

SOLVING THE PUZZLE OF FINANCIAL LITERACY

It's The Law

- **Here's what the new NCUA regulation change says:**
- **701.4 “Paragraph (b)(3) requires that each Board Director be financially literate. The Directors must have a working familiarity with basic finance and accounting practices, (including the ability to understand the credit union's balance sheet and income statement and to ask, as appropriate, substantive questions of management and the internal and external auditors) or become financially literate within a reasonable time, not to exceed six months, after his or her election or appointment to the Board of Directors.”**

Components of Financial Statements

- Statement of Financial Position (Balance Sheet)
- Statement of Income and Expenses
- Statement of Cash Flows
- Statement of Changes in Members Equity
- Notes to Financial Statements (an integral part of the financials)

Statement of Financial Position (Balance Sheet)

- A snapshot at a particular point in time
- Shows the relative health of an organization.
- We must understand the components of the Balance Sheet

Components of the Balance Sheet

ASSETS = LIABILITIES + MEMBER EQUITY

ASSETS

Current Assets – can be used in a short term

i.e. cash, short term investments.

Long Term Assets – must be utilized over a longer period of time.

Member Loans

Long Term Investments > 1 year

Fixed Assets – Building, Hardware, etc.

LIABILITIES

Current Liabilities – Short term obligations such as payroll taxes

Non Current Liabilities – CD's with greater than 1 year maturity

MEMBER EQUITY

Guarantee Fund

Undivided Earnings

Statement of Income and Expenses

- This statement is a report of the activity of an organization over a given period of time.
- Should be a comparative report with a prior period

Statement of Cash Flows

- This statement is not often utilized by boards.
- It shows the sources of cash and the uses of cash.
- It is integral to tie the operations of the organization back to the other financials.

Statement of Changes in Members' Equity

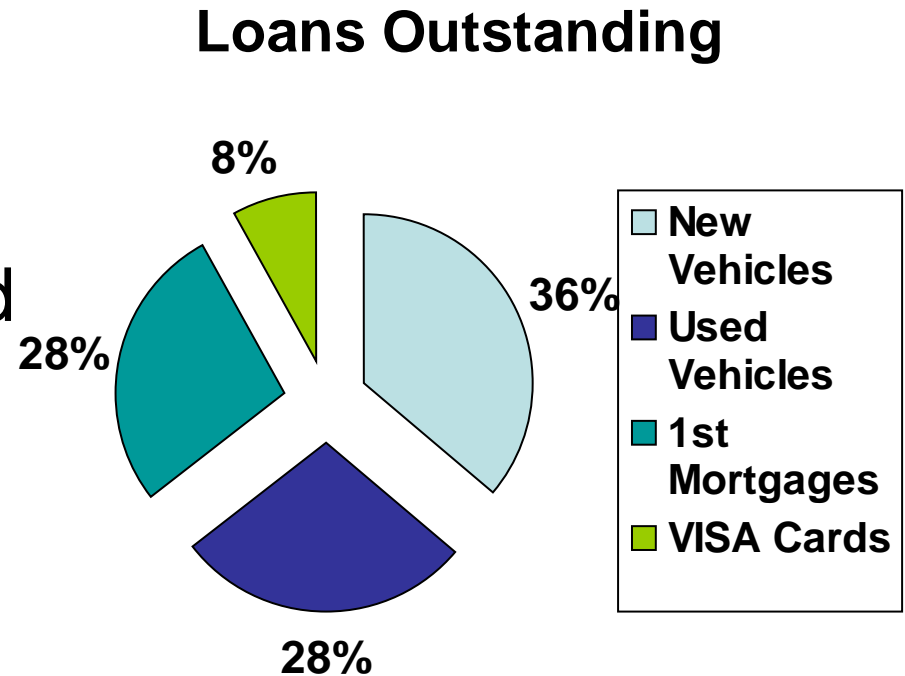
- This statement shows increases to Equity and the use of Equity
- Increases and decreases are broken down into income from operations and other comprehensive income.

Notes to Financial Statements

- These notes are usually issued by the auditor on an annual basis.
- They are not usually reported by management on a monthly basis.
- The notes give an understanding of what accounting methods are being utilized by the organization, i.e. depreciation methods, cash or accrual accounting.

