

Accounting Primer

VBA School of Bank Management

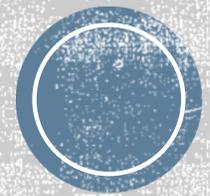
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Agenda & Goals

Approach Accounting with Confidence



Class Format



Section I

Accounting Overview
Financial Statements



Break



Section II

Asset Liability
Management
How do banks make
money?
Financial ratios



Lunch Break



Section III

Liquidity, Risks,
Capital Adequacy
Articulation of the
Statements and
Interrelationships



Zoom Introductions



What was the first concert you ever attended?



What was your favorite childhood vacation spot?



What was your first vehicle?



What is your super power?



Goals



BASIC ACCOUNTING
FUNDAMENTALS

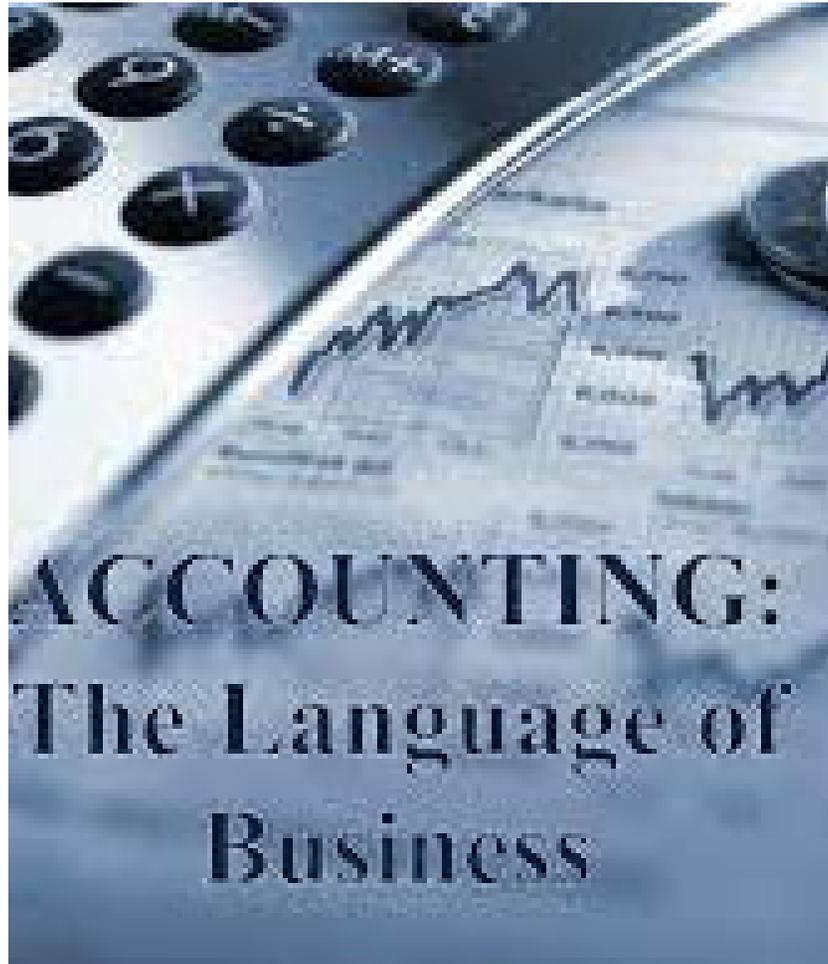


UNDERSTAND A BANK'S
BALANCE SHEET AND INCOME
STATEMENT



UNDERSTAND HOW THEY
RELATE TO LIQUIDITY,
CAPITAL, AND PROFITABILITY





It's not just numbers.

- It tells your Bank's story!



Financial Statements

Road Map telling us about the Bank's past, where it is now, and where it is headed in the future.





Annual
Report

Who Uses The Information?

