



ABOUT ACCOUNTING INTERPRETATION SOME MARGIN PURCHASES, SHORT SALES AND FINANCIAL INSTRUMENTS LENDING

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Abstract

It is axiomatically that financial markets are not only the most sensitive, but also the most dynamic. On these markets are born daily new financial instruments, and also die exhausted attractiveness instruments. This is an ongoing process that requires adequate changes in the accounting information system of banks. This manuscript presents some views on the necessary accounting interpretation of three attractive financial operations, namely:

- short sales;
- margin purchases;
- lending of financial instruments.

Accounting interpretation in this article is limited to the current accounting entries and accounting valuation of shares in cases where they are subject to those three types of transactions.

Keywords: accounting entries; valuation; short sales; margin purchases; lending of financial instruments; shares.

Additional data:

UDC 336.763.061.71

GRNTI 06.73.00

JEL Code G23, M41

Received 20 January 2014

Accepted 27 February 2014

Introduction

A few years ago for the first time Bulgarian government started to regulate margin purchases, short sales and lending of financial instruments (Ordinance of the Republic of Bulgaria 2004 SG. 65). Through these act has regulate where and how banks can use cash and financial instruments of its clients for its own account or for the account of other customers and to use their cash and financial instruments on behalf of its clients. This is done through a number of techniques, the increased interest in which is reasonable bases to the author of this material offer it here (Kolev N., 2008), regardless of the fact that on the Internet can be found some other interpretations on the theme (Hedge fund accounting, 2011). Some topics in some books can be useful as well (The IFRS Foundation and the IASB, 2013).

Research Methodology

Work on the topic is based on the discussions observation, legal framework analysis, case study faced by banks in transactions with client financial instruments on its own behalf and on subjective hypotheses about their possible accounting interpretation.

Discussions observation

Discussion on regulation and accounting interpretation of lending of financial instruments can be found back in the 90s (Lipson P, 1990), but carried out at a meeting of the IASB in October 2009 (The IFRS Foundation and the IASB, 2013). The important thing about it, however, is that in the preparation of materials and the very discussion attention was directed more towards repo transactions financial instruments and their possible accounting interpretation. There are not brought out such hypotheses and no given such prescriptions as in issue in this manuscript banking operations.

Margin purchase

“Margin purchase” was made when the bank bought financial instrument for its client and pay for it by its given credit for the same purpose. Disposition of the financial instruments are recorded in the register of the depository institution in which records are kept for those financial instruments. The debtor owes the creditor financial instruments in the same type, number and issue, under the terms and conditions specified in the contract for margin purchase. It should be borne in mind that the bank can lend its financial instruments, borrowed financial instruments and financial instruments of its clients in the quality of their service agent. Moreover, the bank can use client funds reported on his account for short selling on its own account or the accounts of other clients to the extent that they are regarded as collateral for margin purchases or short sales.

Subject to margin purchases in Bulgaria can only be traded "on the floor" of the Bulgarian Stock Exchange (B.S.E.) securities that are daily turnover (prices "Closing") of not less than 20 million lev. Requests for these transactions are identified and differentiated from the exchange. The settlement of these transactions becomes described above. For this purpose, the Bank opens and maintains itself in a separate account for margin purchases of each customer who performs margin purchases. This account bank results obtained from the customer cash and financial instruments as collateral for margin purchases, and their claims to him provided his margin loans. Analytical reporting on this account must allow identification of the number and type of financial instruments that are secured by collateral or due from him on his margin transactions.

The total value of the margin loan is recorded on the debit side of the special account for margin purchases of customers, which opens in the bank. Cash that are deposited under the contract by the customer in a margin account reduce the size of the margin loan. These funds are recorded on the credit his account for margin purchases, the date of deposit thereof. Moreover, the bank should open at the Central Depository separate margin account for financial instruments of each client.

This mechanism of margin trading of financial instruments and its accounting interpretation can be demonstrated by the following.

Example

Suppose that on 05.01.2014, the client has entered into TB "X" to the agency contract on margin purchases of unlimited duration in cash initially lodged a security of 1000 lev. The agreed maximum margin loan is 2000 lev and provided total security is not less than 125 % of the value to loan any time. The estimated interest on funds deposited as collateral is 6% and the interest margin occupies 8%.

In parallel with the conclusion of the contract, the customer has submitted an order to buy 800 shares of Sopharma (code 3JR) at limited cost 2,255 lev per share.

Bank has opened a client's account, the client's financial instruments and money in the Central Depository and orders executed at the expense of margin loan granted by gathered agreed commission of 1% of the transaction value.

On 05.01.2014, the BSE closed at a price of 3JR = 2, 26.

The accounting entries will be:

For the amount deposited as collateral:

Debit account "Cash in lev" 1000.

Credit account "Trustees of the margin accounts"

- Lot of the client 1000.

For the executed order, settlement, interest and commission shall be established:

a) One off-balance entry:

Debit account "Shares customer margin accounts at the Central Depository"

- Batch of the client.

Position 3JR (800 * 2.26) 1808.

