

DIRECTIONS FOR IMPROVING BUDGETING WITHIN THE COMMERCIAL BANK

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Abstract:

The article is dedicated to the issues of training, development and improvement of the budgeting system of commercial banks in modern conditions. The paper examines the main trends in the development of the banking sector in the Republic of Moldova, analyzes the external and internal factors that hinder the development of commercial banks. The authors of the article reveal the essence and role of the budgeting system in the development of commercial banks in the Republic of Moldova, investigate the content of the bank's budgeting system, analyze the elements of the budgeting system, which allow considering this system as a continuous active process of solving problems. commercial banks.

The study of these issues is of practical importance, because the efficient management of commercial banks requires an efficient budgeting system, which will allow commercial banks to achieve higher financial results.

Keywords: *budgeting system; financial responsibility center; financial planning in banks; the efficiency of the bank's functioning.*

JEL Classification: G21

Introduction

Currently, the banking system of the Republic of Moldova can be considered as developing and is characterized by intensified competition, an expansion of the range of banking products and services, an increase in the volume of transactions and the expansion of bank branch networks. The effectiveness of banking operations in such conditions depends largely on the banking management system.

Meanwhile, existing modern problems of domestic banks, expressed in the form of instability of Moldovan banking and its weak activity compared to Western countries, lack of funds, etc., are often associated with misunderstanding or neglect of the most important component of banking management - financial planning. The low level of financial planning of the activities of commercial banks is one of the factors that prevent the development of banking activities.

Recently, the managers of commercial banks have faced problems in planning the activities of the bank as a whole and its subdivisions, determining the cost of banking services and identifying internal survival reserves. In this sense, the role of intra-bank financial planning is growing, involving the introduction of a system for evaluating the performance of different departments of the bank and the individual areas of its activities.

The topicality of the problem and the insufficient degree of research on the processes of formation and improvement of the bank's budgetary system and the implementation of appropriate instruments require a more in-depth study, which led to the elaboration of this article.

Budgeting is a process of planning, accounting and controlling a bank's interest-free expenses. The budgeting system includes the processes of budget planning, budget management and financial control.

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Budgeting is very essential regulating the day to day operations of any business [3]. It is a framework for ensuring achievement of programmes concerned with business goal and objectives, under a given time period, by use of specific available resources.

Budgeting is a management tool designed to solve the existing variety of tasks of commercial banks by increasing the efficiency of financial planning and management in general. In addition, budgeting is currently a tool for strengthening control over resource spending, balancing cash flow, organizing an efficient assessment of a commercial bank's activities and the prospects of certain areas of activity, etc.

The objectives and tasks of budgeting are based on its functions as a whole. The financial crisis, with the consequences of which domestic banks have been struggling for a long time, has shown that those banking structures that used budgeting in the administration process quickly and easily solved their financial problems, restructured financial flows more efficiently and with minimal losses compared to banks that did not use budgeting technology. In this regard, issues related to budget execution are relevant.

At the same time, the development potential of the banking sector has not been exhausted, the Government of the Republic of Moldova and the NBM are of the opinion that the banking sector can and should play a more important role in the economy. It should be noted that the development of commercial banks is constrained by a number of circumstances, both external and internal.

External factors of restriction include increased lending risks, instability of international financial markets, limited opportunities for banking resources, insufficient credit in the medium and long term, a low level of public confidence in banks.

Internal barriers include underdeveloped management systems, poor financial planning, poor financial management, inefficient risk management, inefficient use of technology and poor quality management information.

Along with the listed factors, there are methodological issues such as the need to further develop and improve the commercial bank's budgeting system as part of its development strategy.

Results and discussion

Budgeting facilitates the primary function of banks, in their capacity as agents that facilitates financial intermediation and the performance of core banking roles [2]. Budgeting together with performance administration are important financial activities in the banking sector. The issue of improving the budgeting system of a commercial bank becomes relevant in cases where:

