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LOANS ACCOUNTING

Phd (c) Romina RADONSHIQI
Lecturer, Public Administration Department Faculty of Political Sciences and Law Aleksander Moisiu University Email: romina_radonshiqi@yahoo.com. Durres, Albania

Abstract: *Accounting has a significant positive impact on the banking system because it represents a detailed financial information system for transactions. It is a major component in the management of credit risk. The important aspects of the accounting of loans are recognition of the rights of the customers and the calculation of provisions for problematic loans. Current practice requires that the risk that accompanies the loan to be reviewed often. Concentration risk refers to the risk of the portfolio resulting from increased exposure against a borrower or a group of borrowers. Traditionally, portfolio managers are based on intuition to assess the risk of concentration and the first limits of exposure were the intuitive defense but arbitrary against concentrations of credit risk. The periodic nature of the concentration of credit problems raises the issue why did the banks allow concentrations to develop. Banks appear more sensitive to the risks in some situations where they are focused on increasing assets or increasing owned part of market. Many banks are exploring techniques for identifying concentrations based on common risk factors or correlations between factors. Small banks may also find it hard not to be near the limits of concentrations.*
Key words: *Accounting, Loans, Bank, Credit risk*

1. Credit Risk

A greater proportion (80%) of biomass of terrestrial invertebrates is represented by earthworms which play an important role in structuring and increasing the nutrient content of the soil. Therefore, they can be suitable bioindicators of chemical contamination of the soil in terrestrial ecosystems providing an early warning of deterioration in soil quality (Bustos-Obregón and Goicochea, 2002). Earthworms are boneless animals with a soft body that stretches more than 3 cm. They digest dead plants and other organic matter and produce vermicompost. They also dig holes in the soil which allow for air and water to seep through and improve plant growth. *Eiseniafoetida* is the most commonly researched member of this family (Correia et al., 2002). 2,4-D is a low-cost herbicide common in world. This herbicide is weak in terms of biological transformation and is usually found in water. The use of this herbicide can cause metabolic changes and tissue death in non-target organisms and important members of the food chain such as fish (Dynes, 2003). Researchers have found that 2,4-D rarely affects earthworms unless it is administrated repeatedly. They have also observed that the worms are mostly affected in pastures and prairies. An in-vitro toxicology study examined the effect of 2,4-D dimethyl amine salt on *Eiseniafoetida* (Corriea et al., 2010). So, Herbicide effectiveness could be strengthened according to the target weed and application dosage and repetition. Neuhauser and Callahan (1990) suggested that more consideration should be given to evaluation of sublethal effects under field conditions.The present study examined the effects of glyphosate and 2,4-D on the reproduction of *eiseniafoetida* earthworms.

Most sensitive markets instruments as financial derivatives are recently seen as relatively sophisticated instruments that require some effort from the part of the bank as well as the client to ensure that the contract will be well and correctly understood by the client (Sudweeks, B.L: 7). The changes of the prices in financial markets means that the value of some instruments can change in a very rough and unfavorable way for the client, it usually has a small probability but no zero. Effective stress testing (Satchell S, Knight J: 2007.,)[1] may reveal the possibility for huge losses, which sustainable practices suggest to be revealed to be client.

Banks have suffered substantial losses when they take insufficient care to ensure that the client fully understands the transaction. This starting from the origin till unfavorable price movements can leave the client a debtor with a large amount to the bank. (I.E. and Margaritis, D. 2010: 875) Credit agreements or sensitive instruments to liquidity require a careful analysis of client toward liquidity concerns. This analysis is done because credit exposure of the bank funds can grow very fast when client are subject to such concerns.

A high pressure to have sufficient liquidity to achieve the fulfillment of the terms of the agreement may directly reflect the price volatility (Mehra, R. and E. Prescott:148). In other cases, the pressure of liquidity in the financial system can reflect credit concerns and a contraction of normal lending.

