

BANKING TRANSACTIONS

So far we have assumed that all the business transactions are settled by the receipt and payment of actual cash. In actual practice, however, most of the business transactions are carried out with the help of banks and cheques. It is, therefore, necessary to understand how banking transactions are recorded in the books. But before doing so, one must know something about banking and cheques.

Definition: The word bank is said to be derived from the Italian word "banco" a bench. The early bankers, the Jews in Lombardy used to transact their business on benches in market places. The original meaning of the "Bank" as a commercial institution is identical with the bank of a ditch where the contents are piled up.

The Imperial Dictionary defines a bank as-- "an establishment which trades in money, an establishment for the deposit, custody and issue of money, and also for granting loans, discounting bills, and facilitating the transactions of remittances from one place to another".

A bank may be defined as an institution which purchases and sells money, and transacts other financial business of like nature.

Functions of a Bank. The functions of a bank may be discussed under three headings: (a) Primary Functions; (b) General Utility Functions; and (c) Agency Functions.

Primary Functions. The primary functions of a bank are to borrow money and to lend it. Banks borrow money in the shape of deposits and lend it in various ways.

General Utility Functions: Besides the above primary functions a bank also performs certain functions for the benefit of general public, which are called General Utility Functions. The more important of them are: (a) Issue of various important documents; (b) to finance the import and export trade of a country; (c) to keep valuable things and papers in safe custody.

Agency Functions: Banks also act as agents of their customers and render great service in that capacity: (a) Banks collect and pay cheques on behalf of their customers, (b) They realise interest and dividend on behalf of their customers; (c) They pay subscriptions

and insurance premiums on behalf of their customers: (d) They act as referees for their customers.

It is not necessary to describe in detail the so-called agency and general utility services. We will describe in brief the two most important functions of a bank - (1) Borrowing and (2) Lending of money.

The receipt of Deposits:

A commercial bank receives money on three accounts.

- (i) **Current Account.** In this case the customer is allowed to deposit or withdraw money as and when he likes. He may thus deposit or withdraw money several times in a day if he likes. Usually the businessmen open this type of account. No interest is allowed by first class banks on current account deposits but some banks do allow interest in case the balance does not fall below a certain minimum limit.
- (ii) **Saving Bank Account. (Profit and loss sharing Account.)** This account as its name suggests is for those persons who want to make small savings. In this case deposits can be made only up to a certain amount and withdrawals are allowed only twice or thrice a week, not exceeding a certain amount. This type of account is opened by small retailers or mostly by wage-earners and salary-earners. The rate of interest on this type of account depends on the amount of profit earned by the bank. It generally varies between 6 per cent to 9 percent per annum.
- (iii) **Fixed Deposit Account.** In this type of account a certain amount is deposited for a fixed period such as six months; one year or longer. The amount cannot be withdrawn till the expiration of fixed period. The interest allowed on fixed deposit varies with the period for which the deposit is made.

Distinction. The important points of distinction are presented below in a tabulated form:-

Sr. No.	Point of Distinction	Current Account	Deposit Account	Saving Bank Account
1.	Point of deposit.	No. fixed period.	Fixed period.	No. fixed period.
2.	Number of deposits	No limit to the number of deposits	Deposits can only be one.	No limit to the number of deposits.
3.	Time and number of withdrawals.	Can be made any time during business hours.	Can be made only after the expiry of the fixed period.	Can be made once or twice a week.
4.	Rate of interest.	No interest.	A high rate of interest.	Small rate of interest
5.	Operation	Normally operated by cheques.	No cheques are used.	Cheques are normal, used.

2. Granting Advances or Loans:

The commercial banks lend money in any one or more of the following ways.

- (a) **Overdrafts:** In this case a customer is authorised to borrow (overdraw) up to an agreed amount in excess of the customer's bank balance. The bank charges the interest at an agreed rate on the amount actually overdrawn by the borrower.
- (b) **Loans:** A loan is made when a commercial bank advances a fixed sum for a definite period of time. The amount is placed to the credit of a borrower who can draw cheques against the sum for any amount. Whether he makes use of full amount, or part amount he has to pay interest on the total amount of the loan.

How to Open a Bank Account ?

