Management Accounting Statements for the Purpose of Decision Making in Banks

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The influence of the environment on bank development resulted in a new trend of banking services development, and this in turn resulted into a range of information necessary for bank management to monitor certain aspects of business, do risk assessment, better market positioning in a competitive environment, but also improve in quality business decision-making. Special attention is paid to defining a quality system of management accounting of a business bank from an experienced professional's point of view, starting with the specifics of management and decision-making in a business bank, whose basic goal is defining the elements of a system of efficient and effective management accounting. It defines the three basic segments of management accounting of a business bank: the Segment of strategic management; the Segment of performances; the Segment of risks management, where for each of the mentioned segments it defines their look, contents and time dynamics of information it is supposed to contain, as well as the level of management structure of the bank requiring the report. It also specifies the purposes of the report, i.e. the types of decisions based on specific reports.

1. Introduction

Banking today is a business undergoing a continual process of change. It cannot be perceived as something special, it is rather something that keeps getting newer and newer every day – it offers new services, performs integration and consolidation into larger and more comprehensive business enterprises that are no longer to be recognized only as banking business operations. It also adopts new technologies that change faster than a majority of us is capable of tracking and is faced with a large number of rules that keep changing, while an increasing number of nations collaborate for the purpose of regulating and controlling banks and other financial institutions in the service of their citizens. It is for these reasons that managing the bank, and especially business decision making, has become highly complicated. In other words, it is necessary that the bank management dispose of quality and up-to-date information, both from the environment and from within the bank business system. (PIS) This can explain why the importance of the so-called Professional Information System, meant to improve the flexibility and efficiency of banking business, is growing. It is also important that the PIS should not be exhausted in providing information that describe only the past and the present of certain business movements and conditions. On the contrary, since the business activities of any organization are oriented towards the future, towards achieving future development goals, the purpose of the PIS is to increasingly support the future business decision making and the future business policies. This actually means that it has to disseminate programme information, plan information, information on prospective limiting factors, on prospective positive factors, as well as information on possible corrective factors. The result of such management requirements is the emergence of the management accounting segment in organizations, banks included.

2. The management process and the management accounting and reporting system

In the conditions of highly dynamic changes in the business environment the top management level in any business entity encounters important and increasing challenges in the business goals achieving process. The top managers make decisions and initiate activities that cover a rather wide range of operations – from organizing daily operations, to defining and implementing a long-term development strategy. The precondition of a successful organizational performance is the presence of an adequate management accounting and reporting system that provides timely and accurate information necessary for managerial decision making. In this context, every business subject must define and develop a system of management accounting and reporting which will allow for the identification, measurement, analysis and correct interpretation of information and data in order that all projected organizational goals should be achieved. Consequently, the business bank, as a complex organizational form must have a well developed, reliable, and efficient management accounting and reporting system. It is evident that the process of *successful* management means the existence of a strong correlation link between the system that "*generates*" managerial information and the decision making system. Namely, the precondition for correct managerial decisions making is the establishing of clear, direct and timely information flows towards the top management, as well as towards the middle level and lower level managements. A rather dynamic development of market environment, the increasing complexity of the structure of the products and services delivered to the clients, the *pressure* of regulatory restrictions etc., set additional barriers and challenges in the business bank management process. The characteristics of the environment the banks do business in put the banks into a specific position where a highly sophisticated managerial information is needed in order that the defined business goals should be achieved. It is for these reasons that the management accounting and reporting system is in practice often extended to the fields of: *strategic management*, where the stress is put upon the "provision" of information and data necessary for strategic (long-term) decision making; *performance management*, concerned with the development of business (operational) decision making through performance management within the organization; and the field of *risk management*, where the set goals are achieved through the development of the practices of identifying, measuring, managing and reporting on risk exposures. In this context, the primary objective of the established management accounting and reporting system in a business bank is to provide an adequate support to the top management in the process of:[1]

- Strategy formulation;
- Business activities planning and defining;
- Optimal use of scarce resources and efficient business decision making;
- Preserving the bank's business property.

