TÜRK BANKACILIK SEKTÖRÜNDE YER ALAN BANKALARIN FİNANSAL VARLIKLARI ÜZERİNE BİR ÇALIŞMA

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Özet:

Son yaşanan finansal kriz sonucunda, finansal piyasaların şeffaflığı ve güvenilirliğini muhafaza etmek amacı ile Uluslararası Muhasebe Standartları Kurulu (UMSK/IASB) 13 Ekim 2008 tarihinde TMS 39 Finansal Araçlar: Ölçme ve Değerleme Standardı'nda bir değişiklik yapmıştır. Bu değişiklik işletmelerin türev ürünler dışında kalan finansal varlıklarını istisnai durumlarda alım-satım amaçlı finansal varlıklar sınıfından satışa hazır amaçlı ya da vadeye kadar elde tutma amaçlı finansal varlıklar sınıfına ya da kredi ve alacaklar sınıfına transfer etmesine olanak tanımıştır. Bu çalışma Türk Bankacılık Sektöründe yeralan bankaların bu değişiklik doğrultusunda finansal varlıklarını 2008 yılında yeniden sınıflandırıp sınıflandırmadıklarını, sınıflandırmışlar ise yeniden sınıflandırmanın hangi finansal varlık grupları arasında gerçekleştirildiğini tespit etmek amacı ile gerçekleştirilmiştir. Bu çalışmada Türk Bankacılık Sisteminde yer alan kırk beş bankanın otuz dördünde 2008 yılında alım-satım amaçlı finansal varlıklarının toplam varlık ve özsermayelerinin içindeki payının azaldığı tespit edilmiştir. Sözkonusu otuzdört bankanın sekizinde ise bu azalmanın finansal varlıkların yeniden sınıflandırılmasından kaynaklanmış olduğu tespit edilmiştir. Yeniden sınıflandırma yapan sekiz bankanın sekizi de yeniden sınıflandırma işlemini alım satım-amaçlı finansal varlıklar grubundan vadeye kadar elde tutma amaçlı finansal varlıklara yapmıştır. Bu bankalar arasından sadece bir banka yeniden sınıflandırma yaparken alım-satım amaçlı finansal varlıklardan vadeye kadar elde tutma amaçlı finansal varlıklar grubuna ve satışa hazır amaçlı finansal varlıklar grubuna transfer yapmıştır.

Anahtar Kelimeler: Finansal Varlıklar, Bankalar, Yeniden Sınıflandırma, TMS 39

TURKISH BANKING INDUSTRY AND A STUDY ON THE FINANCIAL ASSETS OF THE TURKISH BANKING CORPORATIONS

Abstract:

As a direct response to the recent financial crisis and various requests from firms and regulatory bodies the IASB took an urgent action to ensure the transparency and confidence are restored to financial markets by issuing an amendment to IAS 39 as of October 13, 2008, which enables entities to reclassify their financial assets other than derivative instruments from held-for-trading to available-for-sale or held-to-maturity in rare circumstances or to loans and receivables. This paper examines whether and to what extent banks operating in Turkish Banking Industry applied the amendments to IAS 39 regarding reclassification of non-derivative financial instruments in their 2008 financial statements. The share of financial assets held-for-trading in total assets and owners' equity decreased, in the financial statements of 34 of the 41 banks studied, in Turkish Banking Industry in 2008. In 8 of 34 banks studied, it stems from exercising reclassification option in the amendment. All of the 8 banks reclassified them as held-to-maturity and only one of them also reclassified as available-for-sale.

Keywords: Financial Assets, Banks, Reclassification, IAS 39

INTRODUCTION

Since the introduction of fair value accounting by IASB, there has been a debate going on between parties whether fair value accounting is better than historical cost accounting or not. Despite all arguments, for relevant and transparent financial reporting, it was commonly agreed that financial assets should be measured at their fair values. But after emerge of recent financial turmoil, financial institutions especially banks having significant amount of financial assets regarded fair value accounting as the principal reason for the financial crisis. *(Fiechter, 2009, s: 1)* Consequently regulatory bodies in advanced economies have stepped in to provide support to banks and financial institutions and put significant pressure on regulatory bodies for suspending fair value accounting.

As a result of all of these attempts IASB took an urgent action to ensure the transparency and confidence are restored to financial markets by issuing an amendment to IAS 39- Financial Instruments: Recognition and Measurement as of October 13, 2008, and an amendment to IFRS 7- Financial Instruments: Disclosures as of November 2008. The amendment issued to IAS 39- Financial Instruments: Recognition and Measurement as of October 13, 2008 enables entities to reclassify their financial assets other than derivative instruments. The amendment permits an entity to reclassify non-derivative financial assets (other than those designated at fair value through profit and loss by the entity upon initial recognition) out of the fair value through profit and loss category in particular circumstances. The amendment also permits an entity to transfer from the available for sale category to the loans and receivables category a financial asset that would have met the definition of loans and receivables (if the financial asset had not been designated as available for sale), if the entity has the intention and ability to hold that financial asset for the foreseeable future. *(IASB, 2010, a: 4)*

Impacts of financial crisis on international financial reporting, attempts made to reduce complexity in reporting financial instruments and empirical studies (Guo & Matovu; 2009, Kholmy & Ersntberger; 2010, Fiechter; 2010; Bischof & Brüggemann & Daske; 2010) on the impact of reclassification of financial assets under IAS 39 to the financial statements of financial institutions, especially banks from different perspectives, motivated us to develop and conduct a study on this topic. The objective of this paper is to find out whether and to what extent banks operating in Turkish Banking Industry applied the amendments to IAS 39 regarding reclassification of non-derivative financial instruments in their 2008 annual financial statements. The question why banks reclassified their financial assets and the impact of the reclassification on financial statements are not within the scope of this paper. We leave these questions for future research.

