

UNIT – 5 : SOME SPECIAL TRANSACTIONS OF BANKS

LEARNING OUTCOMES

- Learn the concept of a rebate on bills discounted. Try to understand the technique of computing such rebate.
- Understand the technique for considering acceptance and endorsement as assets as well as liability.

5.1 DISCOUNTING, COLLECTION & ACCEPTANCE OF BILLS

With reference to Bills, a banking company performs the following functions:

1. Discounting of bills
2. Collection of bills
3. Acceptances on behalf of customers

5.1.1 Discounting: A bank may straight away purchase a Bill (Discounting). In this case after reducing discount charges, the balance amount is credited to the account of the customer. The total of both is debited to 'Bills purchased and discounted account'. This account is an Asset. For example, a person holds a bill of exchange duly accepted by his customer for retirement after 90 days. He may either wait for 90 days or have the same bill discounted with his banker who will credit the amount under a bill after deducting the discounting charges, to his account with the bank. On due date the bank will retire the bill with the customer and get his payment.

Rebate on Bills Discounted

Banks discount hundreds of bills every day and when someone gets a bill discounted, the bank credits the discount account with the full amount of the discount, the bank will earn in respect of that bill. But in practice, it frequently happens that some of these bills will not mature by the close of the accounting year. The portion of the discount which relates to the period falling after the close of the accounting period is called 'rebate on bills discounted', or 'unearned discount'.

Example

A customer discounted a four month's bill from bank on 1st March, 20X1 and bank charged ₹ 800 as discount. Accounts are closed on 31st March every Year. The date of maturity of the bill is 31st June, 20X1. In this transaction the bank must have credited the discount account with ₹ 800 on 1st March. But out of this, the discount for the months of April, May and June 20X1 is not actually earned. Unearned discount for these three months @ ₹ 200 per month amounts to ₹ 600. This is the income which is related to the next accounting period and is called 'income received but not earned. It is also termed as 'rebate on bills discounted' or 'unexpired discount' or 'discount received in advance.'

Since discount on bill discounted is an income for the bank and is shown in the Profit & Loss Account under schedule 13, the amount of unexpired discount, if given in the adjustments, is deducted from schedule 13 and is also shown on the liabilities side of the balance sheet in the item 'other liabilities and provisions' in schedule 15. Following entry is made for the adjustment:

Discount A/c	Dr.
To Rebate on Bills Discounted A/c	
(For adjustment of unexpired discount)	

Note: However, if the account of unexpired discount is given inside the trial balance, it is shown only in the balance sheet.

The Rebate A/c is shown on the liability side of the Balance Sheet as income received which has not accrued before the close of the year. Immediately on commencement of next financial year the Rebate A/c is closed by transfer to the credit of Discount A/c.

Illustration 1

The following is an extract from Trial Balance of overseas Bank as at 31st March, 20X1

	₹	₹
<i>Bills discounted</i>	12,64,000	
<i>Rebate on bills discounted not due on March 31st, 20X0</i>		22,160
<i>Discount received</i>		1,05,708

An analysis of the bills discounted is as follows:

	Amount ₹	Due Date 20X1	Rate of Discount (%)
(i)	1,40,000	June 5	14
(ii)	4,36,000	June 12	14
(iii)	2,82,000	June 25	14
(iv)	4,06,000	July 6	16

Calculate Rebate on Bills Discounted as on 31-3-20X1 and show necessary journal entries.

Solution

In order to determine the amount to be credited to the Profit and Loss A/c it is necessary to first ascertain the amount attributable to the unexpired portion of the period of the respective bills. The workings are as given below :

- (i) The bill is due on 5th June; hence the number of days after March 31st, is 66. The discount on ₹ 1,40,000 for 66 days @ 14% per annum will be

$$14/100 \times 66/365 \times ₹ 1,40,000 = ₹ 3,544.$$
- (ii) Number of days in the unexpired portion of the bill is 73: discount on ₹ 4,36,000 for 73 days @ 14% per annum will be ₹ 12,208.
- (iii) Number of days in the unexpired portion of the period of the bill is 86: discount on ₹ 2,82,000 for 86 days @ 14% per annum will be ₹ 9,302.
- (iv) Number of days in the unexpired portion of the period of the bill is 97: discount on ₹ 4,06,000 for 97 days @ 16 % p.a. will be ₹ 17,263.

