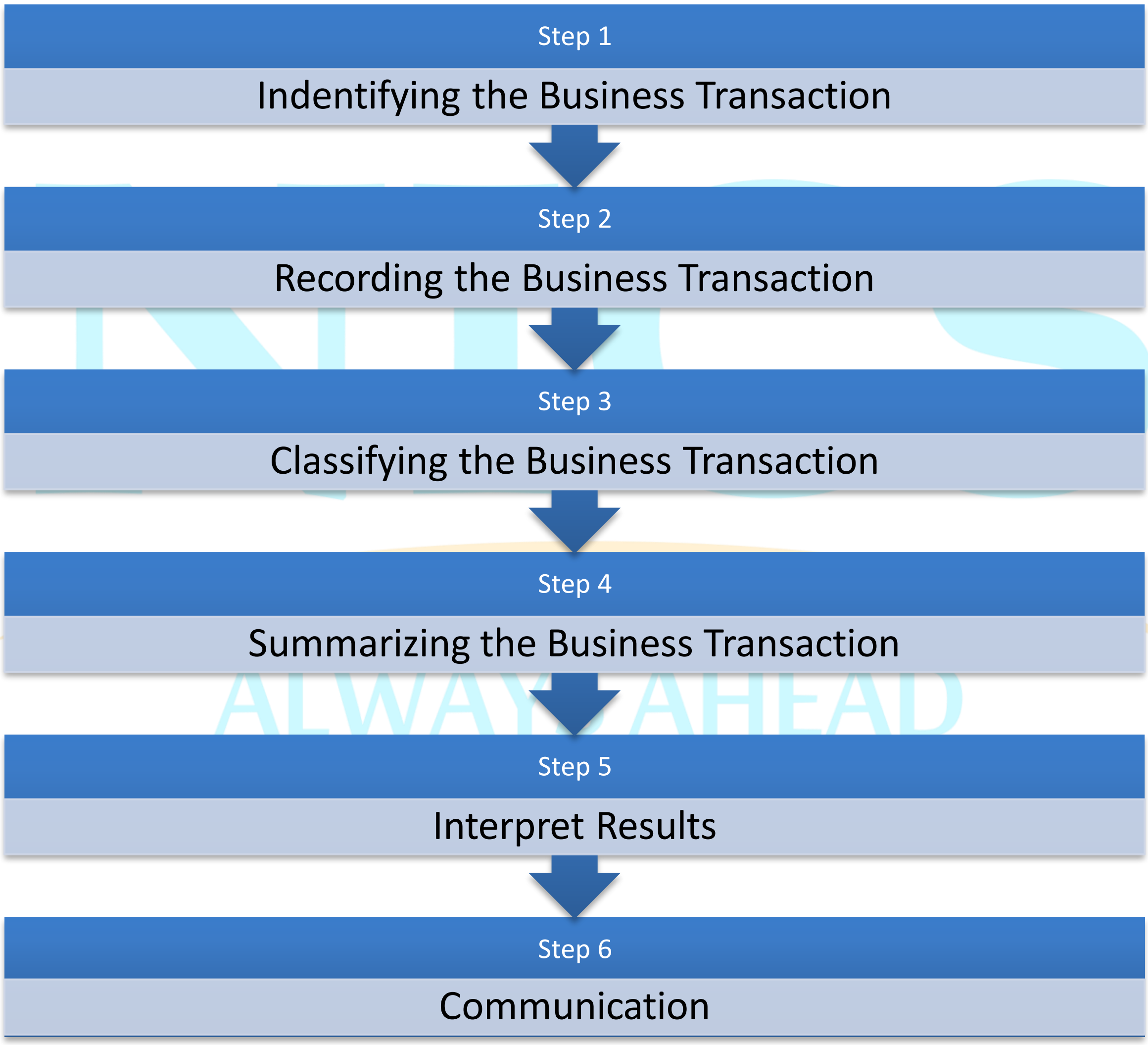
CHAPTER-1

Introduction to Accounting

The aim of the every business organization is to earn maximum profit and every businessman is interested in ascertaining the profit or loss from his business during a particular period of time. He is also interested in knowing the financial position of the business. This necessitated the use of accounting in business.

Accounting is the process of recording, classifying, summarizing, analyzing and interpreting the financial transaction and communicating the results thereof to the persons interested in such information.

ACCOUTING PROCESS:



Functions of Accounting

The following are the main functions of accounting.

1. **RECORDING**
   The main function of accounting is to identify business transactions and record them in appropriate books of accounting in a systematic manner, Recording is originally done in a book called 'Journal'.
2. **CLASSIFYING**
   It is the process of grouping of entries of similar nature in one place. The classification is done in a book called 'Legder'. In ledger financial transactions of similar nature are grouping under an 'Account'.
3. **SUMMARISING**
   Summarizing is the process of presenting the classified date in a manner understandable to the users like managers, bankers, creditors, etc. It involves the preparation of Profit and Loss account and Balance Sheet.
4. **ANALYSIS AND INTERPERTATION**
   The result of financial statements like profit and loss account and balance sheet are analyzed in such way that the users can make a meaningful conclusion about the financial position of the business.
5. **COMMUNICATION**
   The accounting information is to be communicated in a proper from to the persons interested in appropriate time.

