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Cost of Regulatory Compliance – Part II

Scope of project: Compose a narrative that indicates what template was utilized for, how it was used, details on its functionality, explanation of regulatory burden, and supporting documentation.

The Winning Template ~

KALSEE Credit Union placed second in the Cost of Compliance Contest to the 1st place winner of Pathways Financial Credit Union. Originally it was our intent to utilize KALSEE's template in the submission for the second contest but as we moved into production we found there was need for some tweaking of the process. A New Template was born. To give credit where deserved, we did utilize Pathways Financial Credit Union's percentage methodology as to give us a benchmark to start with but the overall percentages used in our go live was based on our thoughts and assumptions as it relates to KALEE. The most significant change from our original version of the template is the broad to granular approach. It was found that going broad was actually far more complex than breaking it down granularly right from the beginning.

Doing the Work ~

While in our original theory utilizing the invoices and payable's system for posting is a great method, it also poses some issues with those that are deferred or amortized. With that being said we opted to change the template to work based on month end balances to ensure all expenses were included. In following this methodology we also found that to create an option within CU was going to be far more complex than just adding a percentage option within the payable. As we moved through different options to satisfy all areas within our accounting practices we found that there are several ways we could go about the process such as an AFT, Payroll Processing, or within the Fixed Assets/Prepays. All ideas good in theory but actually "walking the dog" is problematic due to the complexity with certain percentage expenses and how other expenses may be categorized within your balance sheet or even to the extent of an invoice that is only partially compliance related. For example the salary, benefits or conferences (which may or may not be compliance/regulatory specific). With that being said, below is the New Template for your review:

Step I - Laying the Ground Work ~

Overt Cost

- Training – Board / Staff – Annual Planning Session
- Education & Certification of Compliance Staff
- BSA/OFAC/ACH annual reviews
- Daily/Weekly/Monthly Report Monitoring
 - Cash Structuring
 - Dormancy
 - File Maintenance

- Security Override
- Employee Security
- Escheat/Unclaimed Property
- Personnel
- Third Party
 - CU RX
 - Commercial Alliance
 - CU Solutions – Misc Forms & Membership Cards
 - CLS (Compliance Systems) – TIS Disclosure Mgmt.
 - Cuna Mutual – Loan Liner – Misc Brochures & Loan Doc's
 - ATM Delivery Channel / Accessibility
 - In Branch Accessibility – Elevator & Handicapped Door
- Periodic Statements
- Notices – Privacy, delinquency, maturity, nsf, transfer, etc?

Covert Costs

- Review and assimilation of new and changing regulations
- Exam Management
- Review of regulatory requirements for new products and services
- Third party annual risk assessments
- Policy management
- Annual risk assessments for BSA, OFAC, ACH, GLBA, electronic services, social media
- Material Reprint – CUA, Disclosures, Forms, etc.

Brain Dump:

- Compensation & Benefits - Compliance Officer, CFO, CEO
- Annual Audit
- Business Lending Due Diligence
- Education & Training
- Annual Planning Session & BSA
- Organizational Meeting
- Policy / Disclosure Management
- Forms & Membership Brochures
- Annual Dues / Subscriptions – SAFE ACT
- ADA Compliance – Elevators, Handicap Parking, Handicap Auto Doors,
- Escheat Processing
- 990 & 990T Processing
- Retiree Benefit Processing - Actuarial
- PCI Compliance
- Third Party Due Diligence & Risk Profile
- Record Retention
- VISA Reporting Requirements
- SARS / CTRS

Product Profile Considerations (Hidden Compliance/Audit Expenses):

- Consumer Lending

- Business Lending
- Ancillary Products – Plastics, It’s Me 247, CU Talk, A2A
- Regular Deposit Accounts
- Investment Deposit Accounts
- Transactional Accounts
- Collections
- Teller Area / Vault Management
- Marketing / Social Media / Website
- Information Technology/CYBERSecurity
- Human Resources

Step II - Define & Set Up your Financial Statement Categories / General Ledger Set Up ~

Now that you have laid the ground work to get your mind churning on the possible expenses involved you need to now look at your financial statement set up and see how these items flow into it. With our particular balance sheet structure we have our categories defined as follows:

- Salary & Benefits
- Other Employee Expenses
- Office Occupancy Expenses
- Office Operations
- Professional & Outside Services
- Marketing
- Loan Servicing
- Misc. Operating Expenses

This category definition will allow you now to create the ledgers within the categories that best express the “laying the ground work” items listed above. Below is the spreadsheet with our categories, general ledgers, and expense percentages utilized. As previously stated in the “Doing the Work” section above, we utilize this spreadsheet to take the percentage of the month to date end balance to then determine the regulatory cost of compliance allocation.

