

ACCOUNTING INFORMATION IN THE POLICY AND GENERAL STRATEGY FOR THE ADMINISTRATION OF LENDING CREDIT RISKS

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***Abstract:** Any credit represents an anticipation of some future cashing. From this perspective, by cash flow, any credit contains the risk that these cashing isn't achieved totally or partly. This risk is also called insolvency risk of the creditor; it is essential in the banking activity due to the fact that the main function of a bank represents the granting of credits. The exact appreciation of the credit risk is, thus, of major importance for the bank. Being easier to prevent than to cure, for the minimization of the risk exposal, the most important stage of the crediting process is the choosing of the credit demands. In this stage, the behaviour of a bank might be presented as follows: a credit is granted only if there might be estimated that the probability of reimbursement exceeds the one of non – reimbursement. The appreciation of this reimbursement capacity might be done if it has at its base different procedures, according to the debtor: economic agent, private person, State. The determining elements for the administration of the lend risk are: payment capacity, character of the debtor – his wish to pay, the capital – wealth of the debtor, the guarantee (real or personal), all based on book information.*

***Keywords:** lend risk client, book information, cash flow.*

General conditions regarding the reliability of economic agents in the crediting activity

Accounting information is an important component of the credit granting process. Accounting information establishes the monitoring relationship between the borrower and lender, affects accounting choices made by the borrower, and influences perceptions of the riskiness of the borrower and lender. Using inappropriate accounting information, particularly those that are too restrictive, are noisy signals that could have economic consequences for borrowers and lenders. In this circumstances, professional loan officers analyzed financial and nonfinancial information of candidate borrowers and set preferred levels of collateral and covenants while their decision processes were captured using computerized process tracing.

The strategy of the Bank regarding the lend risk is included in the Crediting Regulation filled in with the General Strategy of the Bank for a short, average and long term, approved by the Board of Administration. The target group of the Bank, in the case analyzed in the present material, are **Micro-enterprisers and small and average enterprises (IMM's)**, category where are also included the micro, small and average private business, that are involved in the production or marketing of goods and services and which is active in Romania. We suppose, as well, that the Bank might finance also authorized natural persons that act as entrepreneurs and any other persons which are involved in entrepreneurial activities. Further on, the term "enterprise" makes reference to any form of business according to the above mentioned. In case of natural person, the main income source (during season, in case of season activities), must result from the development of some entrepreneurial activities.

Generally, there are used two criterions for the segmentation of the target group of the Bank: the number and employees and the rate of turnover.

The turnover criterion is determined in order to establish the type of client but, in exceptional situations, according to the profile of the business and the number of employees, the client might be framed in another category than the initial one.

In any case, the Bank shall not finance enterprises that develop as main activity one of the activities included in the List with Exclusions for Environmental Problems.

The Bank engages itself to observe the policies of a prudent lender, according to the international banking practice. This thing supposes that there shall be granted credits only to clients with reliability. The reliability is established according to:

- Personal aspects;
- Current and future financial situation of the solicitor, including the competition situation, the future perspective for the business type in which the solicitor is involved, and the currency exchange risks;
- Future payment capacities – according to provisions of the cash flow of the borrowed or to the estimated situation of the income.

The data base of the Central Office of Banking Risks (CRB) must be consulted for debtors and co-debtors for all credits. The Credit Officer/ Credit Director of the Subsidiary/ Agency/ the Credit Coordinator/ the Deputy Director of the Subsidiary/ the Director of the Subsidiary/ Agency might ask the consultation of the CRB also in case of guarantees and/ or associates/ administrators of the enterprise and/ or other economic entities considered in the frame of the risk valuation process for the debtor/ co-debtor.

The access to the data base of CRB for debtors and co-debtors mustn't be older than 1 month at the moment of granting the credit and to the moment of granting each installment, if the credit is granted in installments.

The data base of the Credit Office (CredIT) might be consulted in case of Credits for enterprisers for main owners of the respective company, only when the Credit Officer/ Credit Director of the Subsidiary/ Agency/ Deputy Director of the Subsidiary/ Credit Coordinator/ Director of the Subsidiary/ Agency considers that the loan fulfills all conditions for being approved and the access is performed for granting the loan. However, for any debtor or co-debtor, natural person, there must be signed the agreement for the consulting of the Data Base of the Credit Office.

The data base regarding the payment incidents (CIP) shall be accessed for debtors and co-debtors, for all credits, excepting natural person with activity in agriculture and authorized agricultural producers (in this case consultation shall be done only at the request of a member of the credit board). The Credit Officer/ the Credit Director of the Subsidiary/ Agency/ the Credit Coordinator/ the Deputy Director of the Subsidiary/ the Director of the Subsidiary/ Agency might request its consultation, also for other person involved in the business and/ or for guarantees and/ or for other economic entities considered in the frame of the risk valuation process for the debtor/ co-debtor.

The bank classifies the credits granted to enterprises in Micro, Small and Average Credits.

Analysis and processing of information for the risk valuation of the client

Information obtained and checked might be processed by the Credit Officer such as to offer an exact image of the generally current financial situation of the economic unit.

Generally, at *microfinancing*, the relation between families and business is very important. The balance issued by the Credit Officer, that reflects the current situation of the enterprise, shall include all actives used in the activity, even if the juridical owner is one of the family members. The private debts of the family, as well, made for covering the needs adequate to the economic activity, must be included in the balance presented by the credit officer.

In the case of *small and average enterprises* the accent is put on the financial analysis of the economic unit, generally there exists no close connection between the economic unit and the family of associates/ shareholders.