The amount of discount to be credited to the Profit and Loss Account will be:

	₹
Transfer from Rebate on bills discount as on 31-3-20X0	22,160
Add: Discount received during the year ended 31-3-20X1	<u>1,05,708</u>
	1,27,868
Less: Rebate on bills discounted as on 31.3.20X1(3,544 + 12,208 + 9,302+ 17,263)	<u>(42,317)</u>
	<u>85,551</u>

The journal entries will be as follows :

	Dr. ₹	Cr. ₹
Rebate on Bills Discounted A/c To Discount on Bills A/c (Being the *transfer of Rebate on Bills Discounted on 31-3-20X0 to Discount on Bills Account)	Dr. 22,160	22,160
Discount on Bills A/c To Rebate on Bills Discounted A/c (Being the transfer of rebate on bills discounted required on 31-3-20X0 from discount on Bills Account)	Dr. 42,317	42,317
Discount on Bills A/c To Profit and Loss A/c (Being the amount of discount on Bills transferred to Profit and Loss Account)	Dr. 85,551	85,551

Note: In the Profit and Loss Account, the discount on bills will not appear as a separate item but will be included in the heading Interest/Discount on advances/bills as per Form B of the new format.

Illustration 2

On 31st March, 20X1, Uncertain Bank had a balance of ₹9 crores in "rebate on bills discounted" account. During the year ended 31st March, 20X2, Uncertain Bank discounted bills of exchange of ₹4,000 crores charging interest at 18% per annum the average period of discount being for 73 days. Of these, bills of exchange of ₹600 crores were due for realisation from the acceptors/customers after 31st March, 20X2, the average period outstanding after 31st March, 20X2 being 36.5 days.

Uncertain Bank asks you to pass journal entries and show the ledger accounts pertaining to:

- (i) *discounting of bills of exchange and*
- (ii) *rebate on bills discounted.*

Solution**Uncertain Bank
Journal Entries***(Rupees in crores)*

		Dr. ₹	Cr. ₹
Rebate on bills discounted A/c	Dr.	9.00	
To Discount on bills A/c			9.00
(Being the transfer of opening balance in rebate on bills discounted account to discount on bills account)			
Bills purchased and discounted A/c	Dr.	4000.00	
To Discount on bills A/c			144.00
[₹ 4,000 crores × $\frac{18}{100} \times \frac{73}{365}$]			
To Clients A/c			3,856.00
(Being the discounting of bills of exchange during the year)			
Discount on bills A/c	Dr.	10.80	
To Rebate on bills discounted A/c			10.80
(Being the unexpired portion of discount in respect of the discounted bills of exchange carried forward 18% of 600 crs for average period of 36.5 days)			
Discount on bills A/c	Dr.	142.20	
To Profit and loss A/c			142.20
(Being the amount of income for the year from discounting of bills of exchange transferred to Profit and Loss A/c)			

Ledger Accounts**(i) Discount on bills Account**

20X2		₹	20X1		₹
March 31	To Rebate on bills discounted A/c	10.80	April 1	By Rebate on bills discounted A/c	9.00

	To Profit and loss A/c	142.20	20X1-X2	By Bills purchased and discounted A/c	144.00
		153.00			153.00

(ii) **Rebate on bills discounted Account**

20X1		₹	20X1		₹
April 1	To Discount on bills A/c	9.00	April 1	By Balance b/d	9.00
20X2			20X2		
March 31	To Balance c/d	<u>10.80</u>	March 31	By Discount on bills A/c	<u>10.80</u>
		<u>19.80</u>			<u>19.80</u>

Illustration 3

The following information is available in the books of X Bank Limited as on 31st March, 20X2:

	₹
Bills discounted	1,37,05,000
Rebate on Bills discounted (as on 1.4.20X1)	2,21,600
Discount received	10,56,650

Details of bills discounted are as follows:

Value of bill (₹)	Due date	Rate of Discount
18,25,000	5.6.20X2	12%
50,00,000	12.6.20X2	12%
28,20,000	25.6.20X2	14%
40,60,000	6.7.20X2	16%

Calculate the rebate on bills discounted as on 31.3.20X2 and give necessary journal entries.