- the growth rate of administrative expenses exceeds the growth rate of the operational revenues of a commercial bank, ie the activity of a commercial bank is unprofitable;
- the reduction of the bank's administrative expenses (travel, hospitality, etc.) does not lead to the expected effect of saving funds, as there is an increase in costs for other elements of management accounting;
- a decrease in administrative expenses in favor of other elements of management accounting unexpectedly leads to the opposite effect - the resulting savings are several times lower than the indirect losses in other areas of activity of the commercial bank;
- the acquired material resources are used inefficiently and are accumulated periodically in the commercial bank's deposit;
- the payment of rent and utilities is uneconomical and constantly tends to increase;
- there is no clear and adequate assessment of the activities of the structural subdivisions of a commercial bank. As a result, competition between financial responsibility centers (CRFs) is provoked;

- the heads of departments are constantly confronted with the problem of evaluating the perspectives of the business areas and do not clearly understand the possible consequences as a result of their termination or reorganization;

- as a result of carrying out a large volume of operational work, the heads of departments practically do not participate in the process of financial planning and forecasting.

In our opinion, the formation and improvement of the budgeting system of a commercial bank depends on a number of fundamental conditions:

a) the development of a solid concept for the improvement of the banking system as a whole;

b) the presence of its own development strategy for the commercial bank.

The strategy, as a set of interdependent actions aimed at maintaining competitive advantages, should reflect the quantitative objectives of the bank's development, the ways and means of achieving them, as well as the qualitative internal changes in the bank that would be implemented to improve efficiency.

The dynamics of the basic indicators that characterize the state of the banking sector, reflected in Figure 1, in the period 2016-2020 demonstrate the maintenance of its development trends in easy local conditions for the economy.

During the evaluated period, we notice that the volume of loans granted in 2016-2020 is increasing by 31.28% and that of deposits by 44.98%

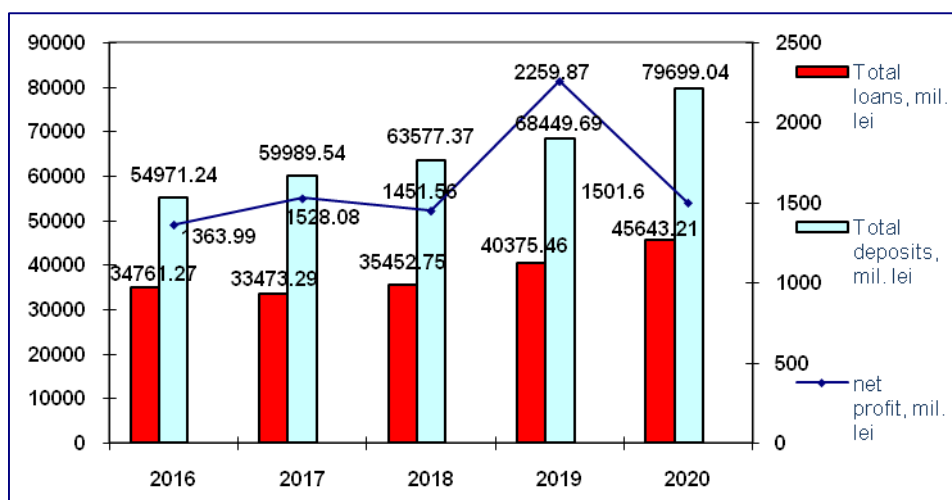


Figure 1: Dynamics of loans, deposits and net profit

Source: elaborated by the author based on data from <https://www.bnm.md>

However, we note based on the data in Figure 2 that net profit also decreases by 5% in 2018 compared to 2017 and in 2020 by 34% compared to 2019, the causes being the change of owners of systemic banks and the Covid 19 crisis, which substantially reduced by bank income.