Credit account "Passive counterpart off-balance sheet account 1808.

b) And two accounting entries with repercussions on the balance sheet and income statement:

Debit account "Trustees of the margin accounts"

- batch of the client ($800 * 2.255 + 17.80$) – 1 797.80.

Credit account “Current account with the Bank”

- Lot “to settle customer orders” 1 780, 00.

Credit account “Commissions in lev” 17.80.

Debit account “Trustees of the margin accounts”

- Batch of the client ($1797.80 * 8\% / 360 - 1000 * 6\% / 360$) is 0.23.

Credit account “Interest income on margin accounts and accounts for short sales” - 0.23.

Therefore, with closing BSE at 05.01.2014 the client will have financial assets (cash and shares) totalling (1 000 + 1 808) 2 808 lev and a loan of 1 798.03 lev, i.e. now he on a profit of 1.97 lev (1 808-1 798.03) but now has the right to order the transactions amount to 175% 2 808 lev, i.e. 4 914 lev.

Short sales

“Short sale” is the sale of financial instruments by the Bank for its own account or on behalf of a customer where the time of the transaction the seller (the bank) has no financial instruments, but intends to perform its obligation through borrowed financial instruments.

In order to undertake and manage the transactions and procedures of “short selling” opened a special bank account for short sales of each customer who carries out such transactions. Addition, the Bank also found in the depository institution a separate account for short sales of each customer. In this account are recorded these financial instruments are deposited in compliance with the initial and maintenance requirements. In the depository institution shall be opened and another - a cash account for short sales, which account provided by the customer cash for “short sales” as well as funds obtained from the “short sales”.

Accounting should be organized so that at any given time to be able to seen the number and types of financial instruments “at short positions” number and types of financial instruments made available initially and supportive collateral for short sales, and information on obligations to the client in connection with his use of financial instruments for short sales at risk of the bank, or on behalf of its other clients.

Bank should perform daily valuation of financial instruments recorded in the account for short sales, and the financial instruments subject to the short sale, which settlement is not completed. The valuation of financial instruments is carried at market value.

Deposited by the client monies and financial instruments and cash proceeds from the short sales are recorded on the credit of the account for short sales. Bank respectively initiate registration of the amounts received and financial instruments in the client accounts in a depository institution immediately on the date of deposit thereof.

The bank's receivables due from customers in financial instruments that have been the subject of a short sale are recorded on the debit side of the account for short sales on the settlement date for the transaction. In the event that the sum on the credit side of the account for short sales to a customer exceeds by 150% the amount of

turnover in the debit side of the account, the surplus can be transferred to his account for margin purchases if the customer has open such an account. This is done in case of margin deficit and if it has been previously agreed between the parties. In other cases, the customer may dispose of excess short sales.

The Bank is required to provide daily reports of each client with an account for short sales, which contain at least data for the current (daily) market value of financial instruments subject of short sales, and deposited as collateral financial instruments, as well as the surplus / the deficit at short sales and data on the number and market value of financial instruments subject of short sales, which settlement was not completed.

In order to demonstrate the mechanism of “short sales” and its accounting interpretation we will offer the following.

Example

Let us assume that on 01.05.2014 the Bank “X” has a contract of agency in carrying out short sales with the client against imported cash 2000 lev initial collateral for short sales in sizes up to 200 % of the available coverage in 1% commission on the amount of each transaction and interest on cash collateral maintained in 3%. Bank has opened an account for short sales to the credit side of which is recorded the amount of 2000 lev and ordered the Central Depository to find relevant customer accounts for short sales and security in the name of the client.

Simultaneously with the deposit of the amount the customer has ordered the sale of 1500 shares of “Chimimport” (code 6S4) price 2.08 lev per piece, while being able to close some of its position of 600 shares “Chimimport” before the end of the trading session by purchase at a price of 2,075 lev per unit.

For the above described events the Bank has compiled the following accounting entries:

- For opening an account for short sales and recording imported as security deposit Debit account “Cash in lev” – 2000.

Credit account “Trustees accounts for short sales” - Lot of the client – 2000.

For short sale of 1500 shares of “Chimimport” prepared off-balance sheet entry:

Debit account “Passive counterpart balance accounts” – 3120.

Credit account “Client obligations on short sales of financial instruments”

- Lot of the client

- Batch “Chimimport” (1500 * 2.08) – 3 120.

For closure of the part of the short position.

Debit account “Client obligations for short sales of financial instruments”

- Lot of the client,

- Batch “Chimimport” (600 * 2.08) – 1 248.

Credit account “Passive counterpart balance accounts” – 1 248.

To made at the end of the day reassessment of the short position of the client in shares of “Chimimport” to the closing price on BSE on 05/01/2014 - 2.10 lev.

Debit account “Trustees accounts for short sales”

- batch - the client.

- Batch “Chimimport” AD (900 * 0.02) – 18.

Credit account “Positive effects (gains) margin operations, short positions and loan financial assets at fair value” – 18.

For money transfer by short selling (T+2 days):

Debit account “Current accounts in Bulgarian National Bank in lev”

- Batch settlement account for client transactions on BSE – 3120.

Credit account “Trustees accounts for short sales”

- batch - the client.