COST OF COMPLIANCY							
						GL BALANCE	ALLOCATION
	SALARY						
	21100	MANAGEMENT PERCENTAGES					
	21100	BANCH MANAGERS / LOAN DEPT	1.00%			Management done by job and branch	
	21100	IT MANAGER	5.00%				
	21100	COMPLICANCE OFFICER PART TIME	50.00%				
	22400	OTHER EMPLOYEE BENEFITS	2.00%			\$ 35,493.07	\$ 709.86
	22100	PENSION COST	2.00%			\$ 16,481.42	\$ 329.63
	22420	POST RETIRMENT HEALTH BENEFITS	2.00%			\$ 4,177.91	\$ 83.56
	22450	COST OF COMPLIANCY SALARIES AND BENEFITS				TOTAL	\$ 1,123.05
		EMPLOYEE CONF. AND ASSOC DUES					
	23110	COMPLIANCE CONF	100.00%			\$ -	\$ -
	24000	ASSOC DUES	2.00%			\$ 1,692.50	\$ 33.85
	23300	COST OF COMPLIANCY EMP TRAVEL/CONF/DUES				TOTAL	\$ 33.85
		OFFICE OCCUPANCY					
	25400	BUILDING EXPENSE	1.00%			\$ 13,660.20	\$ 136.60
	25700	COST OF COMPLIANCY OFFICE OCCUPANCY				TOTAL	\$ 136.60

