### FOUNDATIONS OF FINANCIAL LITERACY FOR DIRECTORS: ANALYSIS OF FINANCIALS AND CALCULATION OF RATIOS

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The board of directors is responsible for the **general direction and control** of the affairs of each Federal credit union. While a Federal credit union board of directors may delegate the execution of operational functions to Federal credit union personnel, the ultimate responsibility of each Federal credit union's board of directors for that Federal credit union's **direction and control is non-delegable**.

(1) Carry out his or her duties as a director in **good faith**, in a manner such director reasonably believes to be in the best interests of the membership of the Federal credit union as a whole, and with the care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances;

(2) Administer the affairs of the Federal credit union <u>fairly and impartially</u> and without discrimination in favor of or against any particular member;

(3) At the time of election or appointment, or within a reasonable time thereafter, not to exceed six months, have at least a **working familiarity with basic finance and accounting practices**, including the ability to read and understand the Federal credit union's balance sheet and income statement and to **ask, as appropriate, substantive questions** of management and the internal and external auditors; and

(4) Direct management's operations of the Federal credit union **in conformity with** the requirements set forth in the <u>Federal Credit Union Act</u>, this chapter, other applicable law, and sound business practices.

Credit Union National Association (CUNA)

Generally speaking, the board's job is to **set direction for and control the credit union**, making sure it is operated in a sound and prudent manner and that all decisions are guided by the <u>best interests of the members.</u>

#### **Primary Responsibilities**

1	Set Policy	4	Keep communication open to educate members on services
2	Plan the credit union's course	5	Review the chief executive officer's progress in achieving goals and objectives
3	Make sure the credit union maintains its sound financial condition	6	Report to the members at the annual meeting

**Necessary Knowledge and Skills** 



# An **understanding** of credit union philosophy



A desire to <u>better the</u> <u>financial lives</u> of members



Ability to **understand basic financial statements** 



Ability to <u>think and plan</u> <u>strategically</u>

**Specific Responsibilities** 

- Work with the CEO and the board to <u>develop objectives and goals</u> for the credit union, including <u>strategic plans</u>
- Make sure the credit union <u>adheres to pertinent laws, regulations</u>, and sound business practices
- Make sure the credit union maintains <u>sound financial conditions and that the credit</u> <u>union's assets are protected against unauthorized or illegal acts</u>. Designate depositories, authorize borrowing and investing, and provide for bonding and other security factors, including internal control policies and procedures. Approve interest rates, dividends, and refunds, or approver policies to guide management in doing so. Approve loan limits and savings minimums.

**Specific Responsibilities** 

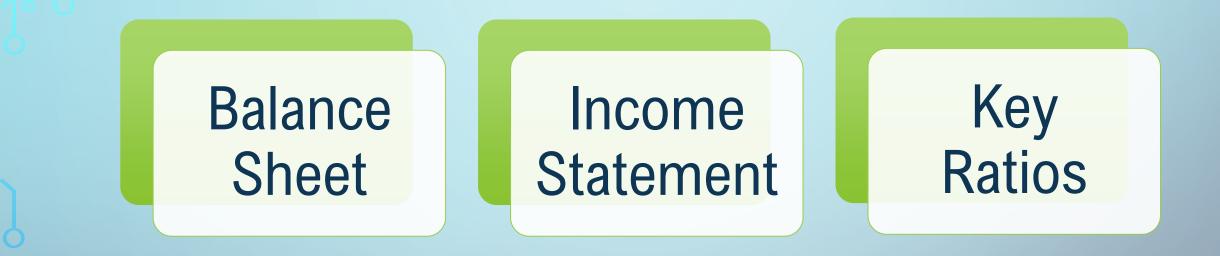
- Develop personnel policies, or make sure they are developed, and then approve them for all credit union programs and activities. Review policies and bylaws at least one a year and update as necessary.
- Make sure new products and services are developed as needed.
- Approve the credit union budget
- Define the scope of the CEO's job, hire someone to fill the position, and review his or her progress in attaining goals and objectives.
- Attend monthly board meetings, exercise judgment independently from the CEO, and report to the members at the annual meeting.

**Key Areas of Responsibilities** 

- ✓ Exercise sound judgment
- ✓ Assure the credit union's viability and strategic direction
- ✓ Develop and Maintain sound, robust policies
- ✓ Assess the credit union's financial performance
- ✓ Provide guidance and oversight of CEO

Foundational to all other duties is the responsibility to assure that the credit union is pursuing a direction that will assure business success.

