile number, connection number, etc., on the reverse side of the cheque while you make payments towards bills for utilities
- It is strictly prohibited to staple, disfigure or fold cheque or any sort of damage to MICR Band

Different banks across India have stated specific guidelines regarding the proper filling of cheques. It is important to go through your bank's guidelines for acquiring proper awareness. Further, do not miss to check out conditions for cheque bounce; this would make you more alert during the cheque filling process.

What are the Possible Reasons why Bank can Dishonour a Cheque

A bank can refuse to make the payment mentioned on a cheque due to various reasons. Some of them are mentioned as follows:

- Insufficient funds in the payer's bank account
- Signature missing or mismatch
- Account number mismatch
- An issue with the date of the cheque
- Mismatch in the amount of words and numbers
- Disfigured or damaged cheque
- Crossing the limit of the overdraft
- Scribbling, overwriting or omissions on the cheque without authorization(signature) of the payer
- Cheque is expired
- Drawer's account is closed
- Payment is stopped by the drawer
- Garnishee order on account
- Death or insanity of the drawer
- The seal of the company is missing on the cheque issued by an organization
- Suspicion of a forged cheque

MICR

MICR or Magnetic Ink Character Recognition is a 9-digit code generally printed at the bottom of the cheque leaf. The first three digits represent the city, the next three the bank and the last three the particular branch code. The MICR code on cheque helps in easier identification of cheques, eliminate payment errors and process cheque payments faster.

5.5 DISCOUNTING OF CHEQUE

In the world of business, **cheque discounting** is a common way for companies to get the cash they need quickly. It's a process where banks or other **financial institutions** (including Mwananchi Credit) will buy cheques from businesses and then collect payment for those cheques from the original payers (customers) over a certain period of time.

Cheque discounting can be beneficial for both parties—it gives businesses an easy and secure way to access funds without waiting for payments to come in, and it gives customers the ability to make purchases with their credit card or debit card.

If you're interested in how cheque discounting works, read on! We'll be teaching you everything you need to know about this common business practice.

What Is Cheque Discounting?

Cheque discounting is a way for businesses to get their hands on some cash quickly from various banks and other financial institutions.

These financial institutions will buy your cheques and then collect the payment from the original payer over a certain period of time. For example, you might find yourself in need of Ksh. 1,000,000 right away—cheque discounting would allow you to access this KES 1,000,000 without waiting for people to pay you back.

It's also worth noting that businesses that use cheque discounting in Kenya don't have to wait for all their customers to pay them before they can receive money. It works by paying out a set percentage of the total amount, plus fees that the business agrees on with the bank at the beginning of the process. The customer pays back the bank as per their agreement with them and is not obligated to pay any interest or any additional fees.

How Does It Work?

An account holder will give a cheque to Mwananchi Credit, a financial institution. Mwananchi Credit will then purchase the cheque from the account holder and then collect payment for that cheque over a period of time.

So, how do you know what you'll be charged for a particular cheque?

There are two ways to find out:

1. You can talk to us about the cost of a particular cheque before you actually make it.
2. You can ask your customer what they're willing to pay for the cheque before writing it.

You'll want to keep track of how many transactions you write as well as how much is written on those transactions, as these factors will affect your final cost per transaction. If you process 50 transactions per month and each transaction has KES 100,000 written on it, your ongoing monthly fee would be KES 100,000 plus KES 500 per transaction (50 x KES 500).

Cheque discounting is an excellent option if you need quick cash and don't want to wait until customers come in and pay their bills!

Cheque Discounting Facility

If you're looking for a quick way to access the funds you need without waiting for your customers to pay, cheque discounting may be an option. Generally, you'll give your bank or financial institution a list of cheques that are good for them to collect over a specific period of time. The more cheques you send in, the more money will be available for you to use.

One of the benefits of cheque discounting is it gives businesses another way to pay their suppliers by giving them access to cash before their customers have paid. It also allows businesses to take credit card and debit card payments right away, so they can avoid waiting 30 days for the payment to clear with their bank account.

Cheque discounting might not be appropriate if you have a high volume of transactions that are very time-sensitive because it will take some time before banks collect payment from your customers and provide you with the funds.

Cheque Discounting Benefits

Cheque discounting is a way for companies to get the cash they need quickly. It's a process where banks or other financial institutions like Mwananchi Credit LTD will buy cheques from businesses and then collect payment for those cheques from the original payers (customers) over a certain period of time.

Fig.5.3 Cheque Discounting Benefits

Cheque discounting can be beneficial for both parties—it gives businesses an easy and secure way to access funds without waiting for payments to come in, and it gives customers the ability to make purchases with their credit card or debit card.

As you may know, there are some downsides to traditional lending options. When you need funding quickly, it can be difficult to find someone willing to lend your company money on your terms. Lending options also often take weeks or months before they fund, which could delay your business's growth. With cheque discounting, you have access to funds without waiting for traditional loans. And since cheque discounting is usually on an interim basis—purchases are collected over a certain timeframe—there are no long-term commitments. **You can also reduce your risk of losing out on sales by card-on-file transactions with customers who frequently use credit cards or debit cards.**

Drawbacks Of Cheque Discounting

Cheque discounting does have its drawbacks. The biggest issue with this type of financing is that businesses will usually receive less than the amount they've written on their cheque, which means they could end up paying more in interest than they were expecting.

The interest rate banks charge can also be an issue as it can vary from bank to bank and has a lot to do with the size of your cheques and what kind of business you're in. If you're not careful, this could result in a situation where your company is paying too much for cheque discounting services.

If you're considering using cheque discounting as an option for accessing funds, it's important to look into the drawbacks and find out if they apply to you:

- You may receive less than the amount on your cheque
- Interest rates may vary from bank to bank
- Your company may end up paying too much for these services.

Cheque Discounting In Nairobi

Mwananchi Credit LTD is the leading financial institution in cheque discounting in Nairobi Kenya. We buy cheques from businesses and then collect payment for those cheques from the original payers (customers) over a certain period of time. Get in touch with us via a call or email to find out how your business can benefit from this service.

- Call: 0709 147 000
- Email: info@staging.mwananchicredit.com

Can I Discount A Post-Dated Cheque?

It is possible to discount a post-dated cheque. However, the financial institution is required to provide payment for the cheques to the business on or before the date of issue.

Cheque discounting is used by every type of company—large and small, old and new, in Kenya and around the world. It’s a way that many businesses access cash quickly without waiting for customers to pay for products or services.