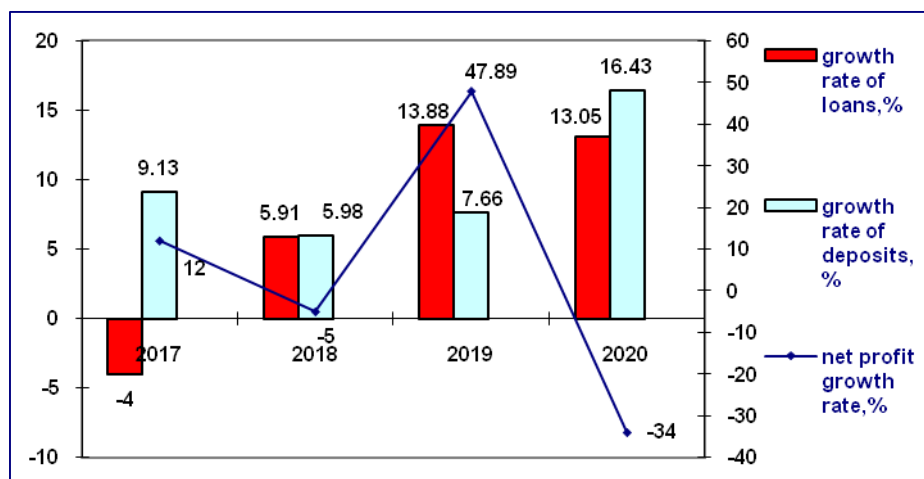


Figure 2: Evolution of growth rate of loans, deposits and net profit

Source: elaborated by the author based on data from <https://www.bnm.md>

The reference values reported per banking sector indicate a 10% decrease in net profit in 2020 compared to 2016, due to the reduction of total revenues by 10%, from 8607 million lei to 7802.4 million lei and 15% of bank expenses. The situation in 2020 was a positive one due to a 4.55% increase in revenue volume even in pandemic conditions.

In the initial stage of budget implementation, it is advisable to select only revenue centers and cost centers. At the same time, subdivisions can receive both real and conditional profits, but they will still be centers of income and costs. Their division is made according to the criterion of obtaining external income, which will form the financial result of the bank (income centers) and subdivisions that ensure the activities of the bank and attract resources (cost centers).

Thus, the revenue center will include the subdivisions that form the bank's income as a result of their activities, and the cost center - the subdivisions that collect funds, as well as accounting, control, technical and similar support for operations performed by the bank.

In modern conditions, with an uncertain situation on the world financial markets, a decrease in profitability in all major segments of the banking market, a decrease in interest margins, an increase in risks, the budgeting system of a commercial bank needs a development concept and improvement. Moreover, all parameters and elements of the existing budgeting system need to be improved, including the system of financial responsibility centers, various mechanisms, budgeting methods, analysis of budget execution, types and forms of budgets.

Improving the budgeting system of a commercial bank eliminates the spontaneity of this process and requires its conscious and systematic implementation. A decisive role in ensuring positive changes in the budget system, in maintaining its adequacy to changing conditions, is played by the common, well-thought-out actions of all participants in the budget process.

The strategy followed by a commercial bank should contribute to the implementation of priority areas for improving the bank's budgeting system. The reform of the bank's budgeting system must be carried out using a set of measures constantly implemented by the Economic and Financial Department and other stakeholders to form the most developed and efficient budgeting system focused on meeting customer needs.

Currently, the bank's budgeting system remains undeveloped and is not used as a strategic planning tool. The costs of implementing a budgeting system in a commercial bank remain high, and the tasks of improving the elements of the budgeting system have not been fully implemented.

The main purpose of improving the budgeting system of a commercial bank is to increase the efficiency of the functioning of structural subdivisions and the bank as a whole, to create the best financial plan for the bank's operation, focused on implementing the development strategy and achieving the main strategic objectives.

The priority tasks of improving the budgeting system of a commercial bank are set out in Figure 3.



Figure 3: The priority tasks of improving the budgeting system of a commercial bank

Source: elaborated by the author

Analyzing the experience of foreign banks, it can be noted that the basic condition for the successful development and improvement of the budgeting system is the development of a balanced and coherent policy in this area by a commercial bank. The objectives of this policy in relation to the budgeting system are to ensure systemic stability and create the necessary conditions for the development of the bank's budgeting system.

In addition, the effectiveness of the process of developing and improving the bank's budgetary system depends largely on the degree of stability of the national banking system as a whole.

The provision by a commercial bank of the conditions for the development and improvement of the budgeting system should be carried out in the following areas:

- improving the system of financial responsibility centers of the bank (improving the budgetary structure of the bank);
- improving the efficiency rating system of the Central Office and the bank;
- improving the regulations of the bank's budgetary process;
- improving the control system over the execution of budgets by the structural subdivisions of the bank;
- improving the management system of administrative expenses of the structural subdivisions of the bank;
- improving the bank's management reporting.

