

VARNEY CARES

COMMUNITY • ACCOUNTABILITY • RELATIONSHIPS • EXCELLENCE

Varney & Associates, CPAs, LLC | 120 N. Juliette Avenue, Manhattan, KS 66502

Vol. 2 Issue 4 | October 2019

INSIDE THE ISSUE

Marijuana-Related Businesses – To Bank or Not to Bank	1
Strategic Planning – Have you considered?	3
Regulatory Exams – Top Findings	4
Varney Tax Tip	5
Varney Kudos	6



Marijuana-Related Businesses – To Bank or Not to Bank?

By Amanda McKeeman, Senior Accountant

OK, Kansas bankers. Earlier this year, farming of industrial hemp became legal in the state of Kansas. If you haven't already, you will likely have potential or existing customers approach your bank to inquire about providing services to these up-an-coming businesses. Do you have a plan in place to respond to these requests? Is your BSA program prepared to handle the significant due diligence and monitoring that these businesses require? Is your staff properly trained to identify marijuana-related activity?

Let's put first things first – can your bank provide services to a customer dealing in marijuana-related business (MRBs)? Per FinCEN's FIN-2014-G001, the answer is yes, provided the business does not violate state law. It is critical that your bank understand the laws in Kansas and surrounding states, especially if you have branches outside of Kansas, or if you have customers that reside in surrounding states that have legalized marijuana in different capacities. Industrial hemp has been legalized in Kansas, Missouri, Nebraska, Colorado, Oklahoma, and

Illinois, among others. Medical and recreational marijuana have been legalized in several states throughout our region.

Before your bank can provide services to customers dealing in MRBs, the Board of Directors (BOD) must approve the risk of doing so. The BSA and OFAC Risk Assessments should be updated to address the additional risks these customers pose, including but not limited to: the customers' completion of the state licensing process; the risk of losing collateral to a loan should the crop have to be destroyed; if it exceeds the legal limit of THC; and the risk the customer will breach the boundaries with their purchases and sales of what is legal within the state.

Bank policy should be updated to address the decision to provide services to these customers. If the BODs chose to not take on these customers at this time, the policy should reflect this decision so there is clear guidance to management and staff if they are approached by a

potential MRB customer. If the BODs decide to bank MRBs, including industrial hemp, the policy and procedures should be enhanced to address the additional customer due diligence (CDD) these customers require. CDD for MRBs should include, per FinCEN guidance:

- Verifying with appropriate state authorities whether the business is duly licensed and registered,
- Reviewing the license application submitted by the business for obtaining a state license to operate the business,
- Request from state licensing and enforcement authority's available information about the business and related parties,
- Developing an understanding of the normal and expected activity for the business, including types of products to be sold and type of customers to be served (ex. medical vs. recreational),
- Ongoing monitoring, and
- Refreshing information obtained as part of CDD on a periodic basis and commensurate with the risk.

BSA Policy should also be enhanced to address when an account should be closed due to MRB activity, with training of staff to quickly follow as that is the best way to ensure a solid understanding of the requirements and expectations. Training should also include means to identify and report potential marijuana-related activity and guidance as to how and when to do so.

Due diligence and monitoring of MRBs is significant and should be completed by someone within the Bank who has the time and resources to do so thoroughly and consistently. At the present time, FinCEN has implemented required SAR filings for MRBs, including industrial hemp. Per FinCEN, "because federal law

prohibits the distribution and sale of marijuana, financial transactions involving an MRB would generally involve funds derived from illegal activity. Therefore, a bank is required to file a SAR on activity involving MRBs including those duly licensed under state law." Until the state and federal governments and FinCEN all agree as to the legality of industrial hemp and how these customers should be treated, customers working with industrial hemp are to be treated as all other MRBs. The federal government recently took steps to legalize industrial hemp but has yet to release guidance on how these businesses are to be regulated and have yet to begin licensing these businesses at the federal level. Required SAR filings fall in to one of three categories, per FinCEN guidance:

- Marijuana Limited SAR – there is no reason to believe the customer has violated the Cole Memo priorities or state law,
- Marijuana Priority SAR – there is reason to believe the customer has violated the Cole Memo priorities or state law, or
- Marijuana Termination SAR – due to the facts and circumstances, it is necessary for the bank to terminate the relationship with the MRB to maintain an effective AML program.

