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INSIDE THE ISSUE

Third Party Loan Reviews

By Dr. K. Alan Deines

I commonly hear the same question from bankers contemplating a third-party loan review - what should the reviewer review? The answer is found in the FDIC's examination manual; the language is similar with the other regulatory authorities as well.

The regulatory review can be boiled down to three areas:

1. **Compliance with internal policies and procedures and applicable laws and regulations should be part of the review. The issues to review are:**
   - Sufficiency of credit and collateral documentation
   - Proper lien perfection
   - Proper loan approval
   - Adherence to loan covenants

   The review should include an analysis of the loan policy to determine if each of the areas are addressed. Management should have reports that detail compliance with each of the sections – a technical exception report, for example. The review should evaluate the accuracy of the report. If the report is large and the items stale, management is not in compliance with the board's policy.

2. **The accuracy and timeliness of credit grades assigned by loan officers -**
   The reviewer should first compare the bank's watch and problem loan list with the previous regulatory exam. Are there loans classified by the regulators that management has not included on the bank's list? The second item the review should note is how much time passes before negative information is received and the internal classification. How well does this adhere to the bank's procedure defined by its loan

policy? Finally, what does the review of the bank's credit indicate? Does the classification appear to be accurate?

3. **Credit quality –**
   The selection of loans to be reviewed should be risk based. A review of the current UBPR of the bank should indicate levels of problem assets. Economic conditions may point to certain categories of loans.
   - Size of the sample. Typically, 20% of customers will account of 80% of the bank's balances. A review of one customer regardless of size does not tell much.
   - Growth. Are certain categories or geographic areas seeing large growth?
   - Concentrations. Concentrations exceeding 300% of capital and reserves should receive special attention.
   - Loan officers. Are all the officers represented in the pool of loans chosen for review?
   - Selection. Is the pool of loans designed to elicit "new information?"

There is value in obtaining a third-party review. First the review may avoid an unpleasant surprise at exam time. Second, the review may very well validate your lending program, giving your board some comfort. Finally, the review helps mitigate regulatory risk. The review is a small price to pay for avoiding the risks of "flying blind."

Equity Investments – How to Account?

By Cindy Buttress

While Accounting Standards Update (ASU) 2016-01 has been in effect for some time, there continues to be uncertainty how to account for equity investments.

Here is a refresher of what ASU 2016-01 requires:

1. Adoption was effective for fiscal years beginning after December 15, 2018, thus, no later than the December 31, 2019 call report.
2. Federal Reserve Bank (FRB) and Federal Home Loan Bank (FHLB) stock are specifically excluded from the ASU.
3. Equity investment **with** a readily determinable fair value include those that meet one of the following conditions:
   a) Sales prices or bid-asked quotations are currently available on the U.S. Securities and Exchange Commission (SEC) or in the over-the-counter market and publicly reported by the National Association of Securities Dealers Automated Quotations (NASAQ) or by OTC Markets Group Inc.
   b) If the equity security is traded only in a foreign market, the foreign market must be of breadth and scope comparable to one of the U.S. markets indicate in a) above.

Dr. K. Alan Dienes
Director, RBI

Dr. Alan Deines is the Director of the Robbins Banking Institute (RBI) and Instructor of Finance at Fort Hays State University. Dr. Deines has over 37 years of experience in the banking industry. He is a great resource for our team and our clients.

ASU 2016-01 eliminated the different treatment of equity investments (e.g. trading, available-for-sale, and held to maturity securities). It is critical you understand this accounting standard for financial reporting purposes, including call reporting. Regulators are reviewing the treatment closely in their examinations.

c) If the investment is a mutual fund or similar structure, the fair value per share (unit) is determined and published and is the basis for current transactions.

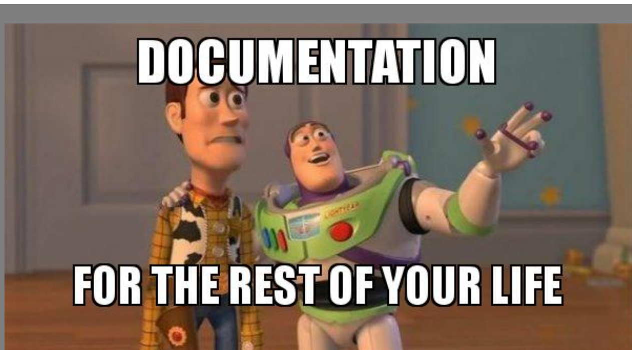
4. Equity investments **without** a readily determinable fair value are to be measured at:
    a) Fair value, if meeting the practical expedient per ASC 820-10-15-4 (e.g., investment is in an investment company or an investment in a real estate fund, under accounting guidance in ASC 946), or
    b) Cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer.

What are observable price changes in orderly transactions? According to accounting standards, banks should make a reasonable effort (one that does not require undue cost or effort) to obtain information regarding price changes in the equity investment during the measurement period (time since the price was obtained last) which are known, or can reasonably be known. Orderly transactions are usual and customary transactions and not forced, due to liquidation or a distressed sale. How does a Bank get the price changes in orderly transactions? This will require a bit of effort, but not much. Obtaining the most recent audited financial statements of the issuer is not sufficient. We recommend you contact the CFO of the equity investment issuer to obtain the observable price and further inquire whether that price is supported with orderly transactions during the specific measurement period. Consider also looking at the shareholder/stock agreement – is the value for buy-back purposes outlined? Is there restriction that need to be taken into consideration? If there are no observable prices during that period, then no adjustment should be reported (however the Bank does need to assess for impairment, adjusting as necessary).

5. All adjustments recorded to equity investments are recorded as Unrealized Gain/Loss on Equity Investments on the Income Statement. We suggest you record this to an account separate from the realized gains/losses on investment securities as these unrealized gains/losses are not taxable events until the investments are sold.