	OFFICE OPERATIONS						
26100	PHONES		1.00%		\$	3,388.84	\$ 33.89
26110	POSTAGE/MAILING		25.00%		\$	2,734.60	\$ 683.65
26130	MAILING OF MEMBER STATEMENTS		100.00%		\$	7,264.75	\$ 7,264.75
26400	STATIONARY & SUPPLIES		20.00%		\$	10,452.97	\$ 2,090.59
26500	INSURANCE BOND		100.00%		\$	5,666.30	\$ 5,666.30
26700	COST OF COMPLIANCY OFFICE OPERATIONS					TOTAL	\$ 15,739.18
	MARKETING						
27000	SPONSORSHIPS		25.00%		\$	2,348.06	\$ 587.02
27100	RADIO MARKETING		25.00%		\$	4,811.79	\$ 1,202.95
27200	SIGNAGE MARKETING		25.00%		\$	-	\$ -
27300	PRINT MARKETING		25.00%		\$	479.22	\$ 119.81
27400	GENERAL MARKETING		25.00%		\$	3,021.82	\$ 755.46
27500	GIVEAWAY MARKETING		25.00%		\$	1,611.78	\$ 402.95
27600	INTERNET/ELECTRONIC MARKETING		25.00%		\$	-	\$ -
27800	COST OF COMPLIANCY MARKETING					TOTAL	\$ 3,068.17
	LOAN SERVICING						
28000	BUSINESS LOAN EXP		5.00%		\$	4,070.10	\$ 203.51
28100	BUSINESS LOAN GOVN'T RECORD FEES		100.00%		\$	837.08	\$ 837.08
28150	C.U. PAID SBA EXPENSE		10.00%		\$	147.82	\$ 14.78
28170	BUSINESS VISA EXPENSE		10.00%		\$	120.61	\$ 12.06
28200	COLLECTION EXP		5.00%		\$	6,899.95	\$ 345.00
28210	OREO EXPENSE		5.00%		\$	4,476.08	\$ 223.80
28300	RECORDING FEES		100.00%		\$	256.00	\$ 256.00
28400	CREDIT BUREAU REPORTS		20.00%		\$	5,344.23	\$ 1,068.85
28500	FIRST MORTGAGE SERVICE EXPENSE		50.00%		\$	6,628.24	\$ 3,314.12
28600	VISA INTERNATIONAL		5.00%		\$	915.58	\$ 45.78
28610	VISA INT'L CURRENCY EXP		5.00%		\$	106.05	\$ 5.30
28620	VISA PROCESSOR EXPENSE		5.00%		\$	263.78	\$ 13.19
28640	VISA FIS		5.00%		\$	15,143.12	\$ 757.16
28800	STUDENT LOAN EXP		10.00%		\$	4,619.25	\$ 461.93
28910	LENDERS PORTECTION EXP		10.00%		\$	20,047.20	\$ 2,004.72
28920	DEALER LOANS SERVICE FEES		10.00%		\$	12,179.00	\$ 1,217.90
28940	COST OF COMPLIANCY LOAN SERVICING					TOTAL	\$ 10,781.17
	PROFESSIONAL & OUTSIDE SERVICES						
26800	DEBIT CARD EXP		10.00%		\$	44,005.43	\$ 4,400.54
26810	ATM EXP		5.00%		\$	5,564.52	\$ 278.23
29200	AUDIT EXP		100.00%		\$	2,100.00	\$ 2,100.00
29300	ACCOUNTING SERVICES		5.00%		\$	1,505.39	\$ 75.27
29340	CHEX SYSTEMS EXP		50.00%		\$	1,520.60	\$ 760.30
29400	CU ANSWERS SERVICE FEE		20.00%		\$	14,441.41	\$ 2,888.28
29410	CU ANSWERS HOME BANKING EXP		20.00%		\$	3,855.56	\$ 771.11
29420	CU ANSWERS RECORDS PROCESSING		20.00%		\$	1,888.05	\$ 377.61
29430	CU ANSWERS INS PROCESSING		20.00%		\$	130.00	\$ 26.00
29440	CU ANSWERS NOTICE PROCESSING		20.00%		\$	3,125.33	\$ 625.07
29450	CU ANSWERS BILL PAY PROCESSING		20.00%		\$	3,206.10	\$ 641.22
29460	CU ANSWERS SHARED BRANCH PROCESSING		20.00%		\$	-	\$ -
29470	CU ANSWERS EFT PROCESSING		20.00%		\$	7,000.00	\$ 1,400.00
29480	CU ANSWERS IT PROCESSING		20.00%		\$	-	\$ -
29490	CU ANSWERS CUSTOM PROCESSING		20.00%		\$	100.00	\$ 20.00
29510	IT SERVICE FEE		75.00%		\$	4,975.00	\$ 3,731.25
29520	IT CONTRACT FEES		75.00%		\$	9,549.21	\$ 7,161.91
29530	IT FIXED ASSET EQUIPMENT		75.00%		\$	-	\$ -
29540	IT EQUIPMENT & SUPPLIES		75.00%		\$	330.42	\$ 247.82
29550	IT CONF/TRAINING		75.00%		\$	-	\$ -
29900	OTHER PROF & OUTSIDE SERV		75.00%		\$	2,015.31	\$ 1,511.48
29910	COST OF COMPLIANCY PROF & OUTSIDE SERV					TOTAL	\$ 27,016.08

	MISC OPERATING						
	32200	EXAMINATIONS FEE EXP	100.00%		\$	2,950.00	\$ 2,950.00
	37110	LOSS BY FRAUD/FORGERIES	2.00%		\$	11,074.35	\$ 221.49
	37102	OVERDRAFT LOSSES	2.00%		\$	964.31	\$ 19.29
	37120	PUBLICATIONS FOR OFFICE	2.00%		\$	146.67	\$ 2.93
	37180	FINANCIAL COUNCELING EXP	2.00%		\$	1,205.39	\$ 24.11
	37190	KALSEE INVESTMENT/RET SRVCS	2.00%		\$	517.30	\$ 10.35
	37200	SHARE DRAFT EXP	2.00%		\$	1,892.56	\$ 37.85
	37300	EMPLOYEE PAYROLL EXP	2.00%		\$	2,407.32	\$ 48.15
	37400	COST OF COMPLIANCY MISC OPERATING					
						TOTAL	\$ 3,314.16

Step III – Define & Categorize ~

1. Each invoice/expense you receive, define any items that may be relevant to regulatory requirement.
2. Confirm the relevancy to the “Cost of Compliance” – Find out what it is and why it’s being charged as to support your reason for the categorization.