2. The loans

Loans classified in the account no. 15[2], should always be the subject of contracts drawn up between the bank and the borrower, in which are defined characteristics of the loan (amount, maturity dates, terms of repayment, interest payments, commissions, etc...). In the accounting records that will be made for them, must be reflected the contract terms. Loans for financial institutions are grouped into three categories according to the original schedule and their initial characteristics:

- ✓ No Term Loans- are the loans, the maturity of which lasts less the none working day
- ✓ Term Loans - are loans which maturity is greater than one working day

a) standard

b) Special mention

c) substandard

d) doubtful

e) lost

The above classifications will be made taking into account the financial strength and ability of the borrower to repay the debt[3]. Standard loans are loans which banks consider that are:

- Well guaranteed-the borrower's financial situation is healthy and payment expected to be in accordance with the terms of the loan. At the same time, there is evidence that the borrower's financial condition will not change;
- Fully guaranteed by a third party, which is able to meet the obligations if the needed. This is true for loans fully guaranteed by an international institution.

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[1] Stress testing has gained importance in financial institutions with the introduction of Basel II. Although discussed from many perspectives, the predominant use for stress testing is in predicting how a portfolio would respond to changes in the macroeconomic environment. Validating stress testing models is inherently difficult, because financial institutions do not have historical data representing portfolio performance through many severe recessions.

[2] http://www.kkk.gov.al/foto/uploads/File/SKK%20ne%20fuqi/SKK%2015.pdf

[3] http://siteresources.worldbank.org/INTGUARANTEES/Resources/Methods_of_Loan_Guarantee_Valuationand_Accounting.pdf

When an instalment is not paid in part or in full and is not anticipated any danger of lack (the loan is fully guaranteed), the amount outstanding shall automatically be reclassified into the account loans outstanding standard. Non-performing loans at the time, a priori, does not represent a risk[4].

Special Mention Loans are those loans which:

- The financial situation of the borrower is currently sufficient but potential weaknesses exist and if not corrected, will result in a weakening of the position of bank credit in a future date[5].

- In the case of instalment loans, loan share are outstanding and interest for the period of 30-90 days.

- In case of non-instalment loans (when loans are not paid under an instalment plan), the settlement is not done at the maturity date and exceeds it for31-90days.

Substandard Loans

Substandard loans are loans which meet one of the following conditions:

a. they are not adequately secured by the market value of collateral;

b. the borrower's financial situation is less than satisfactory. In essence, the primary sources of repayment are insufficient to satisfy the debt and the bank should focus on secondary sources for repayment;

c. in ability to repay the debt has resulted in the need to restructure it;

d. in the case of loans with instalments, one instalment is not paid for within 90 to 180 days;

e. in the case of loans that are not paid by instalments, the payment is not made on the date of maturity for 31 to 90 days.

Doubtful loans

Doubtful assets represent all weaknesses indicated above for substandard loans and one of the following conditions:

a. are view of the financial situation of the borrower is a distinct possibility that the borrower will not be able to fully repay the obligation on a loan or other debt compelled by the bank;
b. There is a real risk that the borrower is declared insolvent;
c. In case of loans with instalments, each instalment is overdue return to180 to 360 days;
d. The client does not pay the loan in time for 90-180 days, in case of non-instalment loans;
e. Loans are restructured more than two times.

Lost Loans

Assets classified as lost, are treated as uncollectible and their continuity as bank assets is not justifiable (Cortavarra. L ., Dziobek C., Kanaya A., Song I, 2000:11).. In addition to having the dubious loan characteristics, the following conditions exist:

the financial condition of borrowers clearly shows an inability to fully meet the terms of the debt to the bank;

borrower involved in a liquidation process and there is a real risk for some creditors that remain unsatisfied;

[4] http://ec.europa.eu/internal_market/accounting/docs/consolidated/ias39_en.pdf

[5] https://www.cgap.org/sites/default/files/CGAP-Technical-Guide-Commercial-Loan-Agreements-Oct-2006.pdf

in the case of instalments loans, one instalment overdue return for more than 360 days;

the client does not pay the loan in time for 90-180 days, in case of non-instalment loans.

Classification as lost does not mean that the asset has absolutely no residual value or return. This loan is classified lost until all legal procedures have been performed.

3. The Accounting of loans

Accounting is done depending on when funds are disbursed as a loan has been given to the customer[6]. When funds are not disbursed immediately, credit commitment must be reflected off balance.

Contracted amount is recorded in the following *accounts*:

DEBIT: 9011 commitments given in favour of credit institution

CREDIT: 90811commitments given in counterparty account

Accounting records are stormed when funds are disbursed

The release of funds- The amount recorded in the accounts represents the first principal (principal debt) extended and accorded to other financial institutions.

