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Nature and Classification of Costs of a Commercial Bank

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Abstract:

The calculation of the financial result of a modern commercial bank is based on a reasonable classification and the formation of an actual cost structure. This issue remains one of the most popular areas for the development of banking in the Russian Federation.

At the same time, traditional approaches require modernization in order to improve the quality of financial management of a modern credit institution.

The article presents the findings on approaches of banking costs' evaluation.

Keywords: *Commercial bank, banking management, bank's costs, bank's performance.*

JEL Classification Codes: *G20, G21, G29.*

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1. Introduction

A commercial bank is an organization engaged in banking operations for the purpose of making a profit. The primary importance in assessing both the final and intermediate results of a commercial bank's activities is taken by competent generation of income and expenses - the main components of the financial result of a credit institution.

2. Modern approaches for the formalization of costs of a commercial bank

Korobov (2013) defines banking expenses as *"...the cost of funds for the implementation of various operations of the bank and ensuring its functioning"*. In the works of Balabanov (2007) a slightly different approach is presented: *"...these are the costs associated with the operations of banks that ensure the functioning of their activities"*.

Kravtsova (2010) offers the following interpretation: "*Bank expenses are a set of costs associated with conducting active and passive operations, carrying out administrative and business operations of a bank, fulfilling obligations to the state budget and extrabudgetary funds, creating reserves for doubtful assets, risks and payments"*.

According to the RAR (Russian Accounting Regulations) and IFRS (International Financial Reporting Standards), the "bank costs" category represents a reduction in economic benefits during the study period as a result of a decrease in assets and / or an increase in liabilities, leading to a decrease in the equity capital of a credit institution that is not related to its distribution among shareholders.

In the theory and practice of organizing commodity production processes, the methodology of research and cost management is sufficiently developed; at the same time, there are certain peculiarities in the implementation of expenditure transactions in banking practice, and the doctrines defining the nature and classification of credit institution costs are limited to the interpretation of regulations of the Central bank of Russia. As we see, an insufficient theoretical elaboration of the subject of this study is obvious.

The basic principles of formation and cost management of a credit institution are presented mainly in the framework of the foundations of strategic and operational management of banking activities, planning and budgeting. Bank costs are a key category when considering optimization processes, which, in fact, is a feature of corporate banking management.

In the study of the cost of credit organizations, the classic works of MacNoton, Kaplan, Higgins, Barltrop, Weins, Falletti, Rose, Barrel, and others are recognized. Analysis, planning and cost accounting in their work is indirectly affected, the main attention is paid to the organization of optimal systems of banks, their assessment and control, building the foundations of management strategies, personnel selection and remuneration policies, compiling operational and annual reporting, etc.

The subject of the formation and management of the bank's costs was practically not covered in the Russian economic literature until 1998, when crisis shocks affected the banking sector. Until that time, the interest of researchers was aimed at finding ways to increase the banking margin, creating approaches to building the foundations of marketing and management, improving methods of expanding the customer base, improving the quality of banking products and services, and optimizing the introduction of innovative technologies. We could emphasize that as a result of the conditions prevailing in the post-Soviet financial market, the priority object of management was the income, and the coditions made possible generating a fairly high marginal profit by Western standards, thanks to funding in foreign banks and placing funds at a higher percentage. The problem of limited liquidity resources was in the background.

3. The need to modernize current approaches to the definition and generation of a modern credit institution's costs

In connection with the introduction of restrictive measures against Russia by the EU countries as well as the USA, Canada, Australia and New Zealand, the objectives of banking management were reoriented to search for marginal products within the country. However, subsequent crisis moments caused by currency volatility made the banks' top management set sights on the increase in profits and capital gains, and on the preservation of available resources and on the reassessment of "risk appetite" as well.

The creation of guidelines for planning and optimizing costs was moved to the forefront of the banking problem. First of all, it was necessary to reverse the trend of high growth of non-operating expenses, which, in most cases, are not covered by the corresponding income and indicate the inappropriate use of capital. In times of crisis these rates become one of the reasons for capital "devouring", reducing trust credit of the organization and cause bankruptcy. In this connection, it is obvious that the economists become more interested in the "costs" category.

