ACCOUNTING OF BANKS AND SOME FINANCIAL INSTITUTIONS FROM THE YEAR 2003

PART II

SECURITIES

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The new Act on Accounting effective from January 1, 2003 allows for certain securities portfolios to be measured at fair value, owing to which the accounting for securities, including REPO operations, under the accounting procedures for banks and certain financial institutions conforms to IAS 39.

Securities (SCs), which are not considered to be an interest in the legal capital of business entities with a controlling influence and of business entities with a significant influence, are broken down into groups according to the purpose of their procurement. Their itemisation is as follows:

Assets		**Balance sheet**	**Liabilities**
• Securities held for trading (debt SCs, shares and equity certificates)	FV	• Payables from traded securities (debt SCs, shares and equity certificates)	FV
• Securities available-for-sale (debt SCs, shares and equity certificates)	FV	• Payables from issued securities (debt securities and equity certificates)	AC
• Securities held to maturity (debt SCs)	AC		
• Securities procured in primary issues not held for trading (debt SCs)	AC		

FV – fair value
AC – accrued value

Upon their initial recording, securities are measured at cost. That comprises the direct cost of any transactions related to these securities (transaction costs) known to an accounting unit at the time of their initial recording, such as fees and commissions to brokers, advisors, and local and foreign stock exchanges. In the case of securities received or delivered as part of a forward transaction, the fair value of a fixed forward transaction or the intrinsic value of an option forms part of the valuation of the securities. The intrinsic value of an option is the difference between the spot price of the underlying financial instrument and the price at which the underlying financial instrument is realised. In the case of call options, the higher the spot price in comparison with the price at which they are realized, the greater their intrinsic value. For put options, the reverse is true.

Following the initial recording, securities are measured at fair value. There are certain exemptions to this rule, which are as follows:

- securities held to maturity;
- securities procured in primary issues not held for trading;
- issued securities.

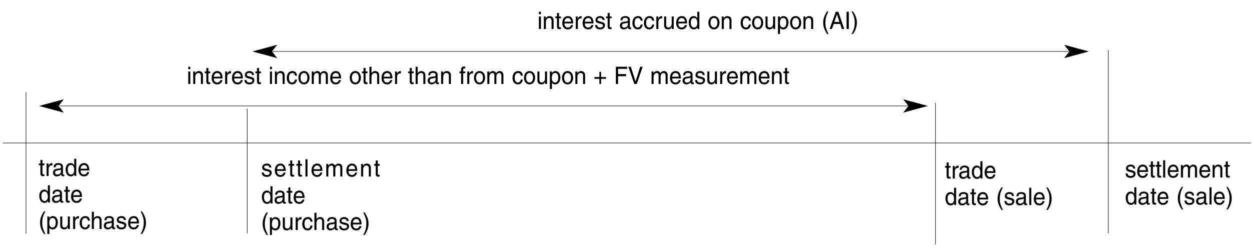
Such securities are measured at an accrued value.

The fair value of a security shall be determined as the market price announced no later than on the day of its valuation on a local or foreign stock exchange or another public market where the security can be indisputably sold at the market price; for a debt security, such price shall include the interest income accrued.

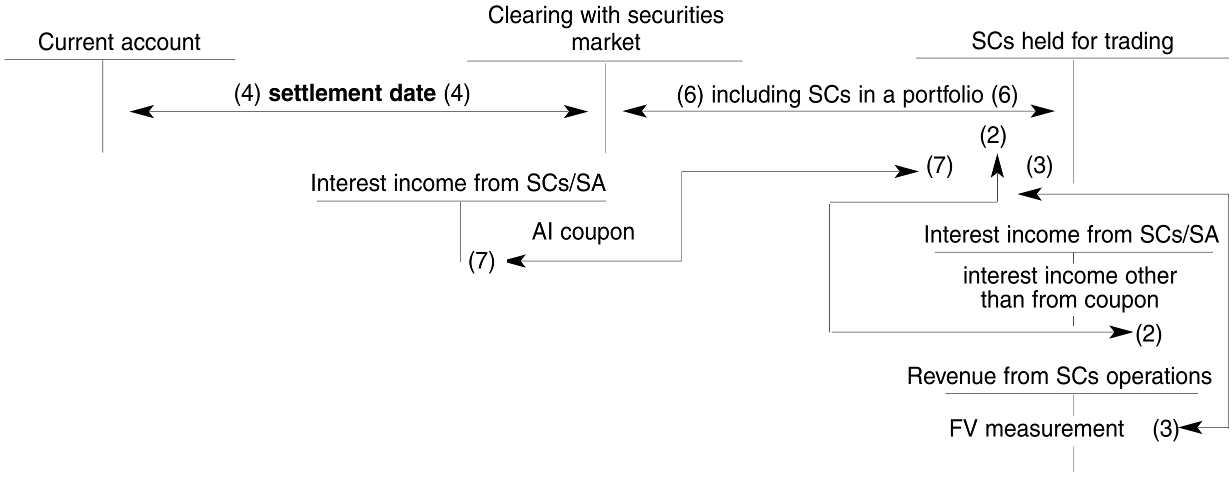
If an asset is kept at a local stock exchange, the market price shall amount to the closing price announced by the stock exchange on the business day as of which the measurement is done.