Step IV – Create a Template or Import Entries for Posting ~

You have two options to process your monthly expensing. You can choose to create a template and use your allocated amounts and manually input or you can create another spreadsheet that will accommodate the import of your entries into CU Base for posting. Either method will suffice and will take equal amount of time to complete. Posting would occur at month end after fixed asset and prepaid posting has occurred and are ready to close for the month.

Step V – Financial Statement Configuration ~

In an effort to better calculate, monitor, inform, report and track, we reconfigured our financial statement to add the category “Cost of Compliancy”. This addition to the financial statement allows for us to not only track and build historical data but also allows for us to share with our board, staff, and regulators the surprisingly very high cost of regulatory compliance.

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KALSEE CREDIT UNION
 SHORT FORM INCOME STATEMENT
 FOR PERIOD 4/01/15 TO 4/30/15

LOCATION(S) - *ALL

	CURRENT Y-T-D	2-1/1 PCT	PREVIOUS Y-T-D	CURRENT PERIOD	LAST YEAR Y-T-D
INCOME					
OPERATING INCOME:					
INTEREST ON LOANS	1,905,394.42-	26.6-%	1,398,238.80-	507,155.62-	1,645,247.11-
INCOME FROM INVESTMENTS	170,935.49-	28.1-%	122,867.04-	48,068.45-	396,885.57-
INCOME - LAND CONTRACT	3,820.27-	24.7-%	2,875.56-	944.71-	4,141.48-
INCOME FEES AND CHARGES	703,012.98-	24.8-%	528,441.40-	174,571.58-	711,065.93-
OTHER MIS. OPERATING INCOME	205,710.10-	30.1-%	143,708.45-	62,001.65-	167,750.86-
TOTAL GROSS INCOME	2,988,873.26-	26.5-%	2,196,131.25-	792,742.01-	2,925,090.95-
OPERATING EXPENSES:					
EMPLOYEE COMPENSATION	766,397.70	31.6-%	524,004.32	242,393.38	743,854.60
EMPLOYEE BENEFITS	297,838.07	26.3-%	219,484.26	78,353.81	322,644.57
TRAVEL & CONFERENCE EXPENSES	44,702.57	21.2-%	35,210.40	9,492.17	48,100.14
OFFICE OCCUPANCY EXPENSES	183,921.63	23.3-%	141,027.86	42,893.77	174,298.15
OFFICE OPERATIONS EXPENSES	107,608.32	26.1-%	79,489.68	28,118.64	171,055.84
MARKETING EXPENSE	51,799.69	17.8-%	42,579.16	9,220.53	64,411.26
LOAN SERVICING EXPENSES	318,696.98	30.1-%	222,704.38	95,992.60	212,134.20
PROF & OUTSIDE SERVICES	379,995.81	24.7-%	285,813.94	94,181.87	420,019.23
PROVISION FOR LOAN LOSSES	255,218.14	15.6-%	215,218.14	40,000.00	173,716.40
MEMBER INSURANCE	16.05	.0 %	16.05	.00	14,064.20
CASH OVER & SHORT	254.79-	25.0-%	190.99-	63.80-	3,251.56
INTEREST ON BORROWED MONEY	1,960.46	16.5-%	1,636.56	323.90	.00
ANNUAL MEETING EXPENSE	239.24	.0 %	239.24	.00	40.00
MISC. OPERATING EXPENSES	41,857.70	55.9-%	18,457.67	23,400.03	32,969.08
COST OF COMPLIANCY	205,342.85	30.2-%	143,286.31	62,056.54	.00
TOTAL OPERATING EXPENSES	2,655,340.42	27.3-%	1,928,976.98	726,363.44	2,380,559.23
GAIN (LOSS) SALE OF ASSETS	10,668.92	.0 %	10,668.92	.00	38,113.49
TOTAL NET INCOME	322,863.92-	20.5-%	256,485.35-	66,378.57-	506,418.23-
INTEREST ON DEPOSITS	121,000.10	24.6-%	91,137.54	29,862.56	144,196.44
DIVIDENDS	95,996.01	25.7-%	71,276.08	24,719.93	91,453.60
NET INCOME (LOSS) AFTER DIV. & INT. EXP.	105,867.81-	11.1-%	94,071.73-	11,796.08-	270,768.19-
NET GAIN(-) OR LOSS	105,867.81-	11.1-%	94,071.73-	11,796.08-	270,768.19-

