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# Adaptation of Modern Methods of Cost Accounting to Practice of the Banking Activities of Russian Banks

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**Abstract:** One of the most important conditions for functioning market economy is a stable and actively working monetary and credit system of the country which is based on the commercial banks. In many ways, the bank effectiveness is determined by the possibility of access to affordable sources of credit resources but now in a reduction of such resources, the role of management of the bank's non-interest income and expenses increases. The study systematizes the features of banking business, influencing the structure of assets, liabilities, incomes and expenses of the bank. During the deepening of the financial crisis in Russia the problem of survival of each individual bank is largely dependent on the organization of cost management. Universally acknowledged classifications and methods of cost accounting does not recognize the specifics of banking activities. The classification of costs in banks has been developed and the methods of their accounting have been grouped, considering the specifics of the management decisions made in the bank and ensuring improvement of their scientific validity. Novelty is the approach to the distribution of indirect (non-operating) costs of banking products, taking into account the scale of activity of a unit and specifics of the operations performed. The necessity of application of non-financial indicators to assess the activities of the units of banks has been shown.

**Key words:** Managerial accounting in banks, costs, cost classification accounting systems, managerial decisions, products

## INTRODUCTION

With the deepening of the financial crisis and the development of price competition in the financial, industrial, commercial markets, there are the processes of decline in profit rate and cost cutting. The days when managers made decisions about the tendencies of cost reduction on the basis of public financial (accounting) statement in order to increase the efficiency of the enterprise have gone now. Today, information base of cost management is the information of management accounting.

The two approaches to the calculation of financial results and cost control have been developed in the banking business practice. The first is based on the assessment of structural bank divisions, united by a criterion (regions, products, customers) consisting of various responsibility centers (cost and profit centers). In the second approach, the profit is calculated allowing for bank in general and a control object is contribution margin and costs. In this article we will investigate the problem cost management being inherent in both approaches. In the theory of management accounting there are various methods for determining the financial result. Thus, the organization of management accounting implies a certain classification of costs, depending on the cost object. Calculation of costs is possible based the types, the places of origin, the responsibility centers and media. Costs are known to be one of the objects of management accounting. Cost management is a process of directiveformation of expenses concerning their types, places and media for continuous monitoring of the level of costs and stimulation of their cutting.

In banking practice, the notion of costs is associated with interest expense (obtained funds), the cost of creation of the reserve for loans, commission and operating expenses. A special part in the system of cost management of the bank is assigned to the justification of the cost price of banking products (services, business processes) and their pricing. And as in any organization, the process of making prices of a banking service can be implemented both "top-down" value approach and "bottom up" cost-is-no-object approach. One of the determining factors of the bank development is an access to affordable credit resources but at the present time when such access is restricted, the questions of management of non-interest expenses and income have been brought into the foreground. In the context of the pursued state policy of reduction of the number of credit institutions, the prospects of further development of each bank are largely dependent on the degree of cost managing ability, the leader's ability to efficiently reduce costs and to plan their behavior when state of the market deteriorates. This is possible only when the organization develops the system and the mechanisms of cost management. They should be based not only on a retrospective analysis of the financial statement but on the information of the internal management accounting and take into account the external environment change.

The question of classification of costs for management accounting is covered in the works by the foreign authors such as K. Drury, C. Horngren, J. Foster, S. Datar, A. Upchurch, E.A. Atkinson, R.D. Bunker, R.S. Kaplan, M.S. Yanag, R. Harrison, R. Noreen, P. Brewer. The problems of cost management in domestic enterprises are dealt with by M. A. Vakhrushina, V. B. Ivashkevich, V.E. Kerimov, V.F. Paly, Y.V. Sokolov, A.D. Sheremet, V.T. Chaya, N.I. Chupakhina, N.V. Kozlyuk, A.A. Lyubushkin, P.A. Zheltkevich, N.O. Chrevko, S.A. Kotlyarov, V.A. Manyaeva, T.G. Sheshukova and others (Bogataya and Kharchenko, 2007; Bulgakova, 2004; Getman, 2014; Ilysheva and Kim, 2009; Kotova and Ignatiyeva, 2014; Nikitina, 2013; Rasskazova and Kondrakov, 2015; Rudakova, 2014).