The management accounting and reporting system established on such bases also assumes a new role and importance of the individuals responsible for creating such reports. According to one definition, the person in charge of accounting reports management (the *management accountant*) "implements his/her professional knowledge and skills to provide and present financial and other reports in such a manner as to give an adequate support to the top management both in policy formulating and in the process of planning and controlling the business operations under way". Based on this definition, it is evident that their activities are oriented towards the future and the decision making that will affect the bank's business operations in the period to come, rather than towards the bookkeeping and historical tracking of the generated accounting data. Consistent with other roles in the present organizational scheme of the bank, the role of the individuals in charge of the management accounting and reporting system functioning is twofold. On one hand, they ensure the information flow towards business functions, whereas on the other, they direct, report and coordinate the operation of the financial (accounting) function. Generally, their activities are related to the planning and forecasting the movements of basic business indicators movements, to the analysis of the variants of the results achieved, to cost control and tracking, etc. In practice, the functions of management and financial accounting and reporting systems usually merge. The essential difference is that the main purpose of management accounting is to supply the top management with adequate information required in the management and decision making processes, while the task of the financial accounting and reporting is primarily to provide and offer financial information to the stakeholders outside the organization (shareholders, creditors, regulatory agencies, tax authorities, etc.). Essentially, financial accounting is part of management accounting and reporting. Namely, the reports made within management accounting may be generated for any period (daily, weekly, monthly, etc.) and are primarily used for monitoring the results achieved and for future movements forecasting (the so-called "*future looking*"). On the other hand, financial reports are usually generated for a strictly defined period of time (for example, one fiscal year). Financial reports are based on historical data and are used by the individuals outside the bank in order that they should make adequate financial decisions.

3. Elements of management accounting and reporting system in the business bank

The very design, structure and complexity of the management accounting and reporting system, the number of participants in the system, and the number of generated reports/analyses are directly preconditioned by the size and complexity of the bank itself (or any other organization, for that matter). More complex and larger business systems are in themselves assumed to have a more highly developed structure of management accounting and reporting characterised by both a larger number of forms of reports and the (hierarchal) lines of reporting (Figure 1).

The general categorization of reports assumes grouping the reports/information into segments of strategic management, the segment of the operative, or performance management as well as the risk management segment (Figure 2). This classification is only conditional, given that the contents of the segments are interrelated and interconditioned, however, it is essentially based on the difference among the end users, the thoroughness of contents and the *provision* rates.

[1] **Bhimani, A. (2006) Contemporary Issues in Management Accounting, Oxford University Press: Oxford.**

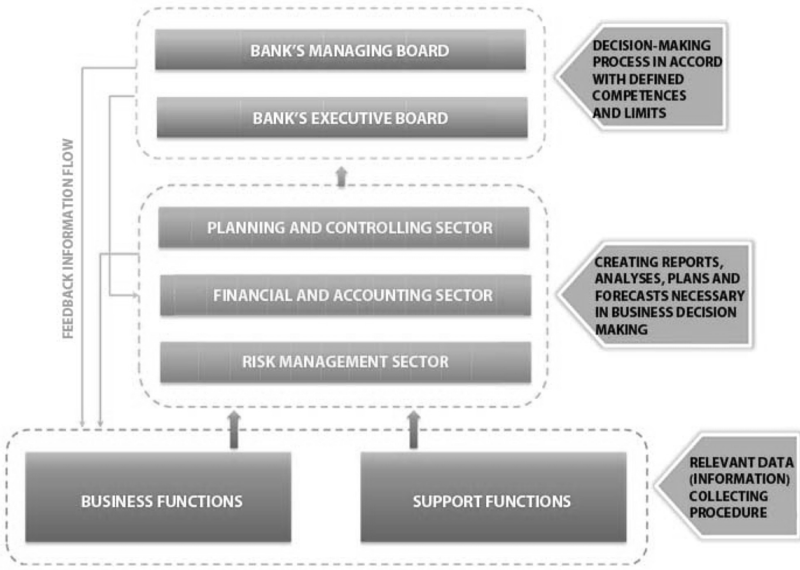


Figure 1: Basic factors of the management accounting and reporting system and the information flow[2]

