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ISSUES OF IMPROVEMENT ANALYSIS OF THE COMMERCIAL BANKS FINANCIAL STATUS

Article offers discussion, on the instruments for determination of sufficient size of capital set by the regulating authorities and providing their accounting evaluation. Their primary goal is optimization of the proportion between bank's debt liabilities and its assets. Systematic non-evaluation of the capital is regarded as the weakness of the accounting procedures. In addition, the normative of determining of capital's sufficiency is considered, market means for capital evaluation.

Article offers discussion of the issues of improvement analysis techniques of the bank's financial characteristics, in particular, analysis of the financial status of commercial bank with its most significant structural divisions, analysis of the bank assets management quality, analysis of the liabilities quality and analysis of the key indices of the bank's financial standing

Key words: *financial and economic activities, deposits negotiability of credit indebtedness is as follows, balance, GAP analysis, profit margin.*

Commercial banks are regulated by the National Bank of Georgia. The Georgian banking sector dominates the financial sector, with very high market concentration, low penetration and mixed ownership structure. Banks remain the most important financial instantions in Georgia accounting for 75% of financial system assets. At the end of 2013, there were 21 commercial banks, including two branches of foreign banks, operating in Georgia.[1] The quality of the banking sector loan poetfolio, as reported by the NBG, remains stable and banks profitability is among the highest in the Europe and Central Asia region. The banking sector has sufficient liquidity, supported by the growth of client deposits, and the NBG increased the refinancing of banks. Financial standing is the characteristic generalizing bank's financial and economic activities, management effectiveness of its assets and liabilities. Analysis of the bank's financial standing should commence from study of effectiveness of its liabilities' management as active operations of the resources allocation could be performed only after operations for attraction of resources. Commercial bank's liabilities and certain part of its own assets comprise the bank's resource basis. Primarily, dynamics of variation of the bank's own assets should be analyzed. Though frequently the own assets are called bank capital, today, in the practices of commercial banks of Georgia, the size of own assets should be disclosed in the aggregate balance statements.

In analysis of the additional capital structure the effective percentage of the reserves of standard term loans should be assessed. Their size should not exceed 1.25% of the solvency ratio (assets weighted by risk from the size of the estimated capital). In addition, basis for including of the subordinated credits into the capital should be determined, from the dependence of subordinated credits' issuance on the subordinated credit terms. Growth of the property value after its revaluation must be provided in calculation of additional capital at amount not exceeding the size of revaluation.

One could make judgment about general scale of the bank's activities on the basis of its authorized capital growth rate.

$$Growth\ rate = \frac{Total\ of\ actually\ paid\ authorized\ capital}{Initially\ registered\ authorized\ capital} \times 100\%$$

At the following stage of analysis the size of monetary part of the authorized capital should be taken into consideration per GEL of all assets, credit investments, own assets, attracted borrowed assets, bank liabilities, as well as the size of the authorized fund per shareholder should be evaluated.

The bank's own assets are divided into net own and immobilized own assets, which could be used as crediting resources. In their analysis the quality of bank's own assets must be identified. For this purpose the following immobilization ration could be used:

$$K_u = \frac{C_U}{C_C},$$

Where Cu – is the total of immobilized assets;

Cc – gross of own assets (total of net own assets and immobilization).

[1] Report on the Observance of Standards and Codes on Accounting and Auditing. Georgia, March 2015 - 4 pp.

Decrease of the value of this ratio is positively evaluated as this shows relevant fall of isolated assets from their total, on its side contributing to growth of the bank's incomes. On the contrary, isolation of the own capital into the immobilized assets may result in reduction of the bank's financial status, inability to cover its liabilities.

As the structure of bank's own resources is directly linked with the means of use of the bank's profits, proportion of their distribution between the bank's funds, what part thereof is the profit for current year and undistributed profits for the previous years, follow dynamics of change of the given indices, study the impact of undistributed part of the profits on formation of the structure of bank's own assets.

In addition, we should take into consideration the fact that the size of undistributed profit and dynamics of its share in the commercial banks' own assets depends heavily when the main part of the bank's profit was distributed, whether within the period under consideration or after its completion.

Accumulation of profits is the easiest and cheap instrument for filling in of the bank's capital. Its advantage is not only absence of the expenses for loans allocation but also loss of control of the shareholders over the bank.

To evaluate the extent to which the internal sources contribute to the bank's capital the analysis of factual composition of the index should be conducted, so called internal capital formation level:

$$\mathbf{g=nHk.\ K_{Hak}=Mn.ИА.МК.K_{Hak}}$$

Where:

nHk – is profit on capital;

Mn – profit margin (ratio of net profit with the total income);

ИА – use of assets;

МК – capital multiplier (ratio of the consolidated assets with the capital);

$\mathbf{K_{Hak}}$ – accumulation rate (share deducted from the distributed profits)

$\mathbf{K_{Hak}=1 - K_{gub}}$, where $\mathbf{K_{gub}}$ = coefficient of the amount of dividend to be paid).