If an asset is kept at a local stock exchange and is quoted at foreign stock exchanges, the market price shall be taken to mean the highest of all closing prices achieved at approved foreign stock exchange markets on the business day as of which the measurement is done. In the event of a public market other than a stock exchange, the market price shall

Securities held for trading and securities available-for-sale – income earned and measurement at fair value (FV)



a) balance sheet entries

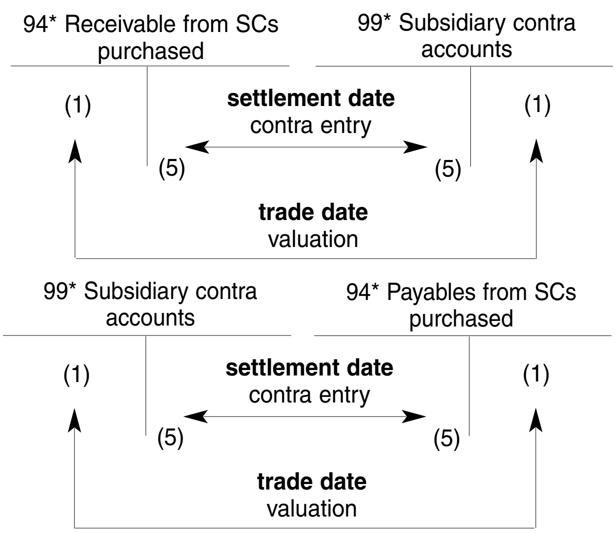


be the highest current price on the day as of which the measurement is done. If on the day the measurement is done, the said markets are not operating, the price announced thereon on the last business day preceding the day as of which the measurement is done shall be applied.

If the market price cannot be safely determined, the fair value will be determined by means of an educated estimate as the sum of all future expenses or revenues at an interest rate occurring most frequently in the case of a similar issuer's instrument carrying a similar measured value, or an interest rate whereby the par value of this instrument is reduced for an interest deduction to a price at which this instrument would be sold.

In the case of securities held for trading and securities available-for-sale, if coupon bonds are concerned, interest will be gradually accrued to their measured value from the settlement date of bought security till the settlement date of its sale, or from their maturity date. From the day of agreement to purchase securities held for trading or sale, where the purchase agreed is part of a spot operation, such securities will be measured at their fair value till the day of agreement on their sale or till their maturity date. In the case of debt securities, revenue other than interest income from coupons, such as premiums or

b) off-balance-sheet entries

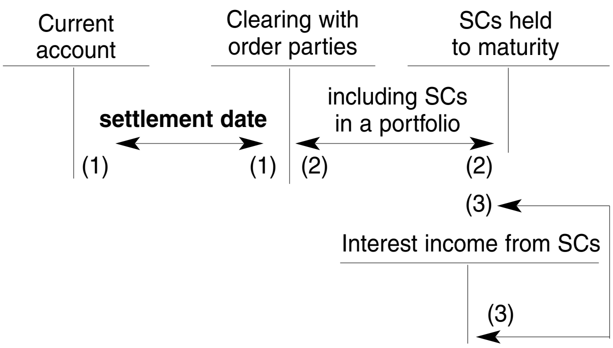


II – interest income
SA – subledger account

a discount will be gradually accrued to their measured value. Debt securities measured in this way will be valued at their fair value as of the measurement date. Changes in fair values will be posted to cost or revenue accounts with corresponding postings made to relevant securities accounts.