But none of the economists has not developed the classification of expenses in bank subject to the characteristics of their activities and described the cost management system subject to the specifics of banking. We will make an attempt at fillingthis gap, we introduce the new features of cost classification inherent in banking activities, describe the methods of cost accounting in banks, structure the management solutions that can be dealt with when using them.

## MATERIALS AND METHODS

The principal feature of banks is that it is directly related to the regulation of the money economy and the country's finance health maintenance by reducing or increasing the money supply in circulation, compression or emission of credit money. This imposes very severe restrictions on both the internal and the external management of banks, explains the ultimate stiffness of the requirements on the part of the state supervision and regulation of the international organizations the Basel Committee on Supervision and Regulation and the International Accounting Standards Committee (IASC) as well as self-regulatory organizations in the process of creating the relevant normative and standards that areput into practice ofmanagement of commercial banks. Another important bank feature is the need to maintain a high level of functionality of the financial market participant, ensuring the provision of quality services. Other features of banking activities are as follows.

The predominance in the resources of banks of outside funds and borrowed assets, entailing a high responsibility for the efficient use first and foremost of the resources of depositors and creditors.

Extraordinary mobility, variability of operating standards of financial markets, caused not only by economic but also political, social, technological reasons and international events, requiring of the employees, primarily of managers, first and foremost, constant analytical intensity and highest efficiency and not to the detriment of the quality of the analysis and operations.

The need to continuously and simultaneously work with miscellaneous clients with contending interests in the financial markets, using the whole range of existing financial instruments which everything taken together creates a complex of management problems, often seeming intractable.

Intangible nature of banking products and the need for participating almost all the bank's subdivisions in the production of each such product.

The prevalence in the aggregate expenditures of fixed outlay, the regulation of which is possible only with a clear organization of the bank's financial structure, the allocation of responsibility centers.

These characteristics of banking business do not have any country-specific features. Its special features being typical of modern Russia are:

- Short historical period of existence of Russian banks, their lack of practical experience, traditions
- Very small amount of bank's capital invested compared with the leading market countries
- Insufficient level of technical equipment of banks with modern means of communication
- All in all, insufficient level of professionalism of management and staff of banks
- The need to work and survive under disadvantages over all of the last ten or so years, among which are: economic, investment, budget, billing and other crises reinforcing one another as a result of which the majority of banking clientele proved to beinsolvent or unable to repay loans
- Lack of prospects for development of the real sector of economic activity
- Lack of reliable credit and other customer's bankingstories
- Low level of public confidence in financial institutions in general and in banks in particular
- Poor adhering toeconomic and criminal law which is of special attraction of the banking sector to the "simple" and organized criminality

For proper organization of cost management, significant is its science-based classification, the main purpose of which is to create a clear and streamlined cost structure in line with the tasks.

## RESULTS AND DISCUSSION

In native literature in specification of the classification of costs according to the sectors, many authors refer to the cost classification developed by C. Drury. According to him, the methods of cost classification depend on the line (target) of cost management. By the line in which costs are being managed, we understand the sphere of activity (or process). K. Drury distribute costs according to the following lines:

- Determining the cost of supplies of products
- Planning and making managerial decisions
- The process of monitoring and controlling

M.A. Vakhrushina, complementing K. Drury's classification, greatly expands the areas of cost classification, grouping them according to:

- Cost objects (types of products (works, services) of the enterprise. This group is essential to determine the cost per unit of output
- Economically homogeneous articles of accounting elements
- The chosen managerialtask-cost calculation, management decision-making and planning, control and regulation of the centers of responsibility

If the general cost classification allows to analyze the structure of costs of enterprise for accounting and management purposes (Table 1), during the analysis of the bank's expenses it is necessary to base on the most important features of their classification. Table 1 shows the main types of costs.