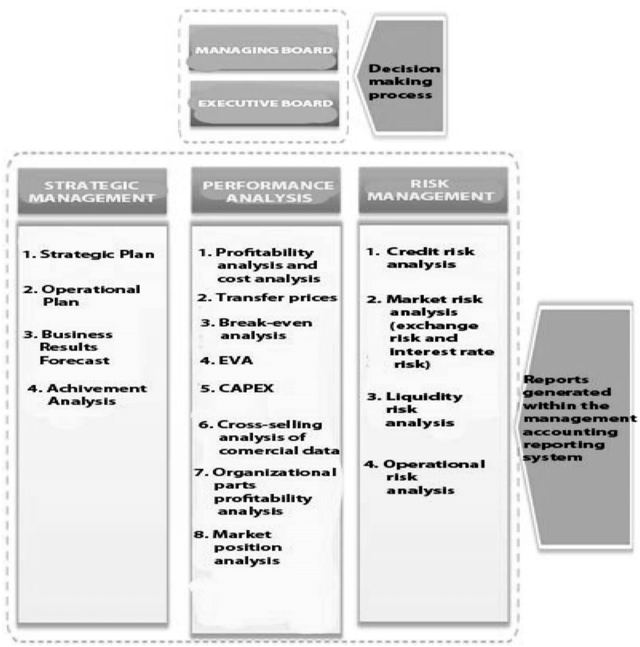


Figure 2: Review of basic reports generated in the management accounting and reporting system[3]

4. The strategic management segment

The entire flow, from creating to communicating/presenting the documents classed withing this category is connected to the strategic management and decision making. Involved in the creation process are all the basic and subsidiary bank functions (with the coordination of the planning and reporting functions), whereas the created documents are exclusively meant for the top management level. Simultaneously, as the strategic development of the bank is directly related to the parent bank developmental plans, in the procedure of generating these documents there is a direct interaction between the subsidiary bank and the parent group (Figure 3).

When dealing with complex international financial organizations, the management accounting and reporting system is normally based on a standardized

[2] **Žarkić-Joksimović N. "Upravljanje finansijama", FON, Beograd, 2008.**
[3] **Žarkić-Joksimović N. "Upravljanje finansijama", FON, Beograd, 2008.**

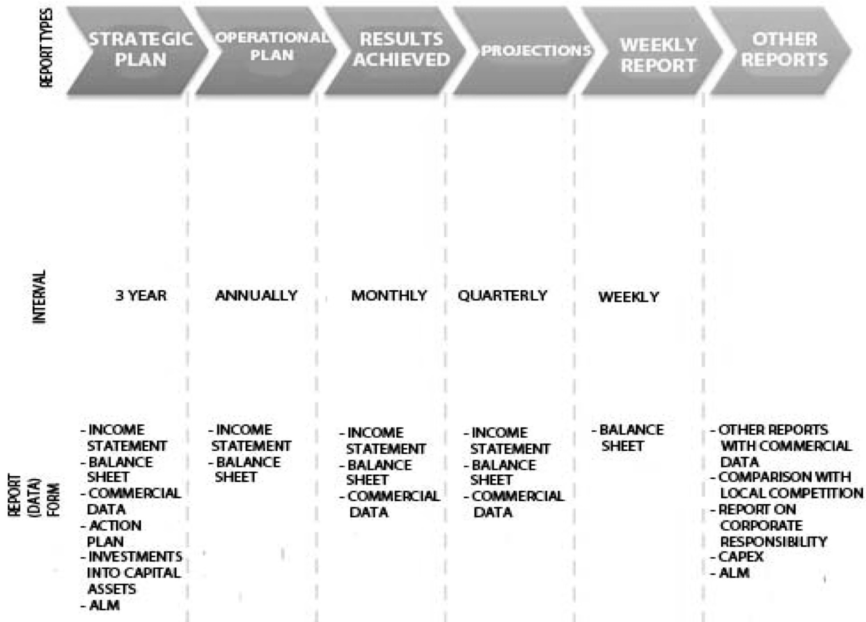


Figure 3: Reporting flow of subsiduary company towards parent banking group[4]

methodology that allows for creating unified forms that will in turn make the comparison of presented information possible. The standard methodology implementation assumes:[5]

- standardized database forming and maintenance;
- standardized reports creating and submitting;
- implementing international accounting standards in reporting;
- reporting in local currency; and
- using the English language as the language of communication.

