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INSIDE THE ISSUE

Compliance Management Systems

Is yours complete?

By Stephen Heimsoth, Manager

I once heard someone say, "Compliance is like a seat belt of a vehicle. You never buy a vehicle specifically because of the seat belt that is in it, but, if properly installed, the seat belt could save your life." While Compliance may not be what you would prefer to think about while providing banking services to your customers, it is an essential part of every aspect of the banking products and services provided, and it might be the very thing that saves you from a number of banking "wrecks."

Having a completed Compliance Management System (CMS) may not be at the top of every bank's priority list. Often, bank management may think their CMS is adequate when in reality it is not. Other times, the idea of spending money to implement compliance is difficult to fathom. However, it is important to not get bogged down by constantly thinking about just the cost to implement compliance but to consider the real savings potential from implementing a sound CMS and ensuring that management and all employees are familiar with it.

What does a sound CMS entail? Depending on where you look, different organizations have slightly different lists, but all of them ultimately include:

1. Board and management oversight
2. Compliance program, which includes
   a) Policies and procedures
   b) Training
   c) Monitoring
   d) Consumer complaints response
3. Compliance audit

The Board of Directors and management have the ultimate responsibility for ensuring the bank is in compliance. They should be involved in the development and administering of the CMS, and, if necessary, receive training about the risks and responsibilities of compliance in order to better fulfill this task. It is also very important that the Board of Directors and management set the tone about how important compliance is to the bank. The chance of non-compliance, and thus penalties, increases if employees see that compliance is not that important to their managers and the Board of Directors. The importance of compliance and implementing a sound CMS should be clearly communicated to all employees, and the necessary amount of resources should be allocated in order to properly run the CMS.

The compliance program is comprised of four parts.

1) Policies and Procedures should provide employees with all the information they need to perform a transaction. This may include applicable regulation citations, definitions and sample forms. Banks should not just copy and paste wording from regulation; they should be sure to make the procedures specific to the individual bank and worded in a way employees can understand and follow. Checklists and other tools may also be obtained or created to assist in employees tasks. Ultimately, effective compliance policies and procedures provide a means to ensure consistent execution of a transaction throughout the organization, as well as provide a standard for the conduction of internal reviews.

2) Training is essential for the Board of Directors, management and all employees. Employees should receive compliance training over laws, regulations, and internal policies and procedures that are specific to their job. The Board of Directors and management should receive an overview training of key elements and risks of laws and regulations, including new risks, regulatory requirements, and examiner trends and hot buttons. The Board and management should receive sufficient training to understand their ultimate responsibility of ensuring compliance. It is useful to maintain a training schedule and to ensure that everyone follows it. Who conducts the training and how often it is done will depend upon the topic and risk of the subject matter. Again, the tone the Board of Directors and management sets is critical. The Board of Directors and management should be notified and take appropriate action if any employee is persistently delinquent or fails to complete training.

3) Monitoring is a proactive approach to identify weaknesses early on and avoid regulatory violations. Monitoring should be done on a risk based approach, focusing time and energy on higher risk and new areas, but also ensuring low risk areas or periodically reviewed. A schedule of areas to monitor should be created based on the risk assessment and testing/monitoring should be done regularly. Regulator and CFPB exam manuals may be used to assist in the testing of compliance. Any issues noted in monitoring should be reported to management and the Board with steps on what is being done to correct the issue.

4) Complaint Management is a critical component and banks should be prepared on how to respond. Complaints may be a sign of compliance weakness and should be addressed early, with any shortcomings on the bank's part addressed in a timely manner. Procedures should be established and documented, and training provided, to assist the proper staff on how to address complaints. If addressed properly, customers that initially had a complaint may become an advocate for the bank. Complaints should be monitored for any trends of compliance weakness.

The overall goal of the compliance program is to manage compliance risk proactively, not just reactively.

A compliance audit is an independent review of the bank's compliance with laws and regulations and to internal policies and procedures. The compliance audit should not replace the internal monitoring that is part of the compliance program, but should complement it. Compliance audits can be done internally, as long as it is completed by personnel independent of the function being reviewed, or by an independent third-party. Any audit findings should be reported to the Board of Directors. A plan of action to address any deficiencies should be created promptly by the Board and management and the compliance officer given that plan to make any required changes. The status of corrective actions should be monitored by management to ensure all deficiencies are addressed.

Remember, weaknesses in a bank's CMS can result in violations of Federal consumer financial laws and regulations which may cause harm to consumers and result in hefty monetary penalties for the Bank. Responsibility for compliance is not just the responsibility of the compliance officer, but is every employee's responsibility to follow compliance every day, with ultimate responsibility for ensuring the bank is in compliance resting on the Board of Directors and management setting the tone in the bank towards compliance and developing and administering a proper CMS.

When developing a compliance program, banks should consider:

- **The bank's size, number of branches, and appetite for risk,**
- **Types of services and products offered,**
- **Business strategy – what is the bank's one year, 3 year, and 5 year plan for products and services,**
- **Third-party relationships and**
- **Location of main office and branches.**

Stephen Heimsoth, CPA
Manager

Varney has developed an easy to use risk assessment for assisting banks in determining the risk and monitoring, and/or the audit schedule for regulatory requirements. Contact Stephen at sheimsoth@varney.com or 1-800-240-5004 to get more information.