Table 1: Classification of costs

| Criterion | Types |
|---|---|
| The possibility of referring to the target cost any activity (or other object of cost accounting), requiring a separatemeasuring of its incurred cost | Factor; costs that can be exactly and uniquely referred to target cost<br>Overhead; costs that cannot be referred to a concrete target cost |
| Relation to the change of the level ofbusiness activity | Variable; the costs that vary in direct proportion to quantum of output or activity level<br>Fixed; the costs remain invariable during theperiod of timeunder review<br>Half-variable; the costs, including fixed and variable constituents<br>Semiconstant; during the time period under review within a certain range of activity levels the costs remain constant but with the occurrence of the critical level they reduce or enlarge |
| Significance for a concrete managerial decision | Relevant; the future costs which vary as a result of decision-making (depending on the decision taken)<br>Irrelevant; the costs on which the decision does not have influence (insignificant for solutions that do not belong to it) |
| The possibility ofelimination of costs when choosing a decision | Avoidable; thecosts that can be avoided or reduced if you take an alternative decision<br>Unavoidable; costs that will be incurred in any case, regardless of the variant of decision |
| Relation to the quantity of production1 that is kept record of | Unit; cost per unit<br>General; cost of volume of production |
| Inclusion of goods sold into cost price | Product costs; spending, including prime cost of goods sold<br>Recurring costs; all expenses in the income statement, except for the costs of goods sold |
| Impact onalternative decisions | Sunk; the costs incurred as a result of decisions taken in the past and cannot be changed by any decisions in the future<br>Alternative; the costs that measure the opportunity being lost or sacrificed as a result of which the selection of one of the decisions<br>Ancillary (incremental, differential); the difference in cost between any two alternatives |
| Recurrence offormation | Current (periodic)<br>Non-recurrent |
| According to norm setting | Normed<br>Non-normed |
| According to time periods | Preceding costs<br>Period costs<br>Future costs |
| According to economy role in activity | Prime (direct) costs; being imminentlyconnected withbusiness processes<br>overhead (indirect); connected with overall performance and cannot be allocated for a concrete business process |
| According to elements and items of costs | Material costs<br>Labour costs<br>Social needs allocation<br>Amortization<br>Miscellaneous inputs |

Table 2: Managerial decisions made when using different systems of calculation of banking products (services) cost

| The system of calculation | Managerial decisions |
|---|---|
| Process-oriented method | Cost estimation of business-processes and ascertainment of the reserves of its reduction |
| Responsibility accounting | Control of cost-effectiveness of subdivision activities; the management of formation of actual expenses |
| Factual method | Management of actual cost; cost-cutting |
| Normative method | Decline in deviation of actual costs of production from the normative ones |
| Standard-costing | Control and management of interest and non-interest expenses; price setting; assessment of the profitability of banking instruments; solution of the problems of practicability of launching pioneer banking products |
| Direct-costing | Break-even analysis;decisions in the field of product updates; decision-making on opening up ofnew areas of the market, production feasibility of unprofitable products, substantiation of changes in the structure of production, selection and replacement of equipment, the choice of production capacity |
| ABC-method | Decisions in the field of production and sales cost cut; product prices determination; decision-making in the field of commodity assortment policy; cost estimating of operations; evaluation of actions and operations |
| Target-costing | Determination of the range of products; loss-making products rejection; product costs control during its life cycle in the planning stage; selecting the production of a specific product |
| Kaizen costing | Product costs control during its life cycle; improvement of the production process |
| "Just-in-time" method | Management of enterprise stocks, decisions in the field ofcosts saving |

When carrying out the external financial analysis of the bank's expenses one proceeds from the classification provided by the bank. According to it, by the form of the cost realization, the costs are interest and non-interest; by economic maintenance-operational, functional and others; by the frequency of occurrence-current and nonrecurrent. To form the system of cost management in banks for internal purposes it is necessary to divide the process of performing banking operations by their types and to analyze each of them.

Information about the costs is needed to assess and control the profitability of the activities, to set prices for services, to make rates, to make decisions on the start or termination of activities (product), to evaluate investments. The dynamics of costs is valuable from the standpoint of management decision-making but in the course of calculation of prime cost of banking products, various methods are used. The basis of the process of calculation is the definition of cost of products (services), for example, types of business, individual products, client, department. The choice of the object of calculation depends on the purpose for which the information is collected. For example, if the purpose is to price, the cost objects will be a single business process (crediting), if the purpose is to determine the costs of the department, the object will be the department as a whole.

Further, let us consider the managerial decisions taken by using different systems of banking product costing (Table 2).

Thus, the methods of cost accounting and cost calculation in banks do not include traditional process and job order methods of costing. When using other methods, the bank faces the problem of choosing the method of distribution of direct and indirect costs according to the objects of calculation.