5.6 CHEQUE PRESENTMENT

Check representment is a service offered by banks that resubmits a bounced check to the check writer's account until funds are available for payment. In the check representment process, the bounced check is usually converted into an electronic item for representment. Many banks and financial institutions offer check representment services to their business clients at no charge.

Key Takeaways

- Check representment is a service offered by banks to resubmit a bounced check to the check writer's account until funds are available.
- Typically banks present a check for payment twice to the Fed's clearing system. After this, the check has to be presented manually at a branch for processing.
- Check representment reduces time and expense involved in collections processes for businesses and helps banks flag accounts that have a history of bounced checks.

Understanding Check Representment

For businesses that rely on incoming checks, there are many benefits of check representment. It gives businesses another opportunity to collect payment for products supplied or services rendered, eliminating the time and expense of the collections process.

It also enables a bank to flag accounts that have a history of bounced checks, allowing the bank to warn a businesses of potential non-payment, so that it can require advance payment.

Representment also often gives electronic checks priority over paper checks, since they have lower handling costs and shorter processing times.

Typically banks present a check for payment twice. This is in line with the Federal Reserve's operating letters which states that its check processing service cannot be used more than two times.1 But the Uniform Commercial Code (UCC), which is used to determine procedures for commercial contracts, does not have explicit instructions for the number of times that a check is presented. In such cases, businesses can present the check manually for clearing at a bank's branch.

5.7 DISHONOUR OF CHEQUE

Dishonour of Cheque mainly happens because most of us are not aware of creating and operating bank accounts & their services. Thus they end up making silly mistakes while writing a cheque. Therefore, it is important to understand the important banking terms and safeguarding your money from fraud and save your cheques from getting rejected.

What is Dishonour of Cheque?

A cheque is said to be honoured if the banks give the amount to the payee. While, if the bank refuses to pay the amount to the payee, the cheque is said to be dishonoured. In other words, dishonour of cheque is a condition in which the bank refuses to pay the amount of cheque to the payee.

Whenever the cheque is dishonoured, the drawee bank instantly issues a ‘Cheque Return Memo’ to the payee banker specifying the reasons for dishonour. The payee banker provides the memo and the dishonoured cheque to the payee. The payee has an option to resubmit the cheque within three months of the date specified on the cheque after fulfilling the reason for the dishonour of the cheque.

Moreover, the payee has to give notice to the drawer within 30 days from the date of receiving the “Cheque Return Memo” from the bank. The notice should state that the cheque amount will be paid to the payee within 15 days from the date of receipt of the notice by the drawer.

However, if the drawer fails to make a fresh payment within 30 days of receiving the notice, the payee has the right to conduct a legal proceeding against the defaulter as per Section 138 of the Negotiable Instruments Act.

Reasons for Dishonour of Cheque

1. If the cheque is overwritten. Know ‘How to write a Cheque?’
2. If the signature is absent or the signature in the cheque does not match with the specimen signature kept by the bank.
3. If the name of the payee is absent or not clearly written.
4. If the amount written in words and figures does not match with each other.
5. If the account number is not mentioned clearly or is altogether absent.
6. If the drawer orders the bank to stop payment on the cheque.
7. If the court of law has given an order to the bank to stop payment on the cheque.
8. If the drawer has closed the account before presenting the cheque.
9. If the fund in the bank account is insufficient to meet the payment of the cheque.

10. If the bank receives the information regarding the death or lunacy or insolvency of the drawer.

11. If any alteration made on the cheque is not proved by the drawer by giving his/her signature.

12. If the date is not mentioned or written incorrectly or the date mentioned is of three months before.

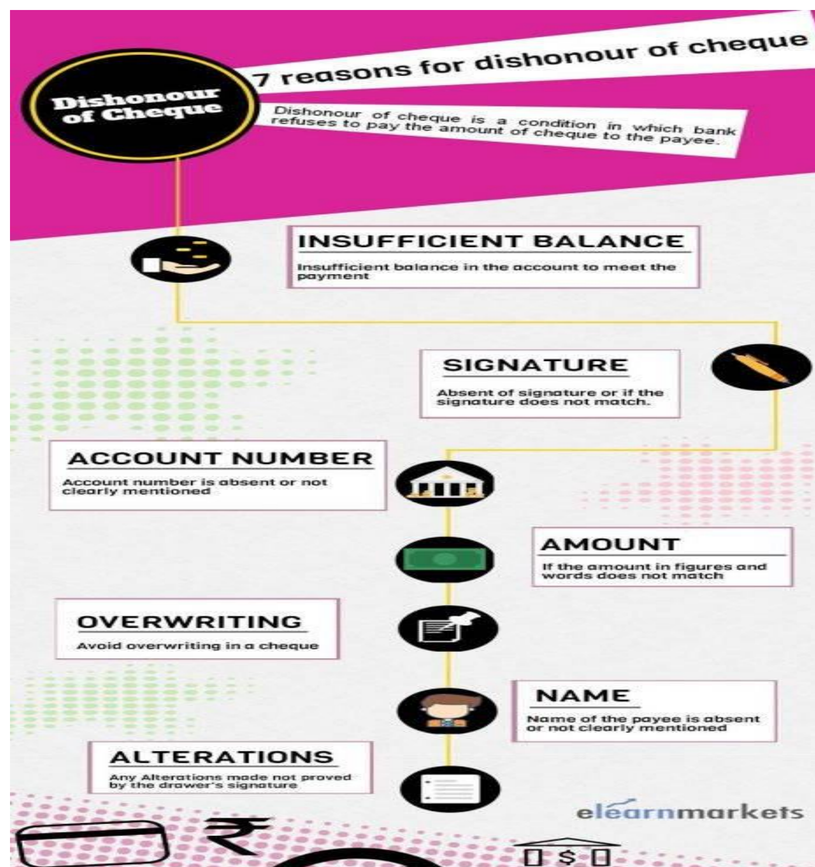


Fig.5.4 7 reason for dishonour of cheque

What are the problems in Dishonour of Cheque?

In the case of Dishonour of Cheque, a 'cheque return memo' is offered by the bank to the payee stating why the cheque has been bounced. The payee can resubmit the cheque if he believes that it will be honoured a second time. The payee can prosecute the drawer legally if the cheque is bounced again.