Basic Terms used in Accounting

The basic items which are widely used in accounting are explained below.

1. **Assets**
   The valuable things or properties owned by the business are called assets. Assets are broadly classified into fixed assets and current assets.
   a) **Fixed assets**
      Assets which are acquired for long-term use in the business are called fixed assets. Examples Land and building, machinery, furniture etc.
   b) **Current assets**
      Assets which are held for short period are called current assets. Example stock, debtors, cash in hand, cash at bank etc.

2. **Liabilities**
   Liabilities are obligation or debts payable by the enterprise in future in the form of money or goods. Liabilities can be classified as short-term liabilities and long-term liabilities.
   a) **Short-term(current) liabilities**
      These are liabilities which become due and payable with in a period of one year. Example creditors, Bills payable, outstanding expenses etc.
   b) **Long-term liabilities**
      These are liabilities which are payable after a long period. Debentures, long term loans etc. are examples of long-term liabilities.
3. **Capital**
   Capital is the money which is invested in the business by the owners. It is the of assets over liabilities.
4. **Revenue**

These are the amounts earned by a business concern by selling its products or rendering services to its customers. The common items of revenue are sales, commission received, rent received etc.

5. **Expenses**

   Expenses are the amount spent in the process of earning income. Expenses can be classified into capital expenditure and revenue expenditure.

   a) **Capital Expenditure**

      It is amount spent for acquiring fixed assets or for increasing the earning capacity of a business. Amount spent for acquiring land, building, machinery etc, are examples of capital expenditure.

   b) **Revenue Expenditure**

      These are expenditure for which the benefit last for a period up to one year. Examples payment of salary, rent, and telephone charges etc.

6. **Purchase**

   The total amount of goods purchased by a business concern for cash or on credit for the purpose of sale or use in business is known as purchases.

7. **Sale**

   It is the amount realized from the sale of goods or services rendered. Sales may be cash and credit sales.

8. **Stock**

   The goods available with the business for sale on a particular date termed as stock. The values of goods remaining unsold at the end of an accounting period is termed as closing stock and at the beginning of an accounting period is termed as opening stock.

9. **Debtors**

   Debtors are persons who own money to the business for goods sold on credit. Debtors are also referred to as accounts payables.

10. **Creditors**

    Creditors are persons who have claim for money against the business for goods supplied on credit. Creditors are also referred to as accounts payables.

11. **Drawings**

    Drawings are withdrawals of goods or cash from the business by the proprietor for personal use.

12. **Business Transaction**

    A business transaction is a dealing which has an impact on the business. A transaction may be either cash or credit. If a transaction involves immediate receipt or payment of money, it is called cash transaction. If payment is postponed to a future date, it is called credit transaction.

ACCOUNTING PRINCIPLES

The rules and guidelines used in preparing accounting reports both internal and external are termed as Generally Accepted Accounting Principles (GAAP). It consists of accounting concepts and conventions.

Accounting Concepts or Assumption

Accounting concepts refers to certain necessary assumptions or conditions on which the accounting system is based. The important concepts are:-

1. **Accounting entity concept**
   According to this concept business is treated as a separate entity apart from its owner.
2. **Going Concern Concept**
   As pet this concept business unit is assumed to have an indefinite life. Therefore, the firm is treated as a going concern.
3. **Money Measurement Concept**
   This concept states that transaction that can be measured in terms of money only are recorded in the books of accounts.
4. **Accounting Period Concept**
   According to this concept a period of one year is considered as a fair interval for ascertaining the result of business.

RECORDING OF TRANSACTIONS

Transactions are recorded in the books of accounts using double entry principles i.e. every debit have corresponding credit. For recording transactions relevant data are collected from sources documents like invoices, vouchers, receipts. The rules for recording transactions are described below.

TRADITIONAL OR ENGLISH APPROACH

In the conventional approach accounts are classified into three. They are:-

1. Personal Accounts
2. Real Accounts
3. Nominal Accounts

1. **PERSONAL ACCOUNTS**
   Personal accounts are accounts of persons, firms or companies with whom the business deals. Example Anil's Account, A Ltd Accounts etc.
2. **REAL ACCOUNTS**
   Real accounts are accounts of assets or properties. Example cash account, Furniture accounts, building account, Goodwill account etc.
3. **NOMINAL ACCOUNTS**
   These are accounts related to all expenses, income, losses and gains. Example- salary account, rent account, commission account etc.

RULES OF ACCOUTING

The rules for debit and credit of various accounts are-

1. **Personal Accounts**

Debit the Receiver Credit the Giver

2. **Real Accounts**

Debit what Comes in Credit what Goes out

3. **Nominal Accounts**

Debit all Expenses and Losses Credit all Incomes and Gains

DOUBLE ENTRY SYSTEM OF BOOK KEEPING

Business transactions are recorded in the books of accounts in the basis of double entry system. According to this system both the aspects of a transaction i.e. debit aspect and the credit aspect are recorded in the books of accounts. This helps in preparing Trail Balance, Trading and Profit and Loss account and Balance Sheet.

