ACCOUNTING PRACTICES REGARDING MERCHANDISE IMPORTS ON ONE'S OWN ACCOUNT, ON SHORT-TERM CREDIT

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Abstract: The paper presents in the first part theoretical aspects regarding merchandise imports on one's own account, on short term trade credit. In the second part it approaches a practical application of accounts related to merchandise imports on one's own account, on short term trade credit. Foreign Trade Companies' merchandise imports, as an indirect form of organizing foreign trade, contains the sum of operations by which merchandise necessary to the national economy is bought for production or individual consumption. Just like exporting, importing can be done by foreign trade companies on their own account, or on commission. In indirect importing, on foreign trade companies' own account, the abovementioned act on foreign markets and onward on the internal market, in their own name, on their own account, and at their own risk. Thus, the financial results of the import activity are reflected, in full, in the administration of the importing foreign trade company. Merchandise imports bought on credit, i.e. imports for which payment is made at a particular date, is determined by the shortage of financial resources of the importer. It is common practice both for simple and complex merchandise, however, generally complex merchandise is more frequently the subject of on credit acquisitions.

Foreign Trade Companies' merchandise imports, as an indirect form of organizing foreign trade, contains the sum of operations by which merchandise necessary to the national economy is bought for production or individual consumption. Just like exporting, importing can be done by foreign trade companies on their own account, or on commission. In indirect importing, on foreign trade companies' own account, the abovementioned act on foreign markets and onward on the internal market, in their own name, on their own account, and at their own risk. Thus, the financial results of the import activity are reflected, in full, in the administration of the importing foreign trade company.

The financial-economic regime, bearing record of the accounting implications, mainly focuses on issues regarding economic affairs of the foreign trade companies, the flow of imported merchandise and their financial relations.

The economic relations of foreign trade companies use the economic agreements signed with external suppliers, internal customers and service providers as a legal base.

Economic agreements with external suppliers, contain, as an essential element, the negotiated price under one of the commercial terms: FOB foreign port, after all origin port charges, CFR or CIF Romanian destination port-paid to arrival. Under FOB terms, the Foreign trade company only pays the merchandise price to foreign suppliers, and organizes its own delivery and bares the external charges accordingly. Under CFR and CIF terms, the foreign trade company must pay the external suppliers the price of the merchandise, as well as the external transportation expenses (under CFR terms) or external transportation and insurance expenses (under CIF terms). It is understood that, under these conditions, the obligation of organizing the delivery of merchandise to the country belongs to the external suppliers.

To the mentioned components of the external price, when the situation requires it, other elements can be added, such as: loading, unloading and handling expenses related to the imported merchandise transportation, paid during the contract, as well as different external commissions: intermediary, handling a.s.o., so that in its final form, the external import price which represents the customs value contains the following:

a) the net price of the merchandise (the external price under the FOB term);

b) external transportation expenses;

c) transportation- related interfacing expenses, paid during external transportation;

d) insurance cost, as well as other external expenses.

Economic agreements between foreign trade companies and internal customers also contain, as an essential element, the price of merchandise established under the term ex-works. The internal selling price of the imported merchandise is negotiated with internal customers, adding the VAT. At the negotiation of the selling price, the foreign trade companies take into account two parts: the customs value and the importer's margin.

The customs value (CIF value) contains, as shown above, all the external expenses made in foreign currency up to customs. It is expressed both in the foreign currency and in lei at the exchange rate in the customs import declaration.

The importer's margin. Its role is clarified neither in the literature nor in the legislation. In the economic literature, the tradesman's margin is generally mentioned, which would have the same meaning as the importer's margin. Thus, some authors state that the tradesman's margin represent his „limits of operation, within which he is to cover his travel-related expenses, pay his taxes, but also obtain a certain profit." According to other authors, the tradesman's margin serves to cover the sales expenses and ensure profit. Taking this view on the matter, two options of calculation for the importer's margin can be brought up for discussion.

