Accounting for Financial Institutions: Fourth year of English Section:

Non-deposit Borrowings.

Borrowing from reserve funds at the Central Bank:

-Originally, reserve funds consisted exclusively of deposits held by the Egyptian banks at the Central Bank. These deposits are owned by banks and are held at the Central Bank to satisfy legal reserve requirements, clearing checks, and pay for purchases of government securities. These reserve balances at the Central bank can be transferred from one bank to another in seconds through a wire transfer.

-Bank deposit balances at the Central bank that are in excess of required reserve balances may be loaned overnight over the weekend to other banks or institutions. These balances are labelled (called) reserve funds at the Central Bank.

Repurchase agreements:

-Banks use repurchase agreements to settle for short-term deficits in the reserve position or for liquidity. A repurchase agreement is the sale of securities with the understanding that a bank will repurchase them in the near future at the sale price plus a specified interest rate. Actually, the securities sold are still listed as an asset by the borrowing bank.

Borrowing from the Central Bank through the discount window:

-Through this tool, the borrowing bank sells to the Central Bank its own customers' notes, drafts, and bills of exchange. The borrowing bank is liable to the Central Bank if the original maker defaults (delays) on the maturity date of the instrument.

Illustration:

(1) On March 1, 2019, Cairo Bank sells L.E.10,000,000 of reserve funds at the Central Bank for one day at interest rate of 12%. In this transaction, Cairo Bank grants a loan to another bank from excess reserves. On the following day, Cairo Bank is repaid the loan and the interest.

(2) On March 3, 2019, Cairo Bank borrows L.E.12,500,000 of reserve funds at the Central Bank for one day at interest rate of 12%. On March 4, 2019, Cairo Bank repays the loan and the interest.

(3) National Bank sells L.E.15,000,000 of Egyptian Government securities on April 1, 2019, with an agreement to repurchase them in 10 days. The interest rate is 12%. On April 11, 2019, the securities are returned to the bank.

Instructions:

Prepare journal entries for the above transactions.

Now, journal entries will take the form presented in your material, pp. 128-130.

Illustration:

On April 10, Misr Bank discounts L.E.10000000 of customer notes at the Central Bank of Egypt at a discount rate of 12%. The note matures in 30 days.

Instructions:

Prepare the journal entries for discounting the notes at the Central Bank and the collection of the notes on May 10, 2019.

Solution

Date	Explanation	Dr. L.E.	Cr. L.E.

Apr. 10	Due from banks-CB……………………………… Interest expense………………………………….. Customers notes discounted…………………… 10000000 × 12% × 30/365 = 98630 (round).	9901370 98630	 10000000
May 10	Customer notes discounted……………………… Customer notes……………………………….. Collection of customer notes.	10000000	 10000000

The effect of the first entry is to record a contra asset account " Customer Notes Discounted" until the notes are collected, then the contra asset account and the original asset account "Customer Notes" are cancelled.

Now, let us test our understanding of this subject, through answering the following questions: MULTIPLE CHOICE:

Choose the best answer for each of the following questions and circle the identifying letter.

Use the following data for questions 1 through 4.

On March 10, 2019, a commercial bank discounted L.E.5,000,000 of Customer Notes at the Central Bank, at a discount rate of 17%. The Notes mature in 30 days.

1. Refer to the above data. The entry to record this transaction on March 10 would be of:

A 5,000,000 debit to Customer Notes a/c. **B** 50,000,000 credit to Customer Notes a/c.
C 5,000,000 debit to Customer Notes Discounted a/c. **D** None of the above.

2. Refer to the above data. The entry to record this transaction at the maturity date would be of:

A 5,000,000 debit to Customer Notes a/c. **B** 50,000,000 credit to Customer Notes a/c.
C 5,000,000 debit to Customer Notes Discounted a/c. **D** None of the above.

3. Refer to the above data. The effect of this transaction on bank's income statement on March 31, 2019 would be of:

A 69,863 expense. **B** 69,863 income. **C** 51,232.877 expense. **D** 51,232.877 income.

4. Refer to the above data. The effect of this transaction on bank's balance sheet on March 31, 2019 would be of:

A 5,000,000 increase in assets. **B** 5,000,000 increase in liabilities.
C 5,000,000 changes between assets' components.
D 5,000,000 changes between liabilities' components.

Best wishes Dr Ali Abdelkarim Rawy