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**Тема: «ACCOUNTING RULES FOR REGULATIONS IN BANKING**

**SECTOR»**

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As many banks and other credit institutions start offering their services globally, they should change the way their business is conducted. This is the main reason way different international rules become more and more popular. Among the others, Basel Committee on Banking Supervision and the International Accounting Standards Board (IASB) issue many important rules that are implementing into banking sector. This paper is going to present the most important Basel Committee’s and the IASB’s standards which affect banking activity.

As for the European Union’s legislation for banking sector, it’s necessary to point out the following.

As more and more countries want to join the European Union, they usually try to apply European law their own law system. That situation refers to banking system, too. There are several European Union Directives which regulate banking activity. One of the most important is the First Council Directive on the coordination of the law, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions [1] and the Second Council Directive [2]. They consist of framework for banking institutions having their headquarters either inside or outside the European Union.

Other European directives regulate deposit-guarantee schemes [3], amount of banks’ own fund [4], supervision of credit institutions on a consolidated basis [5], large exposures [6].

There are also some directives regulating accounting policies of commercial entities (including banks). These are:

1) the Fourth Council Directive [7],

2) the Seventh Council Directive [8],

3) the Eighth Council Directive [9],

4) the Fourth-Bis Directive [10].

The 1 – 3 directives refer to all commercial entities and the 4th regulates banking activity. It gives the framework for banks’ financial statements. It makes banks disclose some special, specific for credit institutions, as income statement and balance sheet positions. According to that directive every bank’s financial statements material differs from that of «normal» enterprise. Due to that solution the reader of financial statement may discover those parts of banking activity that generate incomes and losses.

Since 1992 over 100 countries have implemented the Basel Capital Accord. One can say that generally the document deals with bank capital level and its adequacy to the business size. The First Basel Capital Accord focused on the total amount of bank capital, which is vital in reducing the risk of bank insolvency and the potential cost of a bank’s failure for depositors. It emphasized single risk measure [11]. At the end of 2001 the Committee released another, newer version which is called the Second Capital Accord. It is considered to be more flexible to the modern, changeable world of business. It also allows banks to implement their own, internal methodologies on measuring the risk exposure.

The structure of the new Accord consists of three pillars:

1) minimum capital requirement,

2) supervisory review process,

3) market discipline.

These three pillars together should contribute to the safety of international financial system.

As we consider the international regulations on a single commercial bank’s situation, we do emphasize the first pillar, and briefly summarize the rest.

The first pillar of the Accord was implemented in almost entire world of business. According to this many national supervisory bodies demand that the banks keep capital adequacy on at least 8% level. But there has been a great change in defining the capital adequacy. Before 2001, supervisory bodies described it as total bank’s capital over weighted average in assets and off-balance sheet liabilities. The new Accord differs slightly, because right now the capital adequacy is defined as bank’s capital over total of credit, market and operational risks. The temporary problem is how to measure these kinds of banking risks.

The Capital Accord introduces new models of measuring the risks:

1. The list of approaches to measure credit risks:

a) standardized approach;

b) foundation internal rating based approach;

c) advanced internal rating based approach.

2. The list of approaches to measure market risks:

a) standardized approach;

b) internal models approach.

3. The list of approaches to measure operational risks:

a) basic indicator approach;

b) standardized approach.

c) internal measurement approach.

The first pillar is generally accepted all over the world and almost every commercial bank must keep its capital of 8% of risk-weighted assets.

That requirement is very important for bank’s management, because when they have very poor (of low quality) credit (and other assets) portfolio, they must either raise the capital or release that asset. Otherwise, they may face very serious consequences, including license withdrawal.

But new Accord allows banks to establish their own systems of calculating probability of creditors collapse. According to this banks may implement external or even internal ratings into their clients evaluations. If they do this, they may create new, much more flexible, systems of calculating provisions for likely bad debts.

The second pillar «Supervisory review process», considers how national supervisory bodies should ensure that each bank implement Basel recommendations. As the new Accord stresses the importance of bank’s own systems for calculating capital adequacy, the role of supervisors has dramatically changed. Instead of being standards setters, they must only evaluate and consult appropriateness of these systems.

The last, the third pillar concentrates on market discipline as a power, which push banks into clear and fair disclosure of all risks. This is the power of market that should make banks interested in publishing more information covering banks’ risk profiles and capital adequacy.

As we can see, the Basel Committee propositions, which in fact are not obligatory to any single bank, have a huge influence on their activity, because many national supervisors state them as a bench-mark.

And now let’s consider the International Accounting Standards Board’s principles.