Use of Graphs

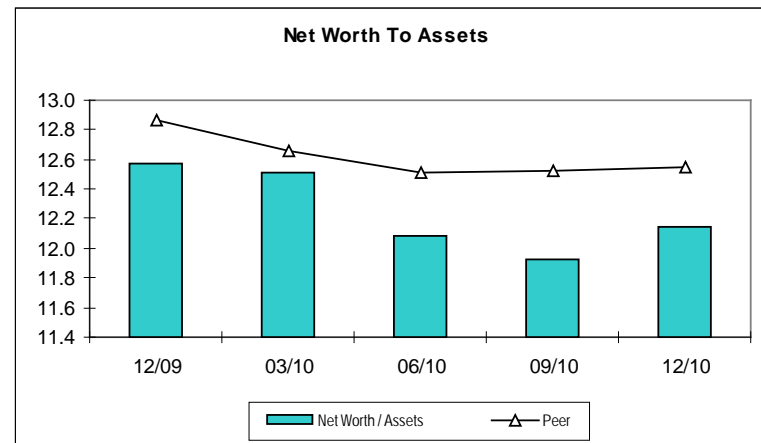
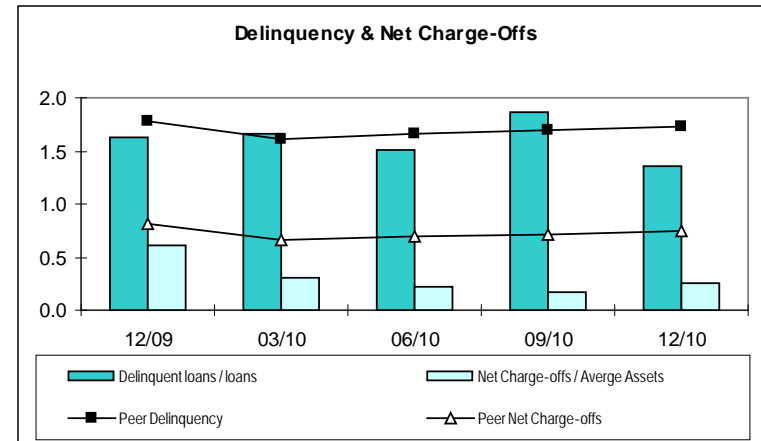
- Graphs make a much better presentation to non numbers people.
- Usually shows a trend or comparative information.



RATIOS

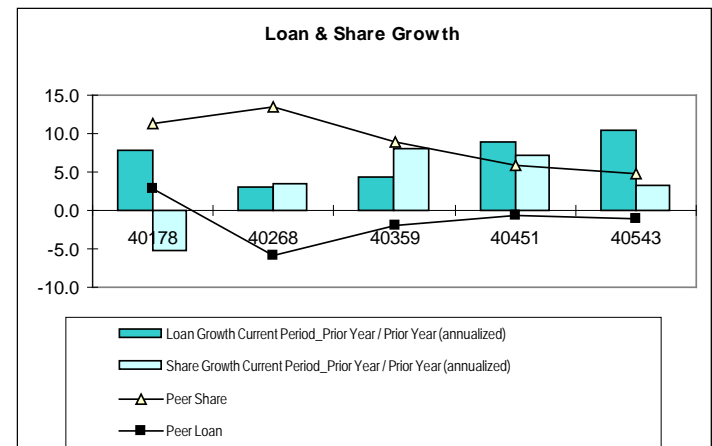
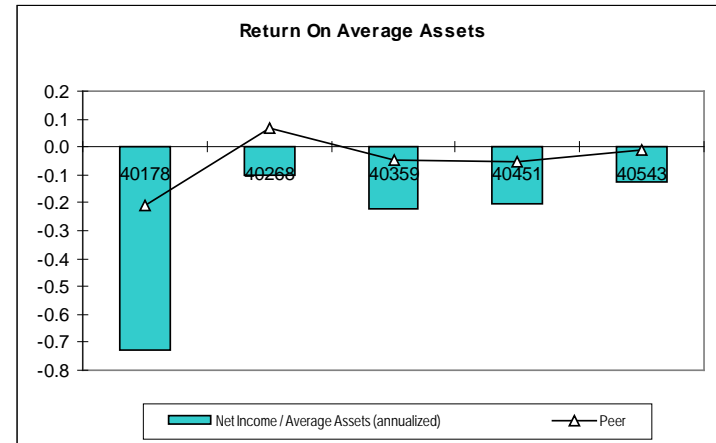
- Which Ratios are Important
 - Delinquency
 - Net Charge Offs