First option.. The base for calculating the importer's margin must be the customs value of the merchandise. Since the internal sale of the imported merchandise takes place at a more or less distant period from the importing, in case of inflation, foreign trade companies can't recover the foreign currency spent on importing the merchandise though their thus established internal pricing. That's why they transform the customs value into lei at the exchange rate set on the day of negotiation with internal customers (internal sales date) and apply the importer's margin to this calculation. From this we see that actually, foreign trade companies negotiate with internal customers only at the level of the importer's margin. Note that with this option, for the calculation of the importer's margin, the merchandise purchase cost isn't taken into consideration, which, in theory, does not correspond to its role. Taking into account that under the current stipulations the importer's margin is unlimited, practically, the statement remains to be made only for respecting the role given to the tradesman's margin..

Second option.. The base for calculating the importer's margin is the purchase cost of the imported merchandise. Usually, this is the customs purchase cost and is made up of the customs value of the merchandise and the customs fees: customs fee, customs excess fares, customs commission and excises.

The customs fee is an indirect fare (paid by the importing company but bared by the final consumer of the imported goods) and is calculated for all merchandise stipulated in the import customs tariff of countries practicing this taxation regime. It is established within percentage limits set by groups of merchandise. It is calculated by applying the percentage quota to the customs value transformed into lei at the exchange rate within the import customs declaration. The calculated and perceived tax becomes income within the state budget.

The customs excess fare is of the same fiscal nature as the customs fee (indirect fare) and can be charged for limited periods of time and for purely fiscal reasons (lack of funding to the state budget), and less for commercial policy reasons, because it applies without differentiation to the value of all imported goods. The customs excess fare was applied in 1998 (6%), 1999 (4%) and 2000 (2%). Its basis for calculation is, as in the case of customs fees, the customs value.

The customs commission is, from a fiscal point of view, an indirect fee, a contribution to a special fund, and is calculated for all of the merchandise going through customs, by applying a percentage quota, usually 0.5% (0.25% for merchandise coming from the European Union), with the same basis for calculation (the customs value). The calculated sum is income for the Customs National Authority for modernization of the material base.

Excises are also indirect fees and are calculated for certain merchandise (considered harmful for human health, for the environment, or luxury products) based on differentiated quotas stipulated in the legal standards for this form of taxation. The calculation of excises presents the peculiarity that the base of taxation is made up of, according to the cascade calculus principle, the sum of the following elements: the customs value in lei at the exchange rate in the declaration + customs fee + customs commission. As well as customs fees, excises are state budget income.

Since in this option the basis of calculation for the importer's margin is the customs purchase cost, expressed in lei, at the exchange rate in the customs declaration, foreign trade companies obviously taking inflation into consideration and transforming the foreign currency customs purchase cost into lei, at the exchange rate at the date of sale (negotiation) to which they add the importer's margin. VAT is obviously added to the negotiated price.

At customs, aside from the abovementioned nonrefundable fees (customs fee, customs excess fares, customs commission and excises, according to the situation), importing foreign trade companies also pay the *value added tax* (VAT) according to the legal quotas. The basis of calculation is the customs purchase cost, precisely the sum of: customs value in lei + customs fees + customs commission + excess fares + excises, according to the situation.

As it is known, VAT is a component of the internal sales price of the imported goods. It is added to the selling price, being considered an operation in the state's account (VAT added to the sales price is called output VAT). From the output VAT, importing foreign trade companies have the right to deduct VAT paid at customs, then the difference is accrued monthly with the state budget.

Certain issues related to the purchase and registration costs of imported merchandise are the *internal expenses*: from customs to the foreign trade company's warehouse. Usually, they must be added to the customs acquisition cost to determine the total purchase cost of the imported goods. This is only possible though, if upon receiving the merchandise at the warehouse, the foreign trade companies also receive the internal transportation documents (the bills of the service providers), a fact which doesn't normally happen (taking into account that they arrive to the beneficiary only after all of the transportation documents have been confirmed by the participants: the exporter, beneficiary, transporter, customs, etc.), the bill being drawn up at a later time, only after receiving all of the confirmations. In such cases, foreign trade companies can act in four ways:

- internal expenses are to be calculated based on a percentage quota which is applied to the customs purchase cost in lei, having the differences accrued upon receiving the invoice, in expenses regarding merchandise (account no. 607);
- internal expenses are not to be included in the actual purchase price of the merchandise. They will be joined in total only when the service providers' invoices are received in a distinctive account 371/x „Merchandise price differences", afterwards they are distributed monthly based on a ratio of sold merchandise cost (account 607).
- customs formalities are to be made at an internal customs point, near the final destination of the merchandise or even where it is unloaded, as result of the development of the Romanian customs system. So, practically, there are no internal route expenses, knowing that all the expenses from the external loading place and until the customs point in the country are considered on route expenses.
- the option where all internal transportation expenses are shown directly in account no. 607 can be taken into consideration as well, if these expenses don't have a significant percentage in the cost of imported merchandise.

One should consider that as a result of additional calculations which are implied by determining actual acquisition costs by adding internal transportation expenses and especially due to delays in registering as a result of not receiving the service providers' invoices on time, foreign trade companies consider it, in most cases as the cost of acquisition that is registered in account number 371, merchandise, and 371/x "price differences for merchandise" (rule), or directly in account number 607 (exception).

Flux of imported merchandise. Usually, merchandise that is imported on foreign trade companies' own account cover the following path: external provider → customs → foreign trade company warehouse → internal clients. When foreign trade companies aim to capitalize on imports in the best possible conditions, they send imported merchandise to a specialized unit to be processed, sorted and repackaged, etc, after which they are returned to the FTC and are then sold to their clients in their renewed aspect. Therefore, before internal sales a merchandise management process takes place and implicitly the tracking of the movement and existence of the merchandise with the help of the corresponding stock accounts.

FTC financial relations consist of a series of payments to partners of the FTC which are paid in the order of merchandise circulation as follows: an importing FTC pays external providers first, then or at the same time its external service providers (shipping, insurance, etc.), customs charges and internal service providers (shipping and handling); then, the FTC recovers its expenditures and makes a profit by taking payment from its clients in exchange for the imported merchandise.

Payment for the merchandise to external providers is made in foreign currency by documentary credit, collection, credit card or valid commercial papers. Foreign currency is exchanged into lei at the daily exchange rate.

When payment for imported merchandise is made after the receipt of external invoices and the actual merchandise, exchange rate differences are calculated when paying external providers using the following formula:

ERD = Pc x (Erp – Eri), where:

ERD = exchange rate difference

Pc = paid currency

Erp= exchange rate at the moment of payment

Eri= exchange rate at receipt of the invoice

Exchange rate differences may be favorable when the exchange rate at the moment of payment is lower than the one at receipt of the invoice, or unfavorable in the opposite situation. Accounting practices classify such eventualities as financial revenues or expenses.

Payment of foreign services (foreign expenditures for transport, insurance, etc.) is made, similarly, in foreign currency.

Other payment operations necessitated by the importing process: customs payments, domestic transport, payments made by clients, etc. are made exclusively in national currency.

A distinct class of payments necessitated by the importing process is the result of eventual violations of contract stipulations regarding quality, quantity, merchandise selection, delivery deadline, lack of endorsement, or lack of timely endorsement on the part of the buyer regarding the dispatch of the merchandise etc. Such situations lead to payment on the part of the guilty party, in the form of reparation fees, penalties and fines, which, in accounting are reflected in the payer's accounts as a number of extraordinary expenditures and as extraordinary revenues on the part of the beneficiary.

Merchandise imports bought on credit, i.e. imports for which payment is made at a particular date, is determined by the shortage of financial resources of the importer. It is common practice both for simple and complex merchandise, however, generally complex merchandise is more frequently the subject of on credit acquisitions.

The exporter facilitates the use of foreign resources by the importer by establishing an interest rate for exported merchandise for the fixed period of its funding. In turn, the importer uses various solutions to find necessary resources to pay foreign interest. Obviously, the difference between foreign interest paid and domestic interest received or additional resulting revenue from other operations by using funds received from the sale of merchandise is reflected in the financial reports of the importing FTC.