Strategic planning is a process of the development strategy defining as well as the decision making process as regards the available resources allocation, in order that the adopted strategy should be implemented. In a sense, strategic planning defines the direction the organization should follow. It is of essential importance for any organization that it define answers to three strategic questions: *where the company is now, which is the direction it should follow,* and *which are the ways to accomplish it*. The document that is to contain the answers to these questions is the strategic plan. The strategic plan usually covers a period of three years. On the basis of the strategic plan the so-called operational plan is devised; this covers a shorter period of time (most often a year) and is more detailed to a considerable extent.

[4] **Arnold A., Hope B. "Accounting for Management Decision", Prentice Hall, London, 1990.**

[5] **Davis, S. and Albright, T. (2004) An investigation of the effect of Balanced Scorecard implementation on financial performance, Management Accounting Research, 15, pp. 135-153.**

The last decade has witnessed significant changes in the business bank budgeting process. In the previous period, the budget preparation used to be a regulatory obligation, where the banks attempted to estimate their costs and income in the following year. Such an approach was promptly changed, as the market environment became considerably more dynamic, better organized and more competitive. Accordingly, in order that they succeed, banks have to constantly improve their capabilities of correctly predicting the future busines operations, as well as of correctly estimating the required resources. In other words, in order to remain profitable, banks can no longer *afford* any discrepancies between the anticipated income and the anticipated costs.

Consequently, the tools implemented in the process itself (the reporting system, in the first place) have become more integrated and more detailed, alongside the growing importance of the budgeting process. The quality of being more detailed, however, does not assume a situation in which the the reports containing a large scope of information are submitted to the top management. A more detailed reporting is required from the business functions/segments that generate larger costs and incomes for the bank. It is for this reason that the key indicators for performance measuring (key performance indicators – KPIs, Figure 4) have lately been introduced into the reporting process. The primary goal is to give support to the management in order that it should be constantly focused upon the basic generators of income growth and costs in the bank.

	Plan	Plan vs Basic year			Plan	P.year 2 vs year 1		Plan	Year 3 vs year 2	
Basic year	Year 1	abs.	%		Year 2	abs.	%	Year 3	abs.	%
16,789	19,569	2,780	17%	*Net operational margin*	21,688	2,119	13%	24,898	3,154	13%
7,065	7,956	891	13%	*Total operational expences*	8,455	499	11%	9,544	1,002	11%
9,724	11,613	1,889	19%	*Net operational profit*	13,233	1,620	2%	15,354	2,152	2%
4,200	5,900	1,700	40%	*Expenses of reserving for credit risk*	6,899	999	23%	7,159	-651	-8%
403	120	-283	-70%	*Other expenses of reserving*	200	80	67%	200	0	0%
5,121	5,593	472	9%	*Net pre tax profit*	6,134	541	-87%	7,995	2,804	11%
-516	-402	114	-22%	*Profit tax*	-579	-177	44%	-860	-280	48%
4,605	5,191	586	13%	*Net profit after tax*	5,555	364	-43%	7,135	2,523	59%
5.9%	5.7%	-0.3%	-4%	*Interest margin*	5.3%	-0.4%	-6%	5.1%	-0.2%	-5%
42.1%	40.7%	-1.4%	-3%	*Cost/income*	39.0%	23.5%	82%	38.3%	31.8%	81%
2,055	2,031	-24		*Total number of employees*	2,069	38		2,100	31	
170	182	12		*Total number of branch offices*	192	10		210	18	

Figure 4: Review of key performance indicators[6]

Regardless of the reporting model adopted, it is general practice that a majority of business banks today budget all their balance sheet accounts at various levels of detail. The concept is such that the top management is now presented basic data, so that it should be able to focus more upon the most important business indicators. If necessary, the details *underlying* the aggregate data are given at request. In this way, the top management level in the bank is in a position to pay more attention to the analysis of the key indicators and take adequate steps. Simultaneously, it is of utmost importance for the management that all the presented data be accurate and clearly formulated, so that the risk of wrong management decision making should be minimized.