- batch “Chimimport” (1500 * 2.08) – 3120.

For cash transfer to the partial closure of the short position of 600 shares:

Debit account “Trustees accounts for short sales”:

- batch - the client.

- batch “Chimimport” (600 * 2,075) - 1245.

Credit account “Current accounts in BNB lev”:

- batch settlement account for client transactions on BSE – 1245.

For accrued commission on the amount of two transactions:

Debit account “Trustees accounts for short sales”

- the client’s lot – (4365 * 1%) - 43.65.

Credit account “Commissions in lev” - 43 65.

For accrued interest coverage per 1 day.

Debit account “Interest expenses on margin accounts and short sales” (3812 * 3% / 360) is 0.32.

Credit account “Trustees accounts for short sales”

Batch - the client - 0.32.

The example may be extended in terms of different hypotheses for the development of the case, but we'll break it here.

Financial instruments lending

“Lending of financial instruments” is a transfer of financial instruments from the lender to the borrower against the obligation to return the financial instruments of the same type number and issue a specified future date or on demand.

The Central Depository shall establish and administer a system of intermediation in lending of financial instruments for the purpose of securing the settlement of short sales, lending and returning of borrowed financial instruments. Depository institution transfer the lent financial instruments from the lender to the borrower's account only after the borrower certifies that it has transferred to the respective accounts in a depository institution collateral due. Upon the transfer of financial instruments employed depository institution reflects in the register that the transfer is in connection with the lending of financial instruments.

Here is an example:

Let's assume that it was the deadline for the transfer of the remaining 900 shares of “Chimimport” which are in a short sale on behalf of the client. Let because of the lack of another option to purchase, the Bank lent them to the client of time “to repay” of existing shares of “Chimimport” in its business portfolio, where they are carried at fair market price 2.10 lev per share. Agreed interest rate for the term of the

disposition of shares is 8 % annually. Accounting entries in the records of the bank on the case will be:

For the order to the Central Depository to transfer the shares from the bank, in the accounts of its customer the client:

Debit account "Receivables on lent financial instruments"

- Lot of the client.
- Batch "Chimimport" (900*2.10) – 1890.

Credit account "Customer liabilities under borrowed financial instruments"

- Lot of the client.
- Batch "Chimimport" (900*2.10) – 1890.

For closure of the short position in the Central Depository of the client (off-balance entry).

Debit account "Client obligations for short sales of financial instruments"

- Lot of the client.
- Batch "Chimimport" (900 * 2.08) – 1 872.

Credit account "Off-balance sheet passive counterpart account" - 1 872.

Assuming that after 10 days the client was able to purchase and restore the borrowed shares, then on that date in the records of TB "X" will be compiled entries:

For recovered shares (off-balance entry):

Debit account "Customer Liabilities on borrowed financial instruments"

- Lot of the client
- Batch "Chimimport" (900*2.10) – 1890.

Credit account "Receivables for lent financial instruments"

- Lot of the client.
- Batch "Chimimport" (900*2.10) – 1890.

For collected interest for the period of holding of shares:

Debit account "Trustees accounts for short sales"

- The client's lot (1890 * 8% / 360 * 10) - 4.20.

Credit account "Interest income on Margin accounts and Short sales" - 4.20.

Interpretations on the development of the case could take another more interesting line but here he has exhausted its purpose.

Results and Conclusion

Developed above hypotheses and proposals in the accounting interpretation of margin trading, short selling and lending of financial instruments are the result of the author's opinion and his experience and analytical skills. Perhaps other authors with other skills and consideration of other practical situations would give other suggestions, but that's the challenge.

Financial markets are not only the most sensitive, but also the most dynamic. To them permanently arise some new financial instruments. Therefore, the practice of this type of banking will increasingly diversify and develop (Gorton, Gary & Metrick, Andrew, 2012). Given that accounting has a technological function in banking, it is reasonable to expect it to meet new challenges.

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ОБ ИНТЕРПРИТАЦИИ УЧЁТА НЕКОТОРЫХ МАРЖИНАЛЬНЫХ ПРИОБРЕТЕНИЙ, ПРОДАЖ БЕЗ ПОКРЫТИЯ И ФИНАНСОВЫХ ИНСТРУМЕНТАХ КРЕДИТОВАНИЯ

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Аннотация. Очевидно, что финансовые рынки являются не только сильно чувствительными, но и самыми динамичными. На этих рынках появляются ежедневно новые финансовые инструменты, а также исчезают исчерпавшие привлекательность. Это непрерывный процесс, который требует объективных изменений в учетной информационной системе банков. Данная статья представляет некоторые взгляды на необходимые бухгалтерские интерпретации трех привлекательных финансовых операций, а именно:

- продажи без покрытия;
- маржинальные приобретения;
- финансовые инструменты кредитования.

Интерпретация учёта в данной статье ограничена текущими бухгалтерскими проводками и бухгалтерской оценкой акций по трём представленным видам сделок.

Ключевые слова: бухгалтерские проводки; оценка; продажи без покрытия; маржинальные приобретения; финансовые инструменты кредитования; акции.