Financial Statements of Credit Institutions. 
An analysis of the Return on Equity (ROE)

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Abstract
By the present paper we have tried to answer the question: Does the measurement and the analysis of performance through the use of accounting information from financial statements allow managers to adopt decisions imposing future directions of evolution for the credit institutions? The measurement and the analysis of performance through the use of information from the financial statements in the credit institutions is increasingly necessary, and at the same time the managers of the credit institutions are increasingly aware of it. Apparently contrary to reality, the main feature of the development of the Romanian banking system has not been the quantitative dimension of its evolution, but the coherence of the structural and qualitative development of the banking activity, in the sense of the ascending direction dictated by the adaptation to the demands of the market economy.

Key words
Financial statements, performance, analysis, profitability rate, banking system

1. Introduction
The national economy of every country relies, as a whole, on the set of assets that can be used efficiently in order to satisfy the social and population development needs. In particular, the circulation on a banking market under the forms of the different types of resources between the credit institutions recording a deficit and those that want to use the excess of resources available to them represents the expression of the real value flows substantiating the viability of today’s national economies, considered strong and flexible.

An increasing number of specialists consider the banking system to be the engine of economic development - an indispensable component of solidity and good functioning on which the whole economic activity depends. The notion of bank is associated to the moment when a group of people had the idea of accepting available money as deposits from those who intended to save money, and, on the basis of these deposits, it then offered loans to those who needed supplementary funds.

As Romania started its way towards the market economy, it was imperiously necessary for the Romanian banking system to get in line with the principles characteristic for this type of economy, so that, beginning with the year 1997, the second stage of the banking reform began, being characterized by the improvement and completion of the legislative framework for the banking sector through the approval of the new banking law (Law no. 58/1998 on banking activity), of the Law no. 101/1998 concerning the Status of the Romanian National Bank and the Law no. 83/1998 concerning the bankruptcy procedure in the banking sector. In the same line, namely of the improvement of the banking system, one can also include the adoption of the Emergency Government Ordinance no. 97/2000, which has created the new legislative framework needed for the functioning of credit co-operative banks.

2. The financial statements of the credit institution – the main connective bridge between accountancy and financial analysis
The actual globalization tendency of the national economies, with consequences on the increase of the number and the power of transnational companies and financial markets, on the capitalization of stock markets and the appearance of new financial products, makes it necessary to obtain and to provide relevant,
credible, comparable financial information making use of a common accounting language, able to assure the communication between all the categories of users of such information.

In this context, the economic indicators providing a general perspective on the financial position of a credit institution, on its financial performances, cash flows and on the administration of the resources entrusted to its management are presented under the form of financial statements. Regardless of the name they bear in accountancy, financial statements represent the necessary source of information for different categories of users when making economic decisions. As a result of the accounting activity, financial statements are the effect of an activity that can be divided into three stages: data gathering; data recording in accounts; formalization in synthesis accounts. According to the definition given by the International Accounting Standard no. 1, financial statements are a structural representation of the financial position and financial performance of a credit institution. The faithful presentation of the information provided by the financial statements is also determined by the reflection - as accurate as possible - of the results of the transactions in which the credit institution participates, by the correct recognition and accounting of the asset elements and of the debts, on the one hand, and of the revenues and the expenses, on the other hand.

According to the general framework of financial statements, an asset is a resource controlled by the credit institution as a result of certain past events and from which future economic benefits are expected, able to bring profit to the credit institution; while a debt is a current obligation of the credit institution, resulted from past events whose payment is expected to determine an outlet of resources incorporating economic benefits from the credit institution. We should mention that both the asset and the debt are not acknowledged in the financial statements unless two demands are respected at the same time:

- There is a probability for the economic benefit connected to one of the elements to enter the credit institution (in the case of assets) or to go out of the institution (in the case of debts);
- They have a cost or a value that can be evaluated credibly, so that there may be no susceptibility of error or subjectivity and the users may rely on the credibility of this value.

Other elements reflected in the financial statements are revenues and expenses. As far as the revenues are concerned, they are defined in the same general framework of the financial statements as increases of the economic benefits during the period accounted for, as active inputs or increase in asset value or debt decrease, resulting in the increase of one’s own capitals, others than those related to the participants’ contributions to the credit institution’s own capitals.

