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TECH_How to Handle LC Transaction in A21

CASE: <u>HANDLING LETTER OF CREDIT TRANSACTION IN A21</u>

Take a scenario of Computer Supplies International (CSI) is a trading company using A21 Accounting.

(a) CSI ordered 1,000 Hard Disk (at 15,000 Yen each) from their supplier OSAKA CO. LTD. in Japan. They issue a Purchase Order to OSAKA CO.

(b) They have an available Letter of Credit facility with DBS BANK SINGAPORE for $500,000/-. Since this is 15 million yen (about S$ 180,000) they then proceed to use the L/C facility at DBS. The bank L/C opening charge is 0.25%. [Show how the transaction is entered in A21]

(c) The need to track delivery dates and how much L/C facility balances with DBS BANK. [Show how A21 is used to track this]

(d) When the goods arrive in Singapore, they need a Shipping Guarantee to claim the cargo. They then proceed to DBS Bank to sign a Trust Receipt (90 days) at 5% per annum for the 15 million Yen. After this done, DBS release the S/G to them to claim cargo. CSI no longer owes OSAKA CO. but owe directly to DBS BANK. [Show how the transaction is entered in A21].

(e) They must book in landed cost items of US$500 for freight, S$200/- for local transport and US$175/- for insurance in the shipment. [Show how this transaction with multi-currency components, is entered in A21].

(f) Since they bought the goods today, at a comfortable exchange of 100 Yen= $1.20, they want to book a forward contract with the bank to hedge this exchange rate against future fluctuations. I.e. no matter what happen to the rate in 90 days time, they will pay at 100 Yen = S$ 1.20. [Show how such a transaction is entered in A21].

(g) After 90 days, they need to pay DBS BANK for the Trust Receipt. [Show how the transaction is entered in A21]

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(B) Some others feel we should book in the liabilities, as an L/C is certainly one. A21 can also do it, and hereunder are the steps to take:

Step 1:
In Purchase, issue a Purchase Order (SO transaction) to reflect order to OSAKA.

Step 2:
Normally a bank L/C line or facility would comprise also a Trust receipt Line. And these are usually combined limits; for example a $500,000 <u>L/C and T/R line</u>. It means that if you use $100,000 in L/C, you have only $400,000 in T/R left. As you pay down the T/R (usually on 90 days), your combined line gets freed up.

It becomes crucial to track these, or the company may end up with line "being full". Create 3 new chart of account codes (all balance sheet items) in the General Ledger to reflect DBS L/C Facility", another "DBS T/R Facility" and another "L/C Contingent Liability".

Step 3:
When you open your first L/C, pass a GJ journal as followed:

GJ-Transaction	DR	CR
DBS L/C & T/R Facility		15,000,000 Yen
L/C Contingent Liability	15,000,000 Yen	

- This entry book in L/C facility consumed.
- Also recognize you book in a contingent liability.

When the bank sends you an Debit Advice Slip after opening the L/C, simply enter under a GC transaction:

GC-Transaction	DR	CR
DBS Current A/c		$ 480/-
L/C Commission	$450/-	
Telex Charges	$ 20/-	
Postage & Courier	$ 10/-	

- This will reflect all bank charges related to this L/C.

Step 4:
Goods arrived, consigned to DBS Bank. To claim the cargo, you need to apply a Shipping Guarantee. The transaction to handle the Shipping Guarantee is through a GJ transaction.

GJ-Transaction	DR	CR
DBS L/C Facility	15,000,000 Yen	

DBS T/R Facility   15,000,000 Yen

- This transaction squares off your L/C line (reduce it down).
- Transfer your liability to T/R line where interest starts counting.

At the same time enter a Supplier Invoice (in this case, an Invoice on P/O). Select the supplier and item you wish to input. The transaction will look like this:

SE-Transaction	DR	CR
Purchase A/c	15,000,000 Yen	
Trade Creditor		15,000,000 Yen
Purchase A/c		15,000,000 Yen
Stock A/c	15,000,000 Yen	

- This transaction will square off the Pending P/O position.
- Recognizes purchase to OSAKA for future analysis of purchases.
- It books in the stock at respective values.

Step 5:

The earlier T/R signifies that your bank will reimburse direct to your OSAKA supplier. It clears your obligation with the supplier and recognizes the T/R debt (via the Shipping Guarantee) at your bank. In recognizing this transaction, go to PV and select OSAKA as supplier, and in details select Contingent Liability.

PV-Transaction	DR	CR
L/C Contingent Liability		15,000,000 Yen
Trade Creditor	15,000,000 Yen	

- Squares off L/C Contingent Liability of 15,000,000 Yen in Debit.
- It clears the supplier bill and reduces the Trade Creditor balance.

Step 6:

For hedging of foreign currency, there are essentially 2 ways to handle.

(a) The easy way is not to do anything; simply book a forward contract with the bank at a pre-agreed rate where they use this rate to offset your T/R balance after 90 days. Use this same rate for your Step 4 (GJ Transaction). When the squaring kicks in, there will be no exchange gain/loss.

(b) The second way is to recognize the forward contract as another transaction. First, create a Japanese Yen Bank A/c. When you confirm a rate with the bank, go to this Jap Yen Bank A/c and perform a buying of Yen at the prescribed rate of today. After 90 days, when you need to square off the T/R account, use the Jap Yen Bank A/c to do it and there will be no exchange gain/loss occurring.

END OF SOLUTION

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