

The Legal and Accounting Dimension of Pawn

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Abstract

The growing tendency of transactions taking place in pawn shops, their importance in obtaining financial resources in times of economic crisis and the need to get complete and accurate accountancy information are the reasons of approaching legal and accountancy aspects regarding pawn. Following the course of the thematic ground, the paper presents the theoretical senses of pawn, the legal framework for the operations taking place in pawn shops, the accounting instruments used in practice, as well as the pawn's implications for the owners of the goods and of the pawn shops. In the current environment, which is continuously changing, this paper wants to be a support element for the ample and complex process of procuring financial resources and managing information.

Keywords: accountancy, pawn, financial resources

JEL code: M41, K23

1. Introduction

Pawning is an old practice, whose origins are found in ancient times, the pawning shops were the first registered credit institution. The first network of pawn shops, "The House of Lombard", was created in Europe at the end of the middle ages. Subsequently, the pawning practice was extended in America and in other areas of the world; therefore, at the end of last century, pawning was the main source of consumer loans.

Today, pawning is the alternate crediting solution that all the social categories turn to when they need to borrow small amounts of money on short periods of time, which the financial institutions can't provide giving the cost of the needed documents to obtain the credit or to avoid the bureaucracy that rules the banking system and it's also a solution that saves time.

It is known that accountancy is the best source to obtain the largest weight of information necessary to make operational and/or strategic decisions. At the same time, it's true that the inflexible patterns of the accountancy techniques were lately eliminated by taking into account the unlimited functioning manner of the accounts indicated by the booking legislation. But this doesn't mean that the theoretical base is ignored when transposing in accountancy the patrimonial implications of any transaction, including the ones taking place in pawn shops.

This paper wants to highlight the characteristics and relations of the triad legislation-accountancy-taxation at the level of pawn shops. It's known that the world is a unit in diversity and accountancy is no exception from this rule, because it is heavily ingrained by legal and fiscal rules. The pragmatic side wasn't neglected either, it supplies several accounting practices of the pawning operations; and the arguments for that particular accounting techniques which maintains the accurate and real image of accountancy weren't neglected either.

2. Theoretical and legal approaches regarding pawning

The legal framework is mainly established on the following normative documents:

- ✚ Government Order no. 28/2006 regarding the regulation of fiscal operations;
- ✚ Law no. 31/1990 regarding the commercial entities, republished with the further alterations and completions;
- ✚ The Civil Code of Romania;
- ✚ Decree-law no. 2561/1936 for the founding of pawning shops.

The Civil Code defines **pawning**⁴⁵ (pledge) as being “an accessory, unilateral, real contract, whereby the debtor remits to his creditor a tangible or intangible good to secure the liability”, in other words, a form of the loaning contract.

The dictionary defines pawning as a bond, a guarantee, a valuable object left or taken as bond. According to the same source, the bond is the tangible good left by the debtor at the disposal of its creditor as guarantee for the payment in time of a debt. Pawning is different from mortgage because it deals with tangible goods that are entrusted to the creditor or a third party. Mortgage is a real right; based on it the creditor can sell the intangible good received in guarantee from the debtor in case he doesn't pay his debt in time.

Pawning happens between two persons, namely the pawning shop as a creditor and a legal or private body, called debtor. In exchange for the pawned good, the debtor receives a sum of money, established after an assessment of the pawned good. The creditor can't use the bonded good, he is obligated to preserve and keep the good until the full payment of the claim in order to return it.

In case at the due date the debtor hasn't acquitted his debt, the creditor can proceed to working the bond. The partial payment of the debt doesn't lead to the partial extinction of the bond, because it is indivisible (Civil Code, article 1695), it is exticted only through the full payment of the debt, including the interests and the expenses generated by the preserving of the good.

An essential element for pawning is the **pawning contract**, which, beyond the reciprocal generator of rights and obligations for the involved parties, states the owed sum, the value and the nature of the pawned goods, as well as a description regarding their quality, weight and dimension. The pawning contract is signed for a period of 5 to 30 days and can be renewed countless times if the requested commission is paid until the date when the renewal is solicited.

