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**NECESSITY OF CREATION AND ACCOUNTING OF PROVISIONS
(RESERVE) FOR COVERING CREDIT LOSSES IN BANKS**

Abstract. Availability of necessary provisions is a predetermining factor and guarantor of activity's development of any organization. The activity of banks is not an exception and the obligation to create provisions is one of the manifestations of the general laws of economic relations. Since 01.01.18 IFRS 9 has come into force, according to which banks evaluate credit losses - expected in the future, instead of actually incurred like in IFRS 39. Thus, domestic banks will face with temporary difficulties, since IFRS 9 requires a completely different format for working with credit risks, nowadays not all banks are actually ready for this.

Keywords: second-tier banks, provisions (reserves), assets, credit, credit risks, international financial reporting standards, impairment, loan portfolio

Banks are obliged to form provisions for covering losses on assets exposed to credit risk, in order to maintain its own liquidity and to ensure stable conditions for normal operation. In crisis conditions, the problems associated with improving the methodology for creating provisions for probable loss on loans acquire special significance. Provisions should reimburse the losses incurred for unreturned loans, it means to minimize credit risks.

Banking practice has developed a unified approach to reduce the risk of credit operations - namely, the formation of reserves (provisions) for possible loan's losses. The difficulty of solving the problem, relatively, how to scientifically justify and manage the reserves (provisions) for possible loan losses are due to many circumstances. It is impossible to solve this problem without researching not only individual, but general risks of credit activity as a whole.

In banking practice, methods of managing credit risk on an individually are theoretically well developed. In the process of review of loan applications banks use multiple methods for assessing the borrower's creditworthiness, the procedure for determining the value of rendering their lending products, etc. In the conditions of various political and financial shocks, studying of issues related to the assessment and accounting's procedure of key factors of credit risk is of great importance and it is necessary to approach them more comprehensively.

O.I. Lavrushin, analyzing them classified into individual and cumulative (total) risk of loan portfolio. The aggregate risk of the loan portfolio is influenced by external factors such as the financial crisis, negative changes in the financial markets, insufficiency of information about the situation on the market, the general state of the market, the region, etc. [1, p.37]

In addition, when second-tier banks manage the provisions of the , it is necessary to analyze the interactions between credit risk and the income received. Unreasonable growth in loan risk, which does not correspond to the growth of net income, contributes to the creation of additional provisions, possibly the sale of certain liquid assets.

In I.V. Peshchanskoy opinion, the reserves for depreciation of assets play an important role in the formation of the main indicator of the bank's stability - the sufficiency of its own funds (capital) [2, p. 386].

This point of view is confirmed by other scientists, saying that reserves minimize the amount of profit received by banks by writing off losses on loans, which leads to change in the amount of capital [3, p.140].

Provisions for credit losses are formed by banks within the framework of the laws of the Republic of Kazakhstan "On Accounting and Financial Reporting", "On Banks and Banking Activities", before the transition to IFRS 9 in accordance with IAS 39 "Financial Instruments: Recognition and Measurement", Rules of the National Bank of the Republic of Kazakhstan "On the creation of provisions (reserves) in accordance with IFRS" No. 65 of 25.02.13 y. [4,5,6,7].

According to the rules of the National Bank of Kazakhstan on the creation of provisions (reserves) for loans issued, the term of provisions is treated as reserves formed for the loan's depreciation. By this document, the amount of banks provisions is presented in the form of the difference between the total balance sheet loan debt and the forthcoming (expected) discounted future cash flows for the loan [8].

Thus, the provision for probable losses on loans granted, in our opinion, is a special reserve of the bank, the creation of which is caused by the risks in the credit activity. A provision for impairment of loans is formed when there is objective evidence that the bank can not receive the amounts due for payment in accordance with the initial terms of the loan agreement. The amount of losses that the bank can establish is recognized as an expense and is deducted from the balance amount of the relevant category of loans, as a provision for covering losses on loans. Thus, the amount of the formed reserve for possible losses is determined by the amount of expected losses that the bank will incur in the future.