In order to explore whether and to what extent banks operating in Turkish Banking Industry used the opportunity to reclassify their financial assets under the amendment made to IAS 39 by International Financial Reporting Standards Board on October 13, 2008, an exploratory study was developed and conducted by analyzing financial statements of 41 banks out of 45 operating in Turkish Banking Industry from the year of 2006 to 2009. We excluded one bank transferred to Department of Insurance Fund since it does not have any balances of the figures that we are studying. We excluded two of the Development and Investment Banks and one of the Foreign Banks since they started operating in Turkish Banking Industry in 2008 and 2009 respectively. We classified banks as Turkish Deposit Banks, Foreign Deposit Banks and Development and Investment Banks.

We conducted our study in two steps: first financial statements of 41 banks from the year of 2006 to 2009 are examined to determine the level of change in the share of financial assets held-for-trading, in total assets and owners' equity. We started examining the financial statements from the year of 2006 since application of IFRS became mandatory for banks not before the year of 2006. As a result of the first step of our study, we found out that, in Turkish Banking Industry 34 of the 41 banks' financial statements, the share of financial assets classified as held-for-trading within total assets and owners' equity decreased in 2008. In order to find out the reason for this change, we conducted the second step of our study and examined related disclosures of banks' financial statements for the year of 2008. We could not reach the related disclosures of 5 of the 34 banks. What we found is that 8 of 29 banks reclassified their financial assets held-for-trading to held-to-maturity and only one of them also reclassified it to available-for- sale.

In this study, first of all brief information about Turkish Banking Industry and financial assets will be given in the first and the second sections respectively. These will be followed by the third section on October and November amendments made to IAS 39: Financial

Instruments: Recognition and Measurement. In the fourth section the study on financial assets of Turkish Banking Industry and our findings will be set forth.

1. HISTORY AND BACKGROUND OF THE TURKISH BANKING SYSTEM

The financial services sector in Turkey composed of banks, insurance companies and non-bank financial institutions such as factoring companies, leasing companies, consumer financing companies, pension companies, intermediary institutions, investment funds, investment partnerships and real estate investment partnerships. Out of all of these the banking system has a major share in this sector.

When we look at the history of Turkish Banking System (This part is taken from; the related section of the book prepared by *The Banks Association of Turkey*, March 2009, s: 1-22 and October 2009) we see that "the first bank was founded in 1847, during the time of Ottoman Empire, under the name of, *Istanbul Bankası* and operated till 1852. But considering the very short life and restricted area of operations, the real beginning of banking business in Ottoman Empire was universally marked by the foundation of *Osmanlı Bankası* in 1856 to which French interests became a partner to, in 1863 and Austrian interests in 1875. The most distinguishing mark between *Osmanlı Bankası* and other foreign banks operating in Ottoman Empire was the privilege granted to *Osmanlı Bankası* to print and issue banknotes.

Following the foundation of Turkish Republic in 1923, the new government realized the importance of developing a national banking industry to accelerate the country's development. At İzmir Economy Congress, held in 1923, with the participation of the government as well as leaders of agriculture, commerce and industry sectors, merchant participants suggested the foundation of a main commercial bank. So, in line with these suggestions, in 1924, *Türkiye İş Bankası* was founded as a private sector bank. Also in line with the suggestions submitted by industrialists, the first development bank of Turkey, *Türkiye Sanayi ve Maadin Bankası* was founded in 1925. However, since the Bank failed to provide its main function, in 1932 its name was changed to *Türkiye Sanayi ve Kredi Bankası* and its ownership was transferred to *Sümerbank* in 1933.

During 1923 – 1932 periods, many single branch banks were founded in Turkey with domestic or foreign capital in order to meet the loan demands of local merchants. One of the major steps taken during this period was the foundation of *Central Bank of Turkey* in 1930. According to the Law No. 1715 for its corporation, the Central Bank is an emission bank, assigned with minting money, protecting the value of currency, adjusting the general liquidity of the economy and lending to banks. This Law remained in effect until 1971 with many amendments during this time all intended to make it possible that the Bank extends more loans to the Treasury and state economic enterprises.

In 1930s Turkey, the country was still characterized predominantly with agricultural production. The strategy of industrialization through encouraging the private sector as adopted in 1920s failed to produce any substantial conclusion due to the lack of capital accumulation in the country. This led to the discussion of opinions asserting that the government should play a more active role in realization of the industrial investments required for the economic Great Depression, and the significant falls in the revenues of the farmers caused by the price, made it possible decreases globally pressed the search for finding new methods for industrialization. Consequently these economic conditions led to the closure of a great majority of single-branch local banks in the beginning of 1930s.

As a result of domestic and external pressures in early 1930s, the Government had to quit the strategy of industrialization based on encouraging private sector as pursued in 1920s, and had to adopt the industrialization strategy based on industrial investment through state economic enterprises. At the base of this industrialization strategy called as "economic statism (policy of state control)" lied the belief that, due to the conditions prevailing in Turkey at the time, the state was better equipped than the private sector for the realization of investments requiring huge capital formation and accumulation and sophisticated technical information.

Economic Statism strategy had significant implications for the banking system too. In 1930 *Türk Ticaret Bankası*, which would in later periods become one of the most significant private banks of Turkey was founded. In 1933 to provide funds to the foundation of industrial companies *Sümerbank* and to provide loans and technical assistance as may be needed by the municipalities *Belediyeler Bankası (Bank of Municipalities)* was founded.