The object of the pawning contract could be tangible assets that are in usage, such as: clothes, linen, cutlery, furniture, etc.; valuable objects: jewels, stones, gold, silver, precious metals and other expensive rocks.

The following categories of goods can't be pawned: objects of religious cult; military equipments and weaponry; objects with the logo of a public establishment; tooling; objects with a very large volume; objects that present fire or explosion danger; as well as deteriorated goods; fragile goods; objects that are known or presumed to be stolen.

As it was previously mentioned, to run pawning operations it is necessary to have a collectivity organized in accordance to certain legal patterns, an organization with an economic and social role. Such an organization is the pawning shop.

⁴⁵ The Civil Code of Romania, article 1685. Source: <http://www.dscllex.ro/coduri/cciv6.htm#t7> (July, 2009).

The main and "sole" object of a pawn shop (according to the regulations of the legal framework) is to grant credits by receiving goods for pawning.

In order to run their activity, pawn shops must observe the following conditions:

- ✚ registering in the Entry Register kept by the National Bank of Romania;
- ✚ the organization and functioning according to Law no. 31/1990, republished, with the further alterations and completions;

Therefore, the pawn shop is a business enterprise subjected to the matriculating in the Register of Commerce, according to Law no. 31/1990 (art. 36-45), and it is a form of non-banking financial institution, its subscription in the Entry Register being kept by the National Bank of Romania through the Regulation and Authorization Direction being mandatory⁴⁶, according to Government Order no. 28/2009 (art. 58 let. a). In the first part of July, 2009, there were 1676 entities registered in this Entry.

Therefore, the legal framework gives the pawn shops the possibility to organize and function in any of the legal forms stipulated by the law of business enterprises (share companies, with limited liability, in limited partnership, limited by shares or partnership firms). From the Entry register of the NBR we can see that the favorite legal form is the limited liability company, probably of its low value of corporate equity (200 lei) and other legal implications generated by the existence and ceasing of the activity of such an entity.

3. The accountancy instrumentation of pawning

The careful management of resources of any type has become an essential imperative in a world where almost everything is sold and bought, where resources are running low and the needs are growing. The informational sources reveal the growth of the number of transactions run by pawn shops with approximately 50% in comparison to last year. Accountancy is fundamental in the careful management of the resources involved in running activities, including in pawn shops.

For the practical side of our demarche, we thought it best to show an actual example regarding the stages, document support and the reflecting manner in the accountancy of pawning. The business enterprise "XZY Pawn House" Limited Liability functions as a pawn shop and was registered in the Register of Commerce in 2001 and in the Entry Register of NBR in 2008. The price list for the undamaged pawned goods practiced by the company is the following:

Price list for the undamaged pawned goods

Table no. 1.

| No. crt. | Operations | Karats | Prices/gr. gold (lei) |
|----------|---------------------|--------|-----------------------|
| 1. | Pawned gold objects | 14 | 35 |
| | | 18 | 40 |
| 2. | Sold gold objects | 14 | 63 |
| | | 18 | 70 |

⁴⁶ In order to get recorded in the Entry Register in 30 days after registering in the Register of Commerce, pawn shops will remit to the National Bank of Romania to registering request in the Entry register accompanied by the following documents: affidavit, filled up and signed by each manager, a copy of the identity document for each manager, a copy of the memorandum of association, a copy of the certificate of registration.

The business enterprise "XZY Pawn House" Limited Liability signed at 15.05.N a pawn contract with P.I., for a period of 30 days. The client leaves as bond a pair of earrings of 14 karat gold, with a weight of 4.5 gr. and a ring of 18 karat gold, with a weight of 3.4 gr. The goods are in good condition, so their price is standard, namely 40 lei/gr. for 18 k gold and 38 lei/gr. for 14 k gold.

