

Quarterly Bank Update

Loan Review Process Changes and Taking Your Bank to the 21st Century



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CPE Requirements

- Answer the polling questions
- If you are participating in a group, complete the CPE sign-in sheet and return within two business days
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About CliftonLarsonAllen

- A national CPA and consulting firm
- Service areas include assurance, tax, consulting, and outsourcing
- 3,600 employees
- Offices coast to coast
- Financial Institutions group serves more than 750 bank clients across the country



Speaker Introductions

- **Scott Lively**

Scott is a principal in the financial institutions practice and has more than 22 years of experience providing audit, tax, and consulting services.



- **Joshua Juergensen**

Josh is a manager in CLA's financial institutions practice and has more than 7 years of experience providing audit, internal audit, and consulting services.



Learning Objectives

- At the end of this session, you will be able to:
 - Understand the impact of lease accounting on bank loan customers
 - Recognize how new technology will change the future of banking
 - Identify the strategies board members should have going forward



Loan Review Process Changes

What are the Effects of the Lease Accounting Exposure Draft on Loan Customers

Current Lease Accounting

- Require lessees and lessors to classify their leases as either capital leases or operating leases by considering the following four criteria
 - 1) Transfer of ownership
 - 2) Bargain purchase option
 - 3) The lease term is equal to 75% or more of the estimated economic life of the leased property
 - 4) The present value at the beginning of the lease term of the minimum lease payments equals or exceeds 90% of the excess of the fair value of the leased property to the lessor at lease inception

Why Is the FASB Issuing This Proposed Accounting Standards Update?

- The current models have been criticized for failing to meet the needs of users of financial statements because they do not always provide a faithful representation of leasing transactions. In particular, they do not require lessees to recognize assets and liabilities arising from operating leases. Thus, limited information about operating leases is disclosed.



Lessee Accounting

Lessee Accounting

	<u>Balance Sheet</u>	<u>Income Statement</u>	<u>Cash Flows</u>
Type A (Most leases of equipment/vehicles)	Right-of-Use asset Lease liability	Amortization expense Interest expense	Cash paid for principal and interest payments
Type B (Most leases of real estate)	Right-of-Use asset Lease liability	Single lease expense on a straight-line basis	Cash paid for lease payments

Lessee Disclosures

Qualitative

- Description of leases
- Terms of:
 - variable lease payments
 - extension/termination options
 - residual value guarantees
- Restrictions and covenants
- Information about leases not yet commenced

Quantitative

- Expense relating to variable lease payments
- Reconciliation of right-of-use asset by asset class (IASB only)
- Reconciliation of lease liability (Nonpublic entity may elect not to disclose)
- Maturity analysis of undiscounted cash flows for each of first 5 years plus total thereafter

Judgments & Risks

- Nature and extent of risks arising from leases
- Significant assumptions and judgments

Leesee Accounting Example

- A lessee enters into a 10-year lease of an asset. Lease payments are \$50,000 per year payable at the beginning of each year. The lessee's incremental borrowing rate is 5.87%. The lease liability is measured at the present value of the remaining 9 payments once the initial payment is made.

LEESEE ACCOUNTING

TYPE A LEASE

	Debit	Credit	Calculation
<u>Initial Entry</u>			
Right-of-use asset	392,017		
Lease liability		342,017	PV of lease payments at 5.87%
Cash (lease payment for first year)		50,000	Amount paid on Jan 1st
<u>First Year Activity</u>			
Interest expense	20,076		342,017 times 5.87%
Lease liability		20,076	
Amortization expense	39,202		392,017 divided by 10 years
Right-of-use asset		39,202	

LEESSEE ACCOUNTING

TYPE B LEASE

	Debit	Credit	Calculation
<u>Initial Entry</u>			
Right-of-use asset	392,017		
Lease liability		342,017	PV of lease payments at 5.87%
Cash (lease payment for first year)		50,000	Amount paid on Jan 1st
<u>First Year Activity</u>			
Lease expense	50,000		Annual lease payment
Lease liability		20,076	342,017 times 5.87%
Right-of-use asset		29,924	50,000 minus 20,076



Lessor Accounting

Lessor Accounting

	<u>Balance Sheet</u>	<u>Income Statement</u>	<u>Cash Flows</u>
Type A (Most leases of equipment/ vehicles)	Lease receivable Residual asset	Interest income and any profit on the lease	Cash received for lease payments
Type B (Most leases of real estate)	Continue to recognize underlying asset	Lease income, typically on a straight-line basis	Cash received for lease payments

