

ACCOUNTING PRACTICES REGARDING THE MEANS OF OPERATION WITH CASH FLOWS

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Abstract

In modern market economies, economic agents have a variety of methods to make payments. Thus, as a rule, they choose the payment instrument they consider appropriate for their needs, from the perspective of the speed of execution of these instruments, the transaction costs, the local characteristics as well as the legal framework that regulates the payment obligations. Another particularly important criterion to consider is that the chosen payment instrument must also be an efficient means of operating and managing the cash flow. In this context, the main objective of this article consists in presentation the letter of credit and the cash advance as effective methods of payment, but also as secure means of operating the cash flow. The secondary objectives of this paper are represented by pointing out the accounting practices related to the operations regarding the settlement and justification of the payment instruments mentioned above.

Key words: *cash flow; payment system; letter of credit; cash advance; stakeholders; accounting practices*

JEL Classification: *M41*

I. INTRODUCTION

The payment system represents an important component of the monetary system, but also of the financial infrastructure of the economy, ensuring the circulation of money and the transfer of monetary assets. As cash flow is of great significance, being considered the strong point of the enterprise's complete business plan (Grosu & Chelba, 2020), the efficient management of this flow must be the main concern of any entity.

Also, any economic entity has a social responsibility and a moral duty in the relationship with stakeholders. Under these conditions, a company that does not properly manage its cash flows and goes bankrupt, generates negative effects on the environment, not only on the owners of the company. Companies thus have a social responsibility for all their actions and decisions, this approach being deontological in nature. Through this paper we want to highlight exactly the payment instruments that can streamline cash flow management.

Today, the letter of credit is recognized by financiers around the world as the most universal method of payment in economic activity (Butakova, 2020), and the cash advance as the most useful way to settle the money needed for employees to cover expenses necessary for delegations or other administrative activities.

The purpose of this article is to present the payment instruments - the letter of credit and the cash advance - but also to present the ways to record them in accounting with the help of the system of accounts and for a clearer understanding, a breakdown of the accounting flows of the settlements based on these means was used.

II. REQUIREMENTS AND BENEFITS OF USING THE LETTER OF CREDIT IN RELATION TO STAKEHOLDERS

The sale of goods and the provision of services to foreign buyers involve additional risks in relation to domestic trade. Although the interests of the parties remain the same, the buyer wants the services to be offered and the seller - for the payment to be made. In international transactions the risks increase. These risks can be reduced by using internationally settled and internationally accepted transaction settlement techniques. In this regard, suppliers have the

opportunity to ask customers to provide them in advance the amounts needed to make payments, by opening letters of credit.

The name creditive is an adaptation of the French notion “accreditif”, derived from “a creditive” which means on credit (Gorincu, 1991: 3). The letter of credit is also called a documentary credit.

Referring to the above, we can define the letter of credit as an elegant form of business guarantee between two partners interested in conducting business operations, but which can be separated by mistrust (Moraru, 2012: 188). Not only the lack of trust is the reason why a company can use the letter of credit, but another reason can be the existence of transactions with high values.

The letter of credit is defined, in the literature, as a method of payment that guarantees the supplier the security of collection of goods delivered and services provided under the conditions and terms established by the sale-purchase contracts. The certainty of receiving the goods and services is given by the fact that according to the contractual clauses, the buyer has the obligation to transfer from his current account, in a separate account opened at the supplier's disposal, the amount provided in the contract to be settled. As the goods are delivered and the services are provided, the supplier shall present to the bank to which the letter of credit is opened in his privilege, the documents for the delivery or provision of services in accordance with the requirements of the contract and the terms of the letter of credit. After the bank to which the letter of credit is opened has verified the documents, it will transfer the equivalent value of the delivered goods and services provided to the supplier's account through his bank (Burada & Dima, 2012: 42)

Documentary letter of credit is one of the most common payment methods in international economic exchanges, in that it offers a high degree of certainty in order to collect the amounts due. The documentary letter of credit is a final payment order in favor of the seller, given by the buyer through his bank and conditioned by the presentation by the seller, at his bank counter, of the shipping documents of the ordered goods (Coman, 2009: 308).