In the event of payables from securities held for trading, if payables from coupon bonds held for trading are concerned, the coupon interest expense will be gradually accrued to the sale price from the day of settling the security sold till the day of settling its repurchase. From the date of an agreed short sale till the day of an agreed repurchase, such payables will be measured at their fair value. As for payables from debt securities held for trading, any interest expense other than the coupon interest expense, such as premiums or a discount, will be gradually accrued to them. Debt securities valued in this way will be measured at their fair value as of the measurement date. Changes in fair values will be charged to expense or revenue accounts, with corresponding postings made to the respective securities payable accounts.

As for securities held to maturity and securities procured in primary issues not held for trading, any revenue other than coupon interest income, such as premiums or a discount, will be gradually accrued to their measured value from the purchase settlement date till their maturity date or the sale settlement date. If securities held to maturity or securities procured in primary issues not held for trading are sold, the difference between the accrued value of such securities and their sale price will, on the date of settling the sale, be charged to revenues or costs as a profit or loss from the sale of the securities.

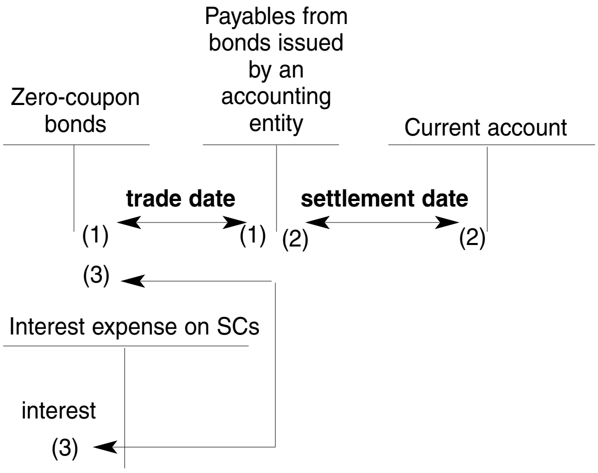


In the event of securities issued by an accounting entity, any interest expense incurred on the issued securities will be gradually accrued to their cost from the date of settling the issue till the maturity date.

The amount of provisions to securities held to maturity and debt securities acquired in primary issues not held for trading will be reviewed as of the date of compiling regular, extraordinary or interim financial statements.

When the book value of securities is reduced, provisions will also be made to:

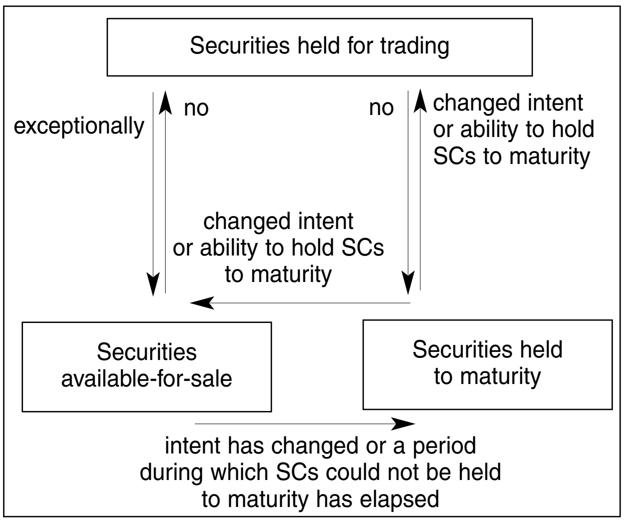
- securities held to maturity delivered by an accounting entity as part of REPOs;



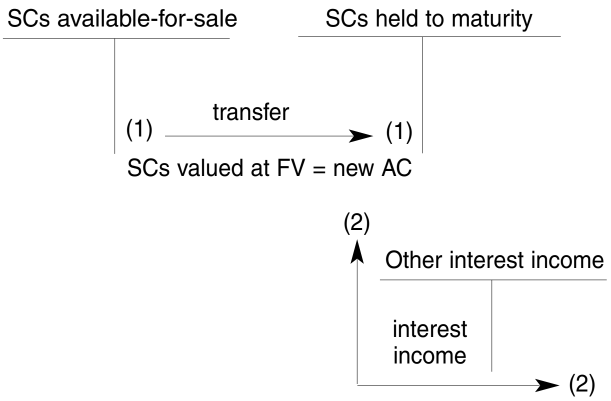
- securities held to maturity lent by the entity to other accounting entities;
- securities procured in primary issues not held for trading and delivered by the entity as part of REPOs;
- to securities procured in primary issues not held for trading lent by the entity to other accounting entities.