Lessor Disclosures

Qualitative

- Description of leases
- Terms of:
 - variable lease payments
 - extension/termination options
 - purchase options

Quantitative

- Reconciliations of lease receivable and residual asset
- Table of lease income
- Carrying amount of residual assets covered by residual value guarantees
- Maturity analysis of undiscounted cash flows for each of first 5 years plus total thereafter

Judgments & Risks

- Nature and extent of risks arising from leases
- Significant assumptions and judgment
- Risk management for residual assets

Leesor Accounting Example

- A lessor enters into a 10-year lease of an asset. Lease payments are \$50,000 per year payable at the beginning of each year. The lessor's incremental borrowing rate is 5.87%. The imputed rate for the lease is 5.50%. The lease liability is measured at the present value of the remaining 9 payments once the initial payment is made. The carrying value and fair value of the equipment/real estate is \$750,000.

LEESOR ACCOUNTING

TYPE A LEASE

	Debit	Credit	Calculation
<u>Initial Entry</u>			
Lease receivable	342,017		PV of lease payments at 5.87%
Residual asset	357,983		
Cash (lease payment for first year)	50,000		Amount received on Jan 1st
Equipment		750,000	Carrying value and fair value
 <u>First Year Activity</u>			
Lease receivable	20,076		342,017 times 5.87%
Residual asset	19,689		357,983 times 5.50%
Interest income		39,765	

LEESOR ACCOUNTING

TYPE B LEASE

	Debit	Credit	Calculation
<u>Initial Entry</u>			
Cash (lease payment for first year)	50,000		Amount received on Jan 1st
Lease revenue		50,000	
 <u>First Year Activity</u>			
None			

Loan Review Process Changes

- Higher debt equates to higher debt to equity ratios
- Lower working capital due to current portion of lease liability
- For type A lease, higher EBITDA, but more debt on the books
- For lessee, inflated balance sheet

Action Items for Loan Review Process under New Lease Changes

- Identify borrowers for which impact is significant
 - Inquire as to mix of Equipment vs. Real Estate
- Plan for covenant issues
 - Modify loan covenant
 - Exclude impact on covenant calculation
 - Waiver protocol

Next Steps

- Revised ED – May 2013 with comment period ends September 2013
- Re-deliberations to begin in 4th quarter 2013
- Final standard to take effect sometime between 2015 and 2017



Taking Your Bank to the 21st Century

What you need to know as updates in technology change the community banking landscape

Agenda

- New Technology on the Horizon
 - Mobile Banking
 - Interactive Teller Machines
 - Quick Response (QR) Codes
 - Social Media
 - Time to go Paperless!
- Technology Risks to Consider

Mobile Banking

- Fastest growing product in retail banking
- Wide variety of uses
- Highly secure
- Do your customers want mobile banking? Will they use it if implemented?



Interactive Teller Machines

- Allows face-to-face connection with customers while providing greater availability than traditional business hours
- Offers the opportunity for banks to reduce the size of branches or open new branches with reduced costs
- Customers can choose to have live support with a teller at a centralized location or use the machine as a traditional ATM

Key Features

- Cash withdrawal and deposit
- Check deposit and cashing
- Bill pay
- Account transfers
- Customer service inquiries
- Account openings
- Coin processing



Interactive Teller Machines (Cont.)

- Examples of Success
 - Costal Credit Union
 - United Bank
 - Bank of America



QR Codes

- Mobile Cash Access
- Use as a marketing tool
- Reduce costs spent to process and correct non-posted transactions as QR code links to accounts automatically
- Concerns?



Social Media

Tips when using social media

- Commit
- Don't be afraid of negative publicity
- Track your success
- Be interactive
- Follow your customers
- Follow @CLA_Banks on Twitter



© Facebook



© Twitter



© LinkedIn
Corporation



Instagram

© Instagram



© Pinterest



© Tumblr

Time to go Paperless!

- Electronic communications with customers is a huge cost saver
- Allows non-active board members, executives, and directors ability to stay connected more frequently
- Many applications available to make this very easy
 - Notability
 - iAnnotate
 - Dropbox
 - Penultimate

Technology Risks to Consider

- Be careful to be too invested/dependent in your core processor
- Don't be a small fish in a big pond
- Mobility of data
- Unsecured email

Questions?



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