The Negotiable Instrument Act, 1881 is applicable for the cases related to the dishonour of cheques. In accordance with section 138 of this act, dishonour of cheque is a criminal offence and is punishable with monetary penalty or imprisonment up to 2 years or both.

1. Penalty

If a cheque is bounced, then a penalty is levied on both drawer and payee by their respective banks. The person will additionally have to pay late payment charges if the dishonoured cheque is against repayment of a loan.

2. Damage To Credit History

Your credit history is negatively impacted if a cheque is dishonoured since your payment activities are reported to the credit bureaus by the financial institutions. The lenders will trust you if you have a good credit score. In order to have a good credit score, it's good practice to avoid your cheques from being bounced. Your good payment activities will help you build a good CIBIL score and benefit you at the time of lending money from financial institutions.

Keep the above points in mind while writing the cheque so that the cheque is not dishonoured.

Go digital, avoid dishonour of cheque charges!

An efficient way of avoiding cheque dishonour charges is to bank digitally. Instead of issuing a cheque, one can choose to transfer funds online. You can use NetBanking or Mobile Banking for transferring funds to third-party accounts. You can also make transfers within your accounts using the digital payment system.

If you have to issue a cheque, here are a few things to keep in mind;

1. Make sure you issue an account payee cheque.
2. Use the signature that is registered with the bank.
3. Ensure that there is sufficient balance in your account.
4. Fill in details on the cheque carefully.

5.8 CURRENT BANK ACCOUNT

Current bank account is opened by businessmen who have a higher number of regular transactions with the bank. It includes deposits, withdrawals, and contra transactions. It is also known as Demand Deposit Account.

Current account can be opened in co-operative bank and commercial bank. In current account, amount can be deposited and withdrawn at any time without giving any notice. It is also suitable for making payments to creditors by using cheques. Cheques received from customers can be deposited in this account for collection.

In India, current account can be opened by depositing Rs.5000 to Rs. 25,000. The customers are allowed to withdraw the amount with cheques, and they usually do not get any interest. Generally, current account holders do not get any interest on their balance lying in current account with the bank.

Current account holder get one important advantage of overdraft facility.

Features of Current Bank Account

The main features of current account are as follows:-

- Current bank accounts are operated to run a business.
- It is a non-interest bearing bank account.
- It needs a higher minimum balance to be maintained as compared to the savings account.
- Penalty is charged if minimum balance is not maintained in the current account.
- It charges interest on the short-term funds borrowed from the bank.
- It is of a continuing nature as there is no fixed period to hold a current account.
- It does not promote saving habits with its account holders.
- Banker requires KYC (Know your Customers) norms to be completed before opening a current account.
- The main objective of current bank account is to enable the businessmen to conduct their business transactions smoothly.
- There is no restriction on the number and amount of deposits.
- There is also no restriction on the number and amount of withdrawals made, as long as the current account holder has funds in his bank account.
- Generally, bank does not pay any interest on current account. Nowadays, some banks do pay interest on current accounts.

Advantage of Current Bank Account

The advantages of current account are as follows:-

- Current account is mainly opened for businessmen such as proprietors, partnership firms, public and private companies, trust, association of persons, etc. that has a large number of daily banking transactions, i.e. receipts and/or payments.
- It enables businessmen to carry out their business transactions properly and promptly.
- The businessmen can withdraw from their current accounts without any limit, subject to banking cash transaction tax, if any levied by the government.
- Home branch is that location where one opens his bank account. There are no restrictions on deposits made in the current account opened in a home branch of a

bank. However, the current account holder can deposit the cash from any other branch of a bank other than the home branch by paying a nominal charge as applicable.

- It helps businessmen to make a direct payment to their creditors by issuing cheques, demand-drafts or pay-orders, etc.
- It enables a bank to collect money on behalf of its customers and credits the same in their customers' current accounts.
- It enables the current account holder to obtain overdraft (short-term borrowing) facility.
- The creditors of the account holder can get credit-worthiness information of the account holder through inter-bank connection.
- It facilitates the industrial progress of the country. Without its help, businessmen would face difficulties in running their businesses.
- It has the facilities of Internet-banking and mobile-banking to carry out important business transactions with ease and quickly.
- It also provides various other advantages (benefits) such as:
- Deposit and withdrawal of money (cash) at any location.
- Multi-location funds transfer,
- Electronic funds transfer,
- Periodical (monthly, quarterly or yearly) e-mail or download of bank statements in various formats like '.XLS', '.TXT', '.PDF', etc.
- Support from customer care executives

5.9 OVERDRAFT

An **Overdraft** is a banking facility that allows customers to withdraw money with a zero balance. Banks offer a loan protecting clients from a bounced check. This facility is chargeable.

A one-time processing fee is charged for this facility. Since overdrafts are a form of loan, account holders also have to pay interest on the overdraft amount. The predetermined limit differs from customer to customer, depending on the relationship with the bank. The customer's credit history and credit ratings are crucial in determining authorized limits on the amount that can be overdrawn.

How Does Overdraft Work?

An overdraft offers financial freedom to account holders. It aids them in paying off bills even when they are out of funds. It potentially prevents embarrassing situations and helps customers maintain relationships with business parties.

Account-holders can submit a written application with their banks activating this facility. For activating the feature, account holders can either visit their bank physically or apply for the same online. Banks can accept or reject such an application at their discretion. For certain types of accounts, these services are provided by default. When the bank accepts a request, the customer has to pay a one-time processing fee.

This facility differs from other credit options. First of all, the bank declares a specific credit limit for each of its clients. Also, this service is not free; banks impose interest on the overdrawn sum. This interest amount is computed daily. It is important to note that the account holder will only need to pay interest on the borrowed amount and not on the total permissible limit. For this facility, banks do not charge any pre-closure penalty. Additionally, joint account holders are also eligible for this facility by co-applying for the same.

Types of Overdrafts

There are primarily two types of overdrafts – secured and unsecured. A mortgaged asset or **collateral** always backs the loan, and if the account holder doesn't pay off the outstanding sum, the bank has the right to recover the loss by selling off this asset. On the other hand, the unsecured type is not secured by any collateral and therefore allows a lower credit limit.