However, the Credit Officer must identify in both analysis types the active and the debts that are bound from juridical point of view to the business owners, that are used in the activity or that are owed to it and that might influence the reimbursement capacity of the crediting enterprise. The active and the passive whose book value doesn't reflect the reality (because of inflation or of other reasons) must be valued by the credit officer according to their market value, the probable investment cost, the depreciation, the replacement cost, etc. (or according to the contractual and juridical clauses in case of debts).

The average cash flow presented in the analysis forms is an important indicator regarding the present and future payment capacity of the client. It considers the influence of the credit on the activity (replacement of expenses with rents, reduction of expenses bound to fuel or consumable materials, etc.) and neglects the incomes or expenses that shall clearly disappear during the credits' reimbursement (cease of the leasing or crediting contracts, temporary incomes, stopped activities, etc.). The foreseeing of the development of the clients' activity has also an important role in establishing the cash flow.

The cash flow shall include incomes that come from economic activities, including future estimation and those that come from other sources (salaries, etc.), as well as monthly expenses and obligations of the enterprise and the family, replacing the projection of the cash flow.

The historical cash flow shall be presented in the analysis form or in analytical book documents supplied by the client in case that the Crediting Board decides it is a representative and useful element for taking the decision of granting the credit and for Average Credits there might be done a **projection of the cash flow**, that shall include the duration of the credit.

In case of Small and Average Credits, the valuation of the Credit Officer might additional include precise information regarding the juridical status of the enterprise, the financial situation issued and checked by the Credit Officer, the historical cash flow and projections that show the probable impact of the credit on the future of the business.

The Credit Office shall do its best to obtain the most exact information possible as base for the performance of the credit analysis. The Credit Officer might use following sources:

- A general discussion with the owner of the business regarding its general, specific features and recent development. The truthfulness of the supplied information must be certified by crossed checking.
- Inspections at the headquarters of the business in order to obtain qualitative information (for ex. Management and administration capacities of the potential client) and in order to collect and check data for the financial and economical analysis (stocks, fixed assets, account receivables, debts, cash, banking accounts), including relevant documents such as contracts, invoices, etc.
- Information regarding the market quota of the enterprise, the situation of the competition, currency exchange risks, etc.
- Collecting and checking the official documents of the enterprise.
- Information regarding other business unfurled by the solicitor.
- Inspection of goods that might be considered as guarantee.
- Estimation of the moral integrity of the future client (references).
- Information regarding the location of the business headquarters and of the client's dwelling (for the facilitation of the future monitoring).
- Comparing the conclusions in case of repeated visits.

In case of average enterprises, considering the complexity of the business and implicit of their relation with the bank, there shall be put a greater accent on financial and legal aspects of the business.

These credits do have usually longer maturities and thus there exists a bigger probability for the apparition of some changes in the activity and evolution of the enterprise. As a result thereto, the Credit Officer must estimate the opportunities and risks associated to these changes. This means that, the aim for which the credit shall be used, plays a much more important role in the valuation of the reliability made by the credit officer than in the case of Micro Credits.

In the performance of the analysis for small and average credits, the Credit Offices must use following additional information sources:

- A discussion with different persons in the management of the enterprise. The correctness of information must be checked by crossing.
- The analysis of the documents of the enterprise.

- The analysis of the documents regarding the participation to other companies, affiliation to groups (if it is the case) and a consolidated and explanatory analysis of these participations (if it is the case).

Conclusions

The risk that appears at the moment that one credit client or counter-party can't or doesn't wish to observe his contractual obligations, resulting an adverse effect on the profits and capital of the bank, represents the *client credit risk*.

The administration of the credit risk starts from the credit officers. Thanks to the detailed analysis made by them, to the adequate guarantee level and to the conservator crediting practices, we reduce the lend risk even at the beginning of the crediting cycle, for example, from the moment the credit demand is received and processes. The decisions regarding credits must be based on the analysis of documents brought by client, on the entire and prudent valuation of the economical – financial situation of the client, on the analysis and valuation of the impact provoked by the use of the credit on the activity of the debtor, inclusively on the valuation of guarantees. The key of the high quality level of our analysis is the intense formation of which our credit officer benefit and the rigorous analysis of the cash flow and of the book balance. The demands regarding the guarantee must be defined as integral part of the credit decision and the credit can't be integrally granted but when there were passed the registration steps of the requested guarantee. Additional demands, such as the composition of the credit boards and the adhering to the rules regarding the levels for approving the credits, create efficient mechanisms for the administration of lend credits during the credit granting and for the reduction of the fraud risk. The mechanisms for the approval of credits are described I detail in the crediting procedures of the bank. The good relations with clients, according to the mission of the bank, are an important instrument in avoiding the delay cases and in the identification of problems bound to the credit, even from its beginning phase. The bank revises half – annual the scoring of the client, according to the demands of NBR and performs, if necessary, the adequate changes in the system. The bank has procedures that define the steps to be followed when the capacity for the fulfilling of credit obligations by a client begins to give deterioration signs.

The crediting and monitoring standards, together with the demands regarding the guarantees and the monitoring of the problem situations bound to credits, tend already to “remove” the potential problem clients. It is important that the bank avoids the creation of an image as a “neglecting creditor”.

The monitoring of the quality of the credit portfolio is constantly done by using the risk portfolio indicator, defined as the credit volume in development that has at least one rate delayed with more than 30 days, as basic unit for the measurement of the quality of the actual portfolio.

In all these analysis the book information is the main data source.

Biography

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