- Capital %
 - Net worth to Assets



Ratios

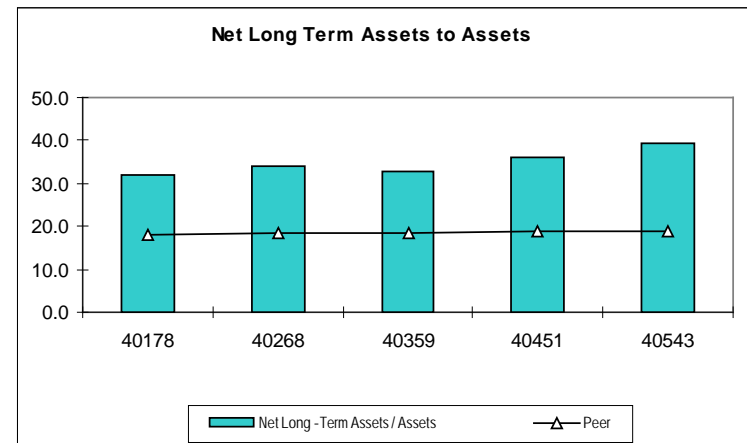
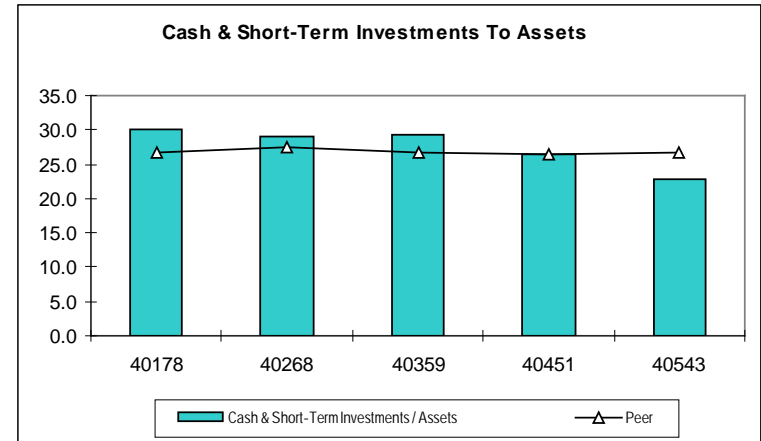
- Return on Assets (ROA)
used to be 1.0% was a magic number.
- Loan & Share Growth
Your survival rate



RATIOS

- Cash and Short Term Assets to Assets
 - Ability to meet your cash needs such as member withdrawals, investment opportunities etc.
 - More important than Liquidity ratio

- Net Long Term Assets to Assets
 - Affects your ability to react quickly to market changes



ASSET LIABILITY MANAGEMENT

- This is the process of analyzing your assets against your liabilities to guide you in making investments and controlling your cost of funds.
- For most credit unions the primary cost of funds is the dividends paid on shares.
- You should make sure you are shocking your rates to see what would happen in a scenario of 1 – 3% changes in current interest rates.

RISK ASSESSMENT

- Credit Risk
- Interest Rate Risk
- Liquidity Risk
- Concentration Risk
- Strategic Risk
- Compliance Risk
- Reputation Risk

Credit Risk

- Everyone realizes that financial institutions are subject to credit risk but what is it really?
- Credit risk is how much risk tolerance does each institution have in their lending program.
- Even some borrowers with “A” paper will go bad.
- Losses will occur, it’s a cost of doing business.
- Some institutions believe that .7% delinquency is all they should have; others think if you don’t have 3.0% delinquency you are leaving too much on the table. There is no magic number.

Interest Rate Risk

- This applies to both dividends on shares and investments.
- Are you willing to risk investing in all 5 year investments? Maybe you want to make all 1 year investments.
- On your CD's are you offering better rates for the short term or long term?

Liquidity Risk

- This ties in very closely with Interest Rate Risk as far as investment goes.
- Do you want to put too much of your funds into outside investments and maybe not be able to handle an influx of loans.
- If you invest long term, will you have the liquidity to make changes if interest rates increase?
- There is a cost associated with each scenario.

Concentration Risk

- This is one of the hottest topics in the industry.
- How much of your assets are invested in each type of investment.
- New Vehicles
- Used Vehicles
- Mortgage Loans
- Mortgage backed Securities

Strategic Risk

- Should you expand services?
- Should you build a new facility?
- Should you change your field of membership?
- Should you change your name?
- Should you make a change in Management?

Compliance Risk

- Who is your Compliance Officer?
- How important is it to agree with Examiners?
- When was your last Compliance Audit?
- What is the cost of non compliance?

Reputation Risk

- Your Credit Union Name has a value.
- How long have you been in business.
- Are you active in the community?
- What do your members think?
- What do your peers think of You?
- What kind of reputation do you have with the Regulators?

PEER GROUPS

- Maybe the PEER Group the NCUA has you in is not what you should be concerned with.
- Do an analysis of credit unions in your area to see if you can create a PEER group which would be more useful to you.
- Local economic climate and similarities of membership may be more beneficial to compare than size.

IT'S UP TO YOU

- Remember that the Board of Directors is responsible for setting direction and monitoring the results of the Credit Union.
- Management is responsible for implementing the methodology to accomplish goals.
- Don't be a RUBBER STAMP BOARD but don't try to manage the Credit Union.

YOU'RE IN LAS VEGAS

- Don't believe "What happens in Vegas Stays in Vegas". Today is an Instantaneous World. What you do here can appear on You Tube or worse.
- Have Fun but remember that your MAMA may be watching.