Given below are some of the most common types of overdrafts available:

1. **Overdraft Against Salary**: If borrowers hold a salary account with the lending banks, then they can be eligible for a limit of two or even three times their salary amount.
2. **Overdraft on Savings Account**: The banks also provide this facility for clients who have active savings accounts with frequent transactions.
3. **Overdraft Against Equity**: Keeping the equity as collateral, a borrower can get this facility; however, the permissible limit is significantly less than the market value of those stocks.
4. **Overdraft Against House**: Homeowners can also overdraw upto 40-50% of their house's value.
5. **Overdraft Against Fixed Deposit**: An account can be overdrawn up to a certain percentage of a fixed deposit. Generally, the interest rate on such credits is 2% higher than the Fixed Deposit's **ROI**.

6. **Overdraft Against Insurance Policy**: The facility can also be availed on the grounds of an insurance policy depending upon its surrender value.

Overdraft Protection

Overdraft protection is the next level of assistance offered by banks. It links checking accounts to other bank accounts. There could be a second checking account, a savings account, a **line of credit**, or a credit card. Thus, whenever the **checking account** is overdrawn, the bank pools in money from the linked account. The bank uses funds from alternate accounts to clear a check. In order to avail such protection, customers need to apply specifically.

Again, the bank imposes a protection charge. While the fees vary from bank to bank, this facility protects the customer from non-sufficient funds (NSF) charges. Banks keep an eye on the number of times the protection is used. If the protection is used repeatedly, the facility will be discontinued.

Overdraft Fee

Initially, banks charge a one-time processing fee. Thereafter, the bank makes payments even when there is a shortage of funds. On top of the initial fee, a certain percentage is charged as interest on the deficit sum. This interest varies from bank to bank. Also, the one-time processing fee can be charged multiple times if a customer keeps making payments with an insufficient **account balance**. However, there is a per-day limit for the processing fee.

In the US, while Ally Bank and Alliant Credit Union don't **levy** any coverage fee when customers overdraw from their accounts. The top financial institutions like Capital One 360 and Bank of America impose **$35** for this option. The fee can be charged a maximum of 4 times a day. At $38, BBVA and Comerica charge the highest. This fee can be charged six times a day.

Advantages

This facility can protect the customer's reputation. Given below are the various advantages of availing of this option:

- **Prevents Check from Bouncing**: This option prevents checks from getting bounced. Consequently, the customer can maintain fair credit ratings with a clear payment record.
- **Timely Payments**: It also assists account holders in disbursing pending payments on time. This way, customers avoid any dues or delayed remittances, despite having a nil balance.

- **Ease of Application**: An account holder can opt for this option by filling a simple form by visiting the respective bank or doing it online on the bank's portal. The facility requires minimal paperwork.
- **No Pre-Closure Charges Applicable**: Unlike other loans, this facility does not impose any early payment penalty on the account holder.
- **No Collateral in Unsecured Overdraft**: In some cases, banks don't ask for any asset, mortgage, or collateral at all. All it takes is an existing account with the respective **financial institution**.
- **Minimal Interest**: The bank charges interest only on the sum that has been overdrawn. This too is incurred only till the amount is repaid.
- **Flexibility and Convenience**: It is a beneficial option considering emergencies. It provides flexibility in **financial planning**.

Disadvantages

This facility mandates having a bank account with the respective financial institution. Also, this option is charged with a high-interest rate, much higher than other loan options. Moreover, account holders end up paying penalties for overdrawing beyond the permissible limit. If account holders fail to pay back the due amount in the allowed time frame, credit ratings are brought down.

5.10 CASH CREDIT

Cash credit is a facility to withdraw money from a current bank account without having a credit balance but is limited to the extent of the borrowing limit, which the commercial bank fixes. The interest in this facility is not charged on the borrowing limit, which the bank gives but on the daily closing balance. We are explaining the calculation of interest in the latter part of this article using an example.

CC is a very common facility by banks. It is one of the essential short-term sources of finance for a business. The availability is also not very difficult.

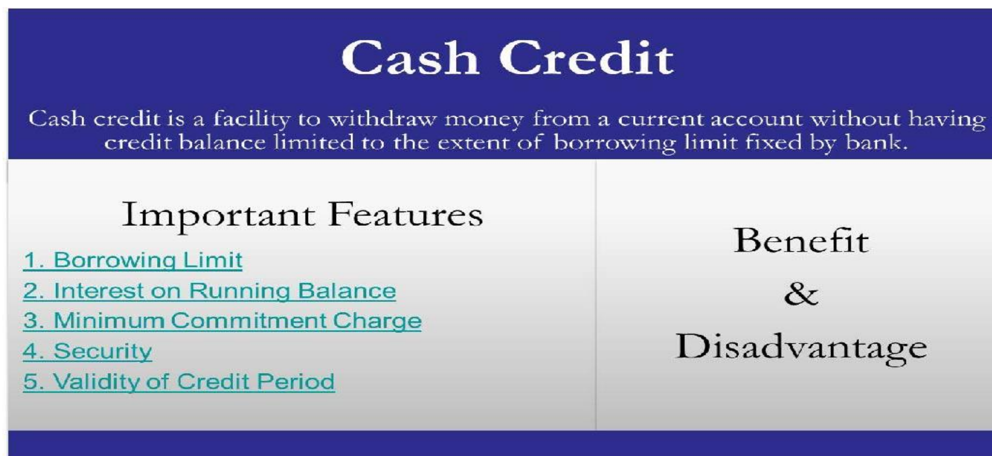


Fig.5.5 Cash Credit

Important Features / Rules of Cash Credit Facility

Borrowing Limit based on Drawing Power

The borrowing limit in the cash credit facility is a limit on the maximum amount of borrowing specified by the bank. Till this limit is not exhausted, the borrower can withdraw and deposit funds any no. of times. The bank determines the borrowing limit based on the drawing power of the borrower. Banks evaluate drawing power by analyzing book debts, inventories, creditors, etc. For detailed knowledge about what drawing power is and how banks calculate cash credit limits? You can read our detailed post on Drawing Power.

Interest on Daily Closing Balance

This is one unique feature of a CC Account. Unlike other types of debt financing products of banks like loans, the interest here is charged on the daily closing balance of the cash credit current account and not on the sanctioned amount. It is an incredible motivation for the borrower to collect money from the debtors as soon as possible and deposit it in the current account. Depositing money back to this account will save the entrepreneur a lot on interest costs. It is as good as investing the surplus funds instantaneously at the interest rate, which he pays on the cash credit limit. We have given a detailed explanation of interest calculation with the example later in the post.

Minimum Commitment Charge

Typically, a bank would levy charges in the situation when the borrower is not using the cash credit account. It's undeniable from the bank's point of view as it is blocking some amount of its 'float' for the borrower.