It is inadmissible to transfer securities from a portfolio of securities procured in primary issues not held for trading to a portfolio of securities held for trading, securities available-for-sale or securities held to maturity.

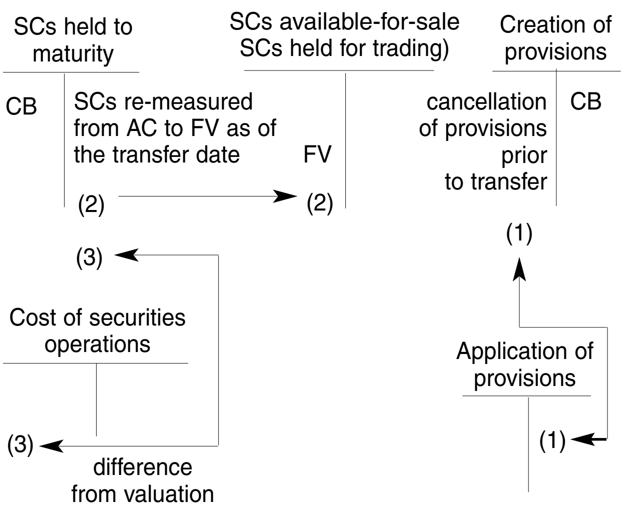
The below holds true for transfers between securities held for trading, securities available-for-sale and securities held to maturity:



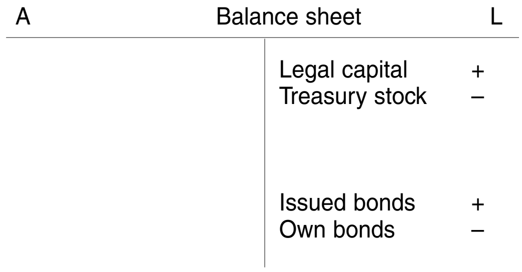
When securities are transferred from a portfolio of securities available-for-sale to a portfolio of securities held to maturity, the fair value as of the transfer date will be considered as a new accrued value, to which interest income will accrue.



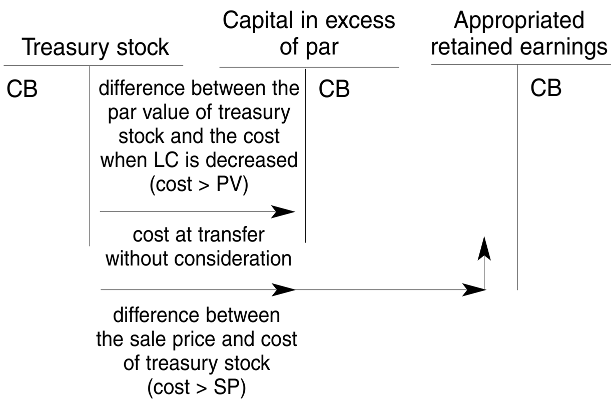
When securities are transferred from a portfolio of securities held to maturity to a portfolio of securities available-for-sale or a portfolio of securities held for trading, a security will be measured at fair value as of the transfer date, with the difference from valuation being concurrently posted to expense or revenue accounts. If there is an adjustment entry made to the transferred securities included in a portfolio of securities held to maturity, such an entry will be cancelled prior to such a transfer by its posting to a held-to-maturity securities account. Upon a transfer of securities to a portfolio of securities available-for-sale or the portfolio of securities held for trading, only the difference between the fair value of the security transferred and its accrued value will be recognised as an expense or revenue.



Treasury stock and re-acquired debt (own debt securities) are accounted for as liabilities regardless of the purpose of their acquisition. Treasury stock will reduce equity capital, and re-acquired debt will reduce securities issued.