In order to understand what cost management systems can be used in banking, let us consider the management decisions that are taken by using a variety of systems of cost management and production costing at enterprises (Table 3).

Present systematization ofthe methods of cost management demonstrates ample opportunities for various combinations of these targets depending on the specific management needs and allows to improvethe scientific content when justifying and managerial decisions, in particular, when the following problems:

- It is possible to make the optimum budgets on the basis of the analytical results on expenditure data for previous periods
- To promptly consider variances in costs, thereby efficiently using savings and preventing overrun of reserves (Lyubushkin A.A. Peculiarities of Financial and Management Accounting of Costs in Commercial Organizations//For Bookkeepers. 2007. No. 23. P. 21)
- To confirm the appropriateness of the activities
- To search and identifythe sources of cost reduction
- To prove the feasibility of introducing certain operations to outsourcing

In commercial banks, in addition to the decisions listed above, on the basis of information about the costs the following decisions should be taken:

- Identifying unprofitable or insufficiently profitable activities and the correcting the product line
- analyzing the clients the cooperation with whom is strategically beneficial to bank
- Identifyingbank units that do not bring optimum profits
- Determining optimal prices for banking products
- Establishing acceptable risks on banking operations
- Stimulating bank subdivisions and individual employees

Table 3: Comparative characteristics of cost management methods

| Cost management technology | The main point | Advantages | Disadvantages |
|---|---|---|---|
| Target costing | Formation of a new production cost for the enterprise, based on the projected market price and the expected profitability of sales | Determining the feasibility of production of a product at the design stage<br>Implements of cost cutting<br>Calculation of target costs (maximum cost acceptable in prevailing market conditions)<br>Calculation of deviations of target cost from estimated cost<br>The decision to launch/reject the production<br>The product is sold at a price not exceeding the market<br>The interests of producer and buyer are taken into account | The result is largely determined by the sector of the enterprise<br>The possibility of changes of environments of the enterprise is not taken into account |
| Kaizen costing | The gradual and continuous cost cutting as a result of the social enterprise program | Improvement of the company business using internal resources without outside major investments<br>Cost reduction implements at the production stage<br>Extended analysis of variable costs<br>Achieving the target cost<br>Ensuring profitability | The limited circuit of costs is taken into account<br>Involving of staff community from different spheres of activity to attained the desired result<br>Dependence of the result on professional level of the staff |
| Direct-costing | The method of accounting of direct (variable) costs | The ability to calculate the breakeven point, determine the price ofbreak-even realization<br>Taking operational decisions, including decisions on overall production | Standing costs are not analyzed<br>Indirect expenses are not analyzed<br>The main function: expenditure accounting |
| Standard-costing | Costs are defined as the average value for a number of previous years, the average value is adjusted by extrapolation amended to change the design, technology of production, etc | The cost standards are approved<br>The variancesare capitalized and included in the actual cost | Insufficient flexibility of technology<br>Accounting and analysis of deviations afteraccounting reference period |
| Standard costing | Determining the total cost of production | Enforcement of technical and technological standards and production discipline<br>Cost management and performance assessment<br>Calculation of the actual cost<br>Variances aredivided by the reasons caused, recorded in current basic documents, sent to the destination | Variances are capitalized and included into actual prime cost |
| «JIT» («just-in time» method) | Organization of production process, time and spoilt production cutting, ensuring the timely delivery of materials, products and minimizing the inventory | Possibility to avoid additional costs resulting from idle periods, long transportation routes, intermediate warehouses | Line production workers, engaged in product release are also obliged to renderservicing, maintenance and adjustment and alignment which are traditionallyprovided by other workers and referred to the category of indirect costs<br>Need for high computational accuracy |
| Benchmarking | The evaluation system of the enterprise by comparing with any suitable analogue | Getting new ideas that can be further developed independently<br>The use of existing practices that can reduce some of the risks | Difficulties in data mining<br>Adherence to the established stereotypes and traditions<br>Difficulties in choosing a suitable analogue, reference |
| Responsibility center management, management control systems | Each unit is delegated some decision-making powers in relation to the state of its costs and performance | The head of the center is fully responsible for the fulfillment of the reduced performance<br>The possibility ofanalyzing cost variances, searching for the causes of deviations<br>Authority delegating allows to focus on fairly narrow areas in the activity of the enterprise | Authoritativeness of decision making which requires a high training manager as well as the his leadership qualities<br>Competence in allocation of responsibility centers and responsibility areas |
| Strategic cost management | The system of expenditure management under which the costs of the entire "value chain" of business, rather than locally in each individual link in the chain are minimized | A close interrelation with a market-oriented environment<br>Focus less on fixing specific facts but rather on tracking trends, trends or significant changes<br>Significant consumer orientation | Not having a recognized theoretical and methodological framework |
| ABC-method (activity-based costing or AB-costing method or the method of function-based costing) | Operations are considered as the main objects of cost accounting | Planning of cost savings<br>The formation of the incentive system in order to optimize costs<br>Qualitative assessment of the activities of the enterprise, its improving<br>High accuracy of cost allocation<br>The possibility of developing those operations that add value and reorganizing those operations that do not add value | Time and force consumption for staff training and data gathering<br>Information availability<br>Multiplicity of application in the firms with long cycle time<br>Undue complexity in allocating the costs in particular cause and effect relationship between the groups of costs<br>Essential resource-intensiveness |