The order of the settlement times based on letters of credit is illustrated in the Figure 1:

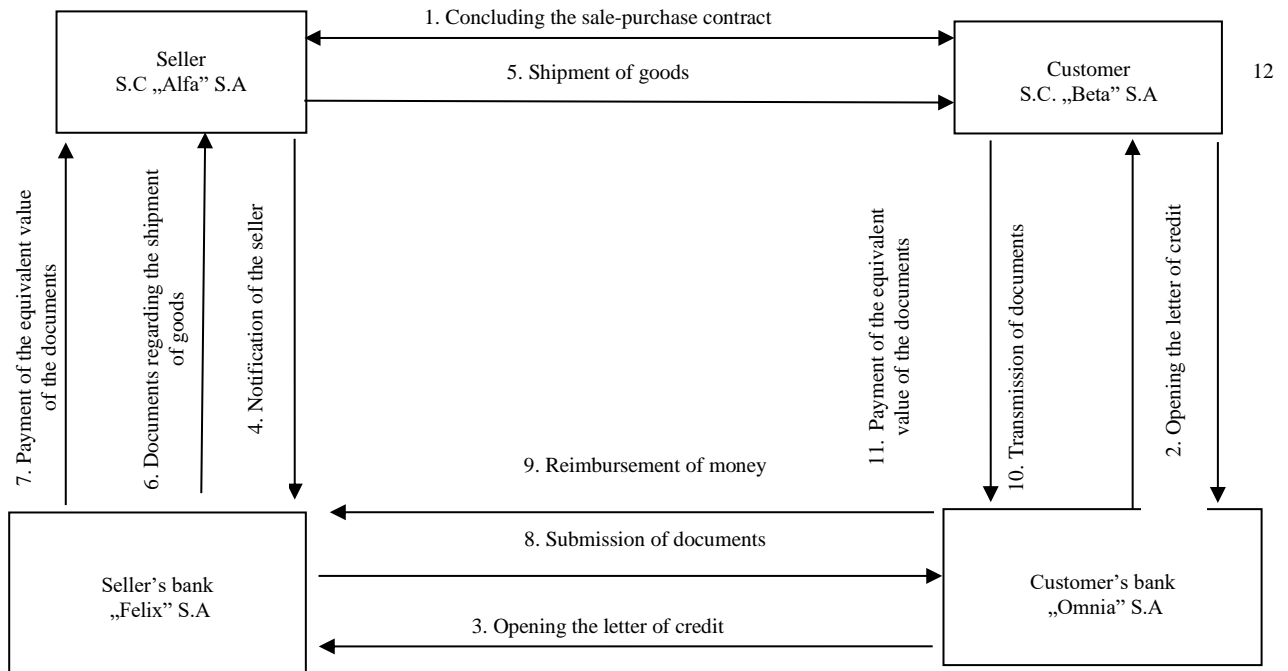


Figure 1 – The mechanism of unfolding a letter of credit

Source: Pop, 2002

The letter of credit offers the following *advantages*:

- Security of all parties involved (buyer, seller, issuing bank) due to the fact that the payment is made only if it is proved that the supplier has met all the requirements mentioned in the letter of credit;

- Buyer's assurance that payment for goods / services is made only in exchange for documents proving shipment and that are in accordance with the terms and requirements of the letter of credit;
- The security of the supplier (beneficiary) to collect the value of the goods / services, but also of the fact that the established requirements are exactly observed;
- Continuous adaptability to the different forms that international exchanges can have (Moroşan, 2011: 257).

