
Considerations regarding the regulation, accounting and audit of bank deposits

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Abstract

Bank deposits have been known even since the Antiquity. From the legal perspective, the bank deposit was always covered with due care and received the deserved attention, while regulations generally reflected the current views, from the legal, economic, social, cultural and religious perspectives. The new Civil Code, applicable in Romania starting from October 1st 2011, brings a new element within article 2191. The fund deposit, a change that is situated against the millennial regulations of the deposit contract, when it specifies that “Subsequent to the constitution of a fund deposit at a credit institution, it gains propriety over the deposited amounts of money”. Even since the Antiquity, the Roman jurists have caught the economic and judicial nature of the unregulated deposit contracts that emphasized the depository’s obligations. The religious obscurantism of the Middle Ages did not allow the differentiation between the deposit contract and the loan contract as passive operations meant to attract the financial resources of the bank. Nowadays, the confusion still exists and fuels the financial instability. Even since the emergence of accounting as a science, the bank deposit has been seen as a financial asset for the depositor and a debt for the banker. The accuracy of the accounting information regarding the bank deposits is validated and confirmed through the internal and/or external auditing procedures.

Keywords: Bank deposit, unregulated deposit, loan contract – mutuum, fractional reserves.

JEL Classification: M41, M42, M 48.

To cite this article:

Avram, M. and Avram, V. (2016), Considerations regarding the regulation, accounting and audit of bank deposits, *Audit Financiar*, vol. XIV, no. 7(139)/2016, pp. 783-790, DOI: 10.20869/AUDITF/2016/139/783

To link to this article:

<http://dx.doi.org/10.20869/AUDITF/2016/139/783>

1. Methodological approach

From the methodological perspective, we intend to follow the bank deposit in terms of the legal rules over a long period of time, starting from the Antiquity, through the Middle Ages and the modern times, until the present.

The investigated timeframe and the area of regulations regarding the bank deposit allow us to have a complex vision regarding the quality of the regulations, their effects on the business environment and the methods through which it is reflected in accounting. Through this approach, we consider that we are able to bring to the specialists' attention, the financial auditors' and that of the academic environment, significant elements to start a public debate meant to correct the inconsistencies that exist within the regulation of the bank deposit according to the new Civil Code.

2. Historical benchmarks

Even since the Antiquity, the public used the banks trustfully, by providing them with different amounts of money in two main ways:

- Unregulated money deposits and
- Loan contracts – mutuum.

The two methods are different both from the perspective of the economic content and from the perspective of the legal form.

The loan contract assumes that at the same moment the bank receives the money, the ownership of the money amounts is transferred to the banker, who in turn will be responsible to repay the money– tantundem at the date of maturity, as well as the corresponding interest for the period in which he gave up on the present money in order to enjoy the future money.

The unregulated money deposit does not involve the transfer of ownership rights from the depositor to the banker; the banker is mandated to ensure the depositors' access to the quantitative and qualitative equivalent of the original deposit. "Classic Roman jurists have discovered and analysed the universal legal principles that rule the unregulated deposit of money... moreover, these principles have been later found in the medieval legal codes of different European states, including Spain, in spite of the serious economic and financial regress that has been associated with the fall of the Roman Empire and the beginning of the Middle

Agas" (Huerta de Soto, 2010, p. 69). Moreover, the religious obscurantism was added. Starting from the interdiction of the interest loan, it has determined changes in the legal doctrine in the form of transferring the loan contract – mutuum, forbidden by the religious rules, into a "depositum confessatum", which apparently was a deposit, but in fact it was an interest-generating loan for the depositor.

The confusion between the unregulated money deposit and the loan contract has created, within the Anglo-Saxon system (common law), by the way of precedent, the possibility that the unregulated deposit be interpreted in a different way depending on the nature of the goods. Thus, if the grains depositors have fraudulently acted when they used the deposited grains to their benefits, bankers that used the clients' money deposits were not accused of fraud. This discrepancy has determined Murray Rothbard to ask himself, not just in the rhetorical manner "Why was the law regarding the grain deposits... oriented in the exact opposite direction, although the circumstances – of depositing fungible goods – were identical? ...was it the fact that bankers have carried out more extended lobby activities than the farmers?" (Huerta de Soto, 2010, p. 154).