Loan repayments- During the period of the loan, repayment of capital is deducted from the principal gross amount. Guarantees received in the case of prepayments are recorded in operating income at the time of subscription.

Revenue recognition-The calculation of interest is based on the contractual terms regarding the start date and the end date of calculating interest, the interest rate and the nominal amount that is taken into consideration. Based on that calculation, interests are accounted piece meal according to the flow time. Interest calculated but that did not come to the payment deadline, pass in profit or loss and are recognized as an asset or liability in the "accrued interest" account. Commissions received on loans are recorded as income when these receives considered fully completed.

Standard loans given to customers

When funds are not immediately disbursed, the loan commitment should be reflected off balance. Contracted amount should be recorded in the following *accounts*:

debit: 9012 commitment given in favour of client

credit: 90812 commitments given in favour of third party

Accounting records are stormed when funds are disbursed and for the amount that is disbursed.

The realise of funds

The amount recorded in the asset represents the nominal amount of the contracts. Loans can be classified into different categories depending on the quality of credit risk (Jobst, N J, Gautam, M and Zenios, S A 2006: 730), customer type, and the initial term of the loan or its object. At first all loans are classified as standard and then depending on their initial term are classified as follows, with the exception of mortgage loans which are provided separately.

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[6] http://siteresources.worldbank.org/INTGUARANTEES/Resources/Methods_of_Loan_Guarantee_Valuationand_Accounting.pdf

The initial deadline

*Short term	less than a year
*Medium	between1 and 5 years
*Long-term	over 5 years

The loan shall be classified in the appropriate sub-account depending on the nature of the client;

The nature of the client:

Clients are included in the account 21 and divided in to the following categories:

- individuals
- private industrial and commercial units
- public industrial and commercial units (more than 50% of the capital is owned by the government)
- bank employees
- Other (such as religious bodies, non-governmental organizations, international non-financial institutions, foreign embassies, financial clients that do not accept deposits, etc.)
- Government and public administration (acc. 26).

In addition to these primary divisions may be necessary to create sub-accounts for the aforesaid division to consider being a resident or non-resident client and sub-accounts to separate exposures into ALL of those in FCY.

Loan repayments

During the loan period, repayment of capital is deducted from the principal the gross amount. Guarantees received in the case of pre payments are recorded in income of activity at the time of prepayment.

Revenue recognition

The calculation of interest is based on the terms of the loan according to the date of commencement and completion of calculating interest, the interest rate and the nominal amount to be taken into account. Based on this estimation, interests are accounted piece meal according to the time flow. Accrued interests, but that did not come to the deadline for the payment, are transferred to the account of income and are recognized as an asset in the account "accrued interest".

Prepaid income

When the interest is prepaid, the nominal amount may exceed the amount disbursed by the bank. In this case, prepaid interest enrols in a separate account as liability on the account of other customers (account number 286). Interest calculated for the period is recognized as income and deducted from the amount of prepaid interest.

Standard loan unreturned on time

When an instalment is not paid partially or entirely and is not anticipated any risk of non-payment (e.g., the loan is fully guaranteed), the unpaid amount (in time) should automatically be reclassified in the account of standard loans outstanding term. Non-performing loans in the time, a priori, does not represent a risk. Only when the expiration period reaches a certain time and/or the loan contains the risk of default, the account receivable is classified into different accounts "accounts receivable risk." In this case, is created a reserve fund to cover the loss based on the probability of default funds.

Review of the quality of credit risk

Current practice requires that the risk that accompanies the loan to be reviewed at least quarterly. The provisions for loan principal are reviewed and recalculated every three months. However, this should not prevent the bank to reclassify loans when problems arise in their settlement in accordance with the instructions set forth below(Cortavarra. L ., Dziobek C., Kanaya A., Song I, 2000:14).

Lost loans

Assets classified as loss, treated as uncollectible and their continuity as bank assets is not justifiable.

Reclassifying loan categories

In cases where a loan is reclassified from one to another of these categories, total outstanding loan and all fees associated with it (principal, accrued interest, interest paid of late, penalties, and commissions) should be converted into a new category, whatever potential loss is and even if such a loan is secured and not simply searchable.

Revenue recognition

When loans are classified as substandard, doubtful or lost, no interest should be calculated. As a rule, this applies when payments are past the 90 day deadline.