In 1935 to found, manage and finance the state economic enterprises to manage the mine fields and energy resources *Etibank* and in 1937 to establish maritime transportation enterprises and provide financing needs for such enterprises *Denizbank (Turkish Maritime Bank)* was founded. In 1938, to satisfy the loan needs of small tradesman and craftsman *Halk Bankası ve Halk Sandıkları (People's Bank)* was founded.

The fact that between1933-1944, it was the government that made the investments which were essential for industrialization and which could not be realized by the private sector due to their relatively small returns made it possible to finance these investments. The Banks Law 1936 introduced the obligation for banks to set aside reserves at a rate of 15 percent of their deposits and in the form of Government Debt Securities or other securities having the same interest rate (about 6-7 percent) and one of the intentions of this obligation was to secure low-cost financing for the government's investment.

Most prominent feature of the period of 1945- 1959 was the replacement of the economic statism with the policy of accelerating economic development by supporting private sector. Strengthening of the private sector and the shift in industrialization policy had its effects in banking sector too. Rapid increases in investments, modern enterprises, national income and population and growth of the cities, and industrial sector's starting to enjoy a higher share from the national income, an increase of production directly for the markets have boosted the need and demand for money and loans. Returns on investments to the banking sector increased with the private banking gaining significance swiftly. During this period in 1944 *Yapı ve Kredi Bankası*, in 1946 *Garanti Bankası*, in 1948 Akbank , in 1955 Pamukbank and in 1950 *Turkiye Sınai ve Kalkınma Bankası* (1950) have all been founded.

Deterioration in economic balances as a result of the policy of governments to use the resources of the Central Bank found its reflections in rising inflation, swelling foreign trade deficits and increasing external debts starting from 1953.

In 1958 under the Banks Law No.7129, The Banks Association of Turkey was founded with the purpose of “development banking profession, ensuring the solidarity between banks and prevention of unfair competition”.

Stagnation in economy starting from the late 1950s and failure to establish macro balances in spite of the Stability Program in 1958 led to the abandoning of the liberal economy policy pursued throughout 1950s and to the switch to mixed economy characterized by increased government intervention to the economy. During 1960-1980 banking industry has been significantly under the control and influence of the public sector. Interest rates to apply to deposits and loans, bank commission rates and loan limits have all been determined in line with the import substitution policy pursued; and the banks’ basic function has been defined as financing of the investments included to the development plans. No new banks- except for some specific cases- no new commercial banks were allowed to be founded during this period. Consequently limited banking sector resources were tried to be distributed via existing banks within a limited competition, the private banks were inclined towards branch-banking policy in order to increase the deposits which they collected with negative real interest rate. Existing banks were encouraged to open new branches and average fixed costs were tried to be pulled down through merging of the small banks. Many small banks that were founded in 1950s were closed down during 1960s. A total of 7 banks – 5 development banks and 2 commercial banks - were founded during this period.

One of the main highlights of this period from the banking viewpoint is that a great portion of privately held Turkish commercial banks have become holding-banks. Meaning the ownership of a significant majority of a bank by an industry or trade group with frequent examples worldwide, holding banking was encouraged by the state in that period with the motive of increasing private sector investments.

Stagnation that hit Turkish economy at the end of 1970s due to problems in balance of payments forced the country to adopt a new industrialization strategy which will make it possible for the industry to meet its foreign exchange needs too. Consequently in 1980, a development policy that targeted opening up the economy and producing for exports based on market economy was adopted in place of an industrialization strategy based on import substitution which solely produced for the domestic market.

Banks Law No.3182 has been put into effect in 1985; international supervision and international banking standards have been introduced to the banking system; uniform chart of accounts was put into practice; balance sheets were started to be subjected to external audit; deposits insurance fund was founded and a more realistic practice has been accepted regarding the provisions to be set aside for nonperforming loans. Interbank market was established. All persons and entities resident in Turkey were allowed to hold foreign currencies and open foreign exchange deposit accounts. The Central Bank of Turkey started open market operations in 1987. Foreign exchange market was established in 1988. Foreign exchange transactions and capital movements became free in 1989. Convertibility of Turkish Lira was announced in 1990. Nonresidents were allowed to invest in domestic securities and to open TL and foreign exchange deposit accounts in Turkey. In 1990, the Central Bank presented its monetary program and started implementation of this program in 1990 in order to increase predictability and reduce uncertainties in financial markets. Electronic fund transfers became functional in 1992.

Legal and institutional structure required for capital markets instruments has been established via Capital Markets Laws in 1982.Istanbul Stock Exchange started in trading in 1986.

These regulations intended for making free market mechanism functional in economy and for liberalization of financial markets had crucial effects on banking industry. Competition in the banking sector increased depending on allowing new domestic /foreign banks to enter to the banking industry and freeing of deposit/loan interest rates. Increased competition led to the rise of a banking activity which unlike conventional deposit banking offered varieties in terms of both resources and placements. In this period some of the banks' funds were used in capital markets operations, purchase of government debt securities and Treasury Bonds, and in foreign exchange transactions. Banks' customers were offered new products and services such as consumer loans, credit cards, foreign exchange deposit accounts, leasing, factoring, forfeiting, swap, forward, future, option, automatic teller machines, point of sale terminals; and productivity in the industry rose as a result of the use of computer systems and other technological novelties and significance placed on staff training.

Funds rose from abroad, as was made possible by the liberalization move in foreign exchange transactions and in capital movements, have become increasingly more important resource for banks in addition to the deposits.

Small and medium size banks doing wholesale banking with few branches rose in number while market shares of larger private banks declined as a result of free interest rate and flexible foreign exchange policies etc.

A "close monitoring agreement" was signed with IMF with effect from the second half of 1998. The Agreement provided that fundamental macro problems would be resolved and the regulations for supervision in financial sector would be increased and government bill on tax law would be passed from the Parliament.