Improving the system of financial responsibility centers

A prerequisite for introducing a budgeting system in a bank is the formation of a budgetary structure based on the allocation of financial responsibility centers. It should be noted that in the implementation of budgeting processes and the allocation of financial responsibility centers in a commercial bank, there are a number of characteristic features. As A.A. Kitaev remarks: "... unlike the entire bank, some departments, subdivisions, sectors, groups have very limited operational and economic independence, do not have the rights of a legal entity and do not always enter into direct relations with other banks" [1]. In these structural units, it is mainly a question of comparing the real costs with the planned ones.

Table 1 summarizes the data on the departments that are directly involved in organizing the budgeting process in a commercial bank and their functions.

Table 1

The functions of the different departments of a commercial bank in organizing the budget process

Departaments	The functions in organizing the budgeting process
Financial and analytical department	consolidating the budgets of the financial responsibility centers and drawing up the general consolidated budget of the bank control over budget execution and deviations from financial data providing information on budget execution for higher levels of bank management compilation of forecast data on bank revenues and expenditures
Management of active and passive operations	processing and analysis of information related to the placement and actual condition of the bank's assets and liabilities providing information to the bank's management and control over the structure of assets and liabilities analysis, control and forecast of economic standards set by the NBM, the board of directors and the bank's board liquidity analysis and control, structure of terms and conditions of maturity of assets and liabilities, interest rates and the required reserve ratio of the bank foreign exchange position control analysis of the possible impact of transactions on the bank's performance indicators
Risk management department	risk analysis, control, calculation, identification and supervision developing a system of limits and control over the execution of limits; preparation and development of a methodological basis for a bank (policies, processes, guidelines) for supervision, identification and execution basic standards set for the risks associated with the bank's activities ensuring the observance of the banking development strategy and of the developed risk policies, their adjustment
Methodological department	developing a methodology for managing the budget process development of a system of coefficients participation in the elaboration of regulatory documents and analysis of the conformity of the information contained in them with the requirements of the legislative acts providing all the structural links of the bank with regulatory documents and internal instructions of the bank and timely correction of these documents
Accounting department	participation in the development of the financial system of a commercial bank elaboration of a unified chart of accounts ensuring the accounting of banking operations and controlling their execution preparation of bank statements (balance sheet, profit or loss account, annexes) and their observance with the requirements of the standards set by the NBM and the internal regulations of the bank

Source: adapted by the author after 1

In our opinion, when organizing the budgeting process, it is advisable: first of all, to form the budget structure of the bank based on the organizational and personnel structure; second, to select only the profit and cost centers. The implementation of the proposed measures will make it possible to assess the economic efficiency of the functioning of the structural subdivisions of the commercial bank.

Improving the efficiency rating system of the Central Office and the bank

In order to improve the performance appraisal system of the structural subdivisions and of the bank as a whole, it is necessary to draw up a list of optimal performance indicators. The list of performance indicators is individual for each bank and is formed according to the needs of the bank's management, financial management and development of the budgeting system.

In our opinion, in order to evaluate the efficiency of the structural subdivisions and of the bank as a whole, it is advisable to analyze the following performance indicators:

- Cost Income Ratio (CIR), which characterizes the ratio between operational and administrative expenses and operating income;
- Operational Performance Coefficient (OPC), which characterizes the ratio between operating and administrative expenses and the operating income of the current year with the ratio between operating and administrative expenses and the operating income of the base year.

The operational efficiency ratio is calculated using the formula:

$$OPC = \frac{CIR_i}{CIR_j}, \quad (1)$$

where CIR_i - the ratio between the operational and administrative costs and the operating income of the current year; CIR_j - the ratio between operational and administrative expenses and operating income for the base year [1].

If the bank's operational efficiency indicator has a value of less than 1, then the growth rate of the bank's operating income exceeds the growth rate of the bank's administrative expenses. Consequently, the bank conducts its activities profitably, otherwise the activity of the structural unit is unprofitable.

The analysis of these indicators allows:

- comparing the real value of the indicator with its standard level;
- comparing the bank's indicator with the coefficients of the competing banks;
- evaluation of the dynamics of the indicators.

The application of these indicators in practice will make it possible to assess the economic efficiency of the functioning of the structural subdivisions and of a commercial bank as a whole.

