STUDY ON THE ACCOUNTING OF ADJUSTMENTS FOR RECEIVABLES DEPRECIATION IN OPERATIONS WITH CLIENTS

ILIE RĂSCOLEAN, ILEANA-SORINA RAKOS *

ABSTRACT: *The present work approaches an important topic for credit institutions: limiting the credit risk and determining the prudential value adjustments for the depreciation of client credits, and their reflection in the accounting statements. The Chart of Accounts applicable to credit institutions includes class-two accounts Operations with clients and expenses and revenues accounts, which help record the adjustments for receivables depreciation in operations with clients. To constitute, diminish or annul depreciations, credit institutions have the obligation to assure the classification of their credits based on classification categories according to three criteria: financial performance, debt service and initiation of juridical procedures. By the present study, we present the way the credit portfolio is structured according to the criteria mentioned and the reflection in accounting of the prudential adjustments of value. The article ends with the authors' conclusions regarding the specificity of the way of classification of the credits according to risk categories in agreement to the evolution of the class determination criteria.*

KEY WORDS: *credit institutions, clients, depreciation adjustment, credit risk, financial performance, debt service, classification criteria, standard, under obsevation, substandard, doubtful, loss.*

JEL CLASSIFICATIONS: *G21.*

1. INTRODUCTION

Credit institutions have the obligation to take measures to limit credit risk, one of the most important financial risks they are faced with, assuring in this way the protection of the availabilities for clients and the safety of the bank's financial state.

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* *Assoc. Prof., Ph.D., University of Petroşani, Romania, ilierasolean@yahoo.com*
  Assist. Prof., Ph.D., University of Petroşani, Romania, nihilsinedeo_68@yahoo.com

In this sense, the National Bank of Romania emitted specific norms obligatory for the credit institutions applicable to banking societies and cooperative credit societies.

According to the provisions of Law no. 58/1998, with its subsequent modifications and completions, of the Regulations of the National Bank of Romania no.16 / 20.12.2012, concerning credit classification and banking investments and the determination and the use of prudential adjustments of value, the credit institutions, Romanian juridical persons, and the branches of Romania of the credit institutions of third countries, have the obligation to determine prudential adjustments of value for the depreciaton of receivables in treasury and interbanking operations and for the depreciation of receivables in client operations.

Prudential adjustments for the depreciation of receivables in client operations are determined based on the classification of the credit portfolio according to the following criteria: financial performance; debt service; initiation of juridical procedures.

The evaluation of the financial performance of a debtor, juridical person, from outside the sector of the credit institutions is realized according to the internal norms of the credit institutions, based on a score attributed for certain quantitative and qualitative factors. The quantitative factors refer mainly to indicators of liquidity, solvency, profitability and risk.

The qualitative factors mainly refer to aspects concerning the way of administration of the juridical person requesting or benefiting of a credit, the quality and structure of the shareholders, the guarantees received (others than the ones accepted at the diminution of the exposure to the debtor), the market conditions in which the credit institution undertakes its activity.

The indicators for the appreciation and evaluation of the quantitative factors are calculated based on the data included in the debtor's financial statements, and the category of financial performance is determined and contributes to the classification into one of the five classification categories: standard, under observation, substandard, doubtful and loss.

If credit institutions find themselves in the impossibility of evaluating the financial performance of a debtor, juridical person, from outside the credit institutions sector, it is direcly classified in the category E-Loss.

The financial performance is determined before making the decision to grant the credit, based on the latest financial statements requested and presented by the client, and depending on the results of the analyisis, the credit institution will make the decision whether or not to grant the credit. At the same time, after having granted the credit, during the development of the specific operations, periodically the credit institution will reevaluate the financial performance of the debtor.

Thus, the frequency with which the category of financial performance of a debtor, juridical person, from outside the sector of the credit institutions is determined, coincides with the frequency with which the financial statements are granted.