Economic activity was shrunk in 1999 and Government bill providing amendments to Banking Law was passed from the Parliament in June. All of the amendments made to the Banking Law were aimed at convergence of Turkish Banking Sector with Basel

Committee's Recommendations, European Union Directives, and other international regulations.

One of the major amendments in Banking Law included the foundation of Banking Regulation and Supervision Authority (BRSA). It was established for taking and putting into practice the decisions regarding banks' start of operations, monitoring of their activities, supervision of their activities, deciding on the results of their audit and supervision and termination of the operation of a bank. Foundation of BRSA and Savings Deposits Insurance Fund (SDIF) was decided under Banks' Law No.4389 dated June 1999 and these two authorities officially started their operations in August 2000.

Problems underlying the fluctuations in November 2000 were further aggravated with the "program for transition to strong economy", which was put into practice in April 2001, was revised at the beginning of 2002 so as to cover the period 2002-2004. Program was targeted increasing the resilience of the economy against external shocks, dropping the inflation, reducing the public sector's debts, ensuring financial discipline, completion of financial reforms and reinforcement of banking industry. Substantial positive developments came about in both economy and banking system due to the determined application of fundamental principles of the program.
During 2002- 2007 period banking system has gone through a significant restructuring process. Private Banks strengthened their equity which they had lost significance after 2001 crisis. Banks failing to do this either merged with other banks or were transferred to SDIF.

State-owned banks were restructured, and collected under a joint management. Duty losses of state-owned banks were settled against government securities and financial structures of these banks were strengthened.

Financial restructuring program ("Istanbul Approach") was adopted and applied for some of the bad loans of banking sector.

Understanding the risk management in banks and understanding of the risk-based supervision of banks in public supervision and audit function has been made more autonomous. Laws and regulations regarding banks' activities were renovated in 2005 and converged to the internationally recognized principles and applications significantly.

Since November 2006, all of the banks in Turkish Banking Industry are using International Financial Reporting Standards.

Starting from the last quarter of 2008 in particular, the global issues have affected the banking sector in Turkey, although to a rather limited extent in comparison with many other countries.

The reasons behind the relatively limited negative effects on the banking system are a high capital adequacy ratio, a high asset quality, low currency and liquidity risks, and successful risk management. The measures taken by the Central Bank and BRSA against the increase in global financial risks helped the banking sector to maintain healthy functioning.

Due to global developments, the external borrowing possibilities for banks became more limited, the cost of external borrowing increased, and currency liquidity management become more important. Banks were rather conservative in lending due to increased risks and the slowdown in loan demand as well as rising demand for funds from the government.

As of July 2010, there are 45 banks are operating in Turkish Banking Industry; 32 of them are deposit banks and the remaining 13 are the development and investment banks." The detailed information related with the number of banks operating in the industry and their branches are shown in the following tables.

Table 1: The Banking Industry in Turkey

Turkish Banking Industry		**45**
Deposit Banks		**32**
State-owned Turkish Deposit Banks	3	
Privately-owned Turkish Deposit Banks	11	
Banks Under Dep. Ins. Fund	1	
Foreign Banks	17	
Development and Investment Banks		**13**

(http://www.tbb.org.tr/tr/Banka_ve_Sektor_Bilgileri/Banka_Listesi.aspx, July 15, 2010)

Table 2: Number of Branches based on Banking Groups as of June 2010

Banking Groups	**# of branches**
Turkish Banking Industry	**9.149**
Deposit Banks	9.105
State-owned Turkish Deposit Banks	2.623
Privately-owned Turkish Deposit Banks	4.442
Banks Under the Dep. Ins.Fund	1
Foreign Banks	2.039
Development and Investment Banks	44

(http://www.tbb.org.tr/eng/Banka_ve_Sektor_Bilgileri/Subeler.aspx, July15, 2010).

Also to give brief information about the size of the Turkish Banking Industry, total assets and owners' equity of banks operating in Turkish Banking Industry as of March 2010 is shown in the following tables.

Table 3: Total Assets based on Banking Groups as of March 2010

Banking Groups	Total Assets (in Thousand TL)
Turkish Banking Industry	823.655.091
Deposit Banks	795.777.014
State-owned Turkish Deposit Banks	258.922.840
Privately-owned Turkish Deposit Banks	424.462.419
Banks Under the Dep. Ins. Fund	809.716
Foreign Banks	111.582.039
Development and Investment Banks	27.878.077

(http://www.tbb.org.tr/tr/Banka_ve_Sektor_Bilgileri/Istatistiki_Raporlar.aspx , July 15, 2010.

Table 4: Total Owners' Equity based on Banking Groups as of March 2010

Banking Groups	Total Assets (in Thousand TL)
Turkish Banking Industry	823.655.091
Deposit Banks	795.777.014
State-owned Turkish Deposit Banks	258.922.840
Privately-owned Turkish Deposit Banks	424.462.419
Banks Under the Dep. Ins. Fund	809.716
Foreign Banks	111.582.039
Development and Investment Banks	27.878.077

(http://www.tbb.org.tr/tr/Banka_ve_Sektor_Bilgileri/Istatistiki_Raporlar.aspx , July 15, 2010.

2. INVESTMENTS IN FINANCIAL ASSETS

The economic/financial system can be characterized in many ways. One way is to organize it into two types of markets: the market for real assets and services and the market for financial assets.