The explanations of the *mechanism of unfolding a letter of credit* are the following:

1- The existence of a commercial contract by which the partners agreed the settlement based on letter of credit;

2- The disposition / order to open the letter of credit is given by the buyer of his bank, which also bears the name of the issuing bank, and contains all the requirements of terms and documents that the seller must meet in order to be paid;

3- The opening of the letter of credit involves the issuance of a "document" by which the issuing bank takes certain responsibility for payment in favor of the seller, under the terms and documents according to the instructions received from the buyer (the author of the letter of credit);

4- The notification of the seller (beneficiary of the letter of credit) is made by his bank and implies the effective remittance of the documents resulting from the opening of the letter of credit;

5- Delivery of the goods, accompanied by the operation of drawing up the documents required by the letter of credit;

6 / 7- The actual use of the letter of credit, respectively the seller's bank (paying bank) verifies the fulfillment of the requirements of the letter of credit and makes the payment;

8 / 9- Remittance of documents / Reimbursement of amounts - the paying bank, after making the payment to the seller, remits the documents to the issuing bank, which, after a new control regarding the compliance with the letter of credit requirements, reimburses the money of the paying bank;

10 / 11- Customer notification / Payment of documents - the issuing bank, having the documents regarding the shipment of the goods, issues them to the buyer who verifies their concordance with the indications given at the opening of the letter of credit;

12- Lifting the goods - the buyer being in possession of the documents related to the shipment of the "goods", he can go to the "carrier" to pick up the goods.

The letters of credit can be classified according to several criteria as can be seen in table below:

Table 1. Classification criteria of letters of credit

Classification criteria	Types of letters of credit
Depending on the object of activity	- commercial letter of credit, used for sales of goods; - non-commercial letter of credit for other regulatory activities for the provision of services.
Depending on the place of opening	- letter of credit opened in the customer's country; - letter of credit opened in the seller's country; - letter of credit opened in another country.
According to the clauses included in the contract	- transferable documentary letter of credit, in which the amounts can also be used for the payment of other suppliers, mentioned by the beneficiary; - non-transferable documentary letter of credit, in which only the person for whom the letter of credit was opened benefits from the values of money entered; - letter of credit for staggered deliveries, it is opened in installments and payments are also made in installments only after the delivery of a consignment of goods.
According to their character	- irrevocable letter of credit, which cannot be modified/canceled without the consent of the parties involved; - revocable letter of credit, when it can be closed, withdrawn, at any time without the consent of the parties.
According to the method of settlement of the obligation to pay	- documentary letter of credit with sight payment; - documentary letter of credit with different payment (deferred) at a certain term or at maturity; - documentary letter of credit with payment by acceptance.

Source: Adaptation from Hlaciuc & Mihalciuc, 2008

The termination of the letter of credit is made upon the expiration of the letter of credit and if the delivery documents are not presented within the validity of the letter of credit, the use of the full amount and the request of the authorizing officer, with the prior consent of the beneficiary. The unused balance from the letter of credit is transferred by the supplier's bank to the cash account of the paying bank.

The letter of credit can be constituted either on the basis of the own merits of the purchasing company, or on the basis of the availabilities attracted from its bank. Letters of credit are usually requested by the selling companies, which can be internal or external (Coman, 2009: 309).

The documents required to open a letter of credit are the following:

- Application for opening a letter of credit, but also the corresponding annexes (if applicable), completed in relation to the data from the external contract/order confirmation/proforma invoice underlying the operation;
- The original or a copy of the commercial contract and/or the proforma invoice/or of the order confirmation;
- External Payment Declaration in two copies (Moroşan, 2011: 257).

Companies that enter into relations with other economic entities have the opportunity to request the letter of credit as a means of payment for goods delivered, works performed and services provided. It is an effective form of payment security, assuring the importer that the obligations set out in the contract will be met by the exporter, as defined in the contractual clauses, with delivery taking place on exactly the set date.

III. ACCOUNTING PRACTICES REGARDING SETTLEMENTS BASED ON LETTERS OF CREDIT

The accounting of the letters of credit is kept with the help of the synthetic account of degree I 541 "Letters of credit", which is detailed on the following synthetic accounts of degree II: 5411 "Letters of credit in lei" and 5412 "Letters of credit in foreign currency" (Lepădatu, 2013: 35). According to the economic content, this account is a treasury account, and according to the accounting function it is an asset account.