Strategic and operative plan

When the bank does business within a financial group, the strategic plan creating process is initiated by the parent bank and it is carried out through a sequence of interactions (Figure 5).

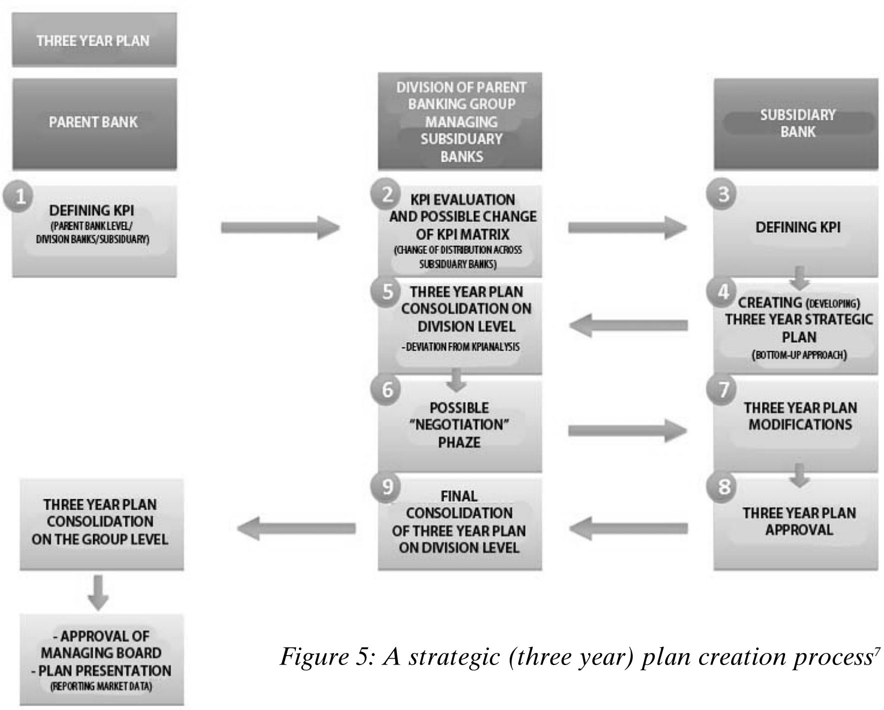


Figure 5: A strategic (three year) plan creation process[7]

[6] Hopper, T., Northcott, D. and Scapens, D. (eds) (2007), Issues in Management Accounting, 3rd edition, FT/Prentice Hall: Harlow.[6]
[7] Arnold A., Hope B. "Accounting for Management Decision", Prentice Hall, London, 1990.

The strategic plan is essentially a formalized report containing a set of business objectives to be achieved, as well as the execution plan. The strategic plan may be *focused* upon internal and external users. Externally oriented strategic plans are predominantly oriented towards the goals important for all the so-called external *stakeholders*, above all the (prospective) investors and clients. On the other hand, internally oriented strategic plans include the so-called meta-goals, the achievement of which assumes the achievement of the so-called external goals. To this category belong the new product and service development, the IT systems development, financial and organizational restructuring, etc. the strategic plan format itself depends on the context of its implementation. It is not (un)usual that organizations use a number of forms of strategic plan presentation. Structurally, the strategic plan is composed of two parts – one is qualitative and the other is quantitative. The qualitative part contains the macroeconomic scenario analyses, the SWOT analysis, the company's mission, the strategic guidelines as well as the action plan to ensure that the the plans defined are achieved (Figure 6).