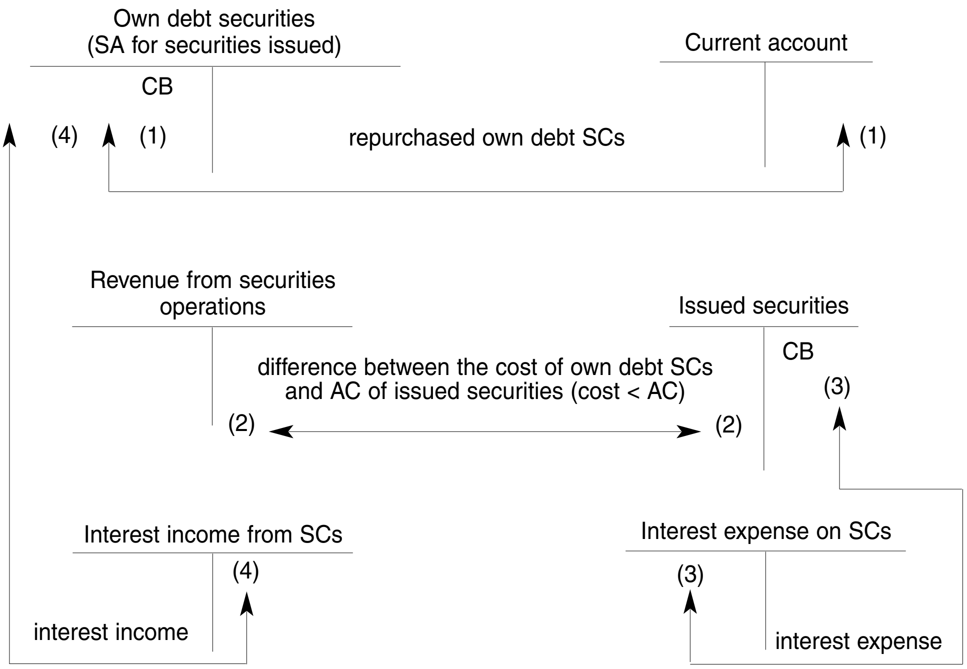


Treasury stock is carried in a separate liability account. When there is a decrease in the legal capital (LC), any difference between the par value of treasury stock and its cost is accounted as an increase or a decrease in capital in excess of par or a decrease in the appropriated retained earnings (reserves). If treasury stock is sold, any difference between the sale price and its cost is posted as of the trade date as an increase or decrease in the capital in excess of par or a decrease in reserves. If treasury stock is transferred without consideration, the cost of the treasury stock is treated in accounting as a decrease in capital in excess of par value or reserves.



OC – cost
SP – sale price
PV – par value
CB – closing balance

Re-acquired debt (own debt securities) is kept in separate accounts within account groups of issued securities. Upon its initial recording it is measured at cost, including any transaction costs. In the case of re-acquired debt received as part of a forward operation, the fair value of a fixed forward operation or the intrinsic value of an option will also be included in the measured value. The difference between the cost of repurchasing one's own debt securities and the accrued value of the securities issued will be charged to revenue or expenses as a gain or loss from the securities trading. Values corresponding to a gradual inc-



rease in the measured value, which consist of accrued interest income from one's own debt securities repurchased, will be deducted from any interest expense incurred on the debt securities issued.

REPOs

Accounting for REPOs (repurchase agreements) under the accounting procedures for banks and certain financial institutions conforms with IAS 39. However, significant change has occurred with respect to the accounting treatment of collateral. Till the end of last year, collateral, i.e., a financial asset received in a reverse REPO, used to be recorded on balance sheet; now it is to be recorded on off-balance-sheet accounts, thanks to which the balance sheet amounts will no longer be unnecessarily overestimated. Under IAS and Slovak accounting procedures for banks and certain financial institutions, a REPO means providing or receiving financial assets in return for cash or other form of payment with a concurrent liability to receive or provide these financial assets as of a certain date for an amount equal to the original cash or other payment amount and interest.