The function of account 541 is shown in Table 2.

Table 2. The function of account 541 "Letters of credit"

Debit		Credit	
581 „Internal transfers”	- represents the amounts transferred from the cash account to a reserved account, opened at the supplier's disposal	- the amounts representing the value of the goods and services paid to the suppliers in the letter of credit	401 „Suppliers” 404 „Suppliers of non-current assets”
765 „Foreign exchange gains”	- favorable exchange rate differences related to letters of credit opened in foreign currency and not used at the end of the month or the financial year	- unused amounts transferred to the cash account as a result of the expiry of the letter of credit	581 „Internal transfers”
		- unfavorable exchange rate differences related to letters of credit opened in foreign currency and not used at the end of the month or financial year	665 „Foreign exchange losses”

Source: Adaption from Balteş, 2015

The balance of account 541 is debit and constitutes the letters of credit in lei and/or foreign currencies opened at the banks, at the disposal of the suppliers and not used until the end of the accounting period.

Depending on the currency used for settlement, the letter of credit can be opened in lei, for internal settlements, or in foreign currency, for external settlements. The liquidation of the letters of credit constituted in foreign currency

is carried out at the exchange rate communicated by the National Bank of Romania, from the date of the liquidation operation. Exchange rate differences between the exchange rate from the date of incorporation or the exchange rate at which the letters of credit are recorded in the accounting and the exchange rate of the National Bank of Romania from the date of liquidation of the letters of credit are recorded as income or expenses from exchange rate differences, as appropriate (Constatin, 2010:31).

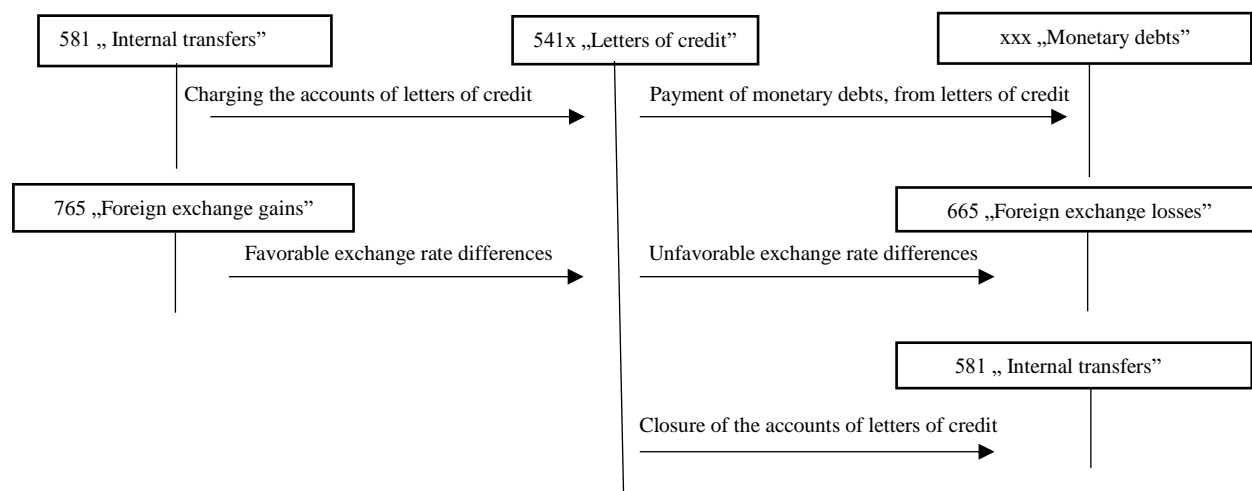


Figure 2 – Accounting flows of settlement based on letters of credit

Source: Pop, 2002

Figure 2 shows the main accounting flows of letter of credit settlements. As can be seen in this figure, in cash flow operations, letters of credit are located in the center of the supply of cash inflows and outflows (whose generation is ensured by the revenues obtained) and the settlement of debts (which involves an outflow of resources cash and obviously an increase in expenses).