Beside revenues, another element reflected in financial statements are expenses, defined as decreases of the economic benefits during the period accounted for, under the form of outlets or asset exhaustion or having to deal with debts resulted from the decrease of one’s own capital, others than those related to the distribution to participants of one’s own capital. So, expenses are costs already paid for or elements that at one point were assets but can be no longer part of this category, as they no longer have a future value. In the category of expenses, beside the costs generated by the current activity of the credit institution, another element reflected in the financial statement are losses, which represent decreases of the future economic benefits and are no different in nature from expenses. Just as for gains in the case of revenues, losses are the result of adjacent transactions and can be classified as operational or non-operational in relation to the sources they come from. A principle we need to consider when reflecting revenues and expenses in financial statements, in order to determine the financial performance of the credit institution as accurately as possible, is the fact that all the revenue-generated expenses should be acknowledged during the same accounting period as the revenues directly related to them.

To conclude, we can say that a piece of information has value from an accounting perspective only inasmuch as it is beneficial for its user, allowing him to make decisions leading to the obtaining of the results hoped for. The relation between information, analysis and decision is presented in the scheme below.

![Figure 1. The relation information - economic analysis – decision](Image)
The adoption of correct economic decisions, in agreement with the reality and able to contribute to solving the multiple and complex problems specific for the financial economic activities depends on the quantity and the quality of the information provided via the economic informational system.

3. Financial performance measurement and analysis with credit institutions

The success of any investment activity, the performance and sustainability of a business depend to an equal extent on a series of fundamental decisions - either individual or collective - of the managerial team. Each of these decisions ultimately has an economic impact on the business.

A common element of all the decisions is the fact that they are weighed from an economic perspective, so that a decision, before being made, is analyzed from the perspective of the cash benefits expected, related to the cash costs involved by this decision.

Starting from the premise that, regardless of their variety, the problems the management is faced with every day and those encountered in the hierarchy of the economic activities, namely the managers’ tasks, are similar, Erich A. Helfert groups all managerial decisions into three great categories:

- Allotting/Investing resources;
- Carrying out business operations making use of these resources;
- Determining an adequate financing structure for the resources allotted.

The basic task of the economic-financial analysis consists in the construction of a set of significant data and relations for the users, a set able to serve in the decisional process in order to create value. Profit is one of the most concise forms expressing the performance of any economic-financial activity of an institution, considering all the stages of its economic circuit: supplies, payment and delivery. Profit is the “ability of a credit institution to generate a result expressed in monetary units”.

According to some finance specialists, “Profit, as a reference indicator, in the orientation of the strategic and tactical decisions, can be approached from different perspectives: accountancy, economic and financial (...) In financial analysis, all these three approaches are logically integrated in the investigation of the <efficiency> and <efficacy> of any institution”.

We can talk about profit when gains prevail over expenses; profit is just a financial profitability component, and in order to characterize an institution in point of its financial profitability, to see if it is profitable or not, we consider that three key points need to be studied, namely:

- activity evolution – increase and decrease of the economic activity;
- evolution of the turnover and of the added value;
- evolution of the actual financial profitability (profit, ROE, as indicators).

Performance represents, for the economic entity, what contributes to the improvement of the couple value-cost and not just what contributes to cost diminution or value increase.

![Figure 2. Performance in relation to the creation of value](image)

The creation of value needs to be seen from the perspective of all the parties involved in the activity of the institution – shareholders, employees, clients and last but not least the environment in which the institution carries out its activity - nature.
According to Professor Serban Claudia, “performance and value represent the ideal couple for an efficient and modern management of the credit institutions; measuring performance is appreciating value and knowing value is translating performance”.

So, we can support the idea according to which a correct appreciation of the value of a credit institution allows the measurement of its performance.

a) The analysis of the ROE at Carpatica Commercial Bank and for the Romanian banking system during the period 2007-2010

This indicator is relevant for bank shareholders as it offers information about the profit recorded per accounting value unit for the investment made by shareholders in a credit institution. In order to determine this indicator, two elements are taken into account, namely: the net profit obtained after the deduction of the fiscal expenses and one’s own capital resulted from summing up the social capital of the reserve funds and the undivided profit.