For example, in a 1 million cash credit limit, 0.5 million may be the average monthly minimum usage level. If the borrower uses the limit below that, say, 0.35 million, the bank will levy some charges on the unutilized portion, i.e., 0.15 million (.5 – .35). The charges

may range between 0.5% to 2% depending on the policy of the bank/financial institution. For an illustration, if the charges are 1%, it would be 1% of 0.15 million = 0.0015 million ~ $1,500.

Security

A cash credit facility is extended against security. Securities may be in the form of stock, debtors, etc., as primary security and fixed assets and other immovable properties, etc., as collateral security.

Validity of the Credit Period

The limit allowed is valid for one year, and then the drawing power will be re-evaluated. One year is just an example, whereas the evaluation may happen every quarter in some cases. This would vary from case to case and also depends on the policies of the various institutions.

Cash Credit Limit and Prepayment Charges

A lot of loan defaults happen globally. Hence, banks have created stringent rules for providing cash credit facilities to a company. After studying a company's books of accounts and income-tax filings of the promoters, a bank will decide on the amount to sanction. It may range anywhere between 50%-75% of the collateral offered as security. This percentage may change based on the company's books of accounts and the amount needed. A bank uses its infrastructure in terms of the time and energy of its employees, software, business visits, etc., to evaluate a limit. Therefore it expects the borrower to utilize the facility for a minimum period, say it is one year. If a borrower for any reason decides to close this facility before that, the bank may levy some prepayment charges.

Accounting Treatment

Cash credit is shown in current liabilities under the sub-head "Short Term Loans" in the balance sheet for accounting purposes. The bank providing the cash credit facility opens a current account in the company's name. Journal and ledger entries are similar to those made for transactions in other bank accounts. But there is a significant difference between the cash credit account and other bank accounts. A cash credit account will always have a credit balance – denoted as "Cr." balance. Whereas other regular bank accounts always have a debit balance- denoted as "Dr." balance.

5.11 BANK RECONCILIATION STATEMENT (BRS)

Bank reconciliation statement is a report or statement prepared by the business to match the bank transactions recorded in the books of accounts with the bank statement. The bank reconciliation statement helps to check the correctness of the entries recorded in the books of accounts and thereby, ensures the accuracy of bank balances.

Fig. 5.6 Bank Reconciliation Statement (Brs)

Accounting solutions to help you manage your business just the way you want.

Why bank reconciliation statements are prepared

With the definition of a bank reconciliation statement, you might be wondering why bank transactions recorded in the books of accounts do not match with the bank statement? There are plenty of reasons and some the common ones are listed below:

- Cheques Issued but not cleared in the bank
- Difference in cheque deposited and cheque credited date
- Date of cheque issued towards payment and date on which it is debited is different
- Cheque issued or received is not presented to the bank for clearing
- Bank interests, charges etc. are not accounted for. Reason being it is not known till you reconcile.
- Banks can also do mistake in debiting or crediting the transactions
- Just like banks, you too can make mistake in accounting the bank transactions in books of accounts and so on….

Due to the reasons listed above, the closing bank balance in your books of accounts and actual bank balance as per bank will not match. This means, the bank balance what you think you have it your bank is not the one available in the bank. Deciding basis the book balance will put you in an uncomfortable situation.

To avoid those situations, bank reconciliation statements are prepared. This statements simply matches the bank transactions as per company books with bank statement so that you always have accurate bank balance reflecting in the books of accounts.

When does a business prepare bank reconciliation Statement?

Depending on the volume and value of bank transactions, the reconciliation activities are carried out daily, weekly, fortnightly etc. If the volume or value of transactions is higher, the reconciliation activities are carried on daily to mitigate the risk of payment/cheque bounce.

How to prepare a bank reconciliation statement?

Bank reconciliation statement (BRS) involves the process of identifying the transactions individually and match it with the bank statement such that the closing balance of bank in books matches with the bank statement. For one which is not matched, suitable adjustments or correction will be done in the book to match it.

Bank reconciliation statement (BRS) format

ABC Company's Bank Reconciliation Statement 31-3-2019		
Balance as per bank statement		**3,00,000**
Add : Cheques deposited but not cleared	**20,000**	**20,000**
		20,000
Less : Cheques issued but not cleared in the bank	**50,000**	**50,000**
Adjsuted Balance		**2,70,000**

Balance as per company books		**2,60,900**
Add : Amount credited into bank but recorded in books	**9800**	
Interest received	**20**	**9820**
		2,70,720
Less : Other charges not recorded in books	**720**	**720**
Adjsuted Bank balance in Books		**2,70,000**

Benefits of using accounting software for preparing BRS

Comparing the two statements with a long list of transactions is stressful and error-prone using the manual and conventional method of bank reconciliation.

The only way to overcome this is to 'automate' the bank reconciliation process using accounting software. It saves time and effort in day-to-day operations. More importantly, you get accurate and near real-time information on bank balance in books of accounts.

Here, automating bank reconciliation is nothing but using accounting software to record the business transactions including the bank transactions such that the bank reconciliation statements are automatically prepared. Also, accounting software will help you automatically reconcile the bank statements with minimum efforts.

The following are benefits of automating the bank reconciliation process using accounting software.

- Easy to reconcile: Using an accounting software will help you to prepare a bank reconciliation statement automatically and reconcile with minimum efforts.
- Saves time and efforts: No matter whether there are 50 or 500 transactions, the efforts and time to reconcile is the same. Since it is reconciled automatically, you will save a lot of time and efforts involved reconciling the bank transactions.
- Detecting unaccounted transactions is easier: Get to know the new transactions(unaccounted) like bank charges or bank interests etc. and easily account and reconcile.

How Tally can help you in preparing bank reconciliation statement

Tally's auto bank reconciliation is designed to perform the bank reconciliation exactly in the same way you use to do it manually. To manually reconcile, you need to match the transaction amount and instrument number with the bank statement. TallyPrime, an business management software exactly mimics the way you used to manually reconcile but the only change is, it is automated for you.

TallyPrime's auto bank reconciliation will minimize the time spent and the risk of errors during bank reconciliation. Auto bank reconciliation in TallyPrime provides a simple and no-frills method of reconciling your company bank books with the bank statement.

Using this option, you just need to import the e-statement you received from the bank to TallyPrime (in Excel, delimited, CSV format) and hit the reconcile button. You are done.

