INTERNATIONAL PAYMENT METHODS AND TECHNIQUES FROM THE ACCOUNTING PERSPECTIVE

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Abstract

The starting point in our study regarding the international payment methods and techniques is the idea according to which the international settlements are based on uniform fundament rules set by the states that take part in international trade. Since the world economy and especially the international trade have evolved, these rules are changed and adapted to international trade necessities resulted from international trade. The importance of the topic consists in the idea that companies in our country are increasingly adopting, international trade activities. For this reason, in this paper we will conceptually determine the methods for international settlement, as well as present the accounting consequences regarding the international trade activity settlement. It is necessary to study the accounting implications that regard the management of collection and payment activities in the intra- and extra-community trade since international trade as well as European and international influences in national accounting regulations have been developed in our country.

Keywords: international payment methods, letter of credit, advance payments

JEL classification: M40, M41, G20

1. Introduction

The obligations for payment that result from trade activities carried out by various trade agents must be fulfilled at a particular moment which involves using payment or settlement methods and techniques, mentioned previously in the partner agreement. The international payment methods consist of all the payment operations and techniques, banking supervision, the flow of documents by which the creditor charges the debtor the receivables resulted from international economic exchange. Among the most popular methods of payment we note: the letter of credit, the documentary collection and the money order.

2. The letter of credit

The letter of credit is a frequently used in international trade activities that we find in two forms: the letter of credit and the import/export letter of credit.

The letter of credit is a frequently used payment method in international transactions that is requested especially in the case of high-value contracts or when there are doubts about the partner’s solvability. This payment method offers warranty to both parties, and defends their interests during the payment process. When using the letter of credit in optimal conditions the exporter will have to make rigorous administrative efforts and the importer will bear certain specific costs.

The Letter of credit (L/C) is a firm engagement that a bank takes, as per the order of its client (the importer), to pay a certain amount to the exporter by another bank, at the set due date by the letter order in...
exchange of the documents that stipulate that the goods have been delivered. In other words, the letter of credit shows the settling method by which payments are made from a distinct account, from the importer to the exporter’s bank, as the goods, services and works are delivered.

Due to the variety of international trade operations and the versatility of the letter of credit, in international practice there are different types of letters: the standard letter and the special letter.[2]

The standard letters are of different types:
- the revocable letter of credit-that can be cancelled and changed without the beneficiary’s consent;
- the irrevocable letter of credit- that cannot be cancelled and changed without both parties’ consent;
- the confirmed LC- the confirmation of payment is done by a second bank besides the importer’s bank;
- the unconfirmed LC- the payment is done only by the issuing bank confirmation.

The forms of the special letter of credit are:
- the red clause LC- that has a special clause by which the bank is authorised to grant a pre-payment to the exporter before the documents are issued;
- revolving LC- the assigner’s bank commits to reactivating the initial amount after being used, a practice used to contract high values that have equal instalments deliveries;
- the Stand-by LC- the assigner’s bank commits to making payments when the importer does not fulfil its contractual obligations;
- the transferrable LC- the initial beneficiary can totally or partially transfer the rights onto another party’s letter (one of its suppliers).

The procedure for the LC involves four parties:
- the applicant – the one that applies for the letter of credit;
- the issuing bank- that takes on the payment engagement on the assigner’s request;
- the credit beneficiary- the parson for whom the credit was opened and that has to provide to the bank the documents according to the transaction in order to be paid the amount for the delivered goods and services;
- the beneficiary’s bank.

In order to open a letter of credit one must follow the following steps:
- the issuance of the LC, an operation by which the importer demands to its bank the opening of a letter of credit and the exporter is informed by the issuance by its bank that has been notified by the importer’s bank;
- the amending operation, by which the terms and conditions of the credit can be modified after the issuance;
- the use operation by which the transfer from the importer to the exporter is made through the banks, after delivering the goods and based on the documents necessary for the payment by credit;
- the settlement operation, by which the payment is made by the banks from the importer to the exporter.

The LCs are to be found in international practice under different shapes: forward payment, acceptance LC, future payment, red-clause payment. The forward payment LC had a 40 day minimum duration, during which the exporter will deliver the goods and the payment is done immediately. The acceptance LC lasts 60-180 days. During this period a forward payment bill of exchange is issued which the exporter will discount, the discount credit amount being calculated by difference between the invoices, the discount fee and banking commissions.

Example on the deployment of an acceptance LC:
An economic agent from Romania exports merchandise with the amount of EURO 40000 to an economic agent from Germany (importer), with payment by acceptance LC, for 180 days.