Increase of all components of this expression results in improvement of the bank's own capital financial management effectiveness. This occurs at expense of increase of net profit or decrease of the distributable profit.

Both, the successful banks and those with financial difficulties require external capital, the former – for realization of the profitable projects and the latter – for improvement of their financial standing.

The other part of bank's resources, the largest one, not belonging to the bank but used at certain terms and conditions as a source of finance, is the attracted and borrowed assets.

The main part of the bank's attracted assets comprises of the clients' deposits – assets deposited at banks, stored at the bank accounts and used in accordance with the account modes and banking laws. Other attracted assets include: attracted special funds; temporary free assets at bank accounts by operations, bank's credit indebtedness. Attracted assets exceed the structure of the bank's resources and comprise the basis of functioning of any commercial bank.

Borrowed assets include: interbank term loans, interbank financial assistance, assets obtained through sale of the bank's debt securities.

It should be noted that the analytical data of the key sources of formation of the bank's resources, unlike the data about use of the assets and particularly, bank's credit portfolio, are not disclosed in the existing forms of the financial statements. Availability of such information, inter alia, would allow analysis of the resources base structure.

In analysis of the bank's resource base the quantities of all attracted and borrowed assets should be calculated by quarters and at the end of year, as well as their share, significance of all types of the resources in bank's credit potential, as well as dynamics of change of the attracted and borrowed assets. In addition, one should take into consideration that the attracted assets are within the normal course of bank's business. But as a rule, due to lack of the bank's attracted assets these are more expensive and less preferable ones.

To calculate the credit investments made at expense of the attracted resources the index of effectiveness of attracted assets' employment by the bank could be used ($\mathbf{Э_u}$) calculated as ratio of the attracted assets ($\mathbf{n_c}$) with the total credit investments ($\mathbf{K_в}$).

$$\mathbf{Э_u = n_c / K_в}$$

If $\mathbf{Э_u}$ exceeds 100% this means that the attracted assets are used not only as credit resources – the source of bank's other active operations but also to cover its own expenses.

Deposits comprise main component of the bank's resources and liabilities. Deposits analysis is provided by the terms and categories of deposits, the terms and conditions of depositing and withdrawal, payable interests, opportunities of discounts due to bank's operations and other factors.

Average value of the deposit instruments may be calculated as ratio of the costs with the average balances of the relevant deposits.

In the process of analysis dynamics of price changes by all types of resources, average interest rate for more expensive and cheaper resources, their stability should be evaluated, as well as total interest expenses, its dynamics, and the reasons for non-compliance with the resources attraction plan should be identified.

External factors are no less significant for formation of the bank's resource base, including specialization of its business or its universal nature.

As for stability of the resource base, to maintain the necessary liquidity level all assets of its resource potential may be classified as absolutely stable, stable and instable ones.

Degree of constancy of deposits is calculated as ratio of the basic (stable) and variable deposits, with correction for inflation rate. In analysis of the deposit base stability maintenance the mathematical models are used, in addition, the dynamics of certain deposits stability indicators are studied.

Credit indebtedness is regarded as a significant component of the commercial bank's liabilities characterizing its financial standing and is subject to timely fulfillment. In addition, the credit indebtedness is used by the banks as a source for attraction of the assets for active operations.

To evaluate negotiability of credit indebtedness the indicators of short-term deposits' and loans' negotiability should be used.

Negotiability of credit indebtedness is as follows:

$$К_{об}=D_о / ОКЗ_{ср}$$

Where

$D_о$ _ is the debt turnover in the analyzed period;

$ОКЗ_{ср}$ _ average balance calculated by formula:

$$ОКЗ_{ср}=(ОКЗ_Н+ОКЗ_К).2$$

Where:

$ОКЗ_Н$ and $ОКЗ_К$ – balance at the beginning and end of the year.

Average term of short-term deposits and loans at bank (turnover per days) is calculated by the following formula:

$$T= ОКЗ_{ср}.D/ DO=D/ К_{об}$$

Where is number of days taken in calculation for thirty days.

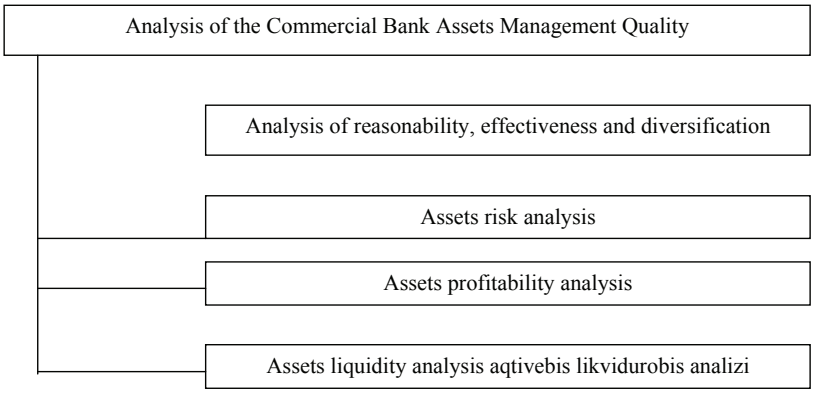
The inter-bank credits play the main role among the loan assets. Analysis of degree of the dependence of bank on the interbank credits is conducted on the basis of main indexes called refinancing ratios, calculated as the ratio of credits received from the other banks with: 1. Total of credit deposits; 2. Issued interbank loans; 3. Total bank liabilities; 4. Authorized capital; 5. Common balance currency.