More News on ASU 2016-01 Financial Instruments

By Amanda McKeeman, Senior Accountant

In our last issue of Varney CAREs, we discussed ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. Adoption of this standard will have an immediate effect on your bank's Call Report. For public business entities institutions, the standard is effective for fiscal years beginning after December 15, 2017 (March 2018 Call Report). For non-public business entity institutions, the standard is effective for fiscal years beginning after December 15, 2018, and interim reporting periods within fiscal years beginning after December 15, 2019. Early adoption is allowed.

As most of you have already noticed, revisions to the Call Report form were visible as of March 31, 2018. Revisions affected a majority of the common reporting schedules including Schedule RI: Income Statement; Schedule RC: Balance Sheet; Schedule RC-B: Securities; Schedule RC-F: Other Assets; Schedule RC-K: Quarterly Averages; Schedule RC-M: Memoranda; Schedules RC-R Part I and II: Regulatory Capital Components and Ratios and Risk-Weighted Assets. Be careful to read each of the lines on these schedules to make sure you are responding correctly, based on your adoptions status of this ASU.

As a reminder on the accounting treatment, when adopting this ASU, while the ASU states adjustments resulting from the amendments outlined in the ASU are to be recorded as a cumulative-effect adjustment to the balance sheet (e.g. recorded through retained earnings) as of the beginning of the fiscal year of adoption, the ASU further clarifies that adjustments relating to equity investments <u>without readily determinable fair values</u> are to be applied prospectively as of the date of adoption. Thus, when applying the standard to equity investments <u>without readily determinable fair values</u>, such as Bankers' Bank of Kansas stock holdings, the adjustment would be recorded to the income statement at the time of adoption. As a reminder, Federal Reserve Bank and Federal Home Loan Bank stock are specifically excluded from this ASU and should continue to be carried at cost.

While the adjustments are now reported on the income statement, these are not taxable until realized. At the time of adoption, a deferred tax asset or liability should be recorded, utilizing the applicable tax rate for the entity. Changes in the valuation will have an impact on the deferred taxes, and will only have an impact on current taxes when the investments are sold.

Amanda McKeeman
Senior Accountant

Amanda McKeeman specializes in financial institutions, regularly performing financial statement audits, directors' examinations, regulatory compliance reviews and other consulting projects. If you have questions regarding the Call Report preparation or instructions, you can reach Amanda at amckeeman@varney.com or 1-800-240-5004.

In Other News...

- Banks with assets of less than $1 billion as of June 30, 2017 can file the FFIEC 051 Call Report form, as opposed to the 041 form. The 051 form includes the addition of Supplemental Schedule SU, replacing Schedules RC-D, RC-P, RC-Q, RC-S, RC-V, and parts of RC-L, RC-M, and RC-N. The election to file the 051 form must be made when filing the **<u>March 31</u>** call report of any given year, requiring the Bank to continue to file using the 051 form for the remainder of that calendar year.
- October is National Cybersecurity Awareness Month. Bankers know all too well the importance of keeping their environment safe. A couple of reminders from the last Varney CAREs issue: training; firewall; securing and protecting all computers, servers and mobile devices; backup processes; controlling physical access to bank computers and networks, including WiFi; limiting employee access to data and installing software to bank computers, patching and last but not least, password security.

There's a New Face at Varney

"Leading the way to your success."

Last month, we shared all of the faces of the Varney banking team members. This month, we want to acquaint you with our newest Information Technology professional. Introducing, Keri Nelson, IT Specialist. Let's get to know a little bit about Keri!

Keri joined Varney in August after taking some time off over the summer to enjoy with her two kids. Prior to joining Varney, she worked over 24 years at financial institutions in Kansas City. Starting off as a CRA/Compliance Officer, she quickly moved over to the lending area as a Loan Documentations System Administrator. Her passion is IT and the majority of her career after lending was as an Information Security and IT Governance Officer or Manager of Internal Planning. She was responsible for managing teams overseeing customer privacy, IT security, vendor management, IT budgeting, business continuity/disaster recovery and IT audit and examinations. She has been on the client side of the table, and is now anxious to share her knowledge with Varney clients as your IT consultant.

We had a little Q&A with Keri and here is what she shared!

What do you like the most about your job? *I like having the opportunity to help Banks understand Information Technology risk, assess the security controls, and provide recommendations on how to enhance or improve their security program.*

What quality is your strongest and how others will emulate? *Integrity and compassion.*

What kind of impact do you believe you have on others, people/companies? *Provide a positive impact by listening and being objective.*

What banking or technology-related blogs, podcasts, tweets or websites do you follow? *bankinfosecurity.com, krebsonsecurity.com, aba.com and listening to Bank Info Security Podcast.*

Keri Nelson
IT Specialist

What is one or two of your pet peeves? *The smell of tuna when your co-workers decide to eat it at work. My kids not turning their socks inside out before throwing them in the dirty clothes to be washed.*

Before you die, you would like to…… *Travel to all 7 continents.*

How would you describe your day job to a child? *I read a lot of documentation and then provide recommendations on ways to improve their processes.*

What is your personal mantra or motto? *It may not be easy, but I know that I can do it.*

We know you will enjoy working with Keri as much as we do. Keri brings real world experience to her client relationships. You can reach Keri at knelson@varney.com or 1-800-240-5004.