The settlement of the transaction involves the following stages:
- the German agent orders its bank to open a LC in a Romanian bank for 180 days;
- the Romanian agent delivers the goods according to the LC conditions and issues the documents in its bank, together with a bill of exchange issued on the issuing bank amounting to EURO 40 000;
the exporter’s bank issues the documents and the bill of exchange to the importer’s bank in Germany.

By this transaction, the exporter has had the possibility to discount the bill of exchange and to get the discount credit from the bank before the due date and the importer could pay for the merchandise after its delivery.

The future payment LC is very similar to the supplier credit given by the exporter to its client. By this payment method, there is a 30-60 day gap between the moment when the documents have been submitted and the moment when the payment is done.

The red clause LC involves a complete or partial payment to the exporter, in the form of an advance, before the arrival at the bank of the documents linked to the transaction. It is assimilated to the client credit and destined to buying raw materials to manufacture the products ordered by the importer.

In order to deploy an LC the following documents are necessary: invoice, shipping documents, delivery note, advice of delivery, insurance policy, import licence, export licence etc.

Using the LC as method of payment ensures the security of all parties involved because the payment is done only after the supplier demonstrates that it has respected all the conditions in the credit. Also, the credit ensures confidentiality and promptness while deployed the credit discount and it is adaptable to the diversity of international transactions.

From an accounting standpoint the track of these payment techniques is kept by the 541 Account “Credits”, mentioning that in international trade the transactions are made in a foreign currency and the synthetic 2nd degree account “Foreign Currency Credits” Is used. Moreover in international transactions there are differences in the exchange rate and for this reason they must be recorded as revenue or expenditure from different exchange rates.\(^1\)

**Next up we are going to present the topic of the documentary credit from the accounting perspective.**

A company has as main activity the delivery of export goods and cashes advance payments from its clients to launch the orders. The guarantee for the advance is made by opening a credit by the export company and also by the client for the remaining amount. The exporter buys raw materials from an EU supplier, by intra-community purchase, and the payment is guaranteed by the company by opening a transferrable credit, with a due date in 60 days after the goods delivery. At the same time, the exporter opens up a credit in lei for the payment of a domestic supplier.

The credits to guarantee the advance payments charged from the clients are opened from a mortgage credit line, and the ones for the payment to suppliers are with collateral cash.

1. The company gets an order of EURO 150 000 from a Moroccan company from which it charges an advance payment of 10%. The accounting records occasioned by the transaction will be the following (in practice, such transactions create exchange rate differences, due to the gap between the invoice and the payment, consequently affecting the profit and loss balance by including these expenditures/revenues as the differences are unfavourable/favourable):

   a) Recording the down payment of EURO 15 000 (150 000 * 10%)

   | Debit | 5124 “Foreign Currency Bank Accounts” | EURO 15 000 |
   | Credit | 419 “Clients-creditors” | EURO 15 000 |

   b) Recording the selling invoice

   | Debit | 4111 “Clients” | EURO 150 000 |
   | Credit | 707 “Revenue from selling goods” | EURO 150 000 |

   According to the fiscal code (art. 143, line 1) this export delivery is VAT exempt with a discount right if the invoice is correctly written, if there is a customs export statement certified by the customs authorities and if there is the shipping document.

   c) Recording the invoice payment, taking into account the advance payment made previously

   | Debit | 419 “Clients-creditors” | EURO 150 000 |
   | Debit | 5124 “Foreign Currency Bank Accounts” | EURO 15 000 |
   | Credit | 4111 “Clients” | EURO 150 000 |
Note: Once the credit in opened for the 15.000 advance payment the record in made in the extra balance account 8011 “Endorsements and warranties given” and for the remaining account the record is made in in 8021 “Endorsements and warranties received”. After completing the delivery these accounts are closed.

2. The purchase of raw materials is done by a supplier in France and it amounts to EURO 75.000. The warranty for the payment is done by opening a credit with 60 day duration after the delivery. The recordings are going to be the following:

a) Opening the credit

\[
\begin{array}{c|c|c}
\text{Debit} & 581 \text{ “Domestic transfers”} & \text{EURO 75.000} \\
\text{Credit} & 5124 \text{ “Foreign Currency Bank Accounts”} & \text{EURO 75.000} \\
\end{array}
\]

and

\[
\begin{array}{c|c|c}
\text{Debit} & 5412 \text{ “Foreign Currency Credits”} & \text{EURO 75.000} \\
\text{Credit} & 581 \text{ “Domestic transfers”} & \text{EURO 75.000} \\
\end{array}
\]