Reserve Fund for the statistical risk is estimated for standard loans and special mention loans. The reserve fund must be documented and calculated based on statistics that determine the amount of potential losses that will be caused in the population of these loans, which in general can be treated as representative of risk.

Creation of statistical reserve fund will meet the following conditions:

- The studied population includes a large number of elements of a similar nature, which risk assessment of each case would be costly.
- It is believed that the reasons for the possible loss incurred, are homogeneous for the population study.
- Losses reasons are known and potential losses estimated based on the study of observed real historical data and updated often.
- No element of the population would lead to a significant loss for the population as a whole or as a result of a unit.
- Reserve fund for statistical losses is recorded in the balance sheet provisioning group presented on the liability side.
- Statistical reserve fund is recorded in the balance sheet as reserve funds listed on the liability side. The provisions for loan losses are required in order to maintain a minimum reserve position with an amount equal to:
    - Standard loans (including loans outstanding in time): 1%
    - Loans special mention: 5%

The minimum reserve fund is calculated as defined above for the principal and accrued interest.

Provisions for Substandard, Doubtful and Lost Loan Amortization

Provisions for depreciation are accounted for every time that the bank sees that there is risk associated with the entire or partial collection of a loan. Rate determined for the reserve fund will cover all potential current and future losses identified. It is based on risk assessment, customer credit history, its current financial situation and forecast value, the opportunity to put up the guarantee and collateral and any other fact that maybe considered in assessing the risk of default (Berger, A.N., DeYoung, R.. 1997: 865).

Assessing the necessary level sufficient reserve funds should be performed on any closing date.

The principal

Principal reserve funds for covering losses from loans are required in order to maintain a minimum reserve position (Merton, R C 1974:450). Reserve funds under the regulations of the Bank of Albania are calculated according to the following minimum standards:

Substandard loans: 20%

Doubtful loans: 50%

Lost loans: 100%

Calculated interest

As mentioned above, the reserve fund must be calculated for the accrued interest of substandard, doubtful and lost loans too and the reserve fund should be created at 100%.

When loans are classified substandard, doubtful and lost no interest should be calculated. This rule applies when payments are past 90 days. The reserve funds are accounted as impairment of assets (in balance) versus loss account in the statement of profit and loss. In cases of payment or when it is removed from the balance sheet, this action is reversed (Angbazo, L. 1997: 57).

If the settlement represents the final payment for the loan (or a group of loans) and if they are exhausted all legal proceedings, accounts of principal, interest and reserve fund this lone will be closed (Cortavarra. L ., Dziobek C., Kanaya A., Song I, 2000:10). All reserve funds registered for these amounts will reversed.

The loan will be deleted by debiting accounts: 656 loss of accounts receivable to be uncollectible.

Reserve funds are debited by crediting the accounts: 75 "Transfer from reserve funds".

If lost loans are refinanced or guaranteed by international institutions, income arising on the settlement that makes international institution should be credited to the account 762"Income from repayments of loan lost by third parties ".If all legal procedures have not been exhausted, the loan is classified to foreign loan lost and the reserve fund is established at 100%.

Repayments of loans for which are recorded reserve funds, first go for the repayment of outstanding interest and then to principal. All reserve funds for these amounts will be stormed against the profit and loss statement (Merton, R C 1974:450),.

Repayments of loans that are considered lost, and therefore are written off the balance are recorded in the account: 761 "Repayment of loans recorded as lost".

CONCLUSIONS AND RECOMMENDATIONS

⇒ Banking sector has purpose profit and increase the level of sustainability.

⇒ The increase in lending activity in Albania has also and its consequences, the credit risk, which is the risk that the borrower will fail to meet its obligations to the bank, under the conditions in the contract between two parties.

⇒ The main cause of the most serious problems of the banking sector continues to be directly related to careless credit standards for borrowers, collateral quality, unrealistic business balances etc

⇒ Problematics of this institution is not only the risk management but also problems of presenting accounting information that must to be clear and real.

⇒ Bank administration should keep accounting records continuously demonstrating its progress day by day, reflecting the principle of accrual.

⇒ Banks should pay attention to credit risk on the control and monitoring of non-performing loans because a good management will increase benefits for commercial banks.

⇒ Banking supervisors must have specific rules that limit concentrations to a single borrower or a group of related borrowers, and, in fact, should also expect by the banks to set lower limits of credit exposure to a single contributor.

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