At the end of 2017, the total assets of second-tier banks decreased by 1398.9 billion tenge (or 5.5%), reaching 24,157.9 billion tenge (Figure 1).

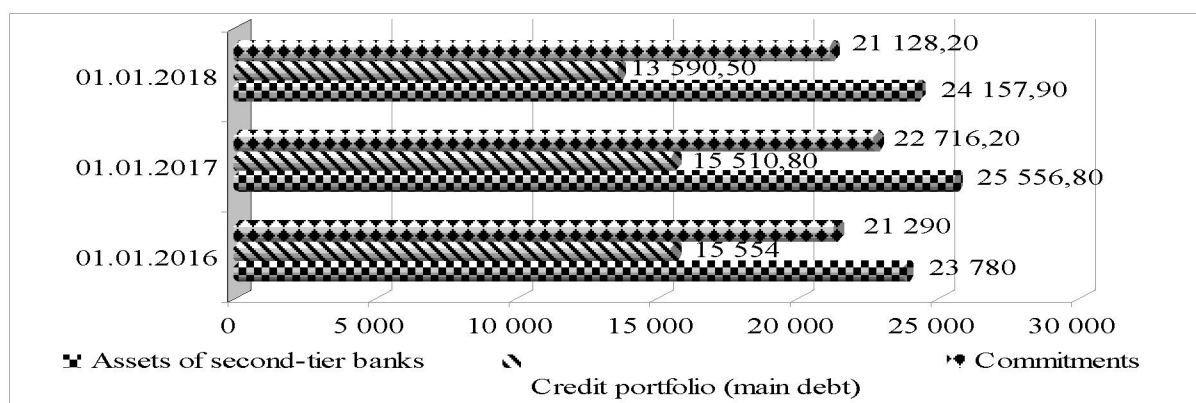


Figure 1 - Assets and loan portfolio (principal) banking sector of the Republic of Kazakhstan for 2015-2017.

Note - composed on source's data [9]

For second-tier banks, it is difficult to call 2017 year a successful , because against the backdrop of cuts in assets, their loan portfolio and liabilities, the volume and share of overdue loans increased. This contributed to the incident, the process of mergers of banks and provided large-scale support from the state. Although the situation has stabilized somewhat by the end of the year, some negative trends remain.

The qualitative composition of the loan portfolio of STB RK is presented in table 1.

Almost two thirds of the problem loans are overdue for more than 90 days, their volume as of 01.01.2018 amounted to 1,265.2 billion tenge, which is 223.10 billion tenge more than in 2016 (the specific weight increased from 6.72 % to 9.31%).

Provisions for loan portfolio amounted to 2,126.4 billion tenge or 15.6% of the loan portfolio (at the beginning of 2017 – 1,647. 8 billion tenge or 10.6% of the loan portfolio).

It should be noted, that the provision for losses resulting from non-repayment of loans is formed on the basis of objective evidence that the Bank is unable to receive the amounts due under the initial terms of the loan agreement.

Provisions are formed at the expense of Unallocated net income by assigning them to the expenses of banks. The Bank's provision for probable loan losses is only applicable to compensate of outstanding loans by customers. At the same time, the overdue amount of loan debt, impossible to exact, will be written off from the balance due to provisions for probable credit losses. If there is a shortage of funds in the provisions account, credit debt, reducing the tax base, will be attributed to the losses of the current year.