Considering the above elements and regarding a series of financial and commercial issues, in economic theory and practice import credits are structured according to various criteria. Therefore, taking into consideration the situation of the FTC regarding its credit relations, one can distinguish: credits received, and credits granted by the importing FTC. According the period of credit, alternatives are: short term credit (up to one year), medium term credit (from one to three years) and long term credit (over 3 years).

Each type of credit mentioned above can be further classified according to its nature. Therefore, one can distinguish:

i) credits received:

• commercial credit. It represents the value of the imported merchandise payable at a deadline;

• bank credit and assimilated accounts payable. They represent sums of money received by means of bank loans or from other commercial companies in order to pay for imported merchandise when commercial credit is not accepted.

ii) credits granted

• commercial credit. It represents the value of the imported merchandise sold to domestic clients at a deadline, in such cases when these practices positively affect both parties.

• financial credit, i.e. sums of money resulting from domestic sales of merchandise loaned to other companies, the interest rates of which are used to compensate for interest bearing expenditures payable at a deadline.

Considering the accounting aspect, accounting practices for different types of import related credit vary according to their nature.

Short term commercial credit import has the following idiosyncrasies:

1. It is used mainly for general merchandise for a period no longer than one year. Usually it is paid off in one single payment at a deadline established in the contract under payment conditions. The deadline is stipulated in the commercial invoice by the exporter.

2. Regarding received commercial credit, the importing FTC owes interest to its foreign provider calculated using the simple interest formula. Foreign interest may be included in the price or the invoice, separate from the merchandise, and represents a distinct element of foreign financial dues. As a result, it is not taken into account when considering the cost of imported merchandise and, therefore, it is excluded from the invoices to the FTC domestic clients. The reason for this is the fact that the importing FTC usually sells its merchandise immediately on the domestic market and the payment received bears financial revenues (interest) on the period from receiving payment from clients to payment of foreign providers.

Domestic interest which is considered as financial revenue of the FTC for imported merchandise may be:

• resulting from sales of imported merchandise on the domestic market in which case the money is kept in a bank account or deposited.

• resulting from sums coming from the sale of imported merchandise in the domestic market by means of granting loans to other companies.

It is possible that the importing FTC sells imported merchandise on the internal market by means of commercial credit. In this situation they separate the interest rate from the invoice, and the interest becomes the source of financing for foreign interests. Also, the FTC may consider using resources gained from domestic sales of merchandise for other commercial operations characterized by shortness of duration, which have the potential to create additional revenue which can cover both foreign interests and part of the profit.

3. If agreed upon when negotiating the foreign contract, it is possible that the payment for imported merchandise on credit be done on the initiative of the importer. In such situations payment is usually by documentary credit and the FTC benefits from a discount, which is considered as financial revenue. However, when analyzed in correlation with financial revenues as interests received from banks as a result of deposits coming from sales of imported merchandise, it becomes clear that they are not revenues, in fact, because internal interest provided by bancs are reduced in correspondence with the anticipated payment period of external credit.

4. Payment of imported merchandise on short term commercial credit, such as any sort of import, can be made by commercial papers. However, payment by valid commercial papers is made by the importing FTC only at the deadline, regardless of the method of their use by the exporter (anticipation, forfeiting etc.)

5. From an accounting point of view, the reflection of operations related to importing on short term commercial credit implies, the use of the following accounts:

• account number 666 – which is designated for registering expenditures of interest owed to foreign beneficiaries. The recording methodology of the expenditures regarding interest differs according to whether interest is included separately or together with price on the invoice.

a) If foreign interest is billed separately from the merchandise, it is usually not recorded in accounting on receipt of the merchandise, but only in the operating register of the commercial service which manages the import, followed by the concurrent payment of interest and merchandise at the deadline (666 = 5124).

b) If external interest is included in the price, then it is deducted from the external price when the invoice is recorded and it is regarded as a financial expenditure and as an account payable (666 = 401). When the credit period stretches over two financial years, on receipt of the foreign invoice it is registered as payment in advance (471 = 401) followed by the registration of current afferent expenditures at the end of the financial period (666 = 471).