While banking MRBs can be profitable for a bank, as fees can be imposed due to the increased monitoring and due diligence necessary for the account activities, banks should weigh the risks and rewards relating to MRB activities, ensuring the BODs are informed in the planning and execution stages. We, at Varneys, do not know all of the answers relating to MRBs, but we are certainly a resource for you to turn to for further guidance, and to research matters further to help you comply with the requirements.

Marijuana Limited SARs:

- *"Marijuana Limited" verbiage to be used in narrative*
- *Customer name, address and fact that SAR being filed solely due to MRB, with no suspicious activity identified*
- *Ongoing filing of the SAR is appropriate*

Marijuana Priority SARs:

- *"Marijuana Priority" verbiage to be used in narrative*
- *Customer name, address and details regard the priorities/laws the Bank believes have been violated, including dates, amounts and other details known*
- *Ongoing filing of the SAR is appropriate*

Marijuana Terminated SARs:

- *"Marijuana Termination" verbiage to be used in narrative*



Amanda McKeeman
Senior Accountant

If you have further questions about MRBs, BSA or AML compliance, Amanda, or any of the members on our team, can be a great resource for you. Contact Amanda at amckeeman@varney.com or 1-800-240-5004 to get more information.

Strategic Planning – Have you considered?

By Melissa Larson, Owner, and Mike Tomandl, Senior Accountant

Strategic planning is a task not everyone looks forward to having to go through. It should be looked upon as an opportunity for senior management and the Board of Directors of a business to formulate their vision on what the future holds for their organization. The resulting plan can then be used to communicate that vision to its shareholders and employees. Shareholders want to know what their investment is going to do for them, both short and long-term. Employees want to know what direction to head and what can they do to benefit the company, and eventually themselves.

Communicating that vision to employees is important to get their buy-in. After all, they are the ones that are going to be doing the legwork in executing the plan.

Our environment is constantly changing, which makes strategic planning an endeavor that should be reviewed at least annually. New opportunities and new threats continuously present themselves. A nimble organization may not need to completely overhaul a strategic plan annually, but it should revisit the plan sooner in response to new opportunities and/or threats, to make sure it can stay on track and achieve the goals set forth in the original plan.

Regulatory guidance suggests a bank's strategic planning process should answer the following four questions:

1. **Where are we now?** Senior management should identify the bank's strengths, weaknesses, opportunities and threats.
2. **Where do we want to be?** Senior management should establish or confirm the bank's missions, goals and objectives.
3. **How do we get there?** Senior management should design the bank's strategic plan to achieve the bank's goals and objectives.
4. **How do we measure success?** Regular measurement and reporting on the bank's objectives keep the board and senior management focused on whether the bank is achieving established goals in the strategic plan.

What is the best way to communicate your strategic plan? The best way is through budgeting and forecasting, allowing you to paint a number picture of what the future holds for your organization.

We understand the importance of strategic planning, budgeting and forecasting. Please contact Melissa Larson to talk further about the processes necessary and how we can help.

Keys to a successful strategic planning include, but are not limited to:

- *Take the courage to try something new – go out on a limb and be risky – be **innovative**.*
- ***Communicate**, communicate, communicate – top down and bottom up!*
- ***Engage** all levels of staff in the organization, as they are key to implementing the strategy!*
- ***Culture** is your company's attitude, value, beliefs and behavior.*



Melissa Larson
Owner



Mike Tomandl
Senior Accountant

Regulatory Exams – Top Findings

By Stephen Heimsoth, Senior Manager

Every bank will have a regulatory compliance exam at some point, sooner or later. In our last newsletter, we reviewed the importance of having a completed Compliance Management System (CMS) which will greatly help in ensuring that any regulatory compliance exam goes smoothly. Now, it is time to review the top findings regulators (FDIC and FRB) highlighted in a regulatory panel at the August 2019 Heartland Compliance meeting.