IV. REQUIREMENTS AND ADVANTAGES OF USING CASH ADVANCES

A special form of letters of credit is the cash advances, which reflect the amounts granted to third parties (employees of the entity, administrators, etc.) in order to make payments in favor of the company or travel in the interest of service (Neag, Pășcan & Mașca, 2008: 199).

The use of the cash advance can be made for many reasons, for example, one of the reasons could be the supply of the company from other cities with different goods. In order to carry out this activity, it is necessary for some employees to travel in person to bring them. In order to cover the expenses of transport, accommodation, daily allowance, cost of materials and other expenses, the delegated persons are offered at the departure a certain amount of money, called cash advance, which will be justified upon the return of these persons.

The amounts representing cash advances may have as destination the following: payment of supplies of materials and other goods of lower value, provision of services, payment of transport expenses, travel, secondments, delegations, payment of advertising or protocol expenses, payment of postal services or telecommunications charges, etc. (Thomas, 2012: 265).

The supporting document on the basis of which the cash advances granted to the company's staff for business trips are recorded in the accounting is the "Travel Order" or "Delegation". This document has the following uses:

- It is a provision to the staff assigned to travel;
- It is used for settlement by the advance holder of the expenses incurred;
- It is used to determine the differences to be received by the advance holder;
- It represents a supporting document for registration in accounting (Hlaciuc & Mihalciuc, 2008: 789).

A specific feature of this category of liquidity is the fact that the amounts appear in the accounts of the holders of advances from the moment of advance until the moment when the payments made are settled. At the end of the

operations for which these advances have been granted, the expenditure shall be justified. To this end, the statement of expenditure to which the supporting documents are attached shall be drawn up. The differences between the advances received and the justified expenses are regularized when submitting the statement of expenses, by collection or payment, as the case may be (Burada & Dima, 2012: 44).

The circulation of the document "Order of travel" is shown schematically in Figure 3.