TallyPrime also shows you complete detail of any unaccounted transactions, like bank charges or bank interests etc. and help you easily account those transactions from the same screen.

It's quick, simple, accurate and stress-free. It saves your time, manpower and money.

5.12 INTERNET BANKING

Internet has made it easier for banks to facilitate banking for their customers online. Customers can now operate their bank accounts, carry out balance enquiry, transfer funds or provide standing instructions to banks almost instantly from wherever they feel like. This can be done with the help of net banking or internet banking by accessing the net banking portal of the specific bank. An account holder just needs to provide a few details to register and carry out transactions without any handholding by the bank. It is accessed by a username and password and sometimes an additional code or OTP is required to authorize a fund transfer. Internet banking has made providing banking services cost-effective and decisions are now data-driven. Read on to know everything about net banking.

INTERNET BANKING

Net-banking, also known as internet banking, is an electronic system managed by banks which enables customers to access financial as well as non-financial banking products online. Earlier, customers had to visit the banks even for a small service. However, after the arrival of internet banking, almost all the services and products can be accessed online. From fund transfer to requesting demand draft, net-banking facilities, and all banking essentials. It is not just convenient but also a secure method of banking.

How does Net Banking Work

To benefit from net-banking, customers are required to register for internet banking at the bank.

- Individuals having a savings account or current account at any bank can register for internet banking
- For net-banking to work properly, you need a personal computer, laptop or mobile, and good internet connection
- After registering, a unique customer ID and password are issued by the bank using which one can log-in to the net-banking portal

Features of Net Banking

Given below are some of the key features of Net Banking:

- A secure and convenient method of banking
- Password-protected banking system
- Easy access to financial and non-financial banking products/services
- Access your bank account anytime anywhere
- Track and manage bank balance, last transactions, statements, etc.
- Transfer funds online via NEFT, RTGS, IMPS anytime
- Process bill payments quickly
- Keep a track of payments, personal loans, home loans, business loans, credit cards, savings account, etc.
- Channelize or cancel automatic payments

How to Register for Net Banking

Most of the banks open an internet banking account for the customers as and when they apply for a new bank account. If you do not have an internet banking account already,

- You can submit the Internet Banking Application Form at your home branch along with required documents such as a copy of your bank passbook, Aadhaar card, etc.
- The bank will verify all the information and then issue a customer ID and password for internet banking
- The net-banking application form can be downloaded from your bank's official website
- After receiving the credentials, you can log-in and access net-banking

How to Register for Net Banking Online

Besides offline registration, which involves the submission of the application form at the bank, users can register for net-banking online from the respective bank's official website. However, it should be noted that not all banks offer online registration for internet banking services.

Step 1: Visit your bank's official net-banking website

Step 2: Click on the 'login' button under personal/retail banking option

Step 3: On the next screen, click on the 'New User? Register Here' option

Step 4: If you have already obtained the customer ID and password from the bank, enter and proceed to login. Otherwise, click 'Next'

Step 5: Now, you will be required to fill a 'Self Registration Form'. Enter details such as account number, registered mobile number, email address, branch code, CIF number, debit card details, etc. After that, click on 'Submit'

Step 6: Authenticate your registration using a one-time password sent to your registered mobile number

Step 7: On the next screen, your temporary customer ID and password will be displayed

Step 8: Log-in using your temporary credentials. You need to create a new log-in password after logging in for the first time

Note: *Login and transaction password should be changed every 2 months to safeguard the net-banking account.*

Steps for Net Banking Login

After successful registration, you can follow the given steps to log into your net banking account-

1. Visit your bank's official net-banking website. (Make sure the URL of the website starts with 'https://'. This means that the URL is secure)
2. If you are a retail user, choose 'Personal Log-in'. If you are a corporate user, choose 'Corporate Log-in'
3. Now, on the next screen, enter your customer ID and password
4. Enter Captcha and click on 'Login'
5. Your Net Banking dashboard will be displayed on the next screen

Types of Fund Transfers available on Net Banking

Net-banking allows the transfer of funds from one account to another through three different ways- NEFT, RTGS and IMPS. Let us understand these three methods in details-

NEFT

National Electronic Fund Transfer (NEFT) is one of the most commonly used payment methods which enables one-to-one fund transfer. It is a time-restricted process at the bank, but available 24×7 on the net-banking portals. Generally, it takes about 30 minutes for the funds to be successfully transferred via NEFT. However, the time can even stretch to 2-3 hours.

RTGS

Real-Time Gross Settlement (RTGS) refers to a continuous settlement of funds individually on an order-by-order basis. This implies that the RTGS system ensures that the beneficiary's account is credited with the funds immediately. Transactions via RTGS are monitored by the RBI which suggests that successful transfers are irrevocable. This method is used to transfer a minimum of Rs.2 lakh. Just like NEFT, RTGS is also a time-restricted service at the bank, but accessible 24×7 via net-banking.

IMPS

Immediate Payment System (IMPS) also deals in the real-time transfer of funds. It is most commonly used to transfer funds instantly within banks across India via mobile, internet and ATM. One can transfer funds via IMPS just with the mobile number of the beneficiary.

What is E-Banking

E-banking or Electronic Banking refers to all the forms of banking services and transactions performed through electronic means. It allows individuals, institutions and businesses to access their accounts, transact business, or obtain information on various financial products and services via a public or private network, including the internet.

Popular Types of e-banking Services in India

- **Internet Banking:**It is the type of electronic banking service which enables customers to perform several financial and non-financial transactions via the internet. With internet or online banking or net-banking, customers can transfer funds to another bank account, check account balance, view bank statements, pay utility bills, and much more

- **Mobile Banking:** This electronic banking system enables customers to perform financial and non-financial transactions via mobile phone. Most of the banks have launched their mobile banking applications available on Google Playstore and Apple App Store. Just like the net-banking portal, customers can use the mobile application to access banking services.
- **ATM:** Automated Teller Machines (ATM) is one of the most popular types of e-banking. ATMs allow customers to withdraw funds, deposit money, change Debit Card PIN, and other banking services. To make use of an ATM, the user must have a password. Banks charge a nominal fee from the customers on every transaction made after crossing the specified limit of free transactions if the transaction is done from any other bank's ATM.
- **Debit Cards:** Almost every person owns a debit card. This card is connected to your bank account and you can go cashless with this card. You can use your debit card for all types of transactions, the transaction amount is debited from your account instantly
- **Deposit and Withdraws (Direct):** This service under e-banking offers the customer a facility to approve paychecks regularly to the account. The customer can give the bank an authority to deduct funds from his/her account to pay bills, instalments of any kind, insurance payments, and many more
- **Pay by Phone Systems:**This service allows the customer to contact his/her bank to request them for any bill payment or to transfer funds to some other account
- **Point-of-Sale Transfer Terminals:**This service allows customers to pay for the purchase through a debit/credit card instantly