A person desirous of opening a current or saving account with a bank has to fill in a printed form which is obtainable free from a bank. Banks usually require that a new depositor must be introduced by one of its existing customers. Thus the application form duly filled must be endorsed by some old customer of that bank. If the bank is satisfied, it will obtain the full signatures of the customer in the Autograph Book for future reference. After all these formalities the customer makes the first deposit, and he will be given three books:-

- (i) Pay-in-Slip Book.
- (ii) Cheque Book.
- (iii) Bank Pass Book.

—**Pay-in-Slip Book:** When money is to be deposited in the bank the Pay-in-Slip is to be filled up. The object of this book is to provide the customer with the banker's acknowledgment for receipt of money to be credited to his account. The book contains many blank slips to which are attached the counterfoils by means of perforation. A person depositing the money or cheques etc. has to fill up the slip along with its counterfoil. The depositor presents his money along with the duly filled slip to the receiving Cashier of the bank. The cashier after receiving the payment retains the slip and its counterfoil is given to the customer after putting stamp on it.

Cheque Book. The Bank also supplies a Cheque Book containing a number of cheques. It enables a customer to make withdrawal from his account or make payment to various parties by issue of cheques.

Bank Pass Book. Whenever an account is opened the customer is furnished with a pass book. This pass book is a copy of the customer's account as it appears in the books of the bank. The customer has to present it to the bank at regular intervals. Usually the pass book is a bound book and there are columns showing (1) Date, (2) Particulars, (3) Deposits, (4) Withdrawals, (5) Balance (6) Initials of the Officer.

Cheques

A cheque is an unconditional order in writing, drawn by a customer on his bank, requesting to pay on demand a certain sum of money, to a person named in the cheque or to the bearer or to the order of a stated person.

Different kinds of Cheques. Cheques are divided into three classes.

- (i) Bearer Cheques
- (ii) Order Cheques and
- (iii) Crossed Cheques

Bearer Cheque -- is one on which the phrase "or bearer" is written after the name of the payee. It is payable to the bearer, holder or possessor, i.e. any one who may present it at the bank. The bank is under no liability to ascertain that the payment is made to the right person.

Order Cheque -- is cheque made payable to a certain person or order. It is a cheque on which the phrase "or order" is written after the name of the payee. If a cheque is made payable to a certain person without the addition of the word 'bearer' or order thereto, it is regarded as an order cheque. It can be transferred only by endorsement and delivery.

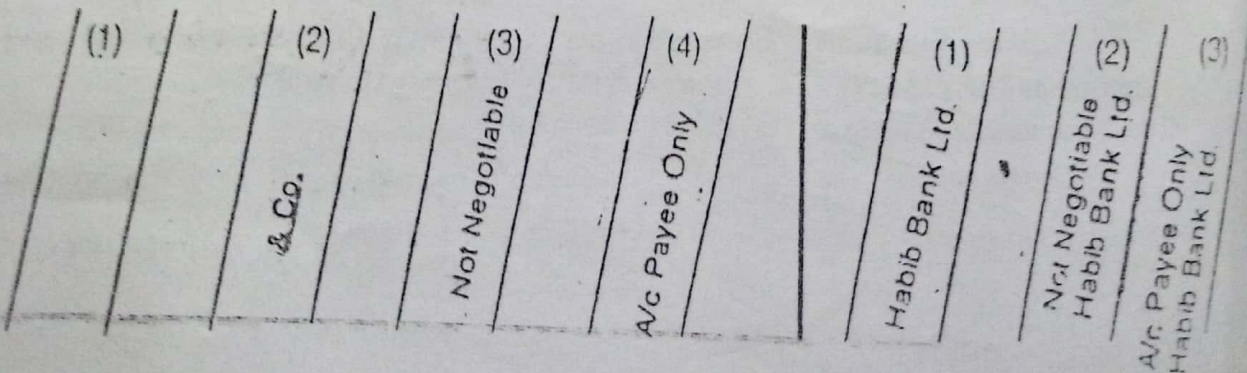
Crossed Cheque. When two parallel lines are drawn across the face of a cheque, it is said to be a crossed cheque. A crossed cheque cannot be encashed at the counter but can be collected only by a bank from the drawee bank. Crossing may be general or special.

General Crossing. A general crossing is one where two transverse parallel lines are drawn across the face of a cheque with or without the words "& Co." etc. The effect of general crossing is that the holder cannot encash it himself at the counter of the bank. He must deposit it with some bank which would obtain cash for it from the drawee bank. In this way chances of fraud are minimised.