When mentioning the money deposit, The Romanian Civil Code in 1865, article 1604 (2) specifies that "A money deposit, when the depositor, according to art. 1602 has made use of it, must be returned with the same coins it was made, both in the case of their value's growth or decrease" (Cercel, 2008, p. 225). The possibility that the banker uses the deposited amounts of money is acknowledged, under the condition that he respects the provisions of article 1602 "He cannot use the deposited good without the express or tacit permission of the depositor" (Cercel, 2008, p. 225). This leads to the transformation of the deposit contract in a veritable loan contract, especially if we are dealing with a term deposit with nominal interest that has been indicated or determined. These aspects have been retained by the judicial courts such as the Oradea Mare Court, which in Sentence no. 3723 of October 31st, 1924 states that "The contract, commonly known as a deposit, between a bank and the depositor of an amount of money, through which the bank has the right to use the deposited amount while paying a certain percentage to the depositor, being mandated to repay the depositor the same type, quality and quantity of currency, is really a loan. Both the ownership of the money and the risks are

transmitted to the one that receives the money, which is mandated to return the whole deposited amount on demand". From this perspective, the new Civil Code furthers the confusion when it calls a deposit a loan through which the bank "gains ownership over the deposited amounts of money and is mandated to return the same amount, of the same currency, on the agreed date of maturity or, depending on the case, upon the depositor's request, meeting the period of notice agreed by the parties, or, in its absence, the customary period" (New Civil Code, 2011, p. 451).

3. The economic content of the bank deposit contract

From the economic perspective, bank deposits represent a well-known mean through which savings are made, as a premise of economic development through investments. According to the data presented by the National Bank of Romania (Banca Națională a României – BNR, 2015) in 2015 bank savings in Romania have increased by 9 percentage points, respectively with 11,7 billion RON as compared to 2014. The growing trend of

the economy is also manifesting in the first part of 2016 (BNR, 2016).

Through the Government Order (G.O.) no. 99/2006 regarding the credit institutions and the capital adequacy, approved and modified through Law 227/2007, among the allowed activities of credit institutions are included attracting deposits and other reimbursable funds. From the commercial perspective, bank deposits are banking products. Banking products, through their nature, are part of a wider category of financial products and are different both from the tangible and intangible products from the real economy. Banking products can also take a tangible form (deposit certificates, savings certificates), but more often take an intangible form such as account entries, the evidence of their existence being proved by the entries and documents.

The lifecycle of banking products is generally long, deposits and credits being known ever since the Antiquity. The duration of a banking product can spread from one day (overnight deposits and credits), to several months, a year or even several decades (real estate loans). The common elements of banking products are displayed in Table 1.

No.	Element	Description
1	The principal	An amount of money representing either a bank receivable in the case of assets, or a bank obligation, in the case of liabilities.
2	The term	The duration of the contractual agreement that stands at the basis of the banking product, which can be: determined, in the case of the term products, undetermined, in the case of the visible products, or conditioned, in the case of collateral deposits.
3	The interest	Expenditure element for the bank in the case of liabilities or operating income in the case of assets. The interest can be fixed or variable.
4	The collateral	Warranties made either by the debtor, by third parties for the banking assets, or for the banking liabilities a deposits warranty scheme within the banking system.
5	The monetary unit	Banking products are denominated in a certain monetary unit, in the national currency or another currency, respectively.
6	The distribution	Can be made through short channels (bank - client) or long channels (by using the services of third parties that can be brokers, leasing companies, non-banking financial companies)
7	Commissions and associated charges	A series of commissions and charges can be attached to banking products.

Source: Authors' processing of Avram and Avram, 2007

The economic content of the bank deposit contract is different depending on the type of the contract, but there are generally three types of deposits:

- Demand deposits;
- Fixed-term deposits;
- Collateral deposits.