Serbia: Macroeconomic scenario

	Unit	Note	2005	2006	2007	2008	2009E	2010E	2011E
Real GDP y/y	%	(1)	6.0	5.7	7.5	5.7	1.0	2.0	3.5
Nominational GDP	RSD, bn	(1)	1,750.0	2,042.0	2,338.8	2,773.8	3,023.5	3,265.4	3,526.6
Per capita GDP	RSD, th	(1)	235	275	315	376	411	445	482
Inflation y/y (average)	%		17.3	12.7	6.8	12.9	8.0	6.0	4.5
EUR/RSD (average)	RSD per Euro		83.72	84.19	79.67	81.46	94.00	93.65	92.73
EUR/RSD (end of period)	RSD per Euro		85.16	79.17	78.44	89.70	94.00	93.30	92.15
Interest rate on currency market (aver.)	%	(2)	n.a.	19.62	10.49	14.60	15.38	12.75	12.25
Interest rate on currency market	%	(2)	n.a.	15.30	9.57	17.75	13.00	12.50	12.00
Interest rate on credits	%		n.a.	16.90	12.50	17.80	18.10	16.00	15.60
Interest rate on deposits	%		n.a.	5.12	4.39	6.80	7.42	4.80	4.30
Bank credits y/y	% RSD	(3)	53.9	17.26	40.17	40.00	6.75	8.00	10.00
Bank deposits y/y	% RSD	(4)	46.5	38.58	50.95	11.00	9.00	8.80	9.60
Bank credits	RSD, bn		487.4	594.3	815.0	1,141.0	1,218.0	1,315.5	1,447.0
Bank deposits	RSD, bn		398.1	555.6	816.2	906.0	987.5	1,074.4	1,177.6

Figure 6: Abstract of the strategic plan qualitative part[8]
(a) Basic macroeconomic indicators

(b) SWOT analysis

SWOT analysis

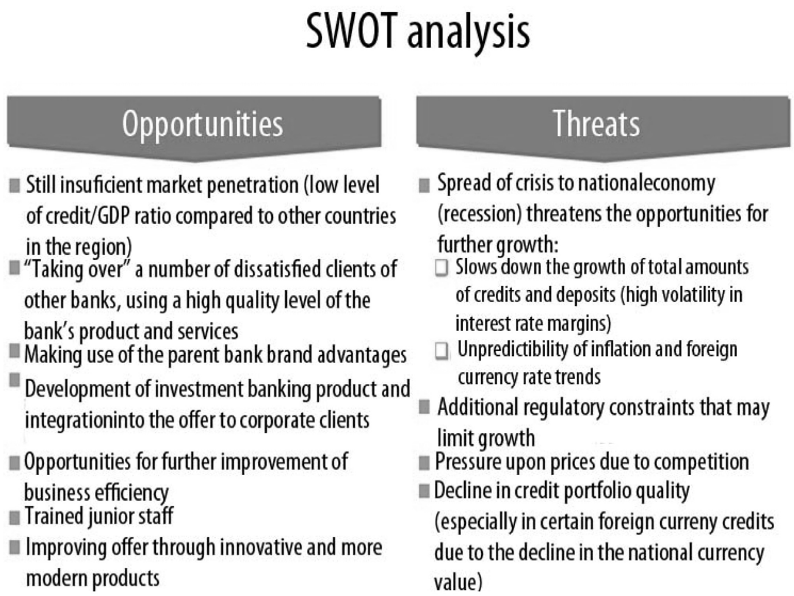
Strengths

- Broad and dispersive client (data) base, from any business sectors and income groups, which guarantees stability in managing liquidity position
- Strong capital position
- Favourable coverage of business network with 179 branch offices and 145 ATMS
- High level of business efficiency
- Strong market position
- Good image - the bank is reputed to be an institution providing high quality products and services
- Good quality of credit portfolio