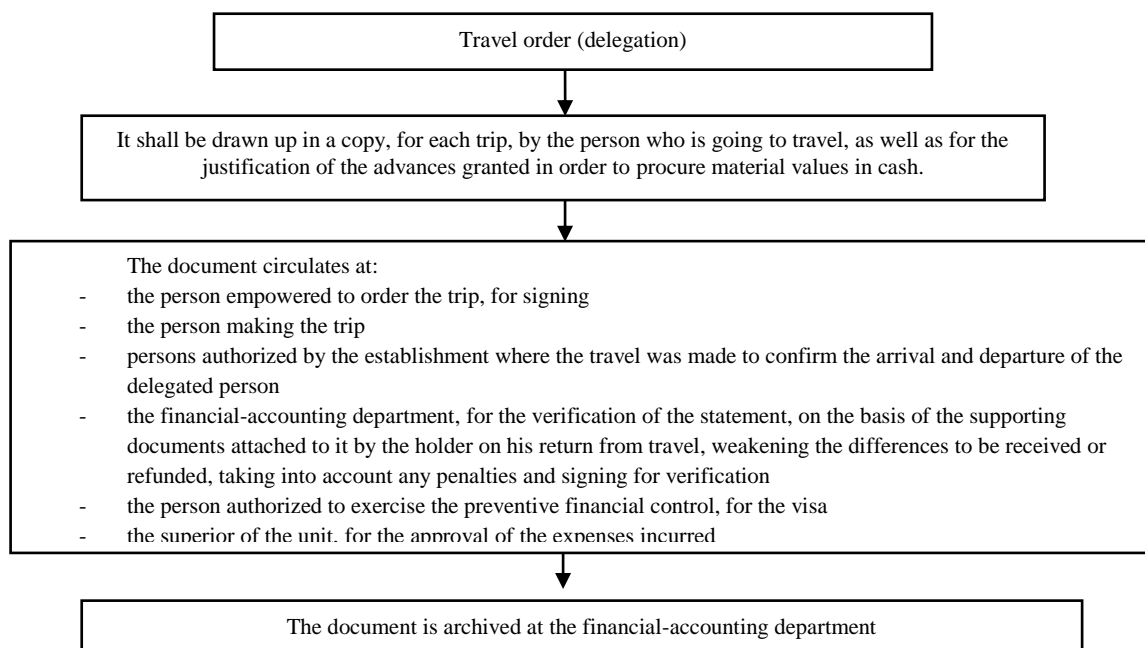


Figure 3 – Circulation of the document Travel (Delegation) order

Source: Adaption after Pop, 2002

According to Law no. 70/2015 for the strengthening of the financial discipline regarding the cash collection and payment operations and for the modification and completion of the Government Emergency Ordinance no. 193/2002 regarding the introduction of modern payment systems, payments can be made from cash advances, within a limit of a daily limit of 5.000 lei, established for each person who received advances to settlement.

According to the labor code of article 43, the delegation represents the temporary exercise, at the employer's disposal, by the employee, of some works or tasks corresponding to the service attributions outside his place of work (see <https://www.codulmuncii.ro/integral.php>). Also, the labor code in article 45 defines “the posting as the act by which the temporary change of the job is ordered, from the disposition of the employer, to another employer, in order to execute some works in his interest. Exceptionally, secondment may also change the type of work, but only with the written consent of the employee” (see <https://www.codulmuncii.ro/integral.php>).

V. ACCOUNTING PRACTICES REGARDING THE SETTLEMENTS AND JUSTIFICATIONS OF CASH ADVANCES

The record of the cash advances granted by the economic entity to the personnel or administrators or to other natural or legal persons, empowered by the company to make payments in its favor, is kept with the help of the synthetic account of degree I 542 "Treasury advances ", being an asset account. (Mateș, David, Bostan, Grosu, Dima, Șteț, Păiușan, Socoliuc & Pușcaș, 2010: 486). The cash advances can be granted in lei or in foreign currency. Within this account the amounts granted through the card system can also be highlighted.

The Table 3 shows the function of account 542. The balance of this account is debit and represents the amounts granted to staff or third parties in the form of cash advances and advances that are not paid yet.

Table 3. The function of account 542 "Cash advances"

Debit		Credit	
581 „Internal transfers”	- cash advances granted to employees or third parties	- cash advances justified by the acquisition of stocks, including related unfavorable price differences	301 „Raw materials” 302 „Consumables” 303 „Materials in the form of small inventory” 308 „Price differences on raw materials and consumables” 361 „Animals and poultry” 368 „Price differences on animals and poultry” 371 „Goods purchased for resale” 381 „Packaging materials” 388 „Price differences on packaging” 401 „Suppliers”
765 „Foreign exchange gains”	- favorable exchange rate differences related to foreign currency cash advances, usually at the end of the month, respectively the end of the financial year	- expenses representing the value of unstored materials, energy and water consumption, maintenance and repairs, insurance premiums, studies and research performed by third parties, commissions and fees, protocol, advertising and publicity, transport of goods, travel, postal and telecommunications, other services executed by third parties.	602 „Consumables” 603 „Materials in the form of small inventory” 604 „Materials not stored” 605 „Electricity, heating and water” 611 „Maintenance and repair expenses” 612 „Royalties and rental expenses” 613 „Insurance premiums” 614 „Studies and research expenses” 622 „Commissions and fees” 623 „Entertaining, promotion and advertising” 624 „Transport of goods and personnel” 625 „Travel” 626 „Postage and telecommunications” 628 „Other third party services”
5125 „Amounts under settlement”	- amounts granted as cash advances by card for the payment of expenses during staff travel (for example in the case of a transport company)	- amounts representing unjustified cash advances	428 „Other employee-related debts and claims”
		- the amounts representing cash advances, not settled until the balance sheet date	461 „Sundry debtors” 428 „Other employee-related debts and claims”
		- amounts returned in cash representing unused cash advances	581 „Internal transfers”
		- the amounts used to pay other values	532 „Cash equivalents”
		- unfavorable exchange rate differences related to foreign currency cash advances recorded at the end of the month, respectively at the end of the financial year, or at their liquidation	665 „Foreign exchange losses”

Source: Adaption after Moraru, 2012

A presentation of the main accounting flows of the settlement and justification of cash advances can be seen in Figure 4.

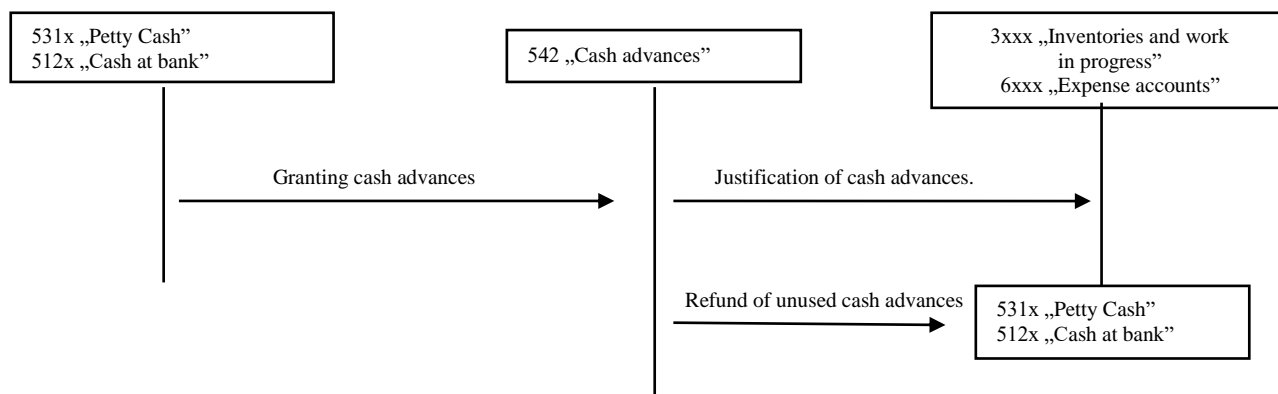


Figure 4 – Accounting flows of settlements based on cash advances

Source: Pop, 2002

If the payment incurred from cash advances is in foreign currency, the expenses are recognized in the accounts at the exchange rate on the date of the operations or at the exchange rate on the settlement date of the advance. The amounts that reflect the cash advances, granted according to the law and not settled until the balance sheet date, are highlighted in account 461 “Miscellaneous debtors” or in account 4282 “Other receivables related to staff”, depending on the nature of the receivable (Lepădatu, 2013: 35).

A difference between letters of credit and cash advances is that cash advances are granted from cash accounts (from petty cash or bank) anticipatory to cover current expenses, but whose justification is mandatory at the end of the operation for which they were given; in the event that they were not spent at the value at which they were initially (and were not justified), the cash advances are refunded to the company that offered them.

V. CONCLUSION

The letter of credit has emerged mainly as a necessity for the existence of a payment instrument in international trade, although it is used equally in both domestic and world trade. Instead, the cash advance appeared as a simple way to settle the amounts needed by the company's employees in order to meet administrative objectives. These instruments are unlikely to change significantly in the future in terms of their economic content. However, the change could be in technological developments that may be able to provide new settlement tools in the future, settlement tools which could be more attractive in terms of speed and ease of use.

Efforts to build trust between trade stakeholders are of the utmost importance in achieving the sustainability of the corporate economic environment. For this reason, in today's economic environment, the letter of credit remains one of the most popular methods of settling trade, which aims to strengthen traders' confidence, while cash advance - one of the safest ways to operate cash flow.

In conclusion, I consider that the application of the letter of credit and the cash advance by economic entities could offer them the possibility of more efficient management of cash flows, in the sense that in certain situations these resources could be involved in certain development or expansion actions of business by giving the company more flexibility in the payment system.

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