Solution**Statement showing rebate on bills discounted**

Value	Due Date	Days after 31.3.20X2	Rate of discount	Discount Amount
18,25,000	5.6.20X2	(30+ 31+5) = 66	12%	39,600

50,00,000	12.6.20X2	(30+31+12) = 73	12%	1,20,000
28,20,000	25.6.20X2	(30+31+25) = 86	14%	93,021
40,60,000	6.7.20X2	(30+ 31+ 30+ 6) = 97	16%	1,72,633
1,37,05,000	Rebate on bills discounted on 31.3.20X2			4,25,254

**In the books of X Bank Ltd.
Journal Entries**

(i)	Rebate on bills discounted Account	Dr.	2,21,600	
	To Discount on bills Account			2,21,600
	[Being opening balance of rebate on bills discounted account transferred to discount on bills account]			
(ii)	Discount on bills Account	Dr.	4,25,254	
	To Rebate on bills discounted Account			4,25,254
	[Being provision made on 31 st March, 20X2]			
(iii)	Discount on bills Account	Dr.	8,52,996	
	To Profit and loss Account			8,52,996
	[Being transfer of discount on bills, of the year, to profit and loss account]			

Credit to Profit and Loss A/c will be as follows: ₹ (10,56,650 + 2,21,600 – 4,25,254) = ₹ 8,52,996

Illustration 4

Calculate Rebate on Bills discounted as on 31 December, 20X1 from the following data and show journal entries:

	Date of Bill	₹	Period	Rate of Discount
(i)	15.10.X1	25,000	5 months	8%
(ii)	10.11.X1	15,000	4 months	7%
(iii)	25.11.X1	20,000	4 months	7%
(iv)	20.12.X1	30,000	3 months	9%

Solution**(a) Calculation of Rebate on Bills Discounted**

₹	Due Date	Days after 31 December 20X1	Discount Rate	₹
25,000	18-03-20X2	31 + 28 + 18 = 77	8%	421.92
15,000	13-03-20X2	31 + 28 + 13 = 72	7%	207.12
20,000	28-03-20X2	31 + 28 + 28 = 87	7%	333.69
30,000	23-03-20X2	31 + 28 + 23 = 82	9%	606.57
		Total		1569.30

Journal Entry

Date	Particulars	Debit ₹	Credit ₹
Dec. 31	Interest and Discount Account Dr. To Rebate on Bills Discounted (Being the provision for unexpired discount required at the end of the year)	1569.30	1569.30

5.1.2 Collection of Bills: One of the services provided by banks to their customers is to collect the dues against Bills of Exchange from their customers on the due dates. Where the bills have been discounted the proceeds of such bills on due date are treated as incomes of the bank. On the other hand, if bills have not been discounted, the proceeds on the same on maturity are credited to the account of the customer. The particulars will be recorded in a separate book called Bills for Collection Register. Bills sent for collection have to be shown by way of Note as per Third Schedule.

Two Accounts have to be opened. They are mirror images of each other. They are:

- (i) Bills for Collection (Asset)
- (ii) Bills for Collection (Liability)

Illustration 5

On 01.04.20X1 bills for collection was 7 lacs. During 20X1-X2 bills received for collection amounted to 64.5 lacs. Bills collected were 47 lacs. Bills dishonoured was 5.5 lacs. Prepare Bills for collection (Assets) and Bills for Collection (Liabilities) Accounts.

Solution**Bills for Collection (Assets) Account**

	₹ in lacs		₹ in lacs
To Balance b/d	7	By Bills for collection	47
To Bills for collection	64.5	By Bills dishonoured	5.5
	—	By Balance c/d	<u>19</u>
	<u>71.5</u>		<u>71.5</u>

Bills for Collection (Liabilities) Account

	₹ in lacs		₹ in lacs
To Bills for collection	47	By Balance b/d	7
To Bills dishonoured	5.5	By Bills for collection	64.5
By Balance c/d	<u>19</u>		—
	<u>71.5</u>		<u>71.5</u>

5.1.3 Acceptance and Endorsement: A bank has more acceptable credit as compared to that of its customer, because of this, more often, the bank is called to accept or endorse a bill on behalf of its customers. The bank has to honour this acceptance on behalf of its client only in the event of a client failing to honour the bill on the due date.