Table 2

Evaluation of economic efficiency of the banking sector of the Republic of Moldova

Indicators	Analyzed period				
	2016	2017	2018	2019	2020
Operational and administrative expenses	1617.34	1778.46	2116.79	2264.08	2383.56
Net operating income	4259.84	3945.94	4536.17	4986.23	5292.75
Cost Income Ratio	0.38	0.45	0.47	0.45	0.45
Operational Performance Coefficient		1.18	1.04	0.96	1

Source: elaborated by the author based on data from <https://www.bnm.md>

The results presented in table 2 indicate an increasing trend of the ratio between operational and administrative expenses and operating income from 0.38 points in 2016 to 0.47 points in 2018, after which the value of this indicator is set at 0.45 points and does not change in the years 2019-2020. This evolution is due to a stable trend of increasing operational and administrative expenses in the conditions of a different evolution of the volume of operating income. Operational

Performance Coefficient takes superunitary values in the years 2017-2018, which indicates the existence of some banks in the banking sector of the Republic of Moldova that register losses in these years, their activity not being profitable. For 2019 we attest a subunit value of the Operational Performance Coefficient, proving that in the banking sector there are no unprofitable banks, all with good results at the end of the year. A similar conclusion is outlined for 2020, when the Operational Performance Coefficient is equal to 1 in difficult conditions for all participants in the banking ecosystem.

Improving the regulations of the banking budgeting process

In our opinion, improving the regulations of the budgeting process is associated with the following activities:

- determining the optimal time period for budgeting. The budgeting period (horizon) is the time interval for which the budget is drawn up. The best budget period is considered to be one year with a quarterly breakdown. The budgeting period depends on internal and external factors;
- determining the timing of possible adjustments to the bank's budgets (monthly, quarterly, half-yearly adjustments). The best is the quarterly adjustment of the bank's budget;
- optimization of workflow schemes for the preparation of specific budgets.

Improving the control over the budget execution by the financial responsibility centers and the bank

Control over the execution of a commercial bank's budgets is an important step in the budgeting process in a bank. Comparing the actual results of the activity of the centers of financial responsibility (CRF) with the planned ones allows the bank's management to evaluate the situation in due time and to take measures to ensure the execution of the budgets of the structural subdivisions.

The control can start with summary budget elements, gradually going down to the constituent elements to identify the causes of the discrepancies. In order to facilitate the adoption of managerial decisions in the automated system of maintaining the bank's budget, it should be possible to effectively analyze the causes of deviations by detailing the deviations identified in the primary documents.

The formation of the most efficient control system on the execution of the bank's budgets is associated with the following activities:

- elaboration and establishment of standards (norms), precise definition of the objectives to be achieved in a specified time interval;
- measuring the actual results for a certain period;
- comparison of the obtained results with the planned values;
- correcting deviations from plans.

The implementation of these measures will allow the bank's management to have information about the existing advantages, problems, their sources. At the current stage, the system of control over the execution of budgets becomes the basis for the sustainable functioning of a commercial bank, contributes to the fulfilment of the bank's goals and objectives, to the achievement of long-term profitability targets and to the maintenance of reliable financial statements

Improving the bank's administrative expenditure management system

In the context of the global financial crisis and the reduction of profitability in traditional banking operations, it is of particular importance to use the internal sources of growth of a commercial bank. In this context, the management of administrative expenditure becomes of vital importance. This is because cost-effective management affects the financial performance of a commercial bank. An important aspect of ensuring the efficient functioning of the bank's administrative expenditure management system is the delegation of powers to the heads of the financial responsibility centers when spending the bank's funds.

It should be noted that this approach is implemented in the practice of commercial banks. A prerequisite for implementing the approach is the formation of a budgetary structure based on the allocation of financial responsibility centers with a standard classification of revenues, expenditures

and profits and the empowerment of decision-makers. This means that each head of the CRF plans the financial result of the activity of his department, taking into account his powers. Each bank independently sets the decision limit. Management reports on administrative and economic expenditure are drawn up on a regular basis. This approach allows to reduce the growth rate of administrative expenses by about 15 - 20%.

Improving managerial reporting

As banking practice shows, the relevant and complete information provided by the operational management is used to assess the risks and profitability of investments, which allows the control of operations, financial condition and deviations from the bank's activities in real time.

The form and structure of managerial reporting are largely determined by the individual commercial bank, because management reporting is directly related to the specifics of banking, organizational structures, personnel and the organization of budgeting, accounting, control and, in general, the characteristics of management and a mechanism for regulating the activities within a commercial bank.