Table 1 - quality of loan portfolio of STB RK for 2015-2017

Indicators	01.01.2018		01.01.2017		01.01.2016	
	Mln. tenge	specific weight %	Mln. tenge	specific weight %	Mln. tenge	specific weight %
Banks loans	13590,5	100,0	15510,8	100,0	15 553,7	100,0
Loans for which there is no delinquency on principal and interest	11600,7	85,4	13613,1	87,8	13 436,7	86,4
Loans in arrears	1989,8	14,6	1897,7	12,2	2217,0	13,6
Loans with overdue from 1-30 days	291,1	2,1	463,8	3,0	477,0	3,1
Loans with overdue from от 31-60 days	309,4	2,3	213,8	1,4	255,7	1,6
Loans with overdue from от 61-90 days	124,0	0,9	178,0	1,1	147,4	0,9
Loans overdue > 90 days	1 265,2	9,3	1042,1	6,7	1 236,9	8,0
Provisions under IFRS	2 126,4	15,6	1642,9	10,6	1647,8	10,6
Provisions for loans with overdue over 90 days	1128,5		751,9		819,0	
The coverage ratio of provisions by IFRS loans with overdue > 90 days	89,2%		72,2%		66,2%	

Note - composed on source's data [9]

Changes to provisions reflected in the appropriate period in the income statement of the Bank. If, after the debt cancellation at the expense of provisions improving the situation in a positive way, the amount under the impairment decreases, and the amount recovered of provisions is credited to the relevant article of the statement of profit and loss [10, p. 74].

According to the standard introduced in late 1990 and early 2000, banks created provisions for incurred costs (model of incurred costs). That is, the Bank created provisions only after the appearance of indisputable facts proving that the loan will not be returned. In practice, in reality, the loss was often regarded in the event of inability to pay debts on loans within the prescribed period (default).

Since January 2018, banks have switched to a different impairment model called the expected loss model. They will have to recognize the expected losses from the moment the loan debt is recorded on the balance sheet of the bank. IASB notes that in the new requirements investors will not be afraid of the fact that recognition of impairment of an asset (loan) will be taken in special order very cautiously and late.

According to the Institute of Chartered Accountants of England and Wales (ICAEW), the reform of IFRS promotes the growth of bank reserves to cover loan losses by an average of 50% [11].

Moving to IFRS 9, banks transform not only the methodology for accounting and disclosure of financial statements, but also the accounting system, business processes.

Thus, recognition of credit losses due to impairment under the previous approach was carried out only when there was objective evidence (significant difficulties of a financial nature for the borrower, failure to comply with the terms of the bank loan agreement).

Therefore, the new approach will be force the recognition of losses of banks for the loans. Banks recognizing the loans in their balance sheets immediately reflect the expected losses, applying a 3-stage model, which is based on the accounting for changes in loan's risk.

The standard has provided a flexible approach to accounting provisions (reserves), as it will significantly show the methods of credit risk management in banks, allowing, at the same time, the application of some aspects of the previous policy on IAS 39.

As stated above, the global financial crisis and its attendant loan crisis forced the banking community to normalize the accounting and credit risk management system to a better way.

As a result, regulators in the banking sector were introduced, requiring banks to have greater transparency in the loan portfolio structure and to monitor the debt structure on an ongoing basis. Banks are required to have full information of the financial position and credit risk of its customers.

Although the size of the banking system of Kazakhstan (in recalculation of total assets to GDP, or total capital to GDP) was almost twice higher than in the Russian banking system, the relative volume of loans in Kazakhstan was significantly higher than in other CIS countries – 61.5% compared to Russia, where this figure was 30.2% [12].

The global financial crisis has exploited this disproportion, as well as other smaller problems.

Before the crisis, Kazakhstan's banks faced two serious problems due to wrong conceived policies:

1) quite impressive amounts of foreign borrowing, which account for more than 50% of the total net borrowing. In particular, during 2006 only, Kazakhstan's banks received international loans worth more than \$ 18 billion dollars, and in 2007 - \$40 billion dollars [13].

Thus, by the end of 2008, Kazakhstan's external debt had reached 42% of the country's exports (as a large proportion of loans were refinanced at a higher interest rate due to the crisis).

2) the construction sector played an important role in the development of banks (for example, 45% of the ForteBank's loan portfolio consisted of construction loans and mortgages), and therefore banks were severely affected by the crisis.