The second criterion based on which the classification of the banking investments is realized on categories of classification is debt service. Debt service represents the debtor's capacity of paying his debts in due time and is expressed as

number of days of delay at payment after the deadline date, and the financial performance highlights the economic potential and the financial solidity of an economic entity and is determined based on data from the periodical financial statements.

The debt service of an economic agent to the bank will be unique and will be established according to the way the debts of the loan-maker (credits and interests) are to be paid, regardless whether they come from credits in lei or in currency.

At the same time, the debt service of an economic agent is determined by the greatest ancientness of the unpaid credits and/or interests.

The initiation of juridical procedures is represented by at least one of the following measures adopted in order to recuperate the debts: decision by the court to open the bankruptcy procedure; opening of the procedure of forced execution for physical and juridical persons.

Credit institutions classify the debtors from outside the credit institutions sector in categories of financial performance according to the descreasing order of its quality, as follows: standard (A), under observation (B), substandard (C), doubtful (D), loss (E).

In order to classify the credits, during the period included between the drafting of two financial statements, the last category of financial performance determined is maintained. The first classification of the credits for debtors, juridical persons, from outside the credit institutions sector considers the financial performance category determined according to the latest financial situations.

According to the norms in force, banking societies have the obligation to classify the credits granted into five categories, for which obligatory adjustment ratios are established (from the value of the credits) as follows: standard: 0; under observation: 0.05; substandard: 0.2; doubtful: 0.5; loss: 1.

Financial performance / Debt Service	A	B	C	D	E
0-15 days	Standard	Under observation	Substandard	Doubtful	Loss
16-30 days	Under observation	Substandard	Doubtful	Loss	Loss
31-60 days	Substandard	Doubtful	Loss	Loss	Loss
61-90 days	Doubtful	Loss	Loss	Loss	Loss
minimum 91 days	Loss	Loss	Loss	Loss	Loss

The correspondence between the credit classification categories and classification criteria is established as follows:

Criteria of classification into categories for the exposures as a result of credits recorded by the credit institutions to debtors from outside the credit institutions system.[1]

If judicial procedures have been initiated, all the credits granted to the non-banking sector, regardless of the clients' financial performance, are considered credits of the type "Loss".

The accounts using which the adjustments for the depreciation of the receivables from client operations are accounted for are presented below.

2. ACCOUNTING OF THE ADJUSTMENTS FOR DEPRECIATION OF RECEIVABLES FROM CLIENT OPERATIONS

The Chart of Accounts and the methodological norms of use of this Chart have been harmonized with the European Directives applicable to credit institutions, by the Order of the National Bank of Romania no. 5 / 22.12.2005, for the approval of the Accounting Regulations harmonized with the European Directives, Applicable to Credit Institutions, Modified and Completed by the Order of the National Bank of Romania no. 24/21.12.2006 (*Reglementările contabile conforme cu directivele europene, aplicabile institutiilor de credit, modificat şi completat prin Ordinul Băncii Nationale a României nr. 24 din 21.12.2006*), and later on by the Order No. 27/16.12.2010 for the approval of the Accounting Regulations in Harmony with the International Financial Reporting Standards Applicable to Credit Institutions (*Reglementărilor contabile conforme cu Standardele Internationale de Raportare Financiară, aplicabile institutiilor de credit*) and the Order No. 26/13.12.2010 regarding the modification and completion of the accounting regulations in harmony with the European directives, applicable to credit institutions, non-banking financial institutions and the Fund Guaranteeing Deposits in the Banking System.

The Chart of Accounts of the credit institutions takes into account the general framework of the Chart of Accounts for the economy and the specific of the activity.