After their assessment, the pawn shop gives the owner of the gold objects the sum of 306 lei. The practiced commission by the pawn shop is 0.5%/day, meaning 45.9 lei for 30 days ($0,5*306/30*100$).

A: The enterprise draws up *pawning contracts* in two copies, one for the „Owner” and the other for the „Pawn Shop” and it includes the following clauses:

1. The object of the contract: handing goods to the Pawn Shop (table no. 2)

Goods handed to the pawn shop

Table no. 2.

| No. Crt. | Goods | Measuring unit (gr.) | Quality unit (k) | | Price/gr. gold (lei) | Value (lei) |
|--------------|-------------------------|----------------------|------------------|----|----------------------|-------------|
| | | | 14 | 18 | | |
| 0 | 1 | 2 | 3 | | 4 | (2*4) |
| 1 | A pair of gold earrings | 4,4 | x | | 35 | 171 |
| 2 | A ring | 3,4 | | x | 40 | 136 |
| 3 | – | – | – | – | – | – |
| Total | | | | | | 306 |

2. The goods' assessment: established on mutual agreement.

3. The calculus method for the terms and commissions:

- ✚ The business enterprise "XZY Pawn House" Limited Liability specifies that the period for which the contract is signed is 30 days. The owner can suggest a different term until he estimates that the goods will be retrieved.
- ✚ The commission is 0.5% / day of the good's pawning value established previously on mutual agreement and it will add up to 45.9 lei.
- ✚ The obligations of the parties:
- ✚ The pawn shop must keep the goods for the disposal of the owner for the period of the contract; in case the goods are lost by the guilt of the shop, the owner will be compensated with the pawned sum associated to the goods.
- ✚ The owner must acquit the loaned sum when retrieving the goods, as well as the commission owed for the days when the loan was used, but not a commission for less than 5 days, because this is the minimum length of the contract.
- ✚ The goods are returned only to the owner or another person who has an empowerment mandate from the owner.
- ✚ Transferring the ownership: the parties decide that at the end of the contract the goods that were not retrieved will pass into the ownership of the pawn shop.

B. The signed *contracts are registered* in a register drawn up by the person who holds the cashier position in the pawn shop. This register is shown in table no. 3 and it stipulates the following:

UNIT: The business enterprise "XZY Pawn House" Limited Liability

Page number

REGISTER month L

Table no. 3

| No. Crt | Recording date | Document (type, no., date) | Explanations | Sum |
|-----------|----------------|----------------------------------|--------------------------|-----|
| 0 | 1 | 2 | 3 | 4 |
| 1 | 15.12. N | Pawning contract no.3214/15.12.N | Pawning precious objects | 455 |
| 2 | 15.12.N | Pawning contract no.3215/15.12.N | Pawning precious objects | 306 |
| To return | | | | 761 |

C: Granting the loan

The booking of the operation is the following:

| | | | |
|---------------------|---|-----------------------|-----|
| 461 Various debtors | = | 5311 Cash desk in lei | 306 |
|---------------------|---|-----------------------|-----|

Outside of the balance are concomitantly registered the pawned goods, at the total value of the granted loan, for both cases:

| | |
|--|-----|
| D 8033,,Material values received for keeping or in custody | 306 |
|--|-----|

D: When the **contracts are due** there are several possibilities, such as:

- D1. The loan is reimbursed, without asking for the extension of the contract;
- D2. The reimbursing term is extended;
- D3. The loan isn't refunded and the pawn shop:
 - a) registers the retained goods as an inventory object;
 - b) decides to sell the goods.