TREATMENT OF DISCOUNT

Discount is reduction allowed on selling price of goods or on the amount die. There are two types of discounts :-

1. **TRADE DISCOUNT**
   It is a deduction from the list price of goods. Trade discount is deducted from the invoice from the list price and the net amount only is recorded in the books of accounts. No separate journal entry is required to record trade discount.
2. **CASH DISCOUNT**
   It is a reduction allowed by creditors to debtors usually on making prompt payment.

OPENING ENTRY

The journal entry passed for bringing the assets and liabilities of a running business form the previous year to the current year is called an opening entry. Here the opening balances of all assets are debited and all liabilities are credited. The excess of assets over liabilities is the proprietors' capital and is credited to his capital account.

LEDGER

A ledger is the most important book in an organization. It may be in the form of bound register or cards or separate sheets may be maintained in a loose leaf binder. A ledger is defined as a collection of all the accounts debited or credited in the general journal. It contains a summarized record of all the transactions of the period.

POSTER
Posting is the process of transferring entries from journal to the ledger. In other words, it is the grouping of all the transactions in respect of one particular account at one place for further accounting process.

TRIAL BALANCE
The Trail Balance is a statement showing the balance of all ledger account. It is prepared to know the arithmetical accuracy of ledger accounts. If total of the debit balances is equal the total of credit balances, it is presumed that there is no mistake and balancing.

SUB-DIVISIONAL OF JOURNAL

CASH BOOK

It is an important book maintained in all organization. It serves the purpose of both a journal and a ledger account. Cash book is used to record all transaction relating to cash receipts and cash payments. The different types of cash book are:-

A. **Single Column Cash Book**
B. **Double Column Cash Book**
C. **Three Column Cash Book**
D. **Petty Cash Book**

A. Single Column Cash Book or Simple Cash Book

A Cash book which contains only one column of amount on each side is called Single Column Cash Book. All Cash receipts are recorded on the CR and all cash payment are recorded on the DR side. Transactions by cheques are also treated as equivalent to cash transactions and are entered in the single column cash book.

B. Double Column Cash Book (Cash and Bank Columns)

A Cash book which contains two columns of amount on each side. One column for cash and another column for bank is called double column cash book. All payments into the bank recorded in. The bank column on the debit side and all withdrawals from the bank are recorded in the bank column on the credit side.

Contra Entries

There are certain transactions which come both on the debit side and credit side of the cash book. Deposit of cash and cheque into the bank and withdrawal of cash from bank for business use are such transaction. The entries that affect the debit and credit sides of the cash book are called contra entries.

C. Three Column Cash Book (Discount, Cash and Bank Columns)

A three column cash book contains three amount columns on each side i.e. discount, cash and bank columns. The discount column is for recording discount allowed and received, cash column for recording cash receipts and payments and bank column for recording deposits and withdrawals from bank.

D. Petty Cash Book

In every business organization, there are large numbers of small payments repetitive nature such as Postage, Stationary, Carriage etc are made. If all these payments are handled by the main cashier and are recorded in the main cash book, it will consume a lot of his valuable time. To avoid this petty cashier is entrusted with the duty of marking small payments. The book maintained by petty cashier to record such payments are called petty cash book.

BANK RECONCILATION STATEMENT

Bank reconciliation statement is a statement prepared to know flee causes of difference between the balance as per cash book and bank passbook on a particular date. The bank reconciliation statements have great importance in the present day business because most of the business transactions are settled through bank. The firm maintains a cash book and the bank maintains a pass book to record these transactions. Both these books should show the same balance. Bit in actual practice the balance shown in the cash book is different from that of the pass book. Therefore, a bank reconciliation statement is prepared to know the reasons for difference.

Causes of difference between the Balance of cash book and Pass book

1. **Cheques issued but not yet presented for payment**
   When a Cheque issued it is immediately recorded in the cash book. But the same will be recorded in the pass book only when it is actually presented in the bank for payment. If accounts are closed before presentation of cheque to the bank, there will be difference between the balance as per cash book and bank pass book.

2. **Cheques paid into the bank but not yet collected**
   When a cheque is deposited into the bank for collection, it will be recorded immediately in the cash book. But the bank will credit the amount only when the cheque is collected. If accounts are closed in the intervening period there will be difference between these two balances.

3. **Direct payment by a customer to the bank**
   When a customer makes payment directly to the bank account of the trader, it will be immediately credited in his pass book. If it remains unrecorded in the cash book, the balance as per pass book will be more than the balance as per cash book.

4. **Interest credited by the bank**
   Bank allows interest on the deposit and credits the amount in the pass book. But the same is usually remains unrecorded in the cash book. In such a case, the pass book balance will be more than the cash book balance.

5. **Interest and expenses charged by the bank**
   Interest on overdraft, bank charges etc debited in the pass book are not immediately recorded in the cash book. As these items are not entered in the cash book, its balance will be more than the balance of the pass book.

6. **Payment made on behalf of the customer**
   The bank makes payment of rent, insurance etc on behalf of the customers as per standing instructions. It will be recoded immediately in the pass book. But it will remain unrecorded in the cash book. Due to his the balance as per pass book will be less than balance as per cash book.

7. **Errors and Omissions**
   An error or omission on the part of the customer or banker will cause a difference between the bank balance shown by the cash book and the balance shown by the bank pass book.