Services Provided through E-banking in India

Telephone Banking	ATMs (Automated Teller Machine)
Electronic Clearing Cards	Mobile Banking
Door-step Banking	Bill Payment
Shopping	Smart Cards
Funds Transfer	Internet Banking
Electronic Funds Transfer System	Electronic Clearing Service

Telebanking	Investing
Fixed Deposits	Insurance

Comparison Between Net Banking and E-Banking

Internet banking and electronic banking are often confused with each other. Let us compare the two for better understanding:

Particulars	Internet Banking	E-Banking
Definition	Internet banking or online banking or net-banking is a digital system which enables customers of a bank or a financial institution to make financial or non-financial transactions online via the internet. On the other hand, E-banking or Electronic Banking refers to all the forms of banking services and transactions performed through electronic means.	Electronic banking or E-banking is a broad category of accessing banking services via electronic means, whereas Internet banking is a part or type of electronic banking. It is also known as electronic funds transfer (EFT) and uses electronic means to transfer funds directly from one account to another.
Types of Services	With internet banking, customers can obtain every banking service, traditionally available through a local branch including fund transfers, deposits, and online bill payments to the customers.	Electronic banking includes various transaction services such as internet banking, mobile banking, telebanking, ATMs, debit cards, and credit cards. Internet banking is one of the latest additions to electronic banking.

How to Transfer Funds via Net Banking

The process of transferring funds via net-banking is mostly the same for the banks. Here is a simple step-by-step guide to transferring funds online via net-banking:

Step 1: Use your customer ID and password to log-in to your bank's official net-banking portal

Step 2: Navigate to the 'Transfer Funds' option and select the method of transfer – NEFT, RTGS, or IMPS. If you are selecting NEFT, you need to make sure that the beneficiary's bank is NEFT enabled
Step 3: Select the beneficiary. If you haven't already added the beneficiary, click on 'Add Beneficiary'
Step 4: Enter the beneficiary's name, account number, IFSC, and bank's branch name. Click 'Submit & Save' to add the beneficiary to your list
Step 5: Enter the amount which you wish to transfer
Step 6: Authenticate the process by entering the one-time password sent to your mobile number
Step 7: Click 'Confirm & Send'. The money will be transferred to the beneficiary's account
How to Make Credit Card Bill Payments via Net Banking

Net Banking is one of the most convenient, safest and secure ways of paying your credit card bills. There is no additional fee like a service or transaction fee charged while making bill payments via internet banking. Moreover, net-banking has been embedded with extra security measures to make the transactions secure. Here is how you can make credit card payments via Net Banking-

Step 1: Log-in to your credit card provider's website

Step 2: Click on 'Pay your Credit Card bill' option

Step 3: Enter your credit card details such as credit card number, email address, and the payment amount

Step 4: You will be redirected to the payment gateway. Select the 'Net Banking' option and the choose the bank account from which you want to make the payment

Step 5: On the next screen, you will be redirected to your bank's payment interface

Step 6: Enter your customer ID and password. Authenticate the transaction by entering the one-time password received on your mobile number

Step 7: Click 'Confirm'. Your bank account will be debited with the amount which you have entered for bill payment. After a successful transaction, you will receive a confirmation message via SMS and email

Important: *Make sure that the URL of your bank's payment gateway starts with 'https://' which indicates that you are using a secure website.*

Bank Specific Net Banking Portals

Given below is a list of the popular public as well as private banks with a dedicated net-banking website for the customers.

HDFC Net Banking	SBI Net Banking	Canara Bank Net Banking
Bank of Baroda Net Banking	Indian Bank Net Banking	Axis Bank Net Banking
Bank of India Net Banking	Standard Chartered Net Banking	IDBI Net Banking
UCO Bank Net Banking	Bandhan Bank Net Banking	Bank of Maharashtra Net Banking
Karnataka Bank Net Banking	Union Bank Net Banking	Tamilnad Bank Net Banking

Advantages of Net Baking

Given below are some advantages/benefits of internet banking available for all the users-

- **24×7 Availability:**Availability of banking services is time-restricted at the bank. However, net-banking caters to customer's banking requirements 24×7. One can access any banking service at any time, from anywhere via net Now, customers need not visit the bank to access banking services as everything is within a click's reach.
- **Convenient Financial Transactions:** Financial transactions such as fund transfer, bill payments, recharges, etc. are the most used services on net-banking. This is because net-banking has made the entire process of payments very easy. Such transactions can easily be performed anytime as per the convenience of the user.
- **Organized Statements and Transaction History:**Keeping a track of the transaction and bank balance was so complicated before net-banking came into action. Customers

had to visit the bank, stand in queues to update the passbook and check details. Nonetheless, with internet banking, it has become very easy to track historical transactions and outstanding balance. Transactions and fund transfers made via net-banking are organized in the 'Transaction History' section along with other details such as payee's name, bank account number, the amount paid, the date and time of payment, and remarks.

- **Secure Banking System:**Your net-banking account as well as financial transactions are secured with log-in and transaction password. Some bank's net-banking portals use two-factor authentication to secure the account. Ergo, internet banking is a secure payment system for customers.
- **Access to Other Services:**Besides fund transfer, net-banking enables customers to use non-financial services such as balance check, requesting demand draft, issuance of cheque books, applying for a personal loan, tax payment, open FD/RD deposits, start investments, check mortgages, manage a trading account, and more.

5.13 RTGS

The full form of RTGS is **Real Time Gross Settlement,** it is a money transfer process that is performed in real-time and without delays. RTGS requires Net Payment which implies that activities are carried out at an individual level without delay and not in batch-wise process. RTGS is one of the fastest methods of transferring Interbank funds via online banking in India. Transfer of the funds takes place between the two accounts in 30 minutes. While transferring money using RTGS method the following information is required

- The amount of money which is to be transferred
- Name of recipient and payee
- Name of payee and recipient bank
- Payee/beneficiary bank IFSC code
- Payee/beneficiary bank account number

The RTGS money transfer method is operated by the Indian Reserve Bank and thus it is one of the famous and safe methods of transfer of funds.