The Chart of Accounts applicable to the credit institutions for drafting the individual annual financial statements contains the accounts needed for recording in accounting the economic-financial operations, and their content. In the elaboration of the Chart of Accounts, what was considered, first of all, were the accounting treatments included in IFRS, the IFRS provisions on the information presented in the annual financial statements (individual) and the demands of reporting to the National Bank of Romania.[2]

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[1] *Regulament BNR nr.16 din 12 decembrie 2012 privind clasificarea creditelor şi plasamentelor şi determinarea şi utilizarea ajustărilor prudenţiale de valoare* (Regulations of the Romanian National Bank no. 16/12.12.2012 regarding credits and investments and the determination and the use of prudential adjustments of value), published in Monitorul Oficial (Official Journal) no. 865/20.12.2012

[2] *Order of the Romanian National Bank no. 27/16.12.2010* for the approval of the Accounting Regulations in harmony with the International Financial Reporting Standards, applicable to credit institutions (*Ordinul B.N.R. no. 27 / 16.12.2010 pentru aprobarea Reglementărilor contabile conforme cu Standardele Internaţionale de Raportare Financiară, aplicabile instituţiilor de credit*), published in M. Of. No. 890 bis / 30.12.2010, Annex 1, p. 29

The accounts are symbolized based on the decimal and are grouped as follows:[3]
- on classes – corresponding to the first digit in the symbol of the account;
- on groups – corresponding to the first two digits in the symbol of the account;
- on synthetic accounts of first degree – corresponding to the first digits in the symbol of the account;
- on synthetic accounts of second degree – corresponding to the first four digits in the symbol of the account;
- on synthetic accounts of third degree – corresponding to the five digits in the symbol of the account.

Usually, with certain exceptions, the synthetic accounts of the first degree are not functional, being developed into synthetic accounts of the second degree, and some of them are developed into synthetic accounts of third degree.

The plan of accounts for the banking societies includes the next account classes:
- Class 1 – Treasury operations and interbanking operations
- Class 2 – Operations with clients
- Class 3 – Operations with titles and various operations
- Class 4 – Permanent capital
- Class 5 – Own capitals, assimilated and provisions
- Class 6 – Expenses
- Class 7 – Revenues
- Class 8 – Operations outside the balance

The accounting of the adjustments for the depreciation of the receivables in client operations is held using Class 2 accounts – Operations with clients, included in group *Grupa 29* – Adjustments for the depreciation of the receivables in client operations, as follows:

291 - Specific ajustments for depreciations identified on the individual level
292 - Specific ajustments for depreciations identified on the level of the groups of financial assets
293 -Collective adjustments for losses generated, but unidentified

There are liabilities credited with the adjustments constituted and debited with adjustments annuled or diminished.

The accounts of expenses and revenues with/from adjustments for the depreciation of the receivables are the following:

662 -Expenses with adjustments for the depreciation of the receivables from operations with clients
    6621 -Expenses for adjustments specific for depreciations identified on the individual level
    6622 -Expenses for adjustments specific for depreciations identified on the level of the groups of financial assets
    6623 -Expenses for collective adjustments for losses generated but unidentified

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[3] I.Răscolean, *Contabilitatea instituţiilor de credit* (The Accounting of Credit Institutions)*,* Ed. Universitas, Petroşani, 2014, p. 28

762 -Revenues from adjustments for receivables depreciation in operations with
    clients
    7621 -Revenues from adjustments specific of depreciations identified on
    the individual level
    7622 -Revenues from adjustments specific for depreciations identified on
    the level of the groups of financial assets
    7623 -Revenues from collective adjustments for losses generated but
    unidentified

The main economic operations and their reflection in accounting concerning the adjustments for depreciation of the receivebles from client operations are as follows:

- constitution of adjustments specific for receivables depreciation in operations with clients, identified on the individual level:

6621-Expenses for adjustments specific   =   *291-Adjustments specific*
for depreciations identified   *for depreciations identified*
on the individual level   *on the individual level*

- constitution of adjustments specific for receivables depreciation in operations with clients, identified on the level of the groups of financial assets:

6622-Expenses for adjustments specific =   *292-Adjustments specific*
for depreciations identified   *for depreciations identified*
on the level of the groups of   *on the level of the groups of financial*
financial assets   *assets*

- constitution of adjustments specific for receivables depreciation in operations with clients for collective adjustments for losses generated but unidentified:

6623-Expenses for collective adjustments   *=293 -Collective adjustments*
for losses generated but   *for losses generated*
unidentified   *but unidentified*

- diminution of the adjustments specific for receivables depreciation in operations with clients, identified on the individual level:

291-Adjustments specific for   =   *7621-Revenues from adjustments*
depreciations identified on   *specific for depreciations identified*
the individual level   *on the individual level*

- diminution of the adjustments specific for receivables depreciation in operations with clients, identified on the level of the groups of financial assets:

292-Adjustments specific for   =   *7622-Revenues from adjustments*
depreciations identified on the   *specific for depreciations*
level of the groups   *identified on the level of the*
of financial assets   *groups of financial assets*

- diminution of the adjustments specific for receivables depreciation in operations with clients, for collective adjustments regarding losses generated but unidentified:

293-Collective adjustments for losses generated but unidentified	=	7623 -Revenues from collective adjustments for losses generated but unidentified

3. A CASE STUDY REGARDING THE RECORDING IN ACCOUNTING OF THE ADJUSTMENTS CONCERNING THE DEPRECIATION OF THE RECEIVABLES FROM CLIENT OPERATIONS:

The structure of the credit portfolio for two periods of administration, on the level of the subunity of a credit institution, according to financial performance and debt service, is presented in the next tables.

Tabel 1. Period of administration N_0

Financial Performance / Debt service	A		B		C		D		E	
	LEI	%	LEI	%	LEI	%	LEI	%	LEI	%
0-15 days	5364086	86.0	2508533	79.0	530738	52.0	158767	28.0	13609	4.0
16-30 days	498984	8.0	412797	13.0	357227	35.0	124746	22.0	27217	8.0
31-60 days	187119	3.0	127014	4.0	61239	6.0	102066	18.0	40826	12.0
61-90 days	124747	2.0	79384	2.5	40826	4.0	113406	20.0	85054	25.0
Minimum 91 days	62373	1.0	47630	1.5	30620	3.0	68043	12.0	173510	51.0
Total	6237309	100	3175358	100	1020650	100.0	567028	100.0	340216	100.0

Table 2. Period of administration N_1

Financial Performance / Debt service	A		B		C		D		E	
	LEI	%	LEI	%	LEI	%	LEI	%	LEI	%
0-15 days	6260145	89	2950459	81	599135	53.0	145702	29.0	10048	4.0
16-30 days	562710	8.0	473530	13	406960	36.0	110532	22.0	20097	8.0
31-60 days	140677	2.0	109276	3.0	67827	6.0	90435	18.0	32657	13.0
61-90 days	70339	1.0	72851	2.0	33913	3.0	100484	20.0	67827	27.0
Minimum 91 days		0.0	36425	1.0	22609	2.0	55266	11.0	120581	48.0
Total	7033871	100	3642541	100	1130444	100	502419	100	251210	100

Structure of the credit portfolio according to the financial performance:

Category	N_0		N_1	
Standard	6237309 lei	55%	7033871 lei	56%
Under observation	3175358 lei	28%	3642541 lei	29 %
Substandard	20650 lei	9 %	1130444 lei	9%
Doubtful	567028 lei	5 %	502419 lei	4 %
Loss	340216 lei	3 %	251210 lei	2%
TOTAL	**11340561 lei**	**100 %**	**12560485 lei**	**100%**

Structure of the credit portfolio according to financial performance and debt service:

Category	N_0		N_1	
Standard	5364086 lei	47.3%	6260145 lei	49.8%
Under observation	3007517 lei	26.5%	3513169 lei	28 %
Substandard	1130654 lei	10 %	1213342 lei	9.7%
Doubtful	767756 lei	6.8 %	732277 lei	5.8%
Loss	1070548 lei	9.4 %	841552 lei	6.7%
TOTAL	**11340561 lei**	**100 %**	**12560485 lei**	**100%**

Adjustments for depreciation identified on the individual level, determined on pe categories of classification (lei):