TRIAL BALANCE AND ERRORS

The trial balance is a statement showing the balances of all the accounts in the ledger. If the total of the debit amount column is equal to the total of credit amount column, it is presumed that posting to the ledger is accurate. The trail balance can be prepared at any time but it is usually prepared at the close of the accounting year. The objectives of preparing trial balance are:-

1. To ascertain the arithmetical accuracy of the ledger accounts.
2. To helps in locating errors.
3. To helps in the preparation of final accounts.

ERRORS

Mistakes that are made unknowingly while recording transaction in books of accounts are called errors. Some errors may affect the agreement of trail balance while some others may not affect agreement of trail balance. On the basis of nature errors are classified into the following categories.

1. Errors of Commission
2. Errors of Omission
3. Errors of Principle
4. Compensating Errors

1. **ERRORS OF COMMISSION**
   These are errors caused on due to incorrect recording of transaction like wrong posting, wrong totaling, wrong balancing etc. These errors are reflected in the trail balance and therefore, they are easy to locate.
2. **ERRORS OF OMISSION**
   These are errors caused due to non-recording of transactions in the books original entry or posting to the ledger. The errors of omission may or may not affect agreement of Trail Balance, if an item completely omitted to record it will not affect the agreement of Trail Balance, while it is partially omitted to record it will affect the agreement of Trial Balance.
3. **ERRORS OF PRINCIPLE**
   Errors of Principle are committed when the accounting principle relating to proper distinction between capital and revenue items are violated while recording transactions in the books of account. These errors may not affect the agreement of Trail Balance.

4. **COMPENSATING ERRORS**
   When two or more errors committed in such a way that the net effect of these errors on the debits area credits of accounts is nil, such errors are called compensating errors. These errors also do not affect the agreement of Trail Balance.

FINANCIAL STATEMENT

The main objective of accounting is to ascertain the profit and loss of a business and to disclose its financial position. In order to ascertain the profit and loss trading and profit and loss account is prepared, while balance sheet is prepared to disclose the financial statement and balance sheet is otherwise called as Position statement. Both these statements are collectively called as financial statements or final accounts. The final accounts of a trading concern consist of :-

1. **TRADING ACCOUNT**
2. **PROFIT AND LOSS ACCOUNT**
3. **BALANCE SHEET**

TRADING ACCOUNT
Trading account is prepared to ascertain the gross profit or loss of a business concern. It is prepared by debiting opening stock, purchases and all direct expenses and by crediting sales and closing stock. The difference is either gross profit or gross loss. The direct expenses include

a. Carriage, Cartage and Freight on purchases (inwards)
b. Wages
c. Customs and Import duty
d. Gas, Water, Electricity, Fuel, Power etc
e. Cost of primary packing materials
f. Consumable stores like cotton waste, grease, engine oil etc.
g. Factory expenses like Factory rent, Factory insurance, Factory lighting, Heating etc.

BALANCE SHEET
A Balance sheet is a statement, which is prepared to show the financial position of a business on a particular date. It is usually prepared at the end of the accounting period after preparing trading and profit and loss account. There are two sides of Balance Sheet i.e. Asset side and liability side. Items of assets are shown in the asset side and items of liabilities are shown on the liability side of balance sheet.

Trade Discount / Cash Discount

1) Trade discount is issued by deduction in list price.
   Cash discount is issued by deduction in payable amount of debtors.

2) Trade discount is issued by deduction in payable amount of debtors.
   Cash discount is given with the aim to get payment fastly and before payment date.

3) Trade discount is shown as deduction in Invoice.
   Cash discount is not shown as deduction in Invoice.

4) There is no any accounting treatment for trade discount.
   There is accounting treatment for cash discount both in vendor and buyer's day book.

5) Trade discount is related to quantity of the goods purchased.
   Cash discount is related to the amount of payment but not to quantity of goods.

6) There is no need to give cash discount with trade discount.
   If seller has given trade discount, cash discount can be given after trade discount.

Basis of difference	Trade Discount	Cash Discount
Meaning	It is allowed when goods are purchase or sold.	It is allowed at the time of payment.
Recording in books	It is recorded in invoice/bill but not in the books.	It is recorded in the discount column of the Cash book's debit side, if allowed, and credit side, if received.
Purpose	It is allowed to increase sale.	It is allowed for earlier payment.
Deduction	It is deducted from the price-list of the goods.	It is not deducted from the price list of the goods.

INTRODUCTION TO TAXATION

Indian Tax Structure

India is well developed country, which also has well developed tax structure. Taxation in India is done through two federal bodies, that is, the state Government and the central Government. The authority of imposing taxes is distributed between these two bodies. These governing bodies implement taxes according to the provision laid by the constitution of India. The main taxes that the central government imposes are income tax, custom duties, central excise, sales tax and service tax. The taxes that the state government imposes are stamp duty, state excise, land revenue and entertainment law.

In India, since 1991, the tax system has been under going a radical change. The taxation structure is divided into two categories:

- Direct taxes
- Indirect taxes

Direct Taxes

Direct taxes are the taxes that levied on the income and resources of individual or organization. Normally, they are levied on wealth or income through income tax, corporate tax, capital gains tax, and inheritance tax.

Indirect Taxes

Indirect taxes are the taxes that are collected by an intermediary body from a person who put up with the ultimate economic burden of the tax, such as a consumer or a customer. This tax is not imposed on any person or organization. Rather, it is levied on goods or services. Indirect taxes include taxes such as sales tax, value added tax, service tax, entertainment tax, fringe benefits tax and food tax.