D1. The loan is reimbursed, without asking for the extension of the contract (cashing disposal);

| | | | |
|-------------------------|---|--|-------|
| 5311,,Cash desk in lei" | = | % | 333,5 |
| | | 461 Various debtors | 306 |
| | | 704 Revenues from performed works and services | 43,5 |

Pawn shops have different commissions (generally between 0.5% and 1% per day), different assessments (for example, for a gram of 14 karat gold they grant between 35 and 38 lei, and for 18 karat gold between 38 and 40 lei) and different pawning conditions.

| | |
|---|-----|
| C 8033 „Material values received for keeping or in custody" | 306 |
|---|-----|

D2. The reimbursing term is extended

This is considered to be practical, the contract is new, but the booking remains the same. The quantum of the loan is the same, only the quantum of the commission is changed and is retained either when extending the reimbursing term, or at the due date. If the first commission was not paid at the end of the contract, then it must be paid / cashed by the pawn shop when the contract is extended. The goods received from the owner, at their pawning value, are registered outside of the balance.

D3. The loan isn't refunded and the pawn shop

a) registers the retained goods as an inventory object (in case the pawned shop meets the necessary conditions to be acknowledged as a fixed asset, the adequate account will be used);

The retained goods are compensated with the loan granted to the owner.

| | | | |
|---|---|---------------------|-----|
| 303 Materials of inventory objects nature | = | 461 Various debtors | 306 |
|---|---|---------------------|-----|

Because the entity sells on the market with 48/50 lei a gram of 14 karat gold and 55/60 lei for 18 karat gold, these must be registered at the market value. The difference is acknowledged as an income.

- for the pair of earrings of 14 karat gold, with a weight of 4.5 gr.:
(4,5g*50 lei - 4,5g*38 lei= 54 lei)
- for the 18 karat gold ring, with a weight of 3.4 gr.:
(3,4*60 lei - 3,4*40 lei = 68 lei)

| | | | |
|---|---|--------------------------------------|-----|
| 303 Materials of inventory objects nature | = | 758 Other revenues from exploitation | 122 |
|---|---|--------------------------------------|-----|

b) decides to sell the goods

When the entity decides to sell the goods, it must also register the VAT debt for the value of the goods that have become its propriety. In this moment, the goods are considered merchandise and the selling to third parties is entered in the books.

| | | | |
|-----------------|---|---------------------------------------|--------|
| 371 Merchandise | = | % | 428,00 |
| | | 461 Various debtors | 306,00 |
| | | 378 Price differences for merchandise | 102,53 |
| | | 4428 Undue VAT | 19,47 |

At the same time, outside the balance, the value of the pawned goods must be diminished and sold off.

| | |
|---|-----|
| C 8033 Material values received for keeping or in custody | 306 |
|---|-----|

Selling the goods pawned previously, which have become the propriety of the pawn shop, is booked as follows:

| | | | |
|-----------------------|---|------------------------------------|--------|
| 5311 Cash desk in lei | = | % | 428,00 |
| | | 707 Revenues from sold merchandise | 408,53 |
| | | 4478 Collected VAT | 19,47 |

The discharging of the sold merchandise:

| | | | |
|---|---|-----------------|--------|
| % | = | 371 Merchandise | 428,00 |
| 607 Expenses regarding the ceased merchandise | | | 306,00 |
| 378 Price difference for merchandise | | | 102,53 |
| 4428 Undue VAT | | | 19,47 |

In practice, pawn shops also have the following accounting options: using account 2678 *Other fixed claims* in order to highlight the claim to the owner of the pawned goods, or using account 708 *Revenues from various activities* instead of using account 704 *Revenues from performed works and services* in order emphasize the commission.

We considered these accounting practices wrong because:

- ✚ the fixed assets are defined assets that generate benefits and are hold for a period longer than one year (OMFP 1725/2005 for the approval of the accounting regulations adequate with the European directives⁴⁷, art 64, align. 1) or the pawning contract is signed for a period of 5 to 30 days;

⁴⁷ Published in Official Gazette no. 1.080 from 30.11.2005

- ✚ for the pawn shop, the agreed commission doesn't have a random, divers feature, it results from its "main and unique" activity object, as it results from the legal framework;
- ✚ using account 2678 *Other fixed claims* calls forth the use of a financial income account (763 *Revenues for fixed claims*) and not an account of incomes from exploitation.