Starting from the principle of „*ubi lex non distinguit nec nos distinguere debemus*” we notice that, as formulated in the new Civil Code, it is applicable to different economic realities, as follows:

- The demand deposit mandates the bank to return, at any moment, the amounts of money that the depositor deposited. “This variety of the contract totally excludes the idea of a loan granted by the client to the bank” (Turcu, 1994, p. 200).
- The fixed term deposit, having set a maturity date and a contracted nominal interest, can be easily considered a loan granted to the bank;
- The collateral deposit made to ensure a credit given by the bank is, within the regulation of the new Civil Code, in the situation when a created warranty enters “the bank’s ownership” alongside the money deposit. From an economic perspective, however, it is the case of mutual loans.

The ceasing of the deposit account contract remains an unsolved issue of the new Civil Code, according to which banks can become perpetual owners for the amounts that are not required by the depositors. For the fixed-term deposit with automatic extension or for the demand deposits, we can practically talk about an undetermined period. For the fixed-term deposits, without automatic extension, it is customary to either transfer the amounts into demand deposits, or pay the amounts into the current account. Collateral deposits can remain the same after the repayment of the loans, just as many mortgages are not closed when the obligations are repaid.

In our opinion, it is incorrect that the legislative authorities give banks the ownership right to the money that has not been requested by the clients. For example, “in the French legal system, a deposit account which has not been active for 10 years is closed and the bank transfers the money to a deposits and consignments house, under the client’s name and ownership. After a period of three decades, the amount is transferred to the state’s ownership, through adverse possession/acquisitive prescription” (Turcu, 1994, p. 223). Starting with January 1st, 2016, the provisions of the French Civil Code were extended, when the Eckert Law no. 617/2014 was passed, from the bank deposits to the inactive bank accounts; therefore, if a client ceased any relation with the bank, after 10 years of inactivity, has all his accounts closed. The amounts are

deposited to the Deposits and Consignments House (DCH) for a period of 20 years, and afterwards are then taken over by the state if the clients or their successors do not contact the DCH in time.

4. The accounting recognition of bank deposits

The International Financial Reporting Standards (IFRS) also include the International Accounting Standard (IAS 30) *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* (IASB, 2005) which states the fact that the deposits attracted by banks are located in the liabilities side of the balance sheet as debts, as follows:

- Deposits in other banks;
- Other deposits on the financial market;
- Attracted deposits;
- Deposit certificates;
- Promissory notes and other liabilities attested by documents;
- Other borrowed funds.

IAS 30 underlines the fact that liabilities are grouped by their nature and are ranked based on their liquidity. The period from the date of the balance sheet until the date of the contractual maturity is of the outmost importance, even if, in practice, some deposits can be withdrawn at any moment, on demand, and others can be maintained for longer periods, by capitalizing the interest and the automatic extension of the deposit contract.

Deposits made at the credit institutions are emphasized using some accounts, such as:

- 132 Deposits of the credit institutions
- 253 Clients’ deposit accounts
- 254 Deposit certificates, savings certificates and librettos.

All these accounts develop into second degree synthetic accounts for deposits made in national and foreign currencies, for each currency listed by the BNR. They have a liabilities accounting function and their balance reflects the obligation of the crediting institution towards the depositors. For each group of accounts, there are provided “Attached liabilities” accounts in order to record

the interest calculated and owed by credit institutions, based on the existing deposit contracts. The analytical accounting is kept separately for each depositor, using a unique identification code.

When a deposit is made with a credit institution, in the bank's assets, one registers an increase of an item such as a financial asset that can be cash, current account, correspondent account or current account at the Central Bank. In the bank's liabilities (passive), one registers an increase of the bank's liabilities towards the depositors in one of the following accounts: demand deposits, fixed-term deposits, collateral deposits.

The most common example is represented by the cash deposit at the bank's cashier desk made to open a fixed-term deposit, reflected in accounting as it follows:

101 Cash = 2532 Fixed-term deposits

When one asks for the repayment of the registered sums in the deposit account, in the assets of the credit institution, a financial asset decreases, and in the liabilities/passive, the bank's liabilities towards the depositors decrease. The most common example is that of cash withdrawal made the depositors from the bank's cashier desk.