• account number 766 – which is used to track revenues from interests receivable by FTC for the deposit of liquidities originating from the sale of imported merchandise that are kept in banks or loaned to other companies.

Registration of interest revenues is done in the moment of receiving payment (5121 = 766);

• account number 767 – tracks financial revenues from the reduction of external price as a result of payment of dues in advance of the payment deadline on its credit side (in case the interest is included in the external price.) If interest is billed separately then payment is recorded together with the net sum of the interest at the deadline (total interest minus received discount.)

For a clearer understanding of the accounting mechanism of keeping the registry of imports on a firm's own account on short term commercial credit, in the following I will present a relevant case study.

FTC "IMPOGLOBUS" SRL imports merchandise in the N financial period from India on its own account on short term commercial credit of 6 months, knowing that:

✶on 1.03.N it acquires merchandise from a foreign provider under CIF delivery terms – unloading in a Romanian seaport, merchandise value: 14.341€;

✶foreign interest is included in the external price and is calculated using the simple interest formula; the interest value is 5%;

✶customs taxes are calculated based on the following quotas: customs fee 10%, customs commission 0,5%, VAT 19%;

✶on 25.03.N it sells its merchandise to domestic clients at a negotiated price of 80.000 lei, VAT 19%; on the same day payment is received;

✶on 1.08.N it pays the foreign provider both for the merchandise and the external interest;

✶variation of the exchange rate:

▪ 1.03.N: 1 € = 4,00 lei

▪ 1.06.N: 1 € = 3,80 lei

▪ 1.03.N: 1 € = 3,75 lei

To illustrate the practical example above, I will record the accounting operations in the registry of the FTC in the following situations:

A) Payment for the merchandise takes place at the due date on 1.08.N.

B) Payment for the merchandise takes place before the due date, on 1.06.N.

C) Payment for the merchandise is done by means of commercial papers, with payment at a due date. A promissory note is accepted on 1.03.N and is paid on 1.08.N.

A) Merchandise payment happens at the deadline, precisely on 1.08.N;

On 1.03.N

A1. Registering imported merchandise according to the external invoice, the customs import declaration and import calculus chart.

Table 1

Import calculus chart

	Calculation elements	Foreign currency value (€)	Lei value (1 € = 4,00 lei)
1.	**External value CIF (excluding interest)**	**14.000**	**56.000,00**
2.	Customs fee (1 x 10%)	–	5.600,00
3.	Customs commission (1 x 0,5%)	–	280,00
4.	***Customs purchase cost (1 + 2 + 3)***	***14.000***	***61.880,00***
5.	*Input VAT (4 x 19%)*	–	*11.757,20*

Observations:
1.) External value CIF (excluding interest)

a) CIF external value: 13.341 €
b) External interest: 341 €
External value CIF (excluding interest) (a – b): 14.000 €

2. External interest calculation

External interest (D) is calculated based on the external value CIF and the recalculated percentage for the interest, with the enhanced hundred formula:

$$\mathbf{D} = \frac{\textbf{EV (including interest) x } \mathbf{K^{r}} \textbf{ x t}}{\textbf{100 x T}} \qquad (1)$$

EV – external value
K^{r} – recalculated percentage with the enhanced hundred formula
t – time (credit period), expressed in months or days
T – one year(12 months or 365 days, according to how ”t” is expressed)
K – interest percentage

$$K^{r} = \frac{100 \text{ x } K}{100 + K} = \frac{100 \text{ x } 5}{100 + 5} = 4{,}76 \text{ (round figure)} \qquad (2)$$

$$D = \frac{14.341 \text{ x } 4{,}76 \text{ x 6 months}}{100 \text{ x 12 months}} = 341 \text{ \$ (round figure)} \qquad (3)$$

371 = % <u>61.880</u> lei
401 56.000 lei
446 5.600 lei
447 280 lei

Observations: External CIF value excluding external interest is recorded in account no. 401, customs fee is recorded in account no. 446, and customs commission is recorded in account 447.