Modern Russian banking practice makes extensive use of the experience of economically developed countries. It is impossible to ignore the example of the USA: until the creation in 1980 of the National Association of Accountants on Bank Expenses, cost accounting departments were formed only in a few of the largest banks. The creation of a comprehensive integrated system of formation and management of costs was one of the reasons for obtaining a competitive placement rate. The availability of credits and loans contributed to their wide distribution. Unlike the countries of the former USSR, where borrowings are often perceived as a last resort, credit in the West has become an integral part of the lives of both citizens and enterprises. The bank’s expenditure function should strive for a minimum extremum weighted by the selected benchmarks that most adequately reflect the actual performance of the credit institution (Mahboud, 2017; Mitrokhin *et al.*, 2016).

A comprehensive assessment of bank expenses includes their systematization, depending on whether these expenses are related to the main banking activities or other non-banking operations. In accordance with the current Russian practice of drawing up financial statements, the structure of bank expenses includes the following:

- *operating expenses:*
a) interest expenses - expenses on passive operations (raising funds), accrued and paid in rubles and foreign currency. They are determined based on the interest rate, term duration and the amount of the loan;
b) non-interest (commission) expenses - expenses on the implementation of passive operations: fixed amounts or a fixed percentage of the amount of the liabilities on the accepted work and services received. At its core, this is the cost of ensuring the functioning of the bank, including the following:
- expenses on staff and freelance staff (wages and contributions to the corresponding extra-budgetary funds, bonuses, compensation, etc.; costs for the training and retraining of personnel);
- the costs of ensuring the economic activities of the bank (expenses on the formation of fixed assets and depreciation of fixed assets and intangible assets; the cost of renting and operating of fixed assets; transportation and communication expenses; office and administrative expenses, etc.);
- other expenses (entertainment expenses, advertising expenses, legal, audit, and consulting services, etc.). In the overwhelming majority of cases, they result from the fulfillment of contractual obligations to counterparties, or in accordance with the requirements of the law.
- *non-operating expenses:*
- fines, penalties paid for late and incorrect withdrawal / transfer of funds from clients' accounts; violation of the order of payment; non-compliance with the terms of lending and deposit agreements; violation of regulatory requirements of the Bank of Russia; violation of the terms and volumes of settlements with the budget, etc.);
- expenses of previous years, located in the process of subsequent control in the reporting period;
- the costs of litigation;
- costs on the sale of property, write-off of bad debts etc.

All the expenses‘ categories are fully reflected in the statement of financial results of the annual financial statements of the bank (form 0409803), as well as in the quarterly report on financial results (form 0409102); as required, a credit institution has the right not only to create additional expense accounting items, but also to provide them in accordance with unified bank reporting standards.

A distinctive feature of banking is that the share of attracted resources in the liabilities of the credit institution amounts up to 90%. The fee for these funds is the interest expenses of the bank, respectively, the share of interest expenses prevails both in total and in operating expenses (Gubin *et al.,* 2017; Bojare and Romanova, 2017; Kassidova, 2016).

Control of interest costs of a credit institution is implemented through analyzing the constituent items in the context of counterparties: interest paid on loans issued by other banks, including The Central Bank of the Russian Federation for liabilities raised from individuals and legal entities, etc. It is important that interest income and expenses should have an identical trend rate.

The state of the financial market and the country's economy as a whole has a significant impact on the amount of interest expenses. We note the degree and direction of state participation, inflation rates, quotes of domestic companies' securities, exchange prices for basic assets such as oil, gold, currency, etc. At the macro level, interest rate expenses are largely affected by the policy pursued by the Central Bank, at the micro level it is affected by the size of the weighted average interest rate on loans and deposits and the sum of average balance of borrowed funds.

4. Conclusion

Now, in our opinion, the management should be focused on optimizing, minimizing and controlling non-operating expenses. The increase in the share of non-interest expenses in the overall structure leads either to an increase in cost, and therefore the selling price of products and services, or to a decrease in bank capital due to the transfer of non-interest expenses to financial results.

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