In the broadest economic sense, a "market" can be defined as a meeting place, geographical location or area in which buyers who wish to exchange money for well defined goods or services and sellers who similarly have a desire to exchange well-defined goods or services for money, can negotiate that exchange. *(Madura, 2006, s: 757)* Based on this definition a "financial market" can be defined as a market in which financial assets (or securities) such as stocks and bonds are traded. What differentiates a financial market from other markets is that, no tangible good or service is exchanged for the monetary consideration. *(Levinson, 2003, s: 2-3)*

Paragraph 11 of IAS 32 defines a financial instrument as:

Any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial instruments include primary instruments such as cash, receivables, investments and payables, as well as derivative financial instruments. *(Alfredson, Leo, Picker, Pacter, Radford, Wise, 2009, S: 150)* So in the broadest sense financial instruments composed of financial assets, financial liabilities and equity instruments. Financial assets are defined from the perspective of the *holder* of the instrument, whereas financial liabilities and equity instruments are defined from the perspective of the *issuer* of the instrument. *(Alfredson ve diğerleri, 2009, s: 150)*

A financial asset can be defined as a claim on an economic unit such as a business or an individual. In other words a "financial asset" defined in IAS 32 as "*any asset that is*:

a. cash;

b. an equity instrument of another entity;

c. a contractual right:

  i. to receive cash or another financial asset from another entity; or

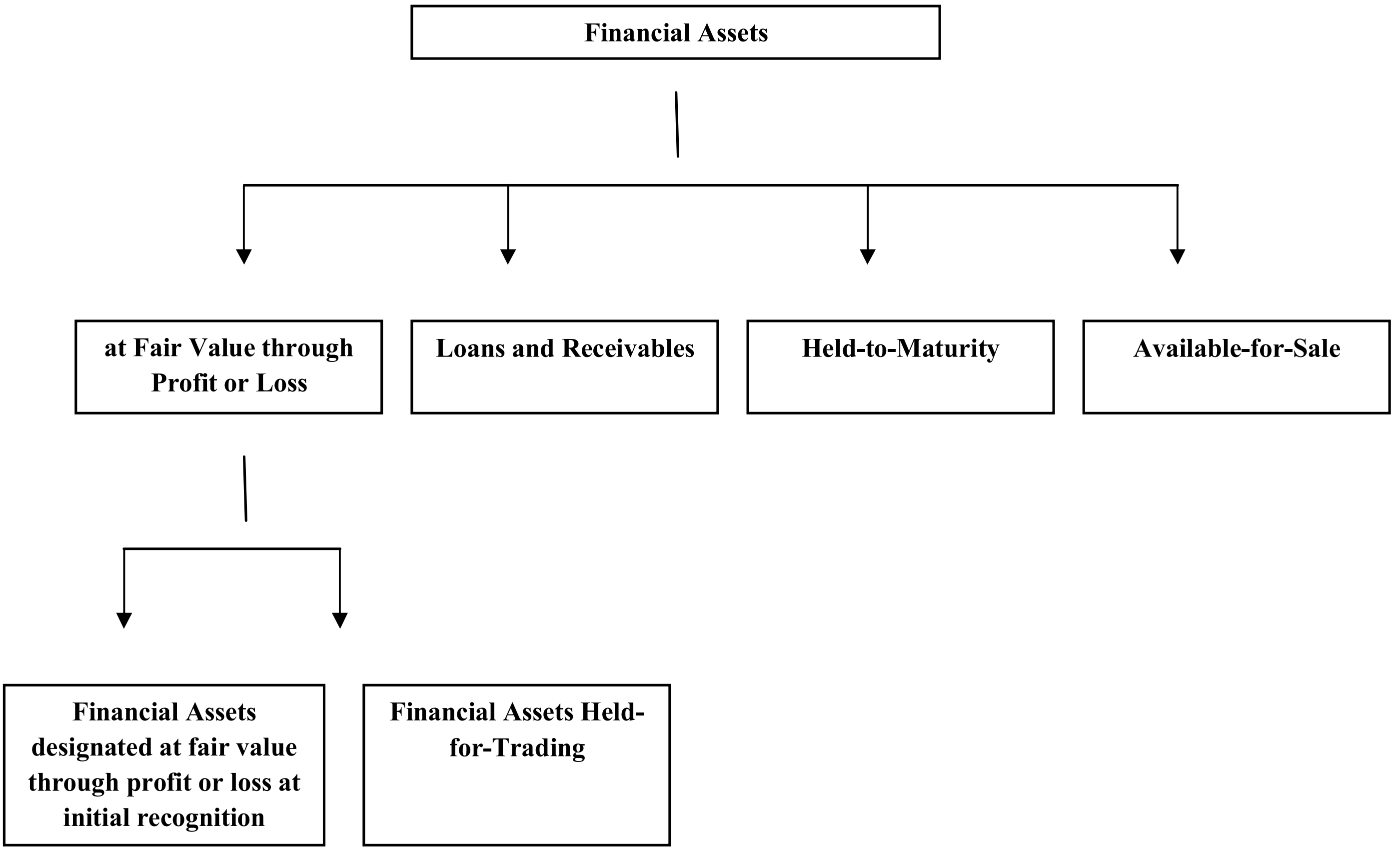
  ii. to exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity; or

d. a contract that will or may be settled in the entity's own equity instruments and is;

  i. a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or

  ii. *a derivative that will or may be settled other than by exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.*

IAS 39 classifies financial assets into four different categories and one category into two subcategories:



Definition and prescription of the associated measurement rules for each category as follows *(Melville, 2009, s: 182-183):*

a) Financial assets at fair value through profit or loss:
These are usually financial assets held for trading. This means that the assets have been acquired with the intention of re-selling them at a profit in the fairly near future. However on initial recognition, an entity may designate any financial asset as being "at fair value through profit or loss" if doing so would result in more relevant information.