As against this liability, the bank has a corresponding claim against the customer on whose behalf it has undertaken to be a party to the bill, either as an acceptor or as an endorser.

Such Acceptance (Liabilities) which are outstanding at the close of the year and the corresponding asset (security) is disclosed as Contingent liability. As a safeguard against the customer not being able to meet the demand of the bank in this respect, usually the bank requires the customer to deposit a security equivalent to the amount of the bill accepted on his behalf.

If the bill, at the end of its term, has to be retired by the bank and the amount cannot be collected from the customer on demand, the bank reimburses itself by disposing of the security deposited by the customer.

5.1.3.1 Drafts and telegraphic Remittances: When a bank issues a bank draft on another bank or on its branch, it credits the account of the bank or that of the branch with amount of the draft. The corresponding debit is raised in the account

of the customer. His account is also debited with the remittances. A similar procedure is adopted in case of telegraphic transfer made on account of customers.

5.1.3.2 Letters of Credit and Travellers' Cheques: These are issued as a facility to travellers within the country or abroad. In either case, the person desiring such instruments of credit, to be issued in his favour or some other party is made to deposit the full value of the letter of credit or travellers' cheques issued in his favour.

The amount deposited by the customer is placed to the credit of Letters of Credit Account or Travellers' Cheques Account, as the case may be. When the bills of Exchanges drawn against the Letters of credit are received for payment, the amount is debited to the Letter of Credit Account. Similarly, the travellers' cheques, when presented are debited to the Travellers' Cheque Account. In the case of customers desiring travellers' cheques in a foreign currency, the equivalent value thereof in home currency is collected from them at the rate of exchange prevailing on the date of issue of the travellers' cheque and the bank either purchases immediately the amount of foreign exchange equal to the value of the travellers' cheque issued, or transfers out of its balances of foreign currency an amount equivalent to the value of travellers' cheques to the Travellers' Cheques Account. In the case of letters of credit in foreign currency, the same procedure is followed.

The transactions entered into for rendering other services *e.g.*, collection of dividend and interest, making periodical payments etc. do not involve any complicated accounting. Basically, when any amount is collected for a customer as dividend or interest, his account is credited and cash is debited. Correspondingly, wherever any payment is made on account of a customer, his account is debited and cash is credited. Usually a separate charge is made for such a service.

Illustration 6

From the following details prepare "Acceptances, Endorsements and other Obligation A/c" as would appear in the General Ledger.

On 1.4.20X1 Acceptances not yet satisfied stood at ₹ 22,30,000. Out of which ₹ 20 lacs were subsequently paid off by clients and bank had to honour the rest. A scrutiny of the Acceptance Register (for transactions during the year) revealed the following:

Client Acceptances/Guarantees *Remarks*

	₹	
A	10,00,000	Bank honoured on 10.6.20X1

B	12,00,000	Party paid off on 30.9. 20X1
C	5,00,000	Party failed to pay and bank had to honour on 30.11.20X1
D	8,00,000	Not satisfied upto 31.3.20X2
E	5,00,000	-do-
F	<u>2,70,000</u>	-do-
Total	<u>42,70,000</u>	

Solution

**Acceptances, Endorsements and other Obligation Account
(in general ledger)**

		₹ '000			₹ '000
20X1-X2	To Constituents' liabilities for acceptances/guarantees etc. (Paid off by clients)	20,00	1.4.X1 20X1-X2	By Balance b/d	22,30
	To Constituent's liabilities for acceptances/guarantees etc. (Honoured by bank ₹ 22.30 lakhs less ₹ 20 lakhs)	2,30		By Constituents' liabilities for A 10,00 B 12,00 C 5,00 D 8,00 E 5,00 F <u>2,70</u>	
10.6.20X1	To Constituents' liabilities for acceptances/guarantees etc. (Honoured by bank)	10,00			
30.9.20X1	To Constituents' liabilities for acceptances/guarantees etc. (Paid off by party)	12,00			42,70

30.11.20X1	To Constituent's liabilities for acceptances/guarantees etc. (Honoured by bank on party's failure to pay)	5,00			
31.3.20X2	To Balance c/d (Acceptances not yet satisfied)	15,70			
		65,00			65,00

Illustration 7

Following facts have been taken out from the records of Adarsha Bank in respect of the year ending March 31, 20X2:

- On 1-4-20X1 Bills for collection were ₹7,00,000. During 20X1-20X2 bills received for collection amounted to ₹64,50,000, bills collected were ₹47,00,000 and bills dishonoured and returned were ₹5,50,500. Prepare Bills for Collection (Assets) A/c and bills for Collection (Liability) A/c.
- On 1-4-20X1, Acceptance, Endorsement, etc. not yet satisfied amounted to ₹14,50,000. During the year under question, Acceptances, Endorsements, Guarantees etc., amounted to ₹44,00,000. Bank honoured acceptances to the extent of ₹25,00,000 and client paid off ₹10,00,000 against the guaranteed liability. Clients failed to pay ₹1,00,000 which the Bank had to pay. Prepare the "Acceptances, Endorsements and other Obligations A/c" as it would appear in the General ledger.
- It is found from the books, that a loan of ₹6,00,000 was advanced on 30-9-20X1 @ 10 per cent p.a. interest payable half yearly; but the loan was outstanding as on 31-3-20X2 without any payment recorded in the meantime, either towards principal or towards interest. The security for the loan was 10,000 fully paid shares of ₹100 each (the market value was ₹98 as per the Stock Exchange information as on 30th Sept., 20X1). But due to fluctuations, the price fell to ₹40 per share in January, 20X2. On 31-3-20X2, the price as per Stock Exchange rate was ₹82 per share. State how you would classify the loan as secured/unsecured in the Balance Sheet of the Company.

(d) The following balances are extracted from the Trial Balance as on 31-3-20X2:

	Dr. ₹	Cr. ₹
Interest and Discounts		98,00,000
Rebate for bills discounted		20,000
Bills discounted and purchased	4,00,000	

It is ascertained that the proportionate discounts not yet earned for bills to mature in 20X2-20X3 amount to ₹ 14,000. Prepare Ledger Accounts.

Solution

(a) Bills for Collection (Assets) A/c

20X1		₹	20X1-X2		₹
Apr. 1	To Balance b/d	7,00,000		By Bills for Collection (Liabilities) A/c	47,00,000
20X1-X2	To Bills for Collection (liabilities) A/c	64,50,000		By Bills for collection (Liabilities) A/c	5,50,500
		71,50,000	20X2 Mar. 31	By Balance c/d	18,99,500
					71,50,000

Bills for Collection (Liabilities) Account

20X1-X2		₹	20X1	₹	
	To Bills for collection (Assets) A/c	47,00,000	Apr. 1	By Balance b/d	7,00,000
	To Bills for Collection (Assets) A/c	5,50,500	20X1-X2	By Bills for collection (Assets) A/c	64,50,000
20X2 Mar. 31	To Balance c/d	18,99,500			
		71,50,000			71,50,000

(b) Acceptances, Endorsement & other Obligation Account

20X1-X2		₹	20X1		₹
	To Constituents' Liability for Acceptance, Endorsement, etc.	25,00,000	Apr. 1	By Balance b/d	14,50,000
	To Constituents' Liability for Acceptances, Endorsement etc.	10,00,000	20X1-X2	By Constituents, Liabilities for Acceptances, Endorsements, etc.	44,00,000
	To Constituents' Liability for Acceptances, Endorsements, etc. (amount paid on failure of clients)	1,00,000			
Mar. 31	To Balance c/d	<u>22,50,000</u>			
		<u>58,50,000</u>			<u>58,50,000</u>

- (c)** For classifying loans as fully secured or otherwise, the value of the security as on the last date of the year is considered. The value of the security is ₹ 8,20,000 covering the loan and the interest due comfortably. Hence it is to be treated as good and fully secured.

(d) Rebate on Bills Discounted Account

		₹			₹
20X1-X2	To Interest and Discount A/c	6,000	20X1 Apr. 1	By Balance b/d	20,000
20X2 Mar. 31	To Balance c/d	14,000			
		<u>20,000</u>			<u>20,000</u>

Interest & Discount Account

20X2		₹	20X1		₹
Mar. 31	To Profit & Loss A/c	98,06,000	Apr. 1 20X1-X2	By Balance b/d	98,00,000
				By Rebate on Bills discounted A/c	6,000
		<u>98,06,000</u>			<u>98,06,000</u>