Basel 3's new rules place an even greater regulatory burden on banks. Moving banks to Basel 3 requirements will force them to increase reserves and reduce the ability to adopt more risky policies. However, as a result, many commercial banks will be less competitive with state-owned banks due to the reduced possibility of attracting funding and lending [14].

Moving to IFRS 9 contributes to the stabilization of the banking system through a significant increase in reserves and, as a consequence, the financial stability of banks. However, banks have faced a number of problems with respect to aggregated calculation systems based on large database, changing the organizational structure of banks, as well as the negative impact of reserve growth on key efficiency indicators, etc.

The assessment on banks identifies the following problematic issues related to the accounting of provisions:

- Insufficient preparedness of banks to move to IFRS 9, banks have not developed a methodological framework for accounting for impairment of assets;
- Not adequate risk assessment in selected loan transactions, both on balance sheet and off-balance sheet accounts;
- Lack of proper control by risk managers, as well as inability to create an effective risk control for credit products within the Bank;
- Insufficient quality of key control actions, such as separation of loan decision-making responsibilities, approvals and reviews of the results of accounting and operating activities for the creation of provisions;
- Existing programs of internal audit of credit operations, in particular issues, that reveal the order of creation and use of provisions, as well as other ways of monitoring are not effective.

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НЕОБХОДИМОСТЬ СОЗДАНИЯ И УЧЕТ ПРОВИЗИЙ (РЕЗЕРВА) ДЛЯ ПОКРЫТИЯ КРЕДИТНЫХ ПОТЕРЬ В БАНКАХ ВТОРОГО УРОВНЯ

Аннотация. Наличие необходимых провизий является предопределяющим фактором и гарантом развития деятельности любой организации. Деятельность БВУ не исключение и обязательность создания провизии является одним из проявлений всеобщих закономерностей экономических отношений.

С 01.01.18 г. выступил в силу МСФО 9, согласно чего банки рассчитывают кредитные потери - ожидаемые в будущем, а не фактически понесенные (МСФО 39).

Таким образом, отечественных банков, возможно, ожидают временные трудности, поскольку МСФО (IFRS) 9 требует совершенно иной формат работы с кредитными рисками, в настоящее время не все банки фактически готовы к этому.

Ключевые слова: банки второго уровня, провизия (резервы), активы, кредит, кредитные риски, международные стандарты финансовой отчетности, обесценение, кредитный портфель

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ЕКІНШІ ДЕНГЕЙДЕГІ БАНКТЕРДЕ НЕСИЕЛІК ЖОҒАЛТУЛАРДЫ ЖАБУҒА ПРОВИЗИЯЛАРДЫҢ (РЕЗЕРВТЕРДІҢ) ҚҰРЫЛУ ҚАЖЕТТІЛІГІ ЖӘНЕ ЕСЕБІ

Аннотация. Қажетті деңгейде провизияның болуы кез келген ұйым қызметінің даму кепілдігі және анықталатын факторына жатқызылады. Провизиялардың құрылуы ЕДБ қызметтерін де қатысты және жалпылама экономикалық қатынастар заңдылығының бір көрінісі болып табылады.

01.01.18 ден бастап күшіне енген ХҚЕС 9 сәйкес банктер несиелік шығынды іс жүзінде келтірілген емес, болашақта күтілетін шығынмен есептейді (ХҚЕС 39).

Осылайша, отандық банктерді қиындықтар күтіп тұр, себебі ХҚЕС (IFRS) 9 несиелік тәуекелмен жұмыстың мүлде басқа форматын талап етеді, бүгінгі таңда кейбір банктер іс жүзінде жеткілікті деңгейде дайын емес.

Түйін сөздер: екінші деңгейлі банктер, провизия (резервтер), активтер, несие, несиелік тәуекелдер, халықаралық қаржылық есеп беру стандарттары, құнсыздану, несиелік қоржын.