Sales Tax

Sales tax is a tax charged at the point of purchase for certain goods and services. It is an important source of revenue of the stated. It is levied on all sales of goods. It is the liability of the seller who recovers this form the buyers. Each state has its own sales tax act under which the sales tax is imposed at different rates. Retail organizations contend that such taxes discourage retail sales. The retailer generally sells the goods on fluctuating rates to gain the benefits and meet his liability. For example: if a retailer purchases a product of a Rs. 100 and the government has imposed tax of 4% on it, then the retailer has to pay Rs. 104 in total.

Service Tax

Service tax is an indirect tax imposed on specified services. It was introduced in India for the first time in 1994. It is imposed at an interest of 5% on commissions and brokerage fees charges by stock brokers, the gross amount of telephone bills, and premiums for non life insurance.

Entertainment Tax

Entertainment tax is a tax that is imposed on entertainment. In India, this tax is levied on entertainment services like movie tickets, commercial shows in large scale, and some private festival celebrations.

Value Added Tax

VAT stands for value added tax. It is a consumption tax that is assessed on the value added to goods and services. VAT is applied to all the commercial activities on the value the production and distribution of goods and the provision of services. We call it a consumption tax because it is borne by the consumer who is at the final stage of supply chain management system. It is a multistage tax, and is levied only on value added at each stage in supply chain management system.

VAT is an indirect tax, in which the tax is collected from someone who is not the one that actually bears the cost of the tax. VAT is charged as a tax burden that is actually visible at each and every stage in the supply chain management system.

Difference between VAT and Sales Tax

There are many differences between the VAT and Sales tax. Some of the differences are as follows:

- Sales tax is levied on the total value of the exchange but VAT is levied on the value added to the goods at each exchange.
- VAT is a multipoint tax where as sales tax is a single point tax.
- A current sales tax is levied on goods only but VAT is levied on goods and services both.
- In current sales tax, assessment is done by the department, but in VAT, assessments are done by dealers.
- In current sales tax, penalty for defaulter is not strict, but in VAT, penalty for defaulter is strict.
- Sales tax is imposed on retail only, but VAT is imposed every step of the inventory process. After discussing the difference between VAT and sales tax, let’s learn the features of VAT.

Features of VAT

There are various features of the VAT. Some of them are as follows:

- VAT is imposed on goods and services at four stages: import stage, manufacturing stage, whole sale stage, and retail stage.
- A uniform VAT rate of 15% is applicable for goods and services.
- A 15% VAT is applied to the business or industrial units whose annual turn over is of Rs. 2million and above.
- A 4% VAT is applied to the business or industrial units whose annual turn over is below of Rs. 2million.
- VAT is applied for all products and services with some exemption.

- VAT is payable at the time of supply of goods and services.
- Tax, which is paid on inputs, creditable against output tax, that is, tax charged on the sales.
- Export is exempted from Vat.
- According to the government notification, VAT returns are to be submitted on a monthly, quarterly or half yearly basis.

TDS

TDS means Tax Deducted at source. The concept of TDS was introduced in the Income Tax Act, 1961, with the objective of deducting the tax on an income, at the source of income. It is one of the methods of collecting Income Tax, Which ensures regular flow of revenue to the Government.

Example: Universal Infotech Is making the payment towards rent to the owner of the building, it is required to deduct the tax on the income (i.e. before payment to the owner), at the source of income.

What is excise duty?

An excise or excise tax (sometimes called an excise duty) is a type of tax charged on goods produced within the country (as opposed to customs duties, charged on goods from outside the country). It is a tax on the production or sale of a good. This tax is now known as the Central Value Added Tax (CENVAT).

Financial intermediation

Role of Bank as Financial Intermediaries

Banks in the process of financial intermediation also perform certain other functions which are very vital to the economy. Banks enjoy the benefit of being the only institutions through which money can be transferred from one person or organization to another person of organization and from one on place to another place. All other depend on banks and cannot work efficiently in their absence.

The services offered by banks as a financial intermediary are:

- Deposit services
- Loan or credit services

Deposit services provided by banks

- Deposit services relating to resident to resident individuals or domestic accounts

- Deposits services relating to non –resident individuals or NRIs (India citizens who work abroad for more than 180 days during a financial year either in whole or in part)

  The various products offered by bank within the deposit services

- Demand deposits:
- Savings Bank (SB) account
- Current Accounts (CAs)
- Foreign current account
- Term deposits:
- Fixed Deposit (FD) accounts
- Recurring Deposit (RD) accounts

Accounts SB

SB accounts enable the customers to temporarily store their surpluses, which are not immediately needed for use. By depositing such surpluses, the customers are able to earn interest and become entitled to certain banking services, such as collection of cheques, remittance facilities, Automated Teller Machine (ATM) or debit card, depending on the product features made available by the bank. With a view to reduce the dependence on bank branches for withdrawing money , obtaining mini statement of accounts, knowing balance or ordering for cheque books, all major banks have started offering ATM facility. RBI has also instructed banks that a customer of a bank can operate his or her account from ATMs of any bank subject to certain restrictions and need not go to the particular ATM of the bank in which he or she has an account.