Weaknesses

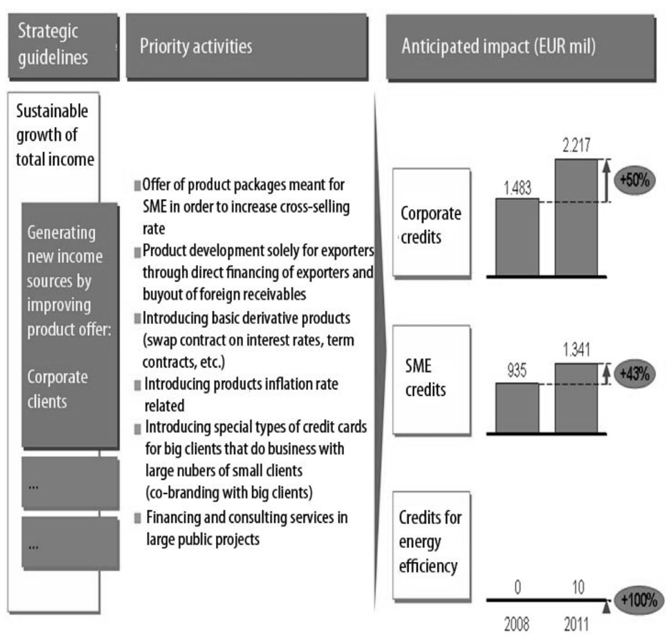
- Inadequate technological platform for further accelerated development
- High concentration of foreign currency deposits
- Low percentage of cross-selling between corporate clients and individual citizens
- High percentage of inactive clients
- Crowded branch ofices (especially in larger cities)
- Inefficiency in recovering outstanding debts

[8] **Davis, S. and Albright, T. (2004) An investigation of the effect of Balanced Scorecard implementation on financial performance, Management Accounting Research, 15, pp. 135-153.**



(c) Abstract from action plan

Action plan



The quantitative part consists of financial projections of the balance sheet and income statement positions, as well as of the projections of a set of selected financial reports (Figure 7). More precisely, the qualtitative plan displays several-year (most frequently three year) projections:[9]

- the balance sheet position, followed by the comments on anticipated trends;
- the income statement position, with a special account on the trends of net operational income, operational costs, operational income and the expenses for reserving;
- basic performance indicators, including:

a) Profitability indicators

ROA – returns on total assets
ROE – returns on bank equity

b) Interest rate margins indicators

Interestbearing assets/total assets
Average interest rate on interest bearing assets
Average interest rate on interest bearing liabilities (sources of financing)

[9] **Major, M. (2007) Activity based costing and management: a critical review, in Hopper, T., Northcott, D. and Scapens, R. (eds) Issues in Management Accounting, 3rd edition, FT Prentice Hall: Harlow.**

c) Capital adequacy indicators
Total capital/total assets
Capital assets/total assets
d) Growth trend indicators
Total assets growth rate
Interest bearing assets growth rate
Loan growth rate
Deposit growth rate
e) Liquidity indicators
Total loans/deposits
Total loans/deposits+capital

The capital, where it is necessary that in all the projection years the criterion of minimum capital level stipulated by law is satisfied. In case the projections show that it is necessary that more capital be raised, possible modalities of equity investment/rise of capital adequacy indicators can be listed.

6. Conclusion

Contrary to many other business operations, the banking business operations require not only the technical knowledge but also the expertise, and not one *or* the other. People gain confidence in the bank they do business with and rely on its honesty, reliability and stability.

The managers providing banking services never stop learning, since their job requires that they get and show new knowledge daily, and the clients and owners expect the manager to be "beyond average", regardless of how fast the environment changes.

It is obvious that the globalization processes pervading the world economy have brought significant changes into the banking business. Banks have grown to be more and more similar to financial supermarkets offering a comprehensive service, from classic business operations, to investment banking, to insurance, to transactions with securities. Besides, new jobs and new technological solutions make it a necessity for the banks to adapt continually, search for new models and tools.

In order to perform this new role of the bank in a complex environment, the bank, among other things, has to have a well developed management accounting and reporting system as a significant decision making support.

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