Shareholders

Regulators

Directors

Employees

Customers

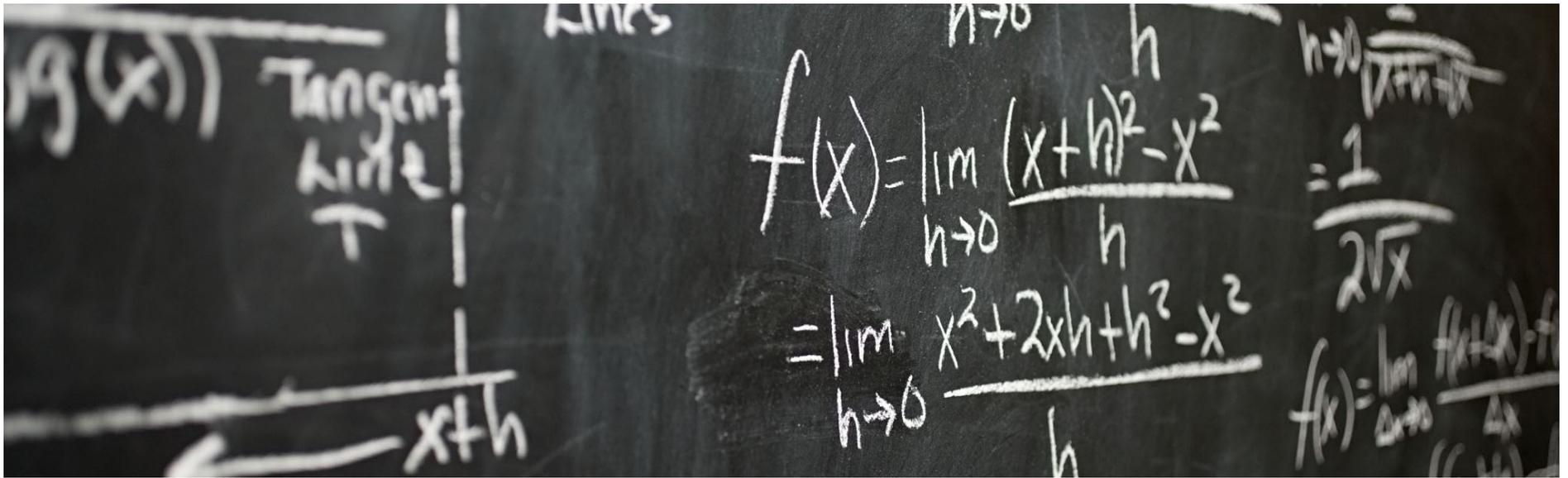




Report of Condition

Balance Sheet

“Snapshot In Time”



Assets = Liabilities + Equity

This is called the accounting equation.



Balance Sheet Must Balance!

Balance Sheet

Assets = OWN

- Loans are Assets
- Assets are USES of funds
- Usually carried at original cost

Liabilities = OWED

- Debts or obligations
- Deposits are Liabilities
- Liabilities are SOURCES of funds

Stockholders' Equity or Capital: Owners

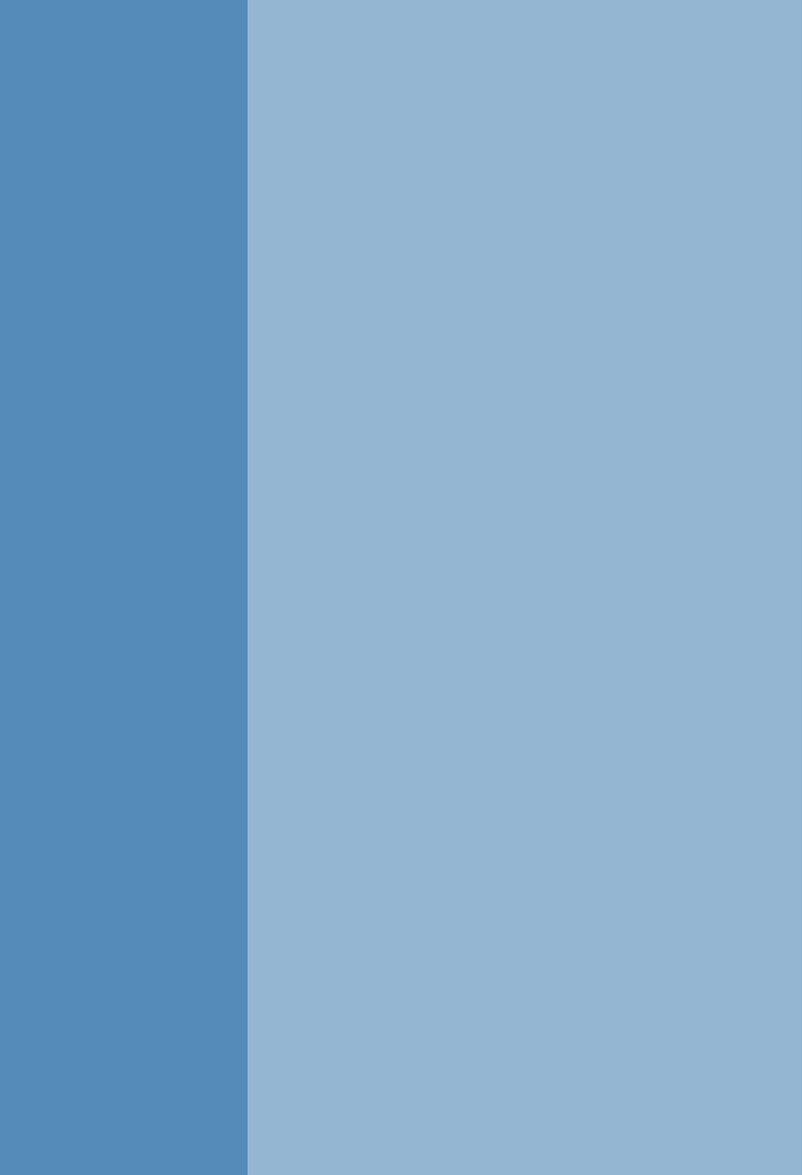
Common Stock

Paid in Capital

Retained Earnings (Undivided Profits)