Advantages of RTGS

RTGS is a common approach of transfer of funds in India, with a variety of features. The advantages of using RTGS as the procedure for money transfers are:

- Reserve Bank of India maintains the RTGS system, which is a secure and safe method of funding.
- There is no room for lag since activities are carried out on a real-time basis.
- The use of RTGS in India is without geographical boundaries.
- Fund transfer is very convenient and can be done from the office or home.

RTGS Timing And Limit

RTGS Timing	Monday to Saturday(Leave on 2nd and 4th Saturday) – 8.00 to 4.30 am
RTGS Limit	Minimum 2 lakhs to no upper ceiling limit.

Difference Between RTGS And NEFT

RTGS refers to Real-Time Gross Settlement. Under this scheme, the beneficiary bank provides direct instructions for the transfer. The payment is gross, so each transaction is performed individually. These payments are final, and can not be withdrawn.

The main difference between NEFT and RTGS is that, unlike RTGS, the movement of funds occurs in batches. Hourly intervals are fixed for this reason, and the settlement is assigned to one such time slot.

5.14 NEFT

The full form of NEFT is the **National Electronic Fund Transfer.** Banking has become an important part of our daily lives. Since the time it became online, a number of our activities have been easy to manage. You don't have to go to the bank and wait in long lines for money transfer like before. You no longer have to fill up cheques, withdrawal forms, and chaplains. NEFT is one of the online money transfer methods which are currently in use.

NEFT is a centralized nationwide payment method owned and controlled by the Reserve Bank of India (RBI). It easily transfers money between banks across India. A bank branch should be NEFT enabled to permit a customer to transfer the funds to another party.

Some of the points to be considered while transferring money through NEFT.

- NEFT transaction timing on weekdays from 9.00 am to 7.00 pm and Saturday 9.00 am to 1.00 pm.
- There is no transaction limit, but Rs.50,000 is per transaction limit.

National Electronic Fund Transfer Process

When individual wishes to transfer an amount of money from his bank account to another person's bank account, he may do so through the NEFT process rather than withdrawing the money and then paying it in cash or by issuing a cheque. NEFT has the primary benefit that it can transfer funds from any branch account to any other bank account at any given venue. The only condition is that both the sender and the recipient branches are NEFT-enabled. On the RBI website, you can check the list of NEFT-enabled bank branches, or call your bank's customer service to confirm the same. The NEFT process also allows for cross-border, one-

way movement of funds from India to Nepal under the Indo-Nepal Remittance Facility Scheme.

Steps To Follow To Transfer Money Through NEFT

The Bank IFSC Code, along with other information such as account holder name, bank account number, bank branch and additional information, is a must for authorizing an NEFT transfer.

- Step 1-Use your user ID and password to sign in to your online banking account.
- Step 2-Go to NEFT Fund Transfer page.
- Step 3- Enter recipient name, bank account number and IFSC code.
- Step 4-You should initiate an NEFT transfer once the beneficiary is successfully connected. Enter the amount to be transferred and click the send button.

Advantages of NEFT System

- There is no need for the physical presence of any party to perform a transaction.
- No bank visit is required, as long as an individual is keeping a valid bank account.
- NEFT is efficient and straightforward. It can be done in less than a minute, and hardly involves any significant formality.
- Confirmation of a successful transaction can be viewed easily via email notifications and text messages.

Difference Between NEFT And RTGS

RTGS refers to Real-Time Gross Settlement. Under this scheme, the beneficiary bank provides direct instructions for the transfer. The payment is gross, so each transaction is performed individually. These payments are final, and can not be withdrawn.

The main difference between NEFT and RTGS is that, unlike RTGS, the movement of funds occurs in batches. Hourly intervals are fixed for this reason, and the settlement is assigned to one such time slot.

5.15 Unit End Questions

A. Descriptive Questions

Short questions

1. What precautions should be taken while using net banking?
2. What is the fee charged for availing net banking facility?
3. How do I connect to a netbanking account?
4. Define bank pass book.
5. Discuss about cheque dishonoured.

Long questions

1. Describe cheque presentment and cheque dishonored.
2. Describe negotiable instruments.
3. Explain internet banking in detail.
4. Discuss about RTGS AND NEFT.
5. Describe current account.

B . Multiple Choice Questions

1. Current account deposits are;

   a. Non repayable
   b. Non repayable on demand
   c. Repayable on demand
   d. None of these

2. What is Repo Rate?

   a. Rate at which RBI allows temporary loan facilities to commercial banks against government securities only on the condition that the bank will repurchase the securities within a short period.
   b. Rate offered by banks to their prime customers.
   c. When any bank has excess cash, securities are bought from RBI against cash with the condition that they will resell the securities to RBI on a pre fixed day and price.
   d. When a bank is in need of cash it can discount bills of exchange and avail loan facilities from Reserve Bank of India.

Q3. Which is the first commercial bank incorporated by the Indians in 1881?

a. Imperial Bank Of India
b. Awadh Commercial Bank
c. Reserve Bank Of India
d. State Bank Of India

Q4.By performing open market operation transactions, RBI regulates which of these factors

a. Borrowing power of the commercial banks
b. Inflation
c. Money supply in the economy
d. Both B & C

Q.5 When RBI increases the cash reserve ratio (CRR), it will

a. Decrease money supply in the economy
b. Increase money supply in the economy
c. Increase supply initially but decrease automatically later on.
d. No impact on money supply in the economy

Answer: 1. C, 2. A, 3. B, 4. D, 5. A

5.16 REFERENCES

Reference Books:

- "Banking Law and Practice" by P. N. Varshney
- "Indian Financial System" by M. Y. Khan
- "Modern Banking: Theory and Practice" by Natarajan
- "Bank Management and Financial Services" by Peter S. Rose

Web Resources:

- Reserve Bank of India (RBI): https://www.rbi.org.in/
- Indian Banks' Association (IBA): https://www.iba.org.in/
- National Electronic Funds Transfer (NEFT) - RBI: https://www.rbi.org.in/Scripts/FAQView.aspx?Id=60

- Real Time Gross Settlement (RTGS) - RBI: https://www.rbi.org.in/Scripts/FAQView.aspx?Id=62
- OnlineSBI (SBI's Internet Banking): https://www.onlinesbi.com/