2532 Fixed term deposits = 101 Cash

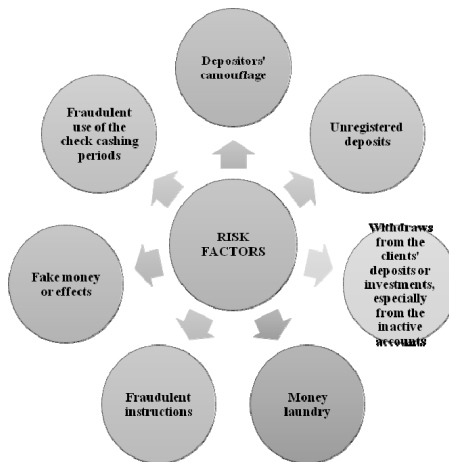
When the client does not ask to be repaid and there is no provision in terms of automatic extension of the deposit on a similar period of time, the value of the deposit is transferred into the current account opened by the client at the bank unit.

2532 Fixed term deposits = 2511 Current accounts

5. Audit procedures applicable to bank deposits

International Standards on Auditing (ISA) start from the significance of the prudential aspect of the banking surveillance authorities' role: "the key objective of the prudential surveillance is to maintain the stability and trust in the financial system, thus reducing the risk of loss for deponents and other creditors" (International Auditing Practice Statement – IAPS 1004, 2007, p. 706). The acceptance of deposits, which is a core activity for each authorized banking entity, can be accompanied by a series of *fraud risk factors* (IAPS, 2007, pp.807-808) of which the management and the other employees are aware of, as presented in Figure 1.

Figure 1. Banking deposits fraud risk factors



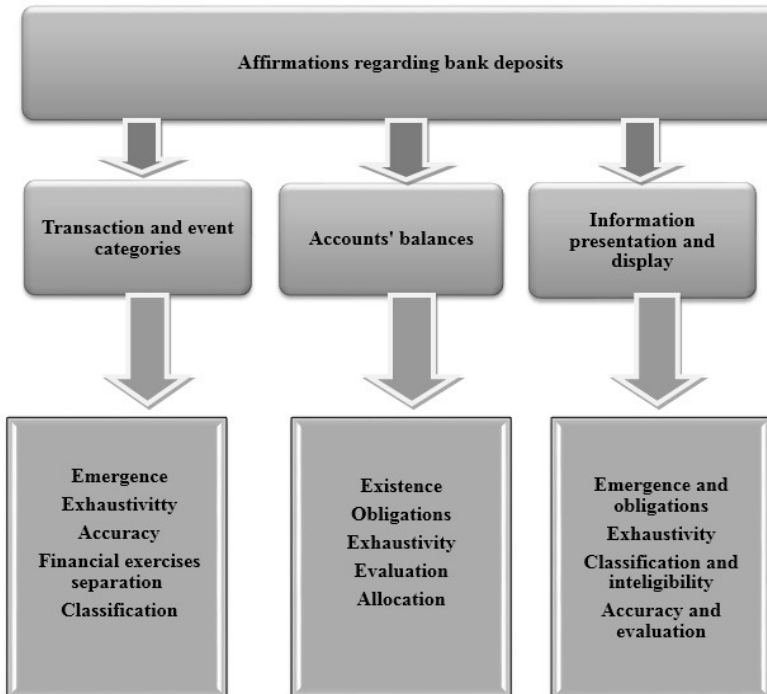
Source: Authors' processing after IAPS 1006, Appendix 1, 2006

In response to the fraud risk factors reported to the depositing cycle, financial auditors are mandated to obtain adequate and sufficient evidence by managing some baseline procedures regarding the bank's control environment and the consistency of due diligence procedures for clients and origin of the amounts deposited in the bank.

Specific procedures regarding bank deposits include analytical and conformation procedures of the average balances with interest expenditures in order to appreciate the acceptability degree of the correlation between the level of the registered deposits and the

interest trend on the specific market. The auditor pursues meeting the regulation norms and the relevant accounting principles, the potential economic dependence on certain depositors and a concentration of the maturity dates that might influence the solvability indicators in the foreseeable future. The auditor must use assertions regarding the bank deposits, displayed in Figure 2, and informational descriptions that are sufficiently detailed, for the purpose of evaluating the emergence risk regarding significant misstatements, and designing the potential additional auditing procedures.