After initial recognition, financial assets which fall into this category should be measured at fair value. Gains and losses arising from fluctuations in fair value are recognized in the calculation of profit or loss for the period in which they arise.

b) Held-to-maturity investments:
These are financial assets with fixed or determinable payments and fixed maturity dates that the entity intends to hold until maturity and has the ability to do so. After initial recognition, held-to-maturity investments should be measured at their amortized cost using the effective interest method.

c) Loans and receivables:
These are financial assets with fixed and determinable payments that are not quoted in an active market. After initial recognition, loans and receivables should usually be measured at their amortized cost using effective interest method.

d) Available-for-sale financial assets:
These are financial assets which do not fall into any of other three categories. After initial recognition, available-for-sale financial assets should generally be measured at their fair value. Gains and losses arising from fluctuations in fair value are recognized in "other comprehensive income".

3. OCTOBER AND NOVEMBER 2008 AMENDMENTS TO IAS 39

The international work on accounting for financial instruments began in 1988 following an OECD symposium on issue. The complexity of the whole issue had led to a decision by the IASC to split the project on financial instruments into two parts, first, presentation and disclosure and, second, recognition and measurement. In 1998 IAS 39- Financial Instruments: Recognition and Measurement was issued and since then the standard has been revised and amended for several times. The real stumbling block in the entire debate on financial instruments has been around the issue of whether financial assets and liabilities involved should be valued at fair value or not. *(Alexander, Briton, Jorrisen, 2009, s: 386)*

During recent past years, it was commonly agreed that measurement at fair value improved the transparency of financial institutions and supported investors in the understanding of their risk profile. During these years, the increase in income volatility caused by the fair value accounting of financial assets was welcomed, since it was reflected in higher profits. After several years of economic growth, fair value accounting, and higher profits the IASB took further action in March 2008 by issuing a discussion paper on reducing complexity in reporting financial instruments. According to this discussion paper, it was mentioned that the long term solution to valuation problems of financial assets can only be solved by using only one valuation method for all of them and fair value seemed to be the most proper value to be used. *(Fiechter, 2009, s: 4-5)*

However, most of the critics criticized fair value accounting for being the major reason for the financial crisis. Banks and other financial institutions blamed fair value accounting as the principal reason for the devastating impact of the global financial crisis on their activities. In response to these reactions the IASB amended IAS 39 and IFRS 7 on October 13, 2008 to allow reclassifications of financial assets at certain circumstances. A further amendment to the standard issued in November 2008, clarified the effective date and transition requirements of the October amendment. *(Fiechter, 2009, s: 4-5)*

The amendment issued to IAS 39- Financial Instruments: Recognition and Measurement as of October 13, 2008 enables entities to reclassify their financial assets other than derivative instruments. The amendment permits an entity to reclassify non-derivative financial assets (other than those designated at fair value through profit and loss by the entity upon initial recognition) out of the fair value through profit and loss category in particular circumstances. The amendment also permits an entity to transfer from the available for sale category to the loans and receivables category a financial asset that would have met the definition of loans and receivables (if the financial asset had not been designated as available for sale), if the entity has the intention and ability to hold that financial asset for the foreseeable future. *(IASB, 2010, a, s:4)*

In IASB's October 13, 2008 press release, the deterioration of the world's financial markets that has occurred during the third quarter of 2008 is mentioned to be a possible example of rare circumstances citied in the related IFRSs' amendments. *(IASB, 2010, b)*

Table 5: Summary of the impact that the most recent amendments to IAS 39 may have on an entity's ability to reclassify non-derivative financial assets subsequent to initial recognition. *(KPMG, 2008)*

Category	Measurement	Type of security	Subsequent reclassification	
			IAS 39 (prior to amendments)	IAS 39 (with most recent amendments)
Fair value through profit or loss - designated	Fair value through profit or loss	Debt	✘ Not permitted • no financial instrument can be reclassified in or out of this category	✘ No change to existing requirements
		Equity		
		Loans and receivables		
Fair value through profit or loss - held for trading	Fair value through profit or loss	Debt	✘ Not permitted • no financial instrument can be reclassified in or out of this category	✓ Can reclassify in 'rare circumstances' to: • held-to-maturity-subject to held-to-maturity conditions, including tainting rules; or • available-for-sale
		Equity		✓ Can reclassify in 'rare circumstances' to: • available-for-sale
		Loans and receivables		✓ Can reclassify to loans and receivables if: • the financial asset would have otherwise met the definition of loans and receivables at inception; and • there is an intention and ability to hold the financial

				asset for the foreseeable future or until maturity.
Held-to-maturity	Amortized cost	Debt (with fixed maturity)	✓ Reclassify to available-for-sale if: • there is a change in intention and ability; or • the portfolio is tainted.	✘ No change to existing requirements

Table 5: (Cont.) Summary of the impact that the most recent amendments to IAS 39 may have on an entity's ability to reclassify non-derivative financial assets subsequent to initial recognition.

Category	Measurement	Type of security	Subsequent reclassification	
			IAS 39 (prior to amendments)	**IAS 39 (with most recent amendments)**
Available-for-sale	Fair value through equity	Debt	✓ Reclassify to held-to-maturity if: • there is a change in intention and ability; or • tainting period has lapsed	✘ No change to existing requirements

		Loans and receivables	✘ Not permitted	✓ Reclassify to loans and receivables if: • the financial asset would have otherwise met the definition of loans and receivables at inception; and • there is an intention and ability to hold the financial asset for the foreseeable future or until maturity.
		Equity	✘ Not permitted	✘ No change to existing requirements
Loans and receivables	Amortized cost	Loans and receivables	✘ Not permitted	✘ No change to existing requirements

4. A STUDY ON FINANCIAL ASSETS OF TURKISH BANKING INDUSTRY

The objective of this paper is to find out whether and to what extent banks operating in Turkish Banking Industry applied the amendments to IAS 39 regarding reclassification of non-derivative financial instruments in their 2008 annual financial statements. The question why banks reclassified their financial assets and the impact of the reclassification on financial statements are not within the scope of this paper.