At the same time, the specialized literature opts for the use of account 708 *Revenues from various activities* in order to highlight the difference between the selling price and the procuring price of the jewels, taking into account this aspect when discharging. We think this accounting solution is not erroneous.

4. A few fiscal aspects

The collected interests or commissions by the pawn shops for granting loans represent the revenues obtained from providing financial services, which, according to the stipulations of the Fiscal Code, are operations free of value added tax. These revenues are VAT free regardless if the fixed assets left by the debtor as a bond are returned or not.

But, if the loan is not reimbursed, the pawn shops owe the value added tax for the value obtained after selling the good that has become its propriety. Pawn shops are taxable persons with a mixed system, because the delivering operation of old objects made out of precious metals or rocks or semi-precious rocks (second-hand goods as they are called by the fiscal legislation) is taxable (art. 152 2), and the operation of granting loans is a exonerated (art. 141 align. (2) let. a) pct. 1). The tax base is represented by the difference between the total profit margin achieved by the re-selling taxable person and the value associated to that margin, according to art. 152 2, align (13). Therefore, taxation means gain for pawn shops because the run transactions are subjected to the mixed VAT system.

5. The advantages and disadvantages of pawning

The granted/received loan as a result of signing a pawning contract has advantages and disadvantages, regardless of the two positions we could find ourselves in. Thus, for: For the pawn shop can be identified a series of advantages, such as: (i) the short loaning period; (ii) the high level of the commission in comparison with the (monthly) interests retained for bank credits; (iii) the commission is VAT free; (iv) increasing the incomes by selling the goods "obtained" at a price below their market value. On the other side, the disadvantages are: (i) the growing stocks of pawned goods that can't be capitalized because of their deteriorating condition; (ii) the need for additional expenses to process the pawned goods as a result of their incondite state. With the (taken) risk to "ignore" the managing principle of accountancy, we mention that the pawning advantages for the owner are: (a) receiving a loan in a short period of time, with minimum documents; (b) the possibility to reduce the length of the contract (a minimum of 5 days); (c) using as a bond goods that are not exactly in fine shape, etc.

Among the disadvantages for the owner are: (a) receiving a relatively small loan, compared to the market value of the goods; (b) high commission in comparison to the (monthly) interests retained for credits (between 0.5 and 1% per day); (c) in case the loan is not reimbursed at the due date, the pawned goods are lost.

6. Conclusions

The aspects mentioned previously allow drawing the following conclusions regarding the features of pawning and the accountancy of pawn shops. Therefore, if from the point of view of the creditor, pawning is a profitable business, especially in periods of crisis (like the current

times), for the owner, pawning is a good solution only for passing financial crises, given the high costs involved in this manner of procuring financial means (over 150% per year). If the necessity of financial resources spreads on a longer period of time, the solution of turning to banking companies or the informal help of the family must come first. The granted loan after signing a pawning contract is a "treasury" loan, on short term, usually 30 days. This is a reason to consider as inopportune the use of a financial fixed assets account (2678 Other fixed claims). Even if, according to the current accounting regulations (The Ministry of Economy and Finances Order 2374/2007⁴⁸), the function of the accounts is not limitative, in support of our theory come the definitions associated to the fixed assets, which are also stipulated in the legal framework.

For pawning a minimum of documents (identity card or passport, pawning contract) and conditions are needed, and through pawning both the pawn shop and the owner reach their goals (obtaining financial resources). The pawn shop obtains income after investing the liquidity surplus, and the owner receives liquidities right away, without the status of an income earner. Both sides face the risks associated with this type of service. We wouldn't like to leave out the role of accountancy in single ledger when booking the pawn operations. Despite of the "primacy" of accounting in double entry, it is still a welcomed presence on the accounting scene.

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⁴⁸ Regarding the alterations and completions of the Ministry of Public Finance Order no. 1752/2005 for the approval of the accounting regulations adequate with the European directives, Official Gazette no. 25 from 14.01.2008