The Return On Equity (ROE) is highly expressive of the bank financial activity, demonstrating by itself a multitude of aspects: “degree of profit generation, operational efficiency, degree of financial endebtment or prevision of fiscal obligations.” The generation of profits for bank owners results on the one hand on the profitability of the assets (Return On Assets - ROA) and on the other hand on the Equity Multiplier (EM).

The relation between these two indicators can be illustrated according to the relations:

\[
\text{Profit from assets} \times \text{Capital multiplier} = \text{Profit from capital} \tag{1}
\]

Or

\[
\text{Return on Assets (ROA)} \times \text{Equity Multiplier (EM)} = \text{Return On Equity (ROE)} \tag{2}
\]

Or

\[
\left( \frac{\text{Net profit}}{\text{Assets}} \right) \times \left( \frac{\text{Capital}}{\text{Capital}} \right) = \frac{\text{Net profit}}{\text{Capital}} \tag{3}
\]

EM is the indicator showing the extent to which the use of supplementary resources contributes to the increase of the bank profit and appears when the engagement of new sources is gainful through their cost, which is lower than or at the most equal to the economic profitability. From a different perspective, EM highlights the fact that the use of borrowed sources (which are not part of the bank’s own capital) is reflected in the increase of the ratio between total assets and equity, as the use of borrowed sources triggers the increase of the assets without increasing the equity as well. Starting from the relation determining the ROE, the higher the bank endebtment (measured using the ratio total assets/equity), the higher the ROE will be in relation to ROA. Analyzing the evolution of ROE for 2007-2010 at Carpatica Commercial Bank compared to the Romanian banking system (Table 1 and Figure 3), the first conclusion that can be drawn is that in the years 2007, 2008 and 2010 the value of the indicator under analysis calculated for the bank was much lower than the aggregate value for the banking system and only in the year 2009 the values of the ROE indicator were relatively close (2.3% for Carpatica Commercial Bank compared to 2.7%, the aggregate value for the Romanian banking system), a situation encountered as well in the case of the indicator rate of economic profit.

Table 1. Evolution of the financial performance indicators for Carpatica Bank in relation to the aggregate values calculated for the Romanian banking system

<table>
<thead>
<tr>
<th>Indicators of bank financial performance</th>
<th>Carpatica Commercial Bank</th>
<th>Aggregate value for the Romanian banking system</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2007</td>
<td>2008</td>
</tr>
<tr>
<td>ROE (%)</td>
<td>1.6</td>
<td>1.7</td>
</tr>
<tr>
<td>Net profit</td>
<td>3,494</td>
<td>4,541</td>
</tr>
<tr>
<td>Equity</td>
<td>214,329</td>
<td>278,628</td>
</tr>
<tr>
<td>ROA (%)</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Net profit</td>
<td>3,494</td>
<td>4,541</td>
</tr>
<tr>
<td>Total assets</td>
<td>2,245,002</td>
<td>2,918,502</td>
</tr>
<tr>
<td>Net profit rate (%)</td>
<td>1.6</td>
<td>1.7</td>
</tr>
<tr>
<td>Net profit</td>
<td>3,494</td>
<td>4,541</td>
</tr>
<tr>
<td>Total revenues</td>
<td>216,931</td>
<td>265,111</td>
</tr>
</tbody>
</table>

Thousand lei
This analysis has shown that in the case of Carpatica Bank, the ROE indicator recorded a favorable evolution in the year 2008 (when it grew from 1.6% to 1.7%), and in the year 2009 (an increase of 0.6 basis points, from 1.7% to 2.3%), while in the year 2010, on the background of the losses recorded by the bank, the ROA indicator recorded a negative value (-8.9%). For the banking system, the favorable evolution of the indicator under analysis was present only in the year 2008 (when it grew from 11.4% to 18.1%), because in the year 2009, following the significant diminution of the profit on an aggregate level, the value of ROE went down to 2.7%. In the year 2010, the loss recorded on the level of the Romanian banking system led to a negative ROE value (-1.7%), yet with a situation less unfavorable compared to the one found at Carpatica Bank (-8.9%).