	N_0	N_1	$N_1 - N_0$
Under observation	150375	175658	+25283
Substandard	226131	242668	+16537
Doubtful	383878	366139	-17739
Loss	1070548	841552	-228996
TOTAL	**1830932**	**1626017**	**-204915**
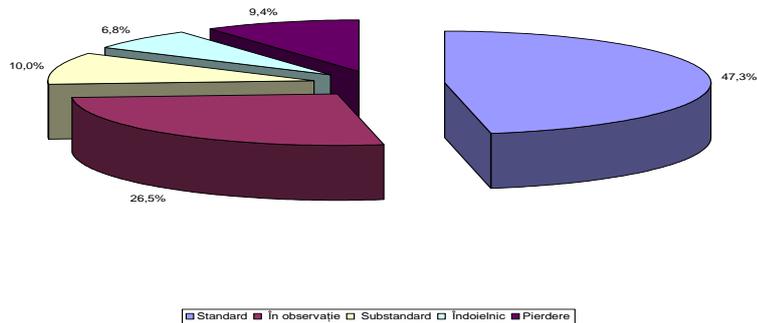
Figure 1. Structure of the credit portfolio on classification categories during the management period N_0

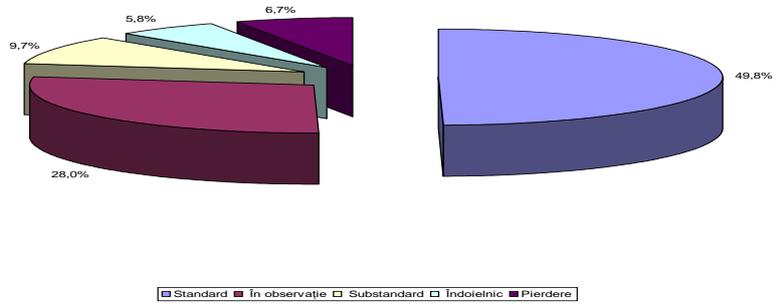□ Standard ■ În observaţie □ Substandard □ Îndoielnic ■ Pierdere

Figure 2. Structure of the credit portfolio on classification categories during the administration period N_1

One records the constitution of the specific adjustments identified on the individual level from the depreciation of the receivables from client operations, according to the structure of the credit portfolio for the administration period N_0:

6621-Expenses for specific adjustments   =   291-Specific adjustments   1830932 lei
for depreciations identified   for depreciations
on the individual level   identified on the individual level

One records the regularization (diminution) of the specific adjustments identified on the individual level from the depreciation of the receivables from operations with clients, according to the variation of the credit portfolio structure during the administration period N_1 compared to N_0:

291-Adjustments specific for   =7621-Incomes from adjustments   04915 lei
depreciations identified on the   specific of
individual level   depreciations identified on the
individual level

4. CONCLUSIONS

The structure of the portfolio of credits on classification categories according to the clients' financial performance has improved during the administration period N_1 compared to N_0 increasing the weight of the credits classified in the higher categories, namely with low risk degree.

Thus, the weight of the credits classified in the standard category grew from 55% to 56%, and the weight of the credits classified in the category under observation increased from 28% to 29%, simultaneously to the reduction of the weight of the credits classified in the inferior categories.

At the same time, the structure of the credit portfolio, considering the debt service as well, follows the same process, increasing the weight of the credits classified in the superior categories and at the same time reducing the weight of the credits classified in the inferior categories.

In this situation, for the administration period N_1 the level of the adjustments for the depreciation of the receivables from client operations is lower than the level of the adjustments constituted and recorded in the accounting statements, an operation of regularization by diminution becoming necessary, with a favourable effect on the financial result.

One can note the unfavourable contribution of the debt service, by the passage of certain credits into categories inferior to those into which they would have been classified according to their financial performance.

For example, for the period N_1 the credits classified into the category Loss according to the financial performance have a weight of 2%, and applying the criterion of the debt service as well, their weight grows to 6.7%, while for the credits classified in the category doubtful the weight grows from 4% to 5.8%.

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