Special Crossing. A special crossing is one which contains the name of the bank also between the two parallel lines drawn across the face of the cheque. The effect of a special crossing is that payment of the cheque can be obtained only through that particular bank whose name appears in the crossing.

General Crossings

Special Crossings



• **" Not Negotiable "** When the words " Not Negotiable " are written between the two lines drawn on the face a cheque it has a special significance . It does not mean that the cheque cannot be transferred . It simply means that the transferee can on no account acquire a better title to the document than his transferor. If the title of the transferor is bad, the title of the transferee will automatically be bad.

• **" Account Payee only "** The writing of these words between the two parallel lines is a direction to the collecting banker to collect the cheque and to place the amount to the credit of the payee only. This gives great safety.

Dishonour of Cheques

If the cheque is in perfect order it is ordinarily paid by the drawee bank. When the cheque is paid by the drawee bank, it is said to be honoured, and when it is not paid it is said to be dishonoured. When the cheque is dishonoured, it is returned by the bank alongwith a printed slip showing the reason for dishonour . Cheques are often refused by the bank owing to any of the undernoted reasons :-

1. Effect not yet cleared .
2. Not arranged for, or not sufficient fund.
3. Payee' s endorsement required.
4. Refer to drawer (R/D).
5. Drawer's signature differs.
6. Alteration requires full signature.
7. Cheque post dated .
8. Cheque out of date.
9. Cheque mutilated.
10. Amount in words and figures differ.
11. Payee's endorsement irregular.
12. Stopped payment

Endorsement of Cheques

The word endorsement means signing on the back of the negotiable instrument with a view to transfer property therein to another person . Thus it is a act of signing on the back of the cheque in order to transfer it to someone else who is called the endorsee . In order that the endorsement may be valid it should be in proper form . While making endorsement the following rules should be observed."

- (i) Endorsement should be made on the back side of a negotiable instrument .
- (ii) Endorsement should be done by the person himself or by his duly authorised agent.
- (iii) The person making the endorsement must sign his name exactly as it has been, written on the face of the instrument.

Bank Drafts

Commercial banks give the facility of remittance or money from one place to another. There are many ways by which money can be remitted from one place to another. Bank draft is one of the means of transferring money from one place to another. It is an order drawn by a bank on one of its branches requesting the later to pay a specified sum of money to the person named in the draft. A debtor can purchase a bank draft and send it to the creditor through the post. In many respects a bank draft corresponds with a cheque.

Hundis

A hundi is exactly like a bank draft. It is drawn by one trading firm upon its branches. For book-keeping purpose hundis are treated like bank drafts.

Postal Orders

Postal orders like cheques are also written orders made by one post-office on another. Whenever the amount of money to be sent by one person to another is small, postal orders serve the same purpose as bank drafts. Postal orders of different dominations are available from the post office. A postal order can be crossed like a cheque.

Method of Recording Banking Transactions

The relation between bank and its customer is that of debtor and creditor. A trader's transactions with his bank are recorded as follows:-

(A) Current Account

- (1) When money is paid into the bank.
Bank Account
 To Cash Account.
- (2) When cash is withdrawn for business use by a cheque.
Cash Account
 To Bank Account.
- (3) When a cheque is received from the debtor and the same is paid into the bank on the same day or date.
Bank Account
 To Debtor's Personal Account.
- (4) When a cheque is received from the debtor and the same is not paid into the bank on the same date it should be treated as a part of the cash.
Cash Account
 To Debtor's Personal Account.
- (5) When a cheque is received from the debtor and paid into the bank is dishonoured
Personal Account of Debtor
 To Bank Account.

- (6) When an outstation cheque received from a debtor is paid into the Bank for collection, the bank charges its customers with "Bank Charges". Local cheques are collected free. To record bank charges.

Bank Charges Account
To Bank Account

- (7) When the account is overdrawn, the interest is charged by the bank on the amount of the overdraft. To record interest

Interest Account
To Bank Account.

- (8) For any other service charges etc. made by the bank

Bank Charges Account
To Bank Account.

(B) Fixed Deposit Account

- (1) When fixed deposit Account is opened

Fixed Deposit Account
To Cash Account

- (2) When fixed deposit matures.

Cash Account
To Fixed Deposit Account

(C) Bank Loans

- (1) When a loan is taken from the Bank.