In our opinion, the formation of the most complete and reliable management report of the bank is associated with the following activities:

- determining the objectives for generating the information used in the management reporting and the methods for evaluating the results;
- determining the information necessary for accounting and management reporting;
- distribution of management and reporting accounting objects by type of activity (process), CRF, territory, banking products, customer groups;
- ensuring the accuracy of calculations and accounting of reporting indicators;
- determining the forms of managerial reporting for the analysis and evaluation of the CRF activity;
- determining the forms of managerial reporting for the analysis of territories, banking products and bank customers.

Thus, the implementation of these measures will allow the formation of the best budgeting system and increase the efficiency of the operation of commercial banks.

In addition to the mentioned improvement measures, it is necessary to characterize the personnel involved in the elaboration and monitoring of the budgeting system within the commercial bank according to those presented in Table 3.

Table 3

The participants at the budgeting process and their basic functions

The participants at the budgeting process	Main functions
Board of Directors (Supervisory Board)	Overview of the bank's development, strategic guidelines for the bank's activities, the planned rate of return on invested capital
Chairman of the bank's board of directors	Approval of the bank's annual (quarterly) financial plan and budgets of the financial responsibility centers, as well as their adjustments Approval of priority development areas, bank positioning on the market, capital flow forecast, as well as internal standards, including non-operating costs, forecast of macroeconomic indicators Dispute resolution Approval of the report on the execution of the financial plan Approval of intra-banking regulations governing the budgeting process in the bank
Budget Committee	Approval of priority development areas, bank positioning on the market, elaboration of a capital flow forecast Taking into account the composition and rates of internal standards, including non-operating costs, and the forecast of macroeconomic indicators Adoption of the bank's annual (quarterly) financial plan and budgets of the financial responsibility center
Department of strategic development	The bank's strategic development plan (up to 5 years)
Banking subdivisions (CRF)	Preparation of planned budgets, quarterly adjustments, monthly forecasts, provision of data for the formation of a financial plan for the bank and a performance report
Structural unit of the bank, which ensures the organization of the financial and budgetary planning process	Aggregation of CRF data in the bank's financial plan, linking the budgets of departments and subdivisions, distribution of allocation costs based on the approved distribution Elaboration of proposals for adjusting the financial plan of the bank and the budgets of the Central Office Formation of budget execution taking into account non-systemic adjustments, including transfer revenues / expenditures, allocation expenditures, etc. Monitoring the execution of approved budgets Development of internal standards, including for non-operational costs, and forecasting of macroeconomic indicators
Assets and Liabilities Management Committee (or credit committee)	Approval of transfer rates to making decisions on the operations of the "internal bank"

Source: adapted by the author after 1

The need for effective and stable development of banks, increasing their capitalization, improving the efficiency of financial and economic activities requires the creation of an adequate planning

and budgeting system, allowing the bank to manage as an integral organizational economic system, including its vertical and horizontal sections individual retail and by fields of activity.

Conclusions

Summarizing the above, we can say that budgeting is a planning process aimed at managing the bank's expenditures and revenues, in order to establish the necessary balance between supply and demand for the bank's financial resources and ensure the necessary level of profitability.

The organization of budgeting in a bank requires the unambiguous definition of a number of conditions (including regulatory ones) under which the bank's financial resources are managed.

First, the bank's financial resources are subject to structuring according to the possibility of generating income and the level of training costs. According to the profitability criterion, financial resources can be divided into assets subject to placement in income-generating assets; stored in liquid form in a corresponding account and, under certain conditions, subject to placement in highly liquid assets; kept in liquid form in the accounts of the required reserve fund and not subject to placement in income-generating assets; held in the bank's funds in the form of previously reserved income. Depending on the degree of payment, financial resources can be divided into groups with a certain level of costs.

Second, the bank's financial resources are formed under the influence of supply and demand, which at times may not coincide in amounts, maturity and profitability, which makes it necessary to take into account unforeseen expenses (lack of financial resources) and unforeseen income (with excess financial resources), opportunities to transform financing sources according to the terms and conditions of refinancing.

Third, the structure of the bank's financial resources and the sources of their formation to a certain extent are regulated (limited) by the regulatory requirements of the NBM.

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