A2. Simultaneously, external interest invoiced by the foreign supplier is recorded (external interest is included in the external price)

Table 2

Calculation elements	Foreign currency value (€)	Lei value (1 € = 4,00 lei)
External interest	341	1.364

666 = 401 1.364 lei

A3. Payments made in customs with issued payment orders

% = 5121 <u>17.637,20</u> lei
446 5.600,00 lei
447 280,00 lei
4426 11.757,20 lei

On 25.03.N

A4. Domestic sale of imported merchandise

411 = % <u>95.200</u> lei
707 80.000 lei
4427 15.200 lei

A5. Simultaneously, the sold merchandise is removed from stock

607 = 371 61.880 lei

Observation: See operation **A1**

A6. Receiving merchandise from domestic customers

5121 = 411 95.200 lei

On 1.08.N

A7. Paying the foreign supplier

Observations: The foreign trade company pays the foreign supplier the external CIF value (including the external interest) of the imported goods for the sum of 14.341 €, meaning the equivalent of the merchandise of 14.000€ plus the external interest of€.

a) Lei value on payment:	14.341 € x 3,75 lei = 53.778,75 lei
b) Lei value at the rate in the customs declaration:	14.341 € x 4,00 lei = 57.364,00 lei
Favorable exchange rate difference (b – a):	**3.585,25 lei**

401	**=**	**%**	**57.364,00 lei**
		5124	**53.778,75 lei**
		765	**3.585,25 lei**

B) Merchandise payment takes place two months before the due date, precisely on 1.08.N;

Observations:

4. Operations A1 – A6 from hypothesis A are maintained, thus becoming operations B1 – B6;
5. For early payment, the foreign trade company will receive a discount, which the company keeps from the invoiced value of the merchandise;
6. The discount is calculated with the external interest formula, mentioning that the time calculated is 2 months (time left until the due date).

$$\text{Discount} = \frac{14.341 \text{ x } 4{,}76 \text{ x } 2 \text{ months}}{100 \text{ x } 12 \text{ months}} = 114 \text{ € (round figure)}$$

Or external interest calculated for 6 months/3 = 341/3 = 114 € (round figure)

On 1.06.N

B7. Merchandise payment 2 months before the due date

a) External CIF value (including external interest):	14.341 €
b) Discount:	114 €
Net payable (a – b):	**14.227 €**

a)Lei value at payment:	14.227 € x 3,80 lei = 54.062,60 lei
b)Lei value at the exchange rate in the customs statement:	14.227 €x4,00 lei= 56.908 lei
Favorable exchange rate difference (b – a):	**2.845,40 lei**

401	**=**	**%**	**56.908,00 lei**
		5124	**54.062,60 lei**
		765	**2.845,40 lei**

B8. Simultaneously, the discount kept by the foreign trade company is recorded as financial income.

Table 3

Calculation elements	**Foreign currency value (€)**	**Lei value (1 € = 4,00 lei)**
The discount	114	456

401 = 767 456 lei

C) Merchandise payment is made by notes receivable

The bill of exchange is accepted on 1.03.N and paid on 1.08.N

Observation: Operations A1 – A3 from hypothesis A are maintained, thus becoming operations C1 – C3

C4. Accepting the bill of exchange for the external CIF value, including the external interest

Table 4

Calculation elements	**Foreign currency value (€)**	**Lei value (1 €= 4,00 lei)**
The value of commercial bill	14.341	57.364

401 = 403 57.364 lei

Observation: Operations A4 – A6 from hypothesis A are maintained, thus becoming operations C5 – C7

On 1.08.N

C8. Commercial bill payment

a) Lei value at payment : 14.341 € x 3,75 lei = 53.778,75 lei

b) Lei value at the exchange rate in the customs statement:14.341€x4,00 lei =57.364 lei

Favorable exchange rate difference (b – a): 3.585,25 lei

401	**=**	**%**	**57.364,00 lei**
		5124	**53.778,75 lei**
		765	**3.585,25 lei**

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