1) Truth In Savings (TIS):

- a. The most common finding in TIS is inaccuracy of disclosures, in particular relating to recent fee changes. Regulators have found that many times, when fees are changed, all account disclosures may not be updated to reflect those changes. It may be prudent to review your bank's account disclosures to make sure they are accurate, especially if there have been any changes since your last regulatory compliance exam.
- b. All consumers must be notified of any change in a term to the account if the change may reduce the annual percentage yield or adversely affect the consumer (section 1030.5(a)). If notices are included with customer statements, banks should verify if consumers receiving only quarterly statements will still receive the change notice 30 days prior to the date the change takes effect.
- c. If fees are changed, banks cannot just send a new fee schedule to consumers; the bank must somehow highlight or note what has changed (official interpretation section 1030.5(a)(1)-1).

2) Electronic Fund Transfers (EFT) - Section 1005.11(d) was listed as the most common finding for EFT. A bank must provide written documentation explaining the results of the bank's investigation and the consumer's right to request the documents the bank relied on in making its determination. If requested, the bank should promptly provide the copies of the documents. When the bank debits the consumers account for the provisional credit given, the bank also needs to notify the consumer of the date and amount of debiting and that the bank will honor checks, drafts, or similar instruments payable to third parties and preauthorized transfers from the consumer's account (without charge to the consumer as a result

of an overdraft) for five business days after the notification.

- 3) Garnishment of Accounts Containing Federal Benefit Payments – A two month look back is required, if there is no “Notice of Right to Garnish Federal Benefits”, to determine if the account had any federal benefits deposited and then, the amount of ‘protected benefits’ from the garnishment is to be calculated. The ‘protected benefit’ would be the lesser of the total federal benefits posted during the lookback period, or the balance of the account when the account review was performed.
- 4) Flood Hazard Protection Act (FHPA) -Having inadequate flood insurance was noted as the main finding for the FHPA. The amount of flood insurance should not just consider the one loan you may currently be working on; all loans secured by the property in a special flood hazard area (SFHA) should be considered. As a reminder, the minimum flood insurance coverage is the smallest of:
 - a. 100% of the insurable value (Replacement cost value) of the structure (disregard land value),
 - b. The amount of the loan (include all loans secured by the property), or
 - c. The maximum limit of coverage available (\$250,000 per 1-4 family residential structures and \$500,000 per commercial structures or 5+ residential structures).
- 5) Truth In Lending - Inaccurate APRs and finance charges, due to improperly excluding credit report fees charged to the consumer from the finance charge for non-real estate loans, continue to be cited. While credit report fees are excluded from real estate related loans, it is listed as a finance charge for other loans per regulation.
- 6) Real Estate Settlement Procedures Act (RESPA)
 - a. Escrow account errors continue to be cited as findings. For example, if a loan is closed in February and the seller paid the prior year taxes in full, the payment in first escrow account computation year should be calculated to only have one-sixth of the annual real estate taxes due monthly into the escrow account. This is due to the fact there is only one RE tax payment due, in December, in the initial escrow account

Varney Tax Tip – S Corp Basis

By Michelle Crow (CEO/Owner) and Laura Wenzke (Sr Manager)

It is extremely important for an S corporation (S-corp) shareholder to maintain their basis in the stock investment. The basis becomes important in tax calculations when a company sustains a loss, makes shareholder distributions, or when there is a change in stock ownership.