# **DEFINITIONS AND TERMS**



# **DEFINITIONS AND TERMS**

**Balance sheet – Statement of:** 

ASSETS – cash, investments, loans, other assets (building, equipment, REO, etc.)

LIABILITIES – money owed, deposits, other liabilities (taxes, accruals, etc.)

EQUITY/CAPITAL –retained earnings, reserves, adjustments to investment value

# **BALANCE SHEET**

Balance Sheet							
Assets			Liabilities				
Consumer Loans	\$	10,000,000	Payables \$ 250,000				
Real Estate Loans	\$	10,000,000	Other \$ 150,000				
Total Loans	\$	20,000,000	Total Liabilities \$ 400,000				
ALLL	\$	(150,000)	Regular Shares \$ 17,750,000				
Net Loans	\$	19,850,000	Share Drafts \$ 4,450,000				
Cash	\$	750,000	Money Market \$ 12,500,000				
Investments	\$	25,000,000	Share Certificates \$ 7,761,000				
Fixed Assets	\$	1,000,000	Total Deposits \$ 42,461,000				
Other Assets	\$	500,000	Equity \$ 4,239,000				
Total Assets	\$	47,100,000	Total Liabilities & Equity \$47,100,000				

# **DEFINITIONS AND TERMS**

**Income Statement** 

REVENUES interest on loans, interest on investments, non-interest income(fees)

EXPENSES operating expenses, dividends

NET MARGIN bottom line earnings

Operating Income	
Total Loan Income	\$ 136,983
Total Investment Income	\$ 12,277
Fees/Charges	\$ 12,063
Total Misc. Income	\$ 12,134
Total Income	\$ 173,457

Operating Expenses	
Total Compensation	\$ 60,541
Travel and Conference	\$ 2,121
Accociation Dues	\$ 1,103
Office Occupancy	\$ 14,468
Office Operations	\$ 19,340
Education and Promo	\$ 2,636
Loan Servicing Expense	\$ <b>23,1</b> 83
Outside Services	\$ 8,139
Prov for Loan Loss	\$ 10,000
Exam Fees	\$ 2,982
Cash Over/Short	\$ -
Annual Meeting	\$ -
Misc Operating Expenses	\$ 1,119
Total Expense	\$ 145,632

Dividends	:	
Regular Shares	\$	652
Share Drafts	\$	35
Club Accounts	\$	1
Share Certificates	\$	3,314
IRA Accounts	\$	400
Total Dividends	\$	4,402
Net After Dividends	\$	23,423

Summary	
Total Income	\$ 173,457
Total Expense	\$ 145,632
Total Dividends	\$ 4,402
Net After Dividends	\$ 23,423

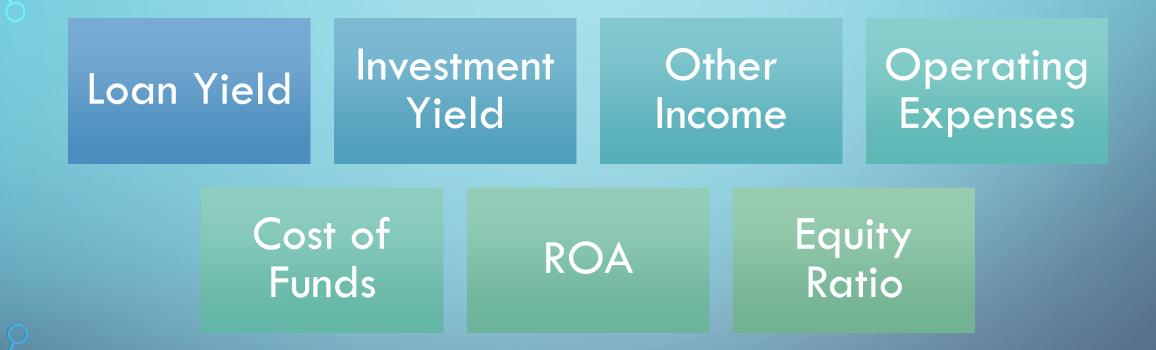
# **KEY RATIOS- FOCUS OF MEASUREMENT**

### **FINANCIAL PERFORMANCE**

Application and return of financial resources

GROWTH Increases in key resources

ASSET QUALITY Risk associated with assets



LOAN YIELD Average interest rate earned on loans

CALCULATION Annualized interest income/total loans

RESULT Return on each dollar of loans

		Annualized (x12)	
Interest Income	\$ 136,983	\$	1,643,796.36
Loans		\$	20,000,000
Loan Yield			8.22%