In order to explore whether banks operating in Turkish Banking Industry used the opportunity to reclassify their financial assets under the amendment made by International Financial Reporting Standards Board on October 13, 2008 to IAS 39; an exploratory study was developed and conducted by analyzing financial statements of 41 banks out of 45 operating in Turkish Banking Industry from the year of 2006 to 2009. We excluded one bank transferred to Department of Insurance Fund since it does not have any balances of the figures that we are studying. We excluded two of the Development and Investment Banks and one of the Foreign Banks since they started operating in Turkish Banking Industry in 2008 and 2009 respectively. We classified banks as Turkish Deposit Banks, Foreign Deposit Banks and Development and Investment Banks. The number of banks in terms of banking groups within the Turkish Banking Industry is shown below:

Table 6: Banking Groups Used in the Study

Banking Groups Used in the Study	#
Turkish Deposit Banks	**14**
Foreign Deposit Banks	**16**
Development and Investment Banks	**11**
Total	**41**

For the purpose of the study, first financial statements of 41 banks from the year of 2006 to 2009 are examined to determine the level of change in the share of financial assets held-for-trading, in total assets and owners' equity. We started examining the financial statements from the year of 2006 since application of IFRS became mandatory for banks not before the year of 2006.

As a result of this examination we found out that, the share of financial assets held-for-trading in total assets was 8.2% in 2006 and 10.9 % in 2007. However in 2008 and 2009 it decreased to 8.5% and 7.6% respectively. On the other hand, the share of financial assets held-for-trading in owners' equity was 53.12% in 2006 and 79.4% in 2007. It dramatically decreased in 2008 to 28.5% but in 2009 unlike the share in total assets, it increased to 33%. The graphical representation of these changes is as follows:

Figure 1: Financial Assets Held-for-Trading to Total Assets for Turkish Banking Industry

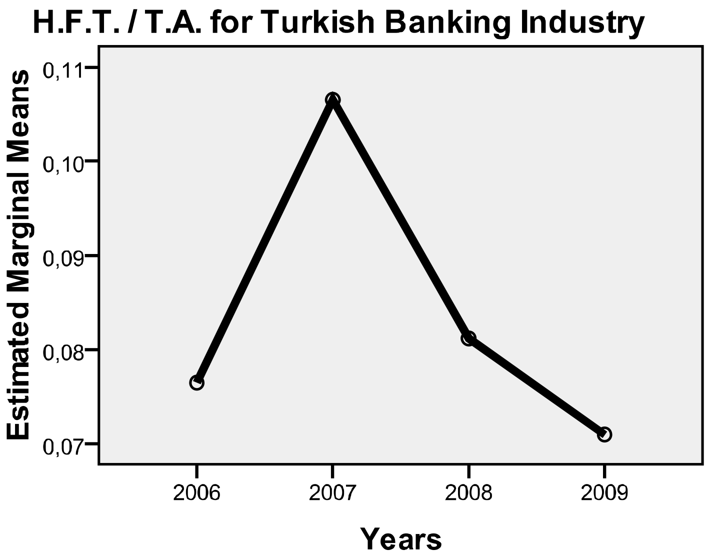
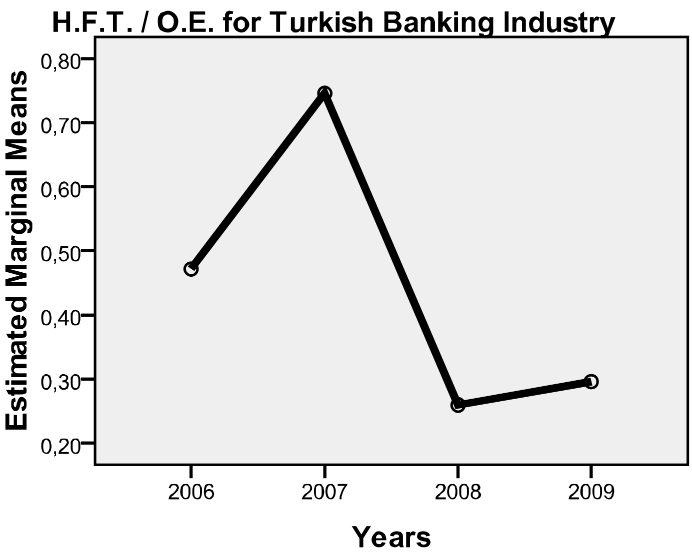


Figure 2: Financial Assets Held-for-Trading to Owners' Equity for Turkish Banking Industry



We carried out our study one step further and examined the share of financial assets held-for trading in total assets and owners' equity in terms of banking groups. Results of this examination are represented in following tables:

Table 7: The Share of Financial Assets Held-for-Trading in Total Assets from 2006 to 2009

	2006	2007	2008	2009
Turkish Deposit Banks	3%	1%	6%	6%
Foreign Deposit Banks	15%	19%	13%	12%
Development and Investment Banks	5%	12%	6%	3%

The share of financial assets held-for-trading in total assets for Foreign Deposit Banks and Development and Investment Banks changed similarly with Turkish Banking Industry whereas for Turkish Deposit Banks it changed just in the opposite direction.