The interest payable on SB accounts is presently 3.5 per cent per annum calculated On daily balance and is credited to the account of individual SB account holders once In a quarter or once in six months as the individual banks may deem fit. Generally, Trading and business organizations are prohibited from opening such accounts.

CAs

CAs are opened to meet the needs to meet the needs of business organization or People engaged in business. CAs can, therefore, be opened for an organization or Individual. The operations on these accounts are unrestricted, which enable the Account holders to route all their banking transactions. No restrictions are imposed On the number of withdrawals that can be made from these accounts.

Banks are required to maintain adequate liquidity at all times in case of CAs. Therefore, banks do not pay any interest on account balances maintained with them. Only a few specified organizations are entitled to receive interest on the balances held in CAs, such as Regional Rural Banks (RRBs) and District Rural Development Agency (DRDA).

FD ACCOUNTS

As the name suggests, Fixed Deposit (FD) accounts are opened with the banks for a

Certain period, as agreed upon at the time of make such deposits. Under such an Arrangement, banks can look forward to the deposits remaining with them for the Contracted period. Banker's obligation to repay such deposits would be deemed to arise only after the period for which the deposit was contracted.
The principal difference between demand deposits and Fds is that in FDs, the customer Cannot ask the bank to return the deposits by drawing a cheque on the account. Therefore, these deposits remain with the banks for longer periods and , consequently They earn higher of interest than the SB account. The rate of interest depends upon The period of the deposit.
The interests earned on FDs are subject to tax Deduction at Source (TDS), if the Amount of interest payable is Rs. 10,000 per annum or more.

RD ACCOUNTS

RD accounts are for the benefit of those who would like to save a fixed sum every month over a long period of one to five years. This enables the customers, at the end of the period, to have a reasonably large sum. It is equivalent to making FDs of say Rs. 500, every month in such a way that all the FDs will mature on the same date.

Deposits cannot be withdraw before the due date without penalty. Therefore , the rate of interest paid on RDs is usually the rate applicable to FDs for similar periods. A penalty is levied on the depositor if he or she defaults in making deposit in any month or withdraws the deposit prematurely. Further, the interest payable will also get reduced according to the period the deposit has stayed with the bank as per rate prevailing at the time of making the deposit.

Deposit services for resident customers:

Customers who are citizens of India and are staying in India can open can open all types of deposit accounts listed above.

Deposit Services for resident customers:

NRI are Indian citizens or Persons of Persons of Indian origin (PIO) or citizens of Indian origin who live abroad for employment, business, vocation, or when the duration of their stay abroad is uncertain.
A person is considered to be a PIO if that person if that person had , at any time, had an Indian passport or any of the person's parents or grandparents was an Indian citizen. The spouse of an Indian citizen is also treated as a PIO. However, the spouse can have a deposit account only jointly with the Indian citizen.
None of the facilities to NRI are available to citizens or residents of Pakistan and bangladdesh of residents of Nepal and Bhutan are , however, treated at par with Indian residents and they can have rupee accounts with Indian banks just any resident of India.

- Non Resident Ordinary Accounts: There are accounts ,such as CA, SB, FD, and RD in rupees.

- Non Resident External Accounts: There are , such as CA , SB ,FD ,and RD in rupees.
- Foreign Currency Accounts: There are FD accounts in foreign and currency.
- Resident Foreign Currency Accounts: There are accounts for NRIs to continue the balances in the NCNR and NRE accounts.

Non Resident Ordinary (NRO) Accounts

NRO accounts are for the local funds and income of the non-residents. On a person becoming a non-resident, the person's existing accounts are designated as NRO accounts , or he or she can open a fresh NRO accounts are meant for crediting income from local sources such as rent, interest or profit from business in India. Such current income credited to NRO accounts can be repatriated, subject to payment of relevant taxes.

When the account holder return to India for permanent residence, the account is redesigned as a local account. NRO accounts can be opened jointly with residents.

- **NRE Accounts**

Only non-residents can open NRE accounts. They can open both, single accounts or joint accounts. However, in case of joint accounts both or all the account holders must be non-residents. A resident cannot be a joint account holder in an NRE account.

All credits into an NRE account have to be from foreign inward remittances. When the Account holders visit India, they can also deposit foreign currency notes and travelers Cheques brought in by them.

Local funds cannot be deposited into NRE accounts except in the following cases:

  - Sale proceeds of shares or bonds, which are purchased with funds from the NRE account
  - Sale proceeds of real estate property purchased with funds from the NRE account

Individual and Joint Account

Individual Account

- An individual account:
  - Can be operated only by an individual or an organization.
  - Can be operated by some other person authorized by the account holder
- For an individual account, authorization can be given by any one of the following methods:
  - Legal mandate
  - Power of attorney
- Authorization valid until cancelled or as long as principal is alive

Joint Account

- A joint account is opened by two persons.
- Mode of operation:
  - Both jointly
  - Jointly or survivor
  - Either or survivor
  - Anyone or survivor
  - Former or survivor

Minors

- Minors are individuals who have not completed 18 years of age.
- Minors are represented by a natural guardian
- Natural guardians of minors
  - Hindus :Father and then mother
  - Muslims: father, executor of father's will, father's father, executor of father's father will