In terms of a creditor as opposed to a debtor distinction, REPOs are divided into:

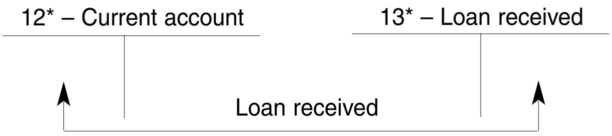
- a REPO consisting of the provision of financial assets other than cash in return for cash or another form of payment with a concurrent liability to accept these financial assets as of a certain date for an amount equal to the original cash or other payment amount and interest;
- a reverse REPO consisting of the receipt of financial assets other than cash in return for cash or another form of payment with a concurrent liability to provide these financial assets as of a certain date for an amount equal to cash or other payment amount transferred and the interest.

It is very important to note that it is possible to record three forms of REPO transactions that differ in legal terms, but the economic substance of which is identical. These forms are as follows:

- a classic REPO consisting of the receipt of a loan secured through a transfer of securities and a classic reverse REPO consisting of the provision of a loan secured through a transfer of securities; usually these involve the provision of a loan in accordance with §§ 497 to 507 of the Commercial Code secured through the transfer of financial assets as per § 553 of the Civil Code, or other contracts with the same economic content;
- the borrowing and lending of securities secured through the transfer of cash, but not the borrowing and lending of securities collateralised using other securities or financial assets;
- the sale of securities with their concurrently agreed repurchase (sell-and-buy-back) and the purchase of securities with their concurrently agreed resale (buy-and-sell-back), where both of the parts (spot and reverse transaction) are agreed simultaneously, irrespective of whether one or two contracts are involved. If the securities transactions are not simultaneously agreed, they will be deemed to be ordinary securities transactions.

a) debtor's accounting treatment

In the event of a classic REPO, where a security is sold and its repurchase is concurrently agreed, and the borrowing of a security secured through a cash transfer, an accounting entry is made on the loan received.

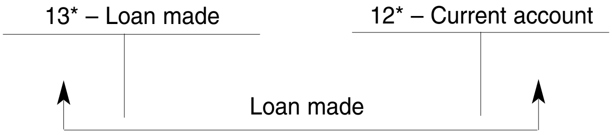


A security in the form of a financial asset, i.e., collateral provided as part of a REPO, is retained on the balance sheet and is recorded in separate subledger accounts pertaining to the relevant ledger accounts in which the respective item was recorded prior to its provision as part of the REPO, while applying the method for valuation used so far.

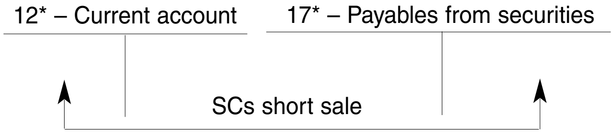
b) creditor's accounting treatment

In the event of a classic reverse REPO, where a security is purchased and its resale is concurrently agreed, and the lending of a security secured through a cash transfer, an accounting entry is made on the loan made.

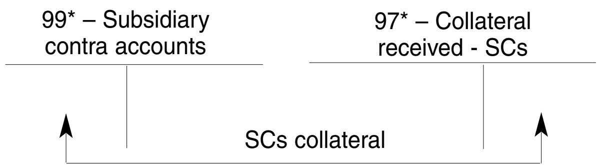
a) balance sheet entries



b) off-balance-sheet entries



Collateral received as part of a reverse REPO is stated at fair value in an off-balance sheet as of the date of compiling regular, extraordinary or interim financial statements. Collateral subject to a short-term sale is not recorded on an off-balance sheet; such collateral is recorded within accounts group 17.



A short sale agreed does not impact upon the results of operations (if charges associated with the settlement of the securities sold are left out of consideration). Securities payable are measured at fair value, while any differences due to the valuation of these payables are recognized as a profit or loss. A profit or loss from a short sale is reflected in the profit or loss during the course of a short sale and not after its termination, or is recognized as a profit or loss only upon the completion of a reverse REPO or the lending of a security, i.e., when the collateral is returned.

In the case of REPOs, collateral may basically consist of any assets, even though the accounting procedures are only confined to financial assets. Since these procedures do not cover cases where collateral consists of tangible assets (inventory, movable items, etc.), an identical accounting procedure can be recommended in such instances.

To be continued with Accounting for Derivatives in the next issue

A time schedule of a short sale and for stating a profit or loss in a profit and loss statement