As far as the evolution of the factors that influence the ROE (Figure 4) and their effect on the indicator under analysis, one can note that in the interval 2007-2009, a determining weight was that of the EM indicator, whose values were very similar for Carpatica Bank and for the banking system. While for the credit institution the values of the EM indicator oscillated around the value of 10 (plus or minus 0.5), being in a continual decrease (from 10.5 in the year 2007 to 9.4 in 2010), for the banking system, the EM indicator had a totally different evolution, increasing from 8.8 in 2007 to 10.8 in 2010. The positive evolution of the EM indicator, on the level of the Romanian banking system, was realized based on the increase of the banking assets in a rhythm that was superior to the increase of the banks’ own capitals. The high EM values indicate that Carpatica Commercial Bank, just as the whole banking system, borrowed sources in order to increase their assets (represented mainly by credits), but the continual depreciation of the quality of the latter (substantiated in the increase of the number of the credits unpaid for in due time and implicitly of the expenses with the provisions) left its mark both on the financial results of the year 2009 (for the banking system), and especially on those of the year 2010, when the Romanian banking system, as a whole, recorded a loss for the first time after the year 1999. Following the unfavorable financial results, 2010 was the year when ROE registered negative values both for Carpatica Commercial Bank (-8.9%), and for the entire Romanian banking system (-1.7%).
Figure 4. Evolution of the indicators for ROE in the case of the Carpatica Commercial Bank and on the level of the Romanian banking system

b) Analysis of ROE at Transilvania Bank and for the Romanian banking system, during the period 2007-2010

Analyzing the values recorded by the ROE indicator at the end of each year in the interval under analysis (2007-2010), for Transilvania Bank compared to the Romanian banking system (Table 2 and Figure 5), the conclusion that can be drawn is that during the entire period under analysis the value of the performance indicator, calculated for Transilvania Bank was higher than the aggregate value for the banking system, especially in the years 2007, 2008 and 2010. Concerning the year 2010, one needs to highlight that the ROE for Transilvania Bank recorded a positive value (4.9%), higher than the one of the year 2009 (3.5%), unlike the aggregate value of the indicator, calculated for the Romanian banking system, which was negative (-1.7%), because of the unfavorable result, recorded for the first time after 1999 for the whole Romanian banking system.

Table 2. Evolution of the financial performance indicators at Transilvania Bank in relation to the aggregate values calculated for the Romanian banking system

<table>
<thead>
<tr>
<th>Indicators of bank financial performance</th>
<th>Transilvania Bank</th>
<th>Aggregate value for the Romanian banking system</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2007</td>
<td>2008</td>
</tr>
<tr>
<td>ROE (%)</td>
<td>27.6</td>
<td>22.8</td>
</tr>
<tr>
<td>Net profit</td>
<td>108,271</td>
<td>126,386</td>
</tr>
<tr>
<td>Equity</td>
<td>391,853</td>
<td>553,183</td>
</tr>
<tr>
<td>ROA (%)</td>
<td>2.5</td>
<td>2.3</td>
</tr>
<tr>
<td>Net profit</td>
<td>108,271</td>
<td>126,386</td>
</tr>
<tr>
<td>Total assets</td>
<td>4,419,111</td>
<td>5,418,568</td>
</tr>
<tr>
<td>Net profit rate (%)</td>
<td>25.6</td>
<td>20.1</td>
</tr>
<tr>
<td>Net profit</td>
<td>108,271</td>
<td>126,386</td>
</tr>
<tr>
<td>Total revenues</td>
<td>422,835</td>
<td>630,268</td>
</tr>
<tr>
<td>Assets use rate (%)</td>
<td>9.6</td>
<td>11.6</td>
</tr>
<tr>
<td>Total revenues</td>
<td>422,835</td>
<td>630,268</td>
</tr>
<tr>
<td>Total assets</td>
<td>4,419,111</td>
<td>5,418,568</td>
</tr>
<tr>
<td>Equity multiplier</td>
<td>11.3</td>
<td>9.8</td>
</tr>
<tr>
<td>Total assets</td>
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<td>5,418,568</td>
</tr>
<tr>
<td>Equity</td>
<td>391,853</td>
<td>553,183</td>
</tr>
</tbody>
</table>
Only in the year 2009, the ROE values were relatively close (3.5% for Transilvania Bank compared to 2.7%, the aggregate value on the level of the Romanian banking system).