We know for certain, as mentioned above, FRB and FHLB stock investments are exempt from this accounting standard. Management needs to perform their own due diligence to determine whether other equity investments meet the criteria for accounting in accordance with ASU 2016-01. Management should ensure their records support their method of accounting and consider incorporating in Bank policies the means by which they will account for equity investments.

This accounting standard continues to be treated by banks differently – the key is how you have documented your position for accounting for these investments. If you don't have that methodology documented, your treatment will be questioned.



It truly is all about the documentation – if you don't have your accounting policy in place for equity investments, do it sooner than later!

Navigating you and your business through change with the most current information available.

If you have uncertainty on how to account for equity investments, contact Cindy or our team of professionals.

We are here to help!

Cindy Buttress
Senior Manager, CPA

Have you Updated your Pandemic Plan?

By Keri Nelson

Banks have been required to have a Pandemic Plan for many years and there have been some virus outbreaks that have occurred including SARs (Severe Acute Respiratory Syndrome), the Avian Flu, and H1N1. However, there has been no modern pandemic that has put a Bank's Pandemic Plan to the test as COVID-19. As such, it is time to reflect on events that have occurred over the last year and update your Pandemic Plan accordingly. COVID-19 introduced numerous challenges. Some of which Banks had expected and some resulted in having to implement new processes and procedures in order to continue serving customers. Below are some of the issues that come to mind:

- Extended school closings
- Extended business shutdowns
- Extended bank lobby closings
- Extensive travel restrictions
- Extensive work from home for critical and non-critical staff
- Supply chain delays
- Issuance of a stimulus package via PPP (Paycheck Protection Program) loans
- Issuance of consumer stimulus checks
- Significant increase in unemployment
- Significant economic down-turn

For each item listed, consider the impact it had on your Bank and how was it specifically addressed. The actions you took should be documented in your Pandemic Plan. I have heard many stories from our clients on the innovative ways they managed these challenges, but most have not had the time to update their documentation. Having detailed documentation will alleviate stress and uncertainty for future personnel. Examiners are also beginning to review whether Banks have updated their Pandemic Plans to reflect lessons learned during the COVID-19 crisis. If you have not adjusted your plan, now is the time.

Keri Nelson
IT Specialist, CISM, CBCP

If you need assistance creating or refining your businesses Pandemic Plan, contact Keri or our team of professionals.

We are here to help!

There's a New Face at Varney

We have added a new face to the banking team and are excited to introduce him to you! **Cory Lindsley** joined Varney in June 2020; yes, during the pandemic. Virtual interviewing can and did work!

Cory, while new to public accounting, is not new to the banking industry. Cory worked for almost 8 years with the Kansas Office of State Banking Commissioner as a financial examiner, conducting examinations on non-depository institutions including mortgage lenders and brokers, loan servicers, finance, payday and title loan companies and credit service organizations. In that role, he became an expert in the various loan regulatory requirements. Most recently, Cory worked for 3 years as Compliance Officer at a $1B publicly traded OCC bank in the Midwest, which included serving also as their Information Security Officer, Bank Security Officer, SAFE Act Officer and Fraud Manager.

Cory Lindsley
Senior Accountant

Get to know Cory further! You can contact him at clindsley@varney.com or 1-800-240-5004.

Now that you have a little background, let's really get to know Cory!

Before joining Varney, what was the most unusual or interesting job you've ever had?
Detasseling corn in the summers in Nebraska.

What is your biggest achievement, personally or professionally?
Graduating college and becoming a father. (Cory has his 3rd child coming in January 2021 with his wife Jessica who also works at Varney!)

What quality/characteristic is your strongest and hope others emulate?
Integrity and not being afraid to ask question when you don't know.

If you could do it all over again, what would you do?
Go into Financial Planning, so that I can help others plan and prepare for the future.

Your dream vacation spot is…..
Somewhere in the mountains; I enjoy the outdoors but am not a big fan of the beach.

What is your guilty pleasure?
Caffeine, specifically Pop (Diet Mt Dew)

What is your motto or personal mantra?
"If you aim at nothing, you will hit it every time." – Zig Ziglar quote. This is in regard to setting goals.

We know you will enjoy working with Cory as much as we do. Cory has worked not just as a bank examiner but also as a banker, so can see both sides of the picture and can definitely relate to compliance needs of banking.

Fixed Asset Capitalization 101

By: Michelle Crow and Laura Wenzke

Does your bank have a capitalization policy? If you do, do you know what the capitalization threshold is and if it is being followed? Under IRS regulations, banks can set their capitalization threshold as high as $5,000 on a per item basis. If $5,000 is too high for your bank, you can set it at a lower amount. Whatever threshold is set in the policy, it is important that the policy is followed. If the amount set in the policy is no longer appropriate for your bank, consider revising the policy. Don't forget to have the Board of Directors approve the policy if it is modified. Whatever that limit is, what is set for tax purposes is also the same limit that must be followed for GAAP/financial statement purposes; however, the depreciation methods will differ.

As we are approaching the end of the year, now is a good time to review the activity in your fixed asset accounts to determine if the items posted to the fixed asset accounts to be capitalized are following the policy. If an item is below the policy threshold, it should be expensed.

We can update depreciation schedules prior to December 31st. Please contact Michelle Crow or Laura Wenzke if you would like your depreciation schedule updated prior to tax preparation.

VARNEY & ASSOCIATES, CPAs, LLC

"Leading the way to your success."

We are here to help with your tax issues – feel free to reach out to any one of our tax team members.

Michelle Crow
CEO/Owner, CPA

Laura Wenzke
Senior Manager, CPA