

# PECULIARITIES OF PAWNSHOPS' ACCOUNTING

## PARTICULARITĂȚI ALE CONTABILITĂȚII CASELOR DE AMANET

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**Abstract:** According to Romanian laws, the pawnshops are non-banking financial institutions that offer monetary loans in exchange for movable assets that are pledged by the customers. They are organized as commercial companies and are supervised by the Romanian National Bank, being recorded into the Entry Register held by this institution. Nonetheless, the pawnshops do not apply accounting rules available for credit institutions, but they prepare the financial statements according to the regulation applied by commercial companies. The paper addresses the peculiarities of the pawnshops' activities in terms of legal, fiscal and accounting aspects. By giving practical examples, the paper emphasizes the assessment of the pawned items (namely the condition and salability of the items) which is necessary in determining the amount of the loan and the upon-agreed interest. It also underlines the situations that are likely to appear by the end of the contractual period of time. The paper discusses the fiscal aspects (mainly the value added tax) that rise from the sell of the items or the cashing of the interest.

**Key words:** pawn contract, pawned items, loan, fee

**Rezumat:** Conform legislației românești, casele de amanet sunt instituții financiare nebankare ce se ocupă cu acordarea de credite în schimbul primirii de bunuri mobile spre păstrare. Acestea se organizează ca societăți comerciale și se află sub supravegherea Băncii Naționale a României, fiind înscrise în Registrul de evidență ținut de această instituție. Cu toate acestea, casele de amanet nu aplică prevederile contabile folosite de instituțiile de credit, ci întocmesc și depun situații financiare conforme cu reglementările aplicabile agenților economici. Lucrarea de față își propune să pună în evidență particularitățile activității de amanet ce sunt de natură juridică, fiscală și contabilă. Prin intermediul exemplelor oferite, lucrarea surprinde procesul de evaluare a bunurilor mobile amanetate (în funcție de care se stabilește valoarea împrumutului acordat și a comisionului perceput) și cazurile posibil a apărea la expirarea contractului de amanet. În plus, lucrarea surprinde și aspectele fiscale (legate de regimul TVA) de luat în seamă la vânzarea bunurilor amanetate și la încasarea comisioanelor.

**Cuvinte cheie:** contract de amanet, bun amanetat, împrumut, commission

## INTRODUCTION

In any modern economy, the non-banking financial industry plays a significant role because it offers an alternative for the banking services, it multiplies the competition on the loan market and it diversifies the financial instruments. Among other non-banking institutions, such as leasing companies and mutual benefit societies, there are the *pawnshops*.

Despite being organized according to the rules applicable to the commercial companies, the pawnshops are supervised by the National Bank of Romania (as any financial entity) and recorded into the Entry-Register held by this institution. Their main business activity is *offering monetary loans in exchange for pledged items held for preservation*. “The act of pawning takes place between two parties – a company and an individual – that engage in a transaction based on an agreement between them, each of the party being creditor and debtor to the other at the same time” (Pătruț, Deju, Păcurari, 2005, p. 31). Basically, the pawnshops lend money to their clients on the security of pledged goods, after signing a contract. They are creditors for the money they lend but also debtors for the pledged items. Their gain consists of the daily fee they cash in during the contractual period of time, fee that is publicly displayed for the customers.

According to the Romanian Civil Code (art. 1685), the pawn is an accessory unilateral real agreement in which the debtor remits tangible or intangible items as collateral. Therefore, the collateral is a real object, much like the mortgage, but the main difference is that the pawn is always based on movable assets that are handed over to the creditor.

The pawnshop is strictly forbidden to use, mortgage, hire, sell, donate or lend the pledged item (except otherwise agreed upon in the pawn contract) and it is compelled to preserve it (without losing or damaging it) and return it to the original owner when the loan and the interest are paid. The rules provide that if the loan is not repaid on the expiration date or if the debtor does not require the extension of the expiration date, the debtor has to pay an extra-fee for the delay. The partial payment of the debt does not end the pledge which is indivisible, being ended only by the full payment of the loan, interests and fees. The lack of payment within the contractual period of time gives the creditor the right to become the owner of the pawned item, offering it for sale or keeping it for own purposes.

## **MATERIAL AND METHOD**

The pawnshops are regulated through legal acts that we researched for this paper. These are:

- a) regulations regarding the incorporation, organization and operation of pawnshops:
  - Ordinance no. 28/2006 governing certain financial and fiscal measures, published in Monitorul Oficial no. 89/2006;
  - Commercial Companies Act no. 31/1990, republished as subsequently amended and supplemented in Monitorul Oficial no. 1066/2004;
  - Civil Code published in Buletinul Oficial no.1/1981;
  - Decree-law no. 2561/1936 for the incorporation of pawnshops, published in Buletinul Oficial no. 264/1936 supplemented through decree-law no. 3621/1937 that were partially repealed by Ordinance no. 28/2006.

Because the majority of the pawned items are golden jewelry and gemstones, it is important to follow the appropriate legislation:

- The method* we choose for the analysis of the application of all these rules is a real *example*: a person brings an 18k golden jewelry that the pawnshop assesses at 1080 RON. The amount of the loan is established at 800 RON, the daily fee 0.6%, and the contract period is 30 days with an additional 30-day grace period explicitly required by the pawner. The extra-fee (after the expiration of the contract or in the absence of its prolongation) is 1% per day (for 10 days). At the expiration of the contract, the pawnshop gets the ownership of the jewelry.