According to OPFM 3055/2009 (line126) the credits are subject to monthly re-evaluation as per the NRB exchange rate, a procedure that affects the profit and loss account by including the expenditures and revenues as well as the favourable and unfavourable differences.[4]

b) Recording the raw material invoice received from the supplier in France:

\[
\begin{array}{c|c|c}
\text{Debit} & 301 - \text{“Raw materials”} & \text{EURO 75.000} \\
\text{Credit} & 401 - \text{“Suppliers”} & \text{EURO 75.000} \\
\end{array}
\]

and

\[
\begin{array}{c|c|c}
\text{Debit} & 4426 \text{ “VAT deductible”} & \text{EURO 18.000} \\
\text{Credit} & 4427 \text{ “VAT collected”} & \text{EURO 18.000} \\
\end{array}
\]

In the case of intra-community purchases, the company has to be recorded in the Intra Community Operators Registry, recording the Vat is made by reverse taxation, and the value of the purchase must be stated in the VAT discount and the recap VIES statement.[5]

c) Recording the payment by credit

\[
\begin{array}{c|c|c}
\text{Debit} & 401 \text{ “Suppliers”} & \text{EURO 75.000} \\
\text{Credit} & 5412 \text{ “Foreign Currency Credits”} & \text{EURO 75.000} \\
\end{array}
\]

To open the credit in favour of the Romanian supplier the accounting records are similar to the ones for the external credit only that they use the 5411 account “Credits in lei”.

3. The documentary collection

The documentary collection is a payment method used in foreign trade that involves more parties, so that the exporter as seller transmits its bank the documents that prove the delivery of the goods and the bank issues to the importer’s bank the documents that are to be presented to its client and to demand the payment of the goods. Consequently, the documentary collection involves some document manipulation between the banks of the partners according to the instructions received from the exporter.[3]

The operation flow by documentary collection is as follows according to the next stages:

- the exporter gets the documents that are the basis of the transaction stated in the contract;
- the exporter submits the documents to the bank together with a collection order;
- the exporter’s bank checks the documents and then sends them to the importer’s bank;
- the importer’s bank issues the documents in exchange for the payment according to the instructions in the collection order;
- the importer’s bank makes the payment by debiting the importer’s account and crediting the exporter’s bank account;
- the importer gets from his bank the documents that are sent by the exporter and so it can gain possession of the goods;
- the exporter’s bank credits the client’s account by the value of the delivered goods.

The necessary documents for the documentary collection are the ones we noted for the Letter of Credit (invoice, shipping documents, delivery note, advice of delivery, insurance policy, import licence, export licence,
bill of exchange, other documents). The international practice uses more types of documentary collection classified by the documents needed for payment and by the way in which the importer gains possession of the documents.

There are two types of collections based on the documents that flow between the banks: the simple collection, which involves a flow of financial documents without using any commercial documents, and the documentary collection that uses commercial documents, the financial ones being optional. The collection may be classified according to the way the importer gains possession of the documents: “documents in exchange for payment” collection, a situation in which the importer gets the documents after completing the payment, the “documents in exchange for acceptance” collection in which case the bank issues the documents to the importer after accepting a bill of exchange and the payment for the goods is at the due date of the bill of exchange usually 30, 60 or 90 days. Unlike the credit, this method in less secure for the exporter since the merchandise is delivered without any payment warranty, a situation in which, for the exporter there are risks of not being paid, delayed payment and other commercial risks. Often, these risks are covered by using the bill of exchange, advance payment demand, protecting the change in the title of ownership, demanding a bank letter of credit for the collection. Another way to minimize the risk of not being paid is the binding of goods, so the merchandise is not released to the importer until proof of payment is provided.

Therefore we note that there are advantages on the part of the importer in the case of this method, and for this reason the documentary collection in international payments is less frequent, being used largely in non-commercial relations.

4. Conclusions

The international payment methods are used in the commercial transactions to cancel the payment obligations that result from the foreign trade and cooperation activities between partners from different countries.

The specific nature of the international payment methods is given by the moments when there are payment obligations between partners. Depending on the provisions in the international agreements between partners there may be the following payment relations: advance payments as down payments, payments when the documents arrive, term-payments.

Regardless of the payment relations, the international payment methods must have warranties for economic deliveries and warranties for payments in favour of the partners.

By using the letter of credit the risk on not being paid is significantly reduced, and for this reason the exporters use it very often as a settlement. The documentary credit is the most frequently used because it has a banking warranty unlike the other international payment methods.

The records of the settlements for the trade activities is relatively easy and must respect the existing national and international accounting regulations so as not to alter the company’s balance.

5. References