In analysis of the commercial banks' liabilities structure the maximal assets used as resources should be calculated, as well as effectiveness of the available assets. It could be presented as ratio of the bank's production assets with its resource base.

Analysis of the active operations. Analysis of the key directions of the bank's activities includes study and evaluation of the economic effectiveness of assets deposited by the bank. Analysis of its directions is provided on Diagram 1.

Key directions of the bank assets management quality analysis

Diagram 1.



Analysis of the bank assets management quality must commence from evaluation of the bank assets structure, primarily, with respect of its reasonability and diversification. In most banks the main part of the assets is composed of the credits. Effective system of their management point to existence of the loan and investment policies developed by the bank, determining to whom, for what purposes, in what amounts and for what term the bank assets may be provided. Formation of the obligatory reserves is the instrument for regulating of the solvency of commercial banks. The reserves are at quite significant place in the structure of bank assets comprising part of the amount payable by the commercial banks to the National Bank.

As the obligatory reserves are related to the quality of bank assets management quality, reserves analysis should be primarily oriented towards studying of the types of loan obligations of the banks, identify the larger indebtednesses, calculate the percentage of the calculated reserve by all types of indebtednesses with the total indebtedness, compare the calculated and actually formed reserves, determine the scope of formed calculated reserves, evaluate the net loan indebtedness of the bank. The key general indicator of the commercial bank's

financial standing characterizing the bank's ability to meet all obligations fully and in due time is the credit institution solvency indicator.

In the end of study of bank's financial standing indices one should study the group of risks relevant to its activities. Though the risk is hard to measure, and especially evaluate it, the analysis should commence from selection of the risk evaluation method. Adequacy of the loss forecasts depend heavily on such method.

At the disposal of analysts there are the following risk assessment methods: statistical, expert evaluation and analytical (individual and complex).

To measure the interest risk two standard methods are applied in the banking practices most of all. These are GAP analysis and evaluation of the sensitivity of bank's economic value to the changes of market interest rates.

GAP analysis includes grouping of the assets and liabilities items by their terms. Such study would allow making conclusions about direction of the bank's interest spread in any period of time at a time of increase or decrease of the market interest rates. Though this method does not allow accurate quantitative evaluation of the bank's possible losses. based on it one could make quite reasonable decisions on hedging of the interest positions and avoid creation of the negative interest margin.

Method for evaluation of the bank's economic value sensitivity is less apparent but on the other hand, it provides indicator generalizing trend of the bank to interest risks.

Credit to the private sector and households increased by 20% in 2013 (as compared to 12.8% in 2012), and reached 37% of GDP in 2013. During 2013 the banking sector assets grew to 66.1% of GDP as compared to 59.2% of GDP at the end of 2012. The share of nonperforming loans is declining gradually from 17.9% in 2009 to 7.5% in December 2013. The return on assets and return on equity stood at 2.5% and 14.6%, respectively, at the end of 2013 as compared to 1.0% and 5.8% at the same period of 2012. Liquid assets to total assest remained at 27.5% at the end of 2013 (just a slight increase from 27.3% in 2012). The loan –to-deposit ratio further improved from 106.7% at the end of 2012 to 102.9% in December compared to 11% growth in 2012. Nonetheless, savings in the economy remain rather low and are among the lowest in the ECA region, despite the fact the shane of deposits **grew from 31% of GDP in 2012 to 38% in 2013.**

Hig quality financial information improves the investment climate, business environment and availability of credit for enterprises. Reliable financial informacion allows banks to make better informed credit decisions, thereby telexing collateral requirements and omproving access to finance. Improving accounting, auditing and financial reporting practices alone is not enough to solve the country s problems, but can significantly contribute to the economic stimulus and raising public confidence in financial reporting and mechanisms that protect the public interest.

The NBG s loan loss provisioning uses a methodology based on the credit worthiness, an asset classification system, and days past due. This approach contrast with the incurred loss model prescribed in IAS 39, the allowance for loan loss is calculated as the difference between the the asset's carrying amount and the present value of estimated cash flows (exclunding future credit losses that have not been incurred) discounted at the financial asset' s original effective interest rate. To ensure system wide consistent application of IFRS standard and particularly IAS 39, NBG is in process of developing specific impairment guidelines under IAS 39.

The NBG and the ISSSG should develop prudential filters for regulatory capital with a view to adjust regulatory own fungs for changes appearing in the accounting equity of financial institutions applying IFRS. Substance of the specified method and orientation of the set of instruments is calculation of the bank's economic value comprising difference between the bank's operations, assets and liabilities all monetary flows calculated by the bank based on the terms and conditions of the contracts.

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