The international Accounting Standards Board (IASB), previously the International Accounting Standard Committee (IASC) an independent standard setting body. It issues the International Financial Reporting Standards (IFRS), previously the International Accounting Standards (IAS) covers main problematic areas and advises how entities should disclose, measure and present different accounting positions. Among them (are four standards deeply connected with banking activity:

1. IFRS 30 – Disclosures in the Financial Statements of Banks and Similar Financial Institutions [12].

2. IFRS 32 – Financial Instruments: Disclosure and Presentation [13.]

3. IFRS 39 – Financial Instruments: Recognition and Measurement [14].

4. IFRS 37 – Provisions, Contingent Liabilities and Contingent Assets [15].

The international Financial Reporting Standard 30 – Disclosures in the Financial Statements of Banks and Similar Financial Institutions, should be applied in the financial statements of all banks (and other institutions which are allowed to credit and receive deposits. This standard describes what kind of information has to be included in banks’ financial statements. These are:

1) in the income statement:

a) interest and similar income;

b) interest expense and similar charges;

c) dividend income;

d) fee and commission income;

e) fee and commission expense;

f) gains less losses arising from dealing securities;

g) gains less losses arising from investment securities;

h) gains less losses arising from dealing in foreign currencies;

i) other operating income;

j) losses on loans and advance;

k) general administrative expenses;

l) other operating expenses;

2) in the balance sheet (assets):

a) cash and balances with the central bank;

b) treasure bills and other bills eligible for rediscounting with the central bank;

c) government and other securities held for dealing purposes;

d) placements with, and loans and advances, other banks;

e) other money market placements;

f) loans and advances to customers;

g) investment securities;

3) in the balance sheet (liabilities):

a) deposits from other banks;

b) other money market deposits;

c) amounts owed to other depositors;

d) certificates of deposits;

e) promissory notes and other liabilities evidenced by paper;

f) other borrowed funds.

According to that standard every bank institutions should also disclose an analysis of its assets and liabilities, based on the remaining period at the balance sheet date to the contractual maturity day (e. g. up to 1 month, from 1 month to 3 months, from 3 months to 1 year, from 1 year to 5 years and over 5 years). Other obligatory notes to the financial statements refers to concentration of assets and liabilities, off balance sheet items, sources of banking risks and related party transactions.

The international Financial Reporting Standards 32 and 39 seemed to be the most difficult standards for applying. They treat of disclosure, presentation, recognition and measurement of financial instruments – an area which is not the easiest to understand. Although these standards refer to every entity collecting financial instruments, the banks and other financial institutions are the most interested groups among them. They define financial assets as any assets that is cash, a contractual right to receive cash or another assets from another enterprise, a contractual right to exchange financial instruments with another enterprise under conditions that are potentially favourable, an equity instrument of another enterprise. And the financial liabilities are contractual obligations to deliver cash or another financial assets to another enterprise, or to exchange financial instruments with another enterprise under conditions that are potentially unfavourable. The standards classify financial instruments into 4 four groups:

1) loans and receivables originated by the enterprise;

2) held-to-maturity investments;

3) financial assets held for trading;

4) available-for-sole financial assets.

Initially measurement should be at cost and subsequent measuring at fair value (except for loans originated by the enterprise, held-to-maturity and assets without quoted market, which have to be valued at amortized cost).

The international Financial Reporting Standard 37 – Provisions, Contingent Liabilities and Contingent Assets states what kind of situations entitle banks (and other entities too) to recognize provisions. Generally, provisions are sub-class of liabilities and should not be disclose separately. They should be estimated on a prudent basis. Any provision is allowed if (and only if) the liabilities connected with provisions exist in the face of balance sheet.

It is necessary to tell a few words about the polish commercial banks’ situation in international environment.

As Polish banks, in many cases, belong to foreign capital groups (including international or even global banking institutions), they are generally well prepared to implementing international regulations. For example, if Polish bank belongs to any institution that presents its financial report in accordance with the IFRS, it ought to apply these rules, apart from local accounting requirements. As far as Basel Committee Accord is concerned, banks are trying to introduce the best system for estimating different kinds of risk (credit, operational and market). The banks’ staffs realize that earlier or later, the same regulations will be obligatory in Poland too. The easier situation his in those banks, which have foreign branch investor. They have unlimited source of global know-how.

The banks that are quoted on Warsaw Stock Exchange, must also be prepared for implementing new corporate governance to be in accordance with Polish Security and Exchange Commission’s law. An appropriate corporate governance policy and investor relationship will make reports readers more familiar with what they read.

As one can see, every bank and credit institution should apply different law regulations set by international bodies. Some of them are included into the law system, in a fact, but some of them must be applied by banks themselves, because it makes their activity and financial statements clearer to the investors. Otherwise, they will look like entities that have something to hide, which is not favourable to modern commercial institutions.

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