Sale of merchandise	1080,00	
Revenues from sundry activities	108,00	
Collected VAT	20,52	
-the acceptance of the sold merchandise:		
Goods purchased for sale = %	<u>1208,52</u>	
Sundry debtors	944,00	
Sundry creditors	136,00	
Commercial margin	108,00	
VAT under settlement	20,52	
-the derecognition of the sold item:		
%	= Goods purchased for sale	<u>1208,52</u>
Merchandise expenses	1080,00	
Commercial margin	108,00	
VAT under settlement	20,52	
-the taking of the sold item off consignment: C: Assets held in custody - consignment 1080		
-the payment due to the original owner: Sundry creditors = Petty cash 136		
Nonpayment of the loan and fee (case C)		
<u>The sale of the jewelry</u>		<u>The keeping of the goods for own purposes</u>
-the selling price:		- the taking of the sold item off consignment C: Assets held in custody consignment 1080
market value – 1080 lei	} 1413,72	-the recognition of the goods as working inventory at market value of 1100 lei:
commercial margin–10% 108 lei		Working inventory = % 1100
VAT 19% - 225,72 lei		Sundry debtors 800
-the recognition of the jewelry:		Other operating 300
Goods purchased = %	<u>1413,72</u>	revenues
for sale		
Sundry debtors	800,00	
Other operating revenues	280,00	
Commercial margin	108,00	
VAT under settlement	225,72	
- the taking of the sold item off consignment C: Assets held in custody - consignment 1080		
-the sale of the goods:		
Petty cash = %	<u>1413,72</u>	
Sale of merchandise	1188,00	
Collected VAT	225,72	
-the derecognition of the goods:		
%	= Goods purchased	<u>1413,72</u>
for sale		
Merchandise expenses	1080,00	
Commercial margin	108,00	
VAT under settlement	225,72	

On the basis of this example, we would like to point out some things:

a) *accounting considerations*

-the pledged item is not recognized as an asset on the pawnshop's balance-sheet because the latter does not hold its ownership (that is why the pawn is recorded as an off-balance-sheet item). The only exception takes the form of the mutual agreement between the pawnshop and the pawner for the taking of the pledge on consignment. The pledge is recognized as a long-term or current asset

only when the pawnshop becomes its owner, that is when the lender may not recoup the loan.;

- the receivables created when offering a loan should be recorded as current receivables (using a “sundry debtors” account) and not as long-term financial assets, using the “Other long-term receivables” account because the loan is a short-term one. We noticed that many pawnshops’ accountants in our country used the latter account. In our opinion this is a mistake because it does not take into consideration the contract duration;

- the fees cashed in by the pawnshops, although representing the interest of a loan, are not financial revenues because the pawnshops are commercial companies in spite of the fact that they are recorded into the Entry-Register as non-banking financial institutions;

b) *fiscal considerations*

- the interests and fees earned by the pawnshops do not involve the VAT even though the pledged items are redeemed by the debtor (or not);

- when the loan is not paid on expiration date, the pawnshop calculates VAT for the revenues earned from the sale of the goods recognized as balance-sheet assets. If the sold item is one previously taken on consignment, VAT is calculated only for the commercial margin (the creditor keeps for itself the amount of the loan plus the interest plus VAT calculated on the commercial margin and hands over the rest of the money to the original owner. In this situation, the fee earned by the pawnshop consists of the interest of the loan plus the commercial margin and is recognized as “revenue from sundry activities”.);

- in order to record the VAT calculated for the consignment transactions, the pawnshops keep special books (VAT journal reports) that differ from the other VAT transactions;

c) *legal considerations*

- when offering a loan, the pawnshop completes two copies of a pawn contract which must include: the description of the pawned item, the item’s value, the lending amount, the lending interest rate, the pawn duration and mode of payment, the handling of the pawned goods upon the liquidation of the contract, the rights and obligations of the debtor and creditor, other stipulations. When the pawner requires an extension of the contract, the creditor completes a new contract;

- when receiving the pledge, a pawn ticket is to be completed but most of the pawnshops use a copy of the pawn contract as an acknowledgment for the item taken as pledge. The return of the pawned item to the debtor is made based on the pawn ticket;

- when taking an item on consignment, the pawnshop completes a consignment ticket used for the temporary recognition of the pledge and for its derecognition after sale.

Also, we would like to underline some of the *risks* that characterize this business. Some risks are the ones inherent to any business, such as the credit risk (due to the uncertainty in the debtor’s ability to meet its obligations). Others are

specific risks: the risk that the pledge is a stolen property (which can be hedged by requiring identification documents from the pawner, following the news about recent robberies in the neighborhood and requesting the police assistance whenever there are suspicions), the risk that the item is counterfeited or fake (against which the pawnshop can fight by hiring specialists to assess jewelry, gemstones, electronics or art). Another risk is that the pawnshop cannot sell the items not redeemed by their original owners (which can be reduced by accepting only items for which there is an active market). Reducing or eliminating those risks depends mainly on the management skills and ...on luck.

## CONCLUSIONS

The peculiarities of the pawnshops' activities have significant consequences upon their accounting books. The most important aspect is, in our opinion, the fact that, although conducting lending activities, the pawnshops are financial institutions *only* because they are recorded into the Entry-Register held by the Romanian National Bank and are supervised by the same entity. But ultimately they are organized and they operate as *commercial companies*. Moreover, their clients are, most of the times, people with financial problems that run out of resources, do not have a bank account or do not qualify for a bank loan. They prefer the simplicity of a pawnshop loan which is a very short-term one (and bears lower interests than ones collected by other informal creditors), it is quick and convenient, does not require co-signers and the failure of payment does not ruin the debtor's credit score (the pawnshops do not report the defaulted loans to the Payment Incidents Register because they have the physical possession of the item and may recoup the loan value through outright sale of the item). These loans generally cover daily expenses and, therefore, there is a great demand for them during the current crisis. The present events turn out to be a blessing for many pawnshops that increase their business and the profits earned from the loans and from the sale of the items not reclaimed by their owners.

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