The value of this indicator decreased constantly, both in the year 2008 compared to 2007, but especially in the year 2009, when the decrease was of 19 basis points (from 22.8% at the end of the year 2008, to just 3.5% at the end of 2009), a phenomenon considered to be the consequence of the significant profit decrease for Transilvania Bank. In the year 2010, the value of the ROE indicator recorded an ascending tendency based on the increase of the bank profit at the end of the respective year compared to the year 2009, a phenomenon that should be appreciated, all the more as for the Romanian banking system the year 2010 recorded a loss, while the aggregate level of the indicator was a negative one.

From the analysis of the evolution of the factors influencing the ROE (Figure 5) and considering their effect on the indicator under analysis, the conclusion that can be drawn is that determining for the ROE values for the whole period under analysis was the EM indicator, whose values were close, even equal at the end of the years 2009 and 2010 for Transilvania Bank and for the Romanian banking system.

While for the credit institution, the value of the EM indicator had a sinusoidal evolution, as it decreased in the year 2008 compared to 2007 (from 11.3 to 9.8), and then increased in 2009 up to 10.9, decreasing again in 2010 (to 10.8), for the banking system as a whole, the EM indicator had a slightly different evolution, increasing from 8.8 in 2007 to 10.9 in 2009, and then decreasing – here as well – in 2010, to 10.8.

The high values recorded by the EM indicator highlighted, on the level of Transilvania Bank as well, the same situation as in the case of the Carpatica Commercial Bank and of the Romanian banking system as a whole, namely that the banks borrowed money, in their “rush” for gaining a market share as large as possible, a fact reflected especially in the volume of the credits approved.
But this phenomenon of excessive crediting acquired, beginning with the year 2009, a less pleasant “facet” for credit institutions, substantiated in the dramatic decrease of the activity result, especially in the year 2009 (for Transilvania Bank and for the Romanian banking system), but also in 2010 (except in the case of Transilvania Bank), due to the continual depreciation of the quality of the credits portfolio (characterized by the increase of the number of credits remained unpaid and implicitly of the expenses with the provisions). Under these circumstances, the ROE indicator, in the case of Transilvania Bank, decreased from 22.8% in the year 2008, to just 3.5% in the year 2009, while for the banking system the decrease was of 15 basis points (from 18.1% at the end of the year 2008 to 2.7% at the end of the year 2009), but which, unlike the case of Transilvania Bank, continued as well in the year 2010, so that after 11 years, the Romanian banking system recorded a negative ROE value (-1.7%), based on the unfavorable aggregate result, recorded for the banking system.

4. Conclusions

Apparently contrary to the reality, the main feature of the development of the Romanian banking system was not the quantitative dimension of its evolution, but the coherence of the structural and qualitative development of the banking activity, in the sense of the ascending direction dictated by the adaptation to the demands of the market economy.

The opening of the Romanian economy has put its mark as well on the current image of the banking system, which has determined the need to develop and adapt its operation systems to the international demands and practices.

In the accounting practice, the annual financial statements constitute the beginning and the conclusion of an accounting cycle, generator of the portfolio of correlated and checked information, which expresses all the chains of the economic activity. The information published through the annual financial statements needs to assure:

- The determination of the net situation of one’s patrimony or capital (equity);
- The determination of the net economic-financial output obtained;
- The provision of detailed information on the evolution and structure of some patrimony components or of some revenue and expense elements.

From the analysis of the activity of the two credit institutions, Transilvania Bank and Carpatica Commercial Bank, during the period under analysis, namely 2007-2010, the difference between the two appeared significant, especially through the value recorded by the main performance indicator - ROE - which was much higher in the case of Transilvania Bank compared to Carpatica Commercial Bank.

What we need to underline is the weight of the profit recorded by each of the two commercial banks in the aggregate net output on the level of the whole Romanian banking system. So, while in the case of Carpatica Commercial Bank this weight did not go over 1% (the highest value being recorded in the year 2009, namely 0.79 % compared to just 0.13 % in the year 2007 and 0.10 % in the year 2008), the net profit obtained by Transilvania Bank represented 12.38% (in the year 2007) of the aggregate net output on the level of the Romanian banking system, 8.48% in the year 2008 and 7.59% in the year 2009, while in the year 2010, the economic activity carried out at Transilvania Bank, according to its own presentation, was concluded with a positive net result, of 31,048 thousand lei, which alleviated the loss recorded on the level of the entire banking system, a loss to which the Carpatica Commercial Bank contributed as well through the result obtained at the end of the respective year.

References