Figure 3: Financial Assets Held for Trading to Total Assets based on Banking Groups

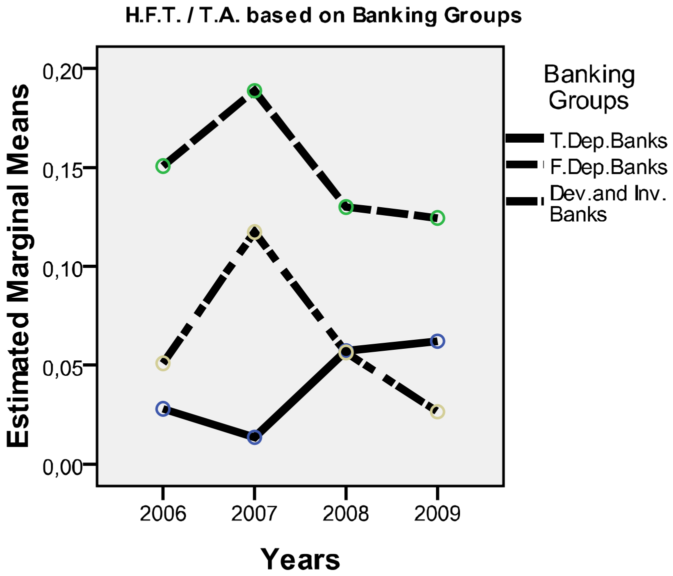
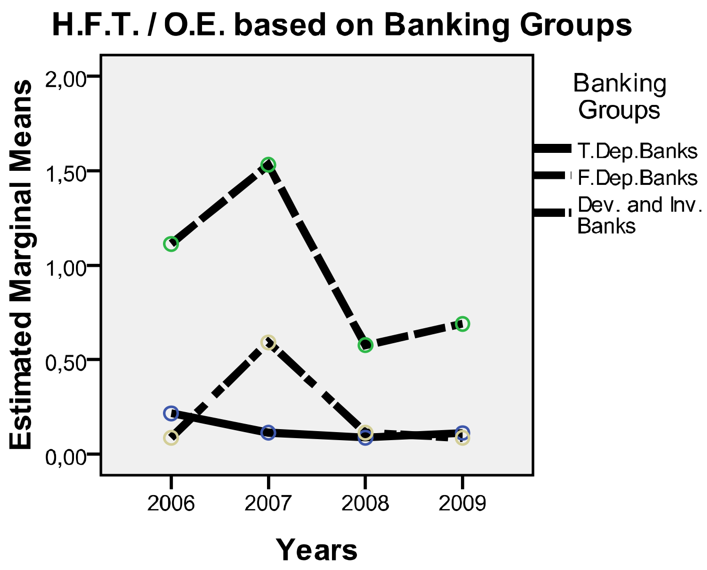


Table 8: The Share of Financial Assets Held-for-Trading in Owners' Equity from 2006 to 2009

	2006	2007	2008	2009
Turkish Deposit Banks	22%	11%	9%	11%
Foreign Deposit Banks	111%	153%	58%	69%
Development and Investment Banks	9%	59%	11%	9%

The share of financial assets held-for-trading in owners' equity increased dramatically in 2007 when compared to 2006 for Foreign Deposit Banks and Development and Investment Banks and it decreased sharply for Turkish Deposit Banks. The level of change in Development and Investment Banks is significantly different from the other banking groups.

Figure 4: Held for Trading Securities to Owners' Equity based on Banking Groups



As it was mentioned before the aim of our study is to find out whether and to what extent banks operating in Turkish Banking Industry applied the amendments to IAS 39 regarding reclassification of non-derivative financial instruments in their 2008 annual financial statements. Up to this point we determined that, in 2008, the share of financial assets held-for-trading in total assets and owners' equity decreased in 34 banks (83%) out of 41. Since the reason of this change will lead us to determine whether this change happened because of the reclassification or not and to what extent banks reclassified their non-derivative financial instruments, we went through related disclosures of banks' financial statements for the year of 2008. Before explaining what we found we have to mention that we could not reach the related disclosures of 5 of the 34 banks.

Table 9: The Extent of Reclassification of Financial Assets in Turkish Banking Industry with respect to Banking Groups.

Banking Groups	HFT to HTM	HFT to AFS
Turkish Deposit Banks	6	1
Foreign Deposit Banks	1	-
Development and Investment Banks	1	-
Total	8	1

When we examined the disclosures of 29 banks, we found that 8 of 29 banks reclassified their financial assets held-for-trading. All of the 8 banks reclassified their financial assets held-for-trading to held-to-maturity, only one of them also reclassified to available-for-sale.

CONCLUSION

Before the recent financial crisis, despite all arguments, for relevant and transparent financial reporting, it was commonly agreed that financial assets should be measured at their fair values. However, when the financial crisis emerged fair value accounting is blamed to be intensively the source of crisis. Consequently in the light of the difficult economic climate, regulatory bodies took an action for suspending fair value accounting and these attempts resulted in various changes in the regulation of the world's financial and economic system. One of these changes came from IASB by issuing an amendment to IAS 39 - Financial Instruments: Recognition and Measurement as of October 13, 2008, and an amendment to IFRS 7 - Financial Instruments: Disclosures as of November 2008 to ensure the transparency and confidence are restored to financial markets.

The amendment issued to IAS 39 - Financial Instruments: Recognition and Measurement as of October 13, 2008 enables entities to reclassify their financial assets other than derivative instruments from held-for-trading to available-for-sale or held-to-maturity *in rare circumstances* or to loans and receivables.

The aim of this study was to explore whether and to what extent banks operating in Turkish Banking Industry used the opportunity to reclassify their financial assets under the amendment made to IAS 39 by International Financial Reporting Standards Board on October 13, 2008. As a result of this study, we found that 8 banks operating in Turkish Banking Industry reclassified their financial assets from held-for-trading to held-to-maturity, only one of them also reclassified to available-for-sale. This result highlights that banks operating in Turkish Banking Industry did not extensively use the opportunities provided by the amendment to IAS 39. The question why those banks reclassified their financial assets and the others did not and the impact of this reclassification on financial statements will be considered for future research.

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