Banks as Constituent of the Payment System

Payment Services

The various products offered as a part of the payment service are:

- Cheques
- Pay order (PO)/ Banker's Cheque
- Demand Draft (DD)
- Multi-city cherubs
- Electronic Funds Transfer (Eft)
- Debit cards
- Credit cards
- Travel cards

Cheques

A cheque is a written instruction issued by a customer (drawer) to his or her bank (drawer) to pay a specified amount to the person named (payee) in the cheque. The Payee can collect the amount of the cheque in cash across the counter of the drawee bank or deposit the cheque with his or her bank for collection. If the cheque is crossed, by putting two lines on the left his top corner, it has to be necessarily collected through the bank .A crossed cheque cannot be encased across the counter. The payee can also give the cheque to a third party (transferee) in payment of his or her dues to the transferee. The payment of the cheque depends upon the drawer sufficient balance in his or her account. The drawer may also stop payment of the cheque by issuing appropriate stop payment instructions to bank. Therefore, there is no guarantee that a cheque will always be paid.

Pay orders (Po) /Banker's Cheque

The uncertainty associated with cheque payment makes it unacceptable to some entities, Such as government and institutions. For example, an application for admission to a government University has to be accompanied by a PO or Demand Draft (DD) towards the application fee. A PO or Banker's cheque is a cheque is sued by a bank on itself. Both the drawer and drawee is the same bank, in fact, the same branch of the bank, unlike the case of an ordinary cheque, where the drawer is the customer. A bank issues a Po after receipt of the money from the applicant. Hence, it is certain to be paid because no bank can afford to default on its promise to pay for fear of losing the trust of the public. Banks collect a fee for issuing PO.

DD (Demand Drafts)

A PO is generally used for making local payments as it is payable at the place where it is issued. DDs are used when payments have to be made to far places and the payee insists on certainty of the payment. DDs (like Pos) are cheque issued by a branch of a bank but are payable at a different branch. In other words, a DD is a cheque issued by one branch (drawee) of a bank and is payable at another branch (drawee) of the same bank. At times, banks, which do not have many branches, arrange with other banks to issue DDs on their branches by entering into correspondent relationship with them. Under correspondent relationship, arrangements are made by the Head office (HO) of the bank requesting for such a facility to reimburse the amount of to the bank paying the DD under the arrangement, along with a commission. This commission is according to the arrangements with the correspondent bank.

No bank will stop the payment of a DD issued by it except in case of fraud. Banks earn a Fee on DDs, in addition to enjoying cost free float funds before the DDs are encashed at the drawee's branch.

Multi-city Cheques

By definition are payable at the branch where the account is maintained. However banks, which are networked and have centralized computer system, are able to pay cheques of a branch at any other branch. Therefore, a cheque issued on a Varanasi branch can be paid at any branch of the bank as the entire database is in a computer at the bank's HO and accessing it from Varanasi or Chennai is no different Cheques, which are payable at any branch, are called multi-city cheques, and they have replaced DDs to some extent. Banks issue multi-city cheques only to select customers only to select customers with large value accounts because issuance of such cheques leads to a loss of commission income for the bank.

Electronic Fund Transfer

Sending or remitting money to distant places DDs involves a delay because the DD has to reach the payee either through post or courier. After receipt of the DD, the payee has to present it to the bank branch where it is payable and collect payment of the same .This also involves time. It is much faster for a bank to send an electronic instruction to their branch at the payee's centre to centre to pay him/her the amount. If the payee has an account with the paying bank, the bank payment can be made instantly by crediting his/her account.

Centralized computer systems enable transaction to be put through in any account from any place. The branch where the remittance is made will simply debit the account of the payer and credit the account of the payee with the amount involved. When the payment from one bank to another is settled instantaneously, the payment system is called the real time gross settlement (RTGS) system. The RBI, which is the settlement bank, operates RTGS.

Debit Card

A debit card is a substitute for cheques. It is a faster mode of withdrawing cash and of making payments to third parties. With the ATM becoming ubiquitous and providing 24 hours service, the utility of debit cards for withdrawing cash is immense. A customer can withdraw cash at his/her own convenience. The bank ensures security by giving a confidential Personal Identification Number (PIN) to the customer. The customer needs to enter the PIN in the machine at the time of withdrawing the cash.

A debit card can also be used to make payments at shops or restaurants where a point of Sale (POS) terminal is available. When a merchant swipes the card on the POS and enters the amount of the transaction, the transaction travels, as an electronic message to the bank, which has provided POS to the merchant. This bank, in turn, forwards it to the customer's bank through VISA or MasterCard.

Credit Card

Credit cards work the same way as debit cards and the process is exactly the same. The only difference is that the customer's credit card account is debited and not his savings account. The advantage of a credit card account is that the customer gets some time to pay back the amount to the bank.

However, if the amount due is not paid by the due is not paid by the due date, an interest is charged from the date of the transaction at rates. This rate of interest is fairly high. Banks are able to offer interest-free credit because on every transaction, they recover a fee from the merchant as in the case of the debit card, but at a higher rate. Credit cards can be used to withdraw cash from ATMs too. However, for every withdrawal, a fee is recovered. Further, interest is charged from the date of the transaction until the date of payment. In other words, there is no interest-free period for repayment of cash withdrawals made with credit cards.