### INVESTMENT YIELD

Average interest rate earned on investments

CALCULATION Annualized interest income/total investments

RESULT Return on each dollar of investments

		Annua	alized (x12)
Interest Income	\$ 12,277	\$	147,321.24
Investments		\$	25,000,000
Investment Yield			0.59%

### COST OF FUNDS Dollar cost on total deposits

CALCULATION Annualized interest expense/deposits

RESULT Interest cost for each dollar of deposits

		Annualized (x12)	
Dividend Expense	\$ 4,402	\$	52,824.72
Deposits		\$	42,461,000
Cost of Funds			0.12%

NON-INTEREST INCOME (fees, charges) Dollar income from non-interest sources

CALCULATION Annualized non-interest/assets

RESULT Non-interest income on each dollar of assets

		Annualized (x12)	
Non-Interest Income	\$ 24,197	\$	290,365.44
Assets		\$	47,100,000
Other Income/Assets			0.62%

OPERATING EXPENSE Dollar cost for non-interest expenses

CALCULATION Annualized non-interest expense/assets

RESULT Non-interest cost on each dollar of assets

		Annualized (x12)	
Operating Expense	\$ 145,632	\$	1,747,587.24
Assets		\$	47,100,000
<b>Operating Expense/Assets</b>			3.71%

ROA (Return on Assets) Dollar return for each dollar of assets

CALCULATION **Interest Income** -Interest Expense =Net Interest Margin +Other Income -Operating Expense =Net Income/Assets = ROA

	Annualized (x12)		
Net After Dividends	\$ 23,423	\$	281,071.08
Assets		\$	47,100,000
Return on Assets			0.60%

#### **EQUITY RATIO**

Dollars of reserves as a percent of total assets (primary indication of financial strength)

CALCULATION Total equity/total assets

RESULT Dollars of reserves in relation to total assets

Total Equity	\$	4,239,000.00
Assets	\$	47,100,000
Equity Ratio		9.00%



ASSETS % change from prior period

DEPOSITS % change from prior period

LOANS % change from prior period

# **CALCULATION METHOD**

- Identify most recent period balance
- Identify previous period balance
- Subtract previous from current
- Divide result by previous period
- Result in the rate of change



	2012	2013	Change \$	Change %	
Assets	\$ 46,750,000	\$ 47,100,000	\$ 350,000	<mark>0.75</mark> %	

	2012	2013	Change \$	Change %
Deposits	\$ 42,011,000	\$ 42,461,000	\$ 450,000	1.07%

	2012	2013	Change \$	Change %
Consumer	\$ 7,500,000	\$ 10,000,000	\$ 2,500,000	33.33%
Real Estate	\$ 11,000,000	\$ 10,000,000	\$ (1,000,000)	-9.09%
Total	\$ 18,500,000	\$ 20,000,000	\$ 1,500,000	<mark>8.11</mark> %

### THE QUALITY OF ASSETS

Measured by delinquency, loss or use of assets

MEASURES Delinquencies Charge-offs Loan to Share

### **DELINQUENCY MEANING**

How many dollars are past due (30 or 60)

Dollars vs. Numbers

### MEASUREMENT

Divide dollars/numbers delinquent by total dollars/number of loans

Delinquencies	\$ 245,800
Loans	\$ 20,000,000
DQ Rate	1.23%

#### CHARGE-OFF MEANING

How many dollars have been charged off (lost) Dollars vs. Numbers

MEASUREMENT Divide dollars/numbers charge-offs by total dollars/number of loans

Charge-off Loans	\$ 56,500
Loans	\$ 20,000,000
C/O Rate	0.28%

### LOAN TO DEPOSIT (SHARE) RATIO

MEANING What percent of deposits are currently out in loans

MEASUREMENT Divide total loans by total deposits (shares)

Loans	\$ 20,000,000
Deposits	\$ 42,461,000
L/S Ratio	47.10%

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