Cash Account
To Bank Loan Account

- (2) If the amount of the loan is credited to the bank current account.

Bank Account
To Bank Loan Account

- (3) When interest on bank loan is paid

Interest Account
To Bank Account

(D) Bank Draft; Hundis; Postal Orders

- (1) When a bank draft etc. is received from a debtor and is cashed direct

Cash Account
To Debtor's Personal Account.

- (2) If the same is paid into the bank for collection.

Bank Account
To Debtor's Personal Account

- (3) When a bank draft or postal order is purchased for making payment and is sent to a creditor.

Personal Account of Creditor
Trade Expenses Account
To Cash Account.

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When a bank draft or postal order is purchased a commission is paid for purchase of it. It should be recorded as Trade Expenses.

Illustration 6.1

Enter the following transactions of a merchant in his journal and give the balance of each account.

1991

- March 1 Paid into the Bank on the Current Account Rs. 6,000 and Fixed Deposit Account for one year Rs. 10,000.
- " 2 Purchased goods from A Rs. 2,000
- " 3 Paid A by cheque Rs. 2,000.
- " 4 Sold goods for cash Rs. 500
- " 8 Received a cheque from Kamal Rs. 200 and paid into bank
- " 9 Paid wages by cheque Rs. 200.
- " 12 Received a cheque from Rahim Rs. 100
- " 13 Paid Rahim's cheque into bank.
- " 14 Gave a cheque to C for Rs. 100.
- " 15 Rahim's cheque returned dishonoured
- " 20 Received an outstation cheque for Rs. 1,000 from D and paid into the bank
- " 22 D's cheque collected and exchange thereon being Rs. 3.
- " 23 Received cash from Rahim Rs. 100 and paid into the bank
- " 24 Drew from bank for office use Rs. 150.
- " 27 Purchased furniture from Z for Rs. 1,000 and paid him by means of a bank draft purchased from the bank for Rs. 1,005.
- " 31 Paid salaries by cheque Rs. 200.
- " 31 Received a postal order for Rs. 500 from K and paid the same into bank

Solution:

Journal

			Rs.	
1991				
March 1	Bank Account Fixed Deposit Account To Cash Account Cash paid into the bank		6,000 10,000	Rs 16,000
" 2	Purchases Account To A Goods purchased on credit		2,000	2,000
	C/F		18,000	18,000

		Rs.	Rs.
	B/F.	18,000	18,000
March 3	A To Bank Account Cheque given to A.	2,000	2,000
" 4	Cash Account To Sales Account Goods sold for cash.	500	500
" 8	Bank Account To Kamal Cheque received & deposited.	200	200
" 9	Wages Account To Bank Account Wages paid by cheque.	200	200
" 12	Cash Account To Rahim Cheque received.	100	100
" 13	Bank Account To Cash Account Rahim's cheque paid into bank.	100	100
" 14	C To Bank Account Cheque given to C.	100	100
" 15	Rahim To Bank Account Rahim's cheque dishonoured	100	100
" 20	Bank Account To D Cheque received & paid into bank.	1,000	1,000
" 22	Bank Charges Account To Bank Account Exchange on outstation cheque collected.	3	3
" 23	Bank Account To Rahim Cash received and paid into bank.	100	100
	C/F	22,403	22,403

		B/F	Rs.	Rs.
			22,403	22,403
March 24	Cash Account To Bank Account Cash withdrawn from bank		150	150
" 27	Furniture Account To Z Furniture purchased		1,000	1,000
" 27	Z Trade Expenses To Bank Account Bank draft purchased from bank and sent to Z.		1,000 5	1,005
" 31	Salaries account To Bank Account Salaries paid by cheque.		200	200
" 31	Bank Account To K Postal order received and paid into bank		500	500
	Total.		25,258	25,258

Bank Account

1991		Rs.	1991		Rs.
March 1	To Cash Account	6,000	March 3	By A	2,000
" 8	To Kamal	200	" 9	By Wages Account	200
" 13	To Cash Account	100	" 14	By C	100
" 20	To D	1,000	" 15	By Rahim	100
" 31	To Rahim	100	" 22	By Bank Charges A/c	3
" 31	To K	500	" 24	By Cash Account	150
			" 27	By Z	1,000
				By Trade Expenses A/c	5
			" 31	By Salaries Account	200
				By balanced c/d	4,142
		7,900			7,900