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THE ISSUES OF FINANCIAL REPORTING AT GEORGIAN COMMERCIAL BANKS

It this article issues of financial reporting at Georgian commercial banks were explored.

Key words: financial reporting, commercial banks, Georgia.

Financial results achieved by the bank reflect impact of the whole set of internal and external factors including: geographical location of the bank, presence of sufficient client base within its service area, competition level, degree of financial market development, social-political situation in the region, presence of the state support and other factors. On the other side, there are size of the own capital, borrowed and allocated funds, income generating and non-generating assets, common banking expenses, sizes of damages and losses, scale of application of the advanced technologies, up-to-date automation means, internal and external audit organization and other factors that depend on the bank's activities and quality of its management. All positive and negative actions of the bank's management and its personnel, in the generalized form, affect the final outcome of the bank's financial activities – the profit.

Commercial bank's operation results are affected by wide variety of factors and therefore, these results should be carefully examined in the course of study of this multi-functional and multi-purpose economic system. Therefore, description should be provided by means of the system of economic indices.

Algorithm of formation of the characteristics of commercial bank's financial results is determined by the adopted accounting system and form of the formal financial reporting applied according to the requirements of the National Bank of Georgia. Though the banking system formation process in our country is not completed yet, the financial reporting forms are changing, improving the contents of the statements and this is caused by the requirement of acceleration of economic integration of the national banking sector into the world banking community, necessity of gradual approaching to the western standards.

The entrepreneurs need the capital for their economic activities. For this, the proprietors need to attract private capital or rising of foreign capital by the creditors. Self-financing is regarded as the reasonable solution for the joint stock companies as the shares, as the securities, are characterized with the agreements with the unlimited term and variable interest rates. In addition, the shares may be allocated at the stock exchange at wide scale. Capital growth is available through attraction of numerous investors.

In June 2014, the Association Agreement with the European Union was signed and this showed the country's readiness for reforms and this requires implementation of measures for improvement of accounting and financial reporting audit regulation according to the requirements of the relevant EU directives. Legal framework effective in Georgia, in relation with financial reporting, is less developed than EU *acquis communautaire*¹, the reforms in the sphere of financial reporting and audit are complex and their implementation in the country requires significant efforts and resources. They comprise significant challenges in the spheres of standards providing, audit quality assurance, accountants' education and training. For Georgia, mobilization of human and financial resources will be of particular significance. Association Agreement provides three years for reforms' implementation. Georgia should use this time for discussing of the possible options and assessment of the experiences of similar economies.² These issues are provided in Annex 28 to the Association Agreement: «Corporative Law, Accounting and Audit, Corporative Management.»

Generally, demand for high quality financial reporting in Georgia is quite low. Capital market in Georgia is quite superficial, given domination of the banking sector in the finance sphere. Georgian banks pay less attention to the adequacy of the financial statements presented by the lenders and rely mostly upon the loan security. Requirements related to the subject of mortgage, in Georgia, comprise, in average, 223% of the requested loan and this is partially caused by lack of reliability of the financial information provided by the lenders and lack of transparency³.

In our opinion, in the small banks, assessment of incomes' and costs' formation would be sufficient once per month, as for the large banks, the above tasks should be performed on a daily basis, as issuance of the balance sheet.

Application of the analytical models, on the basis of prepared profit and loss statements, may become the significant instrument for strategic and operative management of the incomes and costs. By means of this instru-

¹ EU *acquis* is the system of EU law and obligations from 1958 up to present, mandatory for the EU member states

² Georgia – Report on Compliance with the Standards and Codes (ROSC) – Accounting and Audit.

³ <http://www.enterprisesurveys.org/data/exploreconomies/2013/Georgia>

ment, the bank managers can impact formation of the financial results in a timely manner, from their interest-bearing and non-interest-bearing operations, through selection of the high-income operations, work on diversification of the income sources, ensure reduction of the interest rate variation risks.

For internal management of the financial results the scheme of incomes and costs' formation may be used, through conditional grouping as follows:

- Incomes from operation activities;
- Incomes from non-basic activities;
- Assets not processed by the bank;
- Costs required for the bank's functioning;
- Costs for risk operations.

In study of the issues of financial results' formation at Georgian commercial banks the comparative analysis of the solutions in Georgian and western banks should be conducted and the obtained results should provide basis for improvement of financial reporting of Georgian commercial banks. It should be noted here that the composition of the items and their order is regulated by the instruction.

Schematically, the model of formation of the net profit can be presented as follows: 1. Interest income; 2. Interest expenses; 3. Interest margin (line 1 – line 2); 4. Operation incomes; 5. Total operation income (line 3 + line 4); 6. Operation costs; 7. Net operation revenues (losses) (line 5 – line 6); 8. Costs for reserves formation by loans, to cover the possible losses; 9. Costs for bad debts' writing off; 10. Losses (profits) from non-standard activities; 11. Non-operating incomes and costs (line 8+9+10); 12. Net revenues (loses) before taxation (line 7+11); 13. Income tax; 14. Net revenues (losses).

Such grouping of the items allows determining of the degree of dependence of the bank's incomes and costs on their key operations (interest and non-interest) and on the other factors⁴.

The western banks the rules for formation of the financial results are similar to the above ones. The variety modifications do not affect the final result, comprising the bank's net profit. And the models of formation of net profit (loss) differ only by sequence of calculations provided on the basis of the ration between similar types of incomes and costs. Comparison of the methods of financial results' formation applied in Georgian and international banking practices showed that existence of different forms of reporting of the financial results of Georgian commercial banks is due to application of several methodological approaches and complies with the international standards to different extents and this is caused by the reforms ongoing at the commercial banks simultaneously with development and strengthening of market relations in Georgia.

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⁴ Ivanov V.V., Reliability of Your Bank – M FBK-PRESS 1997, pp. 11-16.