- Searching for the reserves of reduction of operating charges of the bank and its units (the expenses for office rent, HR-management, administrative expenses)

The allocation of indirect costs is one of the central issues in the management of non-operating expenses (expenses on maintaining a bank office and supporting business processes) and commission expenses and the justification for the pricing on banking products. The most frequently encountered is the basis of distribution of indirect costs is staff number of employees but it does not allow to precisely calculate the cost of banking services. The main problem arising in applying the base of distribution is the error of calculation in respect of subdivisions having a large number which could affect the overall evaluation of the effectiveness of the bank's subdivision. In allocating the costs in proportion to the staff numbers a large amount of overhead costs falls to the share of the unit with more quantity which in turn leads to the reduction of performance indicator of activity. That is, the profitability index is reduced which in turn may affect the remuneration of the employees and entail the strengthening of the control over the unit activity. We believe that the basis of allocation of indirect costs can be indicators, taking into account the scale of activity of a unit and specifics of the operations performed. This will allow to obtain more complete information about the unit performance. Then, when comparing the branches and subdivisions of the bank, the ones that have a large number are given equal opportunities to assess banking activity. The application of different approaches to the allocation of overheads (indirect costs) according to the levels, namely:

- Direct allocation (it is used if it is possible to determine the cost object in reflecting the operation)
- Direct allocation (it assumes allocation of costsaccording to a single parameter for all CFR)
- Cascade step-by-step allocation (a sequence of several steps in allocatingthe costs is used, its own parameters and set of CFR are applied at each step)
- Cascade cross-allocation (mutual redistribution of services, taking into account rendering by service subdivisions of counter services to each other) will provide the most accurate result and allocate the cost of service units more correctly to other units of the bank

For job rating of the unit (as the center of financial responsibility) for the purpose of finding the reserves to reduce the costs, it is necessary to develop a system of indicators based not only on the information of the cost and other financial information but also on non-financial information.

**Cost income ratio:** The ratio of operating expenses to operating income. The indicator is reasonably to be used as a tool of internal control. The aim of analyzing the causes of the changes of CIR is the search for negative trends, the timely taking measures and diagnostics and spread of the administrative decisions to the entire network which has led to its positive dynamics. Also, as a recommendation, one can offer to detail the indicator of CIR in the context of banking products. Operational efficiency and quality of service allows you to get a more complete picture of the effectiveness of a representative office or a branch of the bank.

## CONCLUSION

Today, Russian commercial banks are operating in conditions of stagnation of economy, heightened by price and information competition. One of the factors of success of banks is an increase in the share of non-interest income and a decrease in non-interest expenses. The study presents the current classification of costs for management purposesand systematizes the applied methods of their accounting. The increased transparency and reasonableness of the formation of the costs of banking products, on the one hand and encouraged staff performance, on the other hand, achieved by adapting modern methods of cost accounting to banking practice, allow to realize a competitive advantage. The system of management accounting taking into consideration the entire arsenal of conventional methods of financial and cost accounting and using its own tools, taking into account external factors and the latest methods of accounting and distribution of costs, creates the preconditions for complex comparative analysis for the development of managerial decisions on updating technologies, plans, redistribution of human and other resources in the bank.

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