Accumulated Other Comprehensive Income





ILLUSTRATIVE BALANCE SHEET

Cash Assets

Account is Called Cash and Due From Banks

Includes:

- Vault Cash
- Deposits with Other Banks (Correspondent Deposits)
- Cash Items in Process of Collection
- Reserve Account with the Federal Reserve

Sometimes Called Primary Reserves



Cash Assets

Designed to meet the bank's need for liquidity.

This includes customer withdrawals, demand for loans, or other unexpected needs.



GOAL: Balancing Act

To keep cash balance as low enough, because cash balances earn little or no interest income, and high enough to meet customer demands.

Federal Funds Sold

- Fed Funds Sold are Overnight Loans
 - Banks loan excess liquidity to other banks
 - Earn fed funds rate

Investment Securities



Often Called Secondary Reserves

Back-up Source of Liquidity



Satisfy Pledging Requirement



Source of Income

Earn more than cash but less than loans
Less risky. Less reward.

Investment Securities

Taxable Securities

- U.S. Government Treasury Bills and Bonds
- Government Agency Securities
 - Federal Home Loan Bank, Federal Farm Credit Bank
- Corporate Bonds
 - Commercial Paper

Tax-Exempt Securities

- Municipal Bonds

Loans & Allowance

Types of Loans

Why does a bank need an allowance?

Types of Loans

Real Estate Secured Loans

- 1-4 Family
- Multi-Family
- Home Equity Line/loans
- Construction and Development
- Commercial Real Estate

Commercial and Industrial

Consumer Loans

Credit Cards

Overdrawn Deposit Accounts



Allowance for Loan Losses

- Estimate determined by management
- Calculation to determine an appropriate amount to set aside in case loans default
- Evaluate impaired loans
- Evaluate historical loan categories
- Evaluate environmental factors



Allowance for Loan Losses

Calculation:

Beginning ALLL Balance

+ Provision for Loan Loss (Expense from Income Statement)