If a financial institution has a loss, shareholders can only deduct the loss on their individual tax return if they have sufficient basis to do so. Incorrect basis may allow deduction of losses when not allowed. Distributions can create an issue for a shareholder when they take out their basis and then some, which creates a taxable capital gain. Changes in ownership result in taxable gain for the amount of proceeds less the stock basis. If the basis has not been tracked, shareholders run the risk the entire amount received is taxable. In addition, the IRS began requesting basis information on the 2018 individual tax returns when one of the above situations has occurred. Shareholders must check a box on Schedule E, where the S corporation activity is reported, and attach a basis computation.

Maintaining shareholder basis in an S-corp is the shareholder's responsibility, not the corporations'. Often, the S-corp is not privy to all of the transactions occurring within their shareholder group. For example, stock may be bought or sold between shareholders instead of through the corporation and purchase price would not be known. Of course, shareholder basis will also change each year with the S-corp activity, which is provided each year within the K-1 received by shareholders.

While maintaining basis schedules is a shareholder responsibility, many shareholders will look to the financial institution to provide this information. If you have not been receiving basis schedules with your K-1's each year and would like to, please contact [Michelle Crow](#), [Laura Wenzke](#) or [Erin Escobar](#) to see what information is needed to receive up to date basis schedules.

computation year. Banks, however, are not adjusting the escrows appropriately and setting up escrow accounts to collect for twelve months of taxes. If only one six-month payment is calculated into the escrow account the first year, the problem could result in payment shock by the consumer the second year when escrow payments increase significantly to account for two tax payments. Banks should consider discussing the situation with the consumer, letting them decide whether they want to pay extra voluntarily the first year, or at least be informed and prepared for an increase in payment the second year. If the consumer elects to pay extra, get written acknowledgement from consumer and maintain that documentation in file.

- b. Banks cannot force consumers to pay real estate taxes from escrow annually. Rather, customers should be given the option to pay annual or semi-annually.
- 7) Equal Credit Opportunity Act (ECOA) - ECOA applies to all credit, not just consumer credit. Bank's should make sure that they are documenting intent to apply for joint credit at the time of application for all loans, paying particularly close attention to agricultural and commercial loans.
- 8) Be aware of the risks of geofencing and geotargeting, if marketing online. These can lead to a fair lending issue depending on the area ads are targeted.

In addition to these areas, regulators mentioned there will likely be additional emphasis placed on construction loans in upcoming compliance exams.

Before your next exam, it is wise to get a 'health check' on your compliance program and provide additional training to Bank staff relating to these regulations, as well as others. Varney can assist you in doing both! Give us a call to coordinate a compliance review; the investment of self-detection is better than a compliance violation cited in your exam report.



[Stephen Heimsoth](#)
Senior Manager

Bank regulations can be confusing and complex. Contact Stephen, or any one of the banking team members, at 1-800-240-5004



[Michelle Crow](#)
CEO/Owner



[Laura Wenzke](#)
Senior Manager

Varney Kudo's



*“Leading the way
to your success.”*

Like you, we have great things going on in our firm and we want to share these highlights!

Congratulations go to.....

Stephen Heimsoth, Manager, specializing in the banking industry providing consulting services to clients. Stephen recently passed the Certified Regulatory Compliance Manager exam and is now a CRCM. Stephen is one of our go-to guys for all things compliance – BSA, ACH, loan and deposit regulatory compliance. This certification is a testament to his skills and knowledge. Congratulations Stephen!



Amanda McKeeman, Senior Accountant, specializing in the banking industry providing consulting and auditing services to clients. Amanda recently passed the Certified Public Accountant's exam and will soon be a licensed CPA in Kansas. Congratulations Amanda!



Julie Spiegel, Owner, specializing in the agriculture industry, providing tax planning, transition and succession planning and consulting services to individuals and corporate agribusiness clients. Julie was recently appointed by Governor Kelly to the Kansas Board of Accountancy. There are only seven members appointed to the Board – quite an honor for Julie and the firm!



We take care of community bankers so they can take care of their communities.