Credit can be used for remittance too. Money can be transferred from one credit card to another credit card through the internet. However, not all banks offer this facility. Credit cards issued by banks in India can be used across the world. Payment will have to be made in Indian rupees only. Nowadays, credit card is extensively used for making payments for tasks, such as online shopping, utility payments. In order to prevent fraudulent use or misuse of credit cards, VISA and MasterCard International have come out with additional safety measures by introducing PIN numbers, which are in addition to transaction password of individual card holders. Further, safety of transactions is ensured through encryption and Card Verification Value Code (CVV) number on the reverse of the card near signature band.

Travel Card

A travel card can be said to be a prepaid debit card. A person who does not have a debit card or credit but would like the convenience of a debit or credit while travelling abroad can buy a travel card by paying a certain amount. He/she can then use the card just like a debit card to make purchases or withdraw cash from ATMs up to the amount paid by him/her and loaded on the card.

Other Services Provided by Banks

Banks as Providers of Other Services

The non- banking services provided by banks under the role of provider of financial services are:

- Distribution
- Collection of taxes & bills
- Dematerialized or Demat accounts
- Safekeeping
- Advisory services

Distribution

The third party products offered by banks within distribution service are:

- MF units
- Insurance polices
- Government bonds
- Gold coins
- Mobile phone recharge
- Share of organizations offering public issues

Mutual Fund Units

Investing in the shares of organization is rather tricky because nobody can predict the movement of share prices on the stock exchange. A lot of time and expertise is required to keep track of the fortunes of organizations. Individuals are best advised to take the help of focused investment professionals. MFs come to the rescue of such investors who are interested in investing in the capital market but do not have the time or experience needed to keep track of their investments.

MFs collect funds from investors, both individuals and others, & invest it in shares and bonds. Since investment is their only activity, they have the expertise to judge the strengths & weaknesses of individual organization & take rational investment or disinvestment decisions. MFs invest their pool of funds in a numbers of securities to diversify risk. They also track corporate action, such as payment of dividend & issue of bonus shares, & ensure that all amounts and benefits due from the organization are received. MFs also ensure liquidity by returning the investments of investors whenever they ask for it. Providing bank account number of investor is made mandatory so that dividend payments & redemption payments are credited directly to the bank account of the investor. This avoids fraudulent encashment of dividend or redemption proceeds.

Insurance Products

Life insurance organizations, in both the public & private sectors, have tied up with banks to offer their life insurance and savings products to the individual customer. Examples of such products are term policies, endowment policies, and unit- linked insurance policies. The process of banks offering insurance product is called bank assurance, & it has been a successful business model across the world. The benefits to the banks are the same as in the case of MF distribution.

Government Bonds

It was in 1999 that the government of India started using banks to mobilize funds from retail investors. Until then, government bonds were sold only by RBI. The banks were able to mobilize so much of funds that RBI stopped selling government bonds directly to the retail investors. The rate of interest paid on such bonds is more than what bank offers. So, individual investors find it a good investment option. Banks also service the bonds or arrange to pay the interest due on the bonds every half year & also the maturity proceeds as & when due. By selling & servicing these bonds, banks earn a commission and the goodwill of its customers.

Gold Coins

Banks are prohibited from trading in any commodity except gold. Initially, banks used to import gold for selling to jewellery makers only. Now, many banks offer this service to other retail customers also, and coins of 5 grams to 50 grams are sold by banks to individual customers. Because the coins are purchased in bulk, the banks get a good profit margin and customers are happy to get gold coins of assured purity. Banks also offer repurchase facility to individual customers.

Mobile Phone Recharge

Banks with the necessary technical capability offer mobile phone recharges (prepaid connection) through their ATMs & internet Banking facilities. This service has proved to be very popular and earns a good commission for the banks.

Shares of Organizations offering Public Issues

Organizations raise capital by issuing shares. They offer the shares to the investors through public issues. Organizations depend upon banks to reach to the retail investors. Banks, with their reach, are the only institution that can collect subscriptions to shares from every nook of corner of India. The organizations pay the banks a fee according to the number of applications and amount collected.

Collection of Taxes & Bills

Banks also provide various collection services. Collection facility is offered in case of:

- Taxes

- Utility bills
- Online payments

Taxes

Earlier, taxes payable to the central government & state governments could be paid only at the branches of the SBI & other public sector banks. Now, almost all the banks, including private sector banks, have been authorized to collect taxes on behalf of the government. Banks collect all taxes, such as income tax, sale tax, exercise duty, customs duty, and property tax. The amounts collected are remitted to RBI where government accounts are kept. To facilitate easy payment of taxes, banks are providing the facility of online payment of taxes through net banking.

Utility Bills

A great convenience offered by banks is accepting payment of utility bills, such as for electricity, telephone, mobile phone, and gas. In the process, banks earn a commission and also get to maintain the accounts of utility organization.

Online Payments

Many banks have come out with online payment facility for making payments in respect of monthly mobile, telephone, electricity, property tax, advance income tax, services tax, insurance premium, and investment in MFs. Using a bank's online banking facility. Similarly, customers can pay for online shopping, e- tickets of railway and airways can also be done through online payments either by direct debit to the customer account or by paying through credit card or debit card.