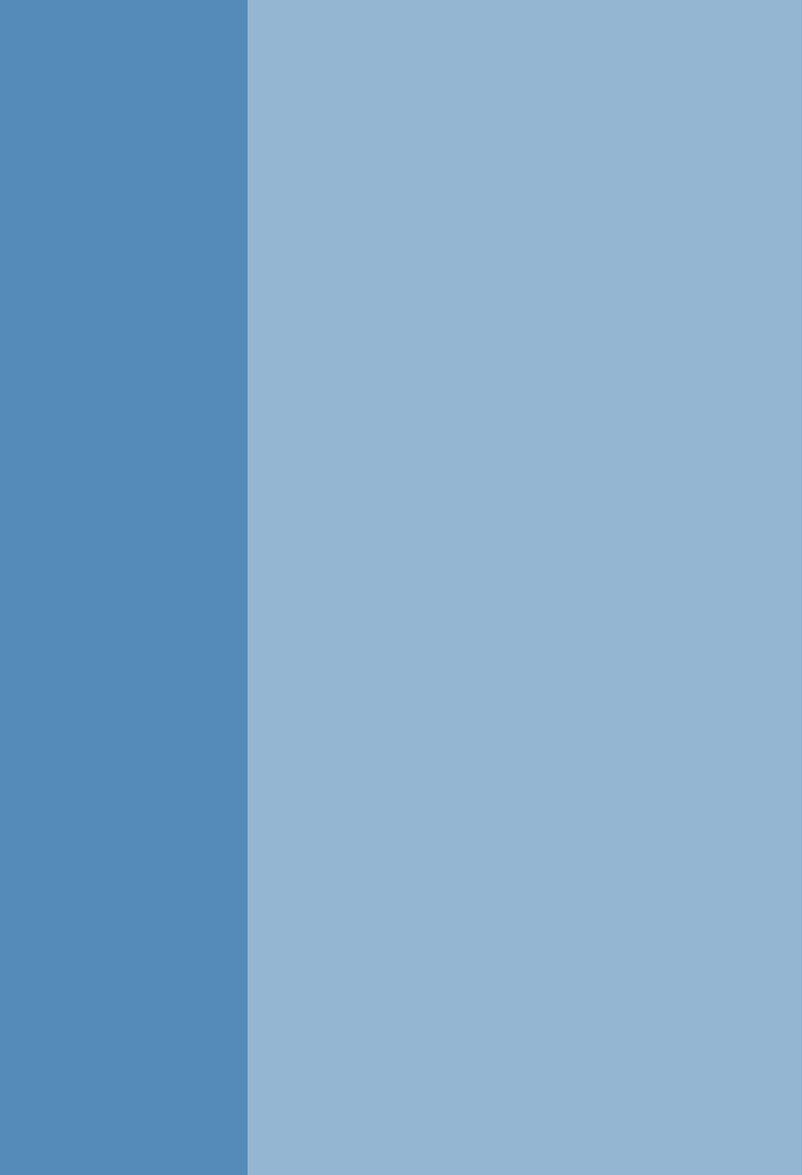
Actual Loan Charge-Offs

+ Recoveries from Previous Charged-Off Loans

= Ending Allowance for Loan Losses

Allowance for Loan Losses

Exercise



ILLUSTRATIVE BALANCE SHEET

Liabilities: Deposit Accounts



Non interest-bearing
Demand Deposits - Checking



Interest Bearing Deposits

Savings Deposits
Interest Checking
Money Market Deposit Accounts
(MMDA)
Time Deposits (Certificates of
Deposits)

Borrowings

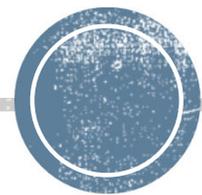
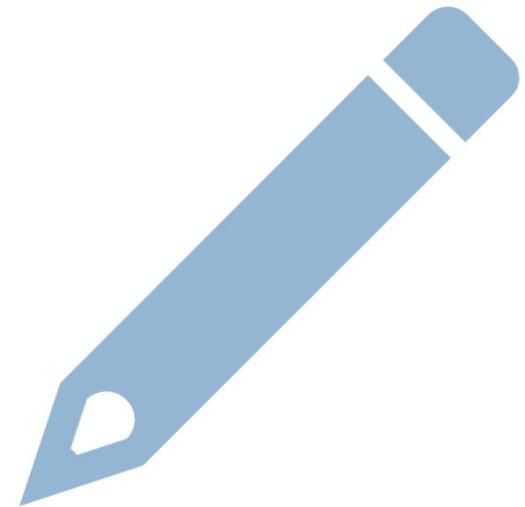
Fed Funds Purchased

- Opposite of Fed Funds Sold
- Banks pay the fed funds rate to borrow liquidity from another bank overnight.

Subordinated Debt

In Class Exercise

Can you Balance a Balance Sheet?





Income Statement
(Profit and Loss)

“Performance over
a period of time”



Income Statement

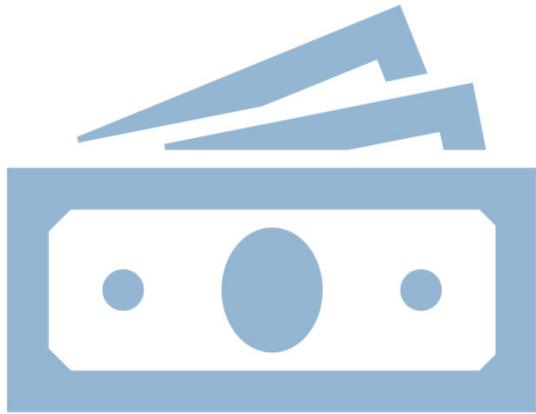
The income statement lists all categories of income and expenses. This statement details the financial performance and determines the amount of profit (loss).

+	Interest Income
-	Interest Expense
=	Net Interest Income
-	Provision for loan losses
+	Non-interest income
-	Non-interest expense
=	Income before income taxes (pre-tax)
-	Income Taxes
=	Net income (loss)

Income Statement Components

Exercise to mark the components





Illustrative Income Statement



Net Interest Income =

Interest Income – Interest Expenses

- Interest and Fees on Loans
- Federal Funds Sold
- Taxable Securities Revenue
- Tax-Exempt Securities Revenue
- Other Interest Income

- Deposit Interest Costs
- Interest on Short-Term Debt
- Fed Funds Purchased
- Interest on Long-Term Debt
or Other Borrowings

+ Non-interest Income
– Non-interest Expenses

Non-interest Income

- Service Charges on Deposit Accounts
- ATM/Debit Cards
- Mortgage origination fees
- Investment and Trust Fees
- Other Non-interest Income

Non-interest Expenses

- Salaries and Employee Benefits
- Premises/Facilities/Occupancy and Equipment Expense
- Marketing Expense
- FDIC Insurance Expense
- ATM/Debit Card Expense
- Other Operating Expenses

Service Charges on Deposit Accounts

Checking Account Average Balance Fees

Overdraft Fees

Stop Payment Fees

In Class Exercise

Can you calculate Net Income?



In Class Exercise

Can you distinguish which accounts go on which statement?