Plan of Action ~

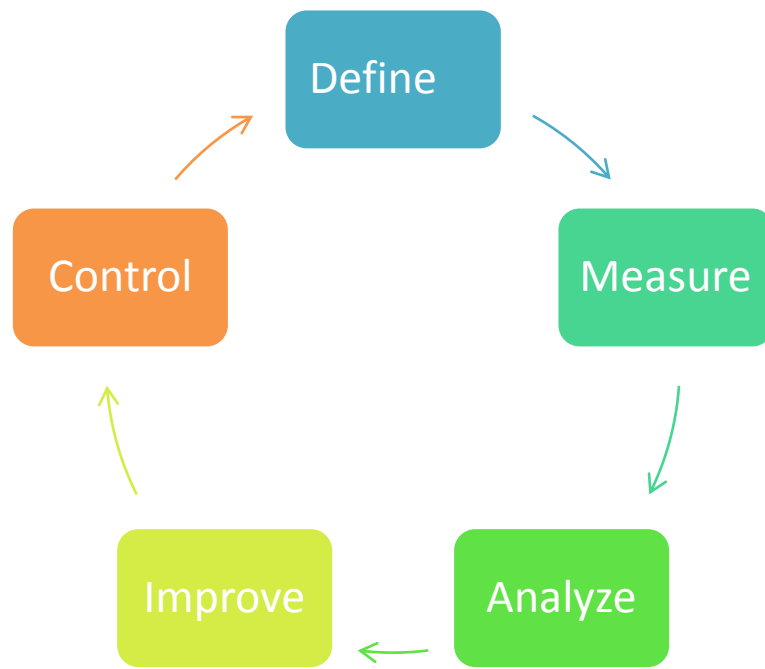
It goes without saying that accounting individuals by nature value data and lots of it. As things continually change, as does the need to be cognizant of the risks inherent in sailing in uncharted waters. Credit Unions are still trying to catch up to the banking industry with the fast track product and service implementation. As a movement we are learning that it isn't good enough just to be existent but rather we need to retail ourselves much like banks in order to stay competitive and survive. In order to stay alive we need to have regulatory oversight, it's a given as we have seen in past credit union failures. The amount of regulatory oversight and to what degree is necessary remains to be the primary issue. This remains to be why this type of analysis is crucial as we need to bring to the forefront the necessity vs overkill. I believe that transparency is essential to any organization and at times requires additional documentation, continued validation, and awareness. In building awareness with our boards, members, employees, regulators, auditors and peers we may find that this objective of proving argumentatively is not necessary as we have made it transparent. In any good argument lies the details and the awareness. If the details and awareness aren't visible then the argument doesn't exist.

Now shift from my overall summary of this project to... What plan of action do I have? As with any other line item on my income statement it is imperative that we continually improve our knowledge and perfection of being good stewards of our member's financial success. My plan is to utilize this information much like I do any other line item (product or service) and ensure that we are getting the best bang for our buck while still maintaining regulatory requirements. In reality, compliance is really a service to our members, albeit restrictive, expensive and inefficient. Its sole purpose is to ensure our members share in the cooperative is secure and safe. I would like to continue on the path of reducing the costs, improving the efficiencies, and finding new ways in which to relieve the restrictions but that's another contest to be had (***The next Vilker Challenge***). I will utilize this information to create that relief internally as I suspect the length of time it will take to "win" the argument will be turtle speed. Not to be discouraging but we work in an ever changing technological world that seems to be all too quick to roll the next best thing but not yet quick enough to control the outcome. Going forward my budget will reflect this new line item as well as continued ROA and Net Worth impacts as we too feel this with the NCUSIF. As you have seen from my financial statement above, this will continue to remain as a permanent section to continue the awareness and transparency as this contest proved to be worthy of bringing the "WoW" to the forefront.

Many thanks to Jim Vilker and CU Answers for their continued support and passion within our industry by coming up with an idea (that is not on everyone favorite topic list) and exposing the reality in our regulatory world. Well Done!!!

The Cost of Compliance

DMAIC



Define the expenses to be considered

Measure the specifics of what you have defined for further analysis

Analyze the data by breaking out expenses

Improve the process by taking action with the output of analysis

Control the costs!!!!

Beyond Foot Notes

1. Continually evaluate your necessity to expand the expense categories as they relate to your goals for cost containment, compliance management, and budget.
2. Look for redundancies or overlaps.
3. Log or track the amount of