Figure 2. Assertions regarding bank deposits



Source: Authors'– own processing after IAPS 1006, <http://www.bis.org/publ/bcb06a.pdf>

6. Long and short term consequences

The new Civil Code did not consider the extensive doctrinary debates concerning the bank deposit contract and settled a subject on which specialists have not yet reached a common perspective by "assuming the governmental responsibility" and without consulting the civil society or the professionals.

The new Civil Code supports the illusion that the amounts deposited in a bank give it the ownership right on the deposited amounts, which will determine the bank to place these funds to gain profit. Meanwhile, the funds are at the same time available to the public, which trusts that the bank will meet its obligations "of returning the same amount of money, of the same currency, on the agreed term or, depending on the case, at any moment when the depositor asks, by meeting the notice period agreed upon by the parties or, in its absence, by the custom" (Noul Cod Civil, 2011, p. 351).

There is a wide literature that criticizes the uncontrolled expansion of the credit and the fractional reserves banking systems. The fractional reserves promoted by central banks through the policy of the minimal mandatory reserves are considered a "must have" ingredient of financial crises, whose causes are found in the uncontrolled expansion of the credit. "The profound cause is the artificial expansion of the credit and the currency offer which a banking system with a central bank and fractional reserves inevitably produces" (Cerna, 2014, p. 169).

Internationally, the debate is old and there is an entire series of opinions according to which "...it is probable that there is an extreme economic instability in every financial system where the same funds are used at the same time for investments in industry or trade and as cash reserves of individuals. Our financial structure has been mostly built on the illusion that the funds can be available and invested at the same time – and this observation is applied in the case of our savings banks (and, to a lower extent, in the case of other financial institutions), like in the case of commercial banks, that offer demand deposits" (Simons, 1948, p. 320).

There is a dangerous illusion which was never absent from the history of financial crises, stock exchange and banking crashes, which, according to Hayek's profound observations, acts every time when "a universal law

principle is violated, either by a systemic coercion of the state, or by privileges, governmental advantages granted to groups or individuals" (Huerta de Soto, 2010, p. 197).

Conclusions

Bank deposits, as a means of mobilizing temporarily available savings, are at the base of the capital circuit and the renewal of the productive means through investments. The carefully regulated legal framework can contribute to the advancement of social progress reflected in the increase of public trust in banking services and products. A regulation that emphasizes "the fatal arrogance" of the authorities, by ignoring the millennial values of the human civilization, can open the way to some undesired secondary effects. Credit institutions, specialized in financial brokerage, have a vast social responsibility, their real capital being the public's trust in the integrity of the placements made by the bank for the amounts attracted from third parties. Corporate governance of credit institutions must ensure, at the same time, both the banking secret and the transparency of decisions reflected in the observance of the IFRS and the creation of a control environment suitable for the banking performance according to a well-known set of good practices.

The provisions of the new Civil Code regarding the bank deposits (art 2191) adopted through the mechanism of assuming governmental responsibility legislates the dangerous illusion according to which the amounts deposited in the bank can be, at the same time, both under the ownership of the bank, and available to the public. It is a regulation opposite to the millennial legal tradition in force, and opposite to the provisions of the Romanian Civil Code issued 150 years ago. It is time that, through the involvement of the academic environment, specialists, accounting professionals, civil society in general, a debate be initiated on this subject and generate a legal text that emphasizes the economic reality of the rights and obligations that originate in the bank deposit contract.

Last but not least, a regulation is needed for the situation of inactive accounts, starting from the example of the French regulation, so that the unclaimed amounts would not remain under the perpetual ownership of the bank, as it currently happens. The new regulation should present a clear procedure for the identification of inactive

accounts, followed by the registration of the amounts for a period of time established by law and, in the end, to be transferred as income to the state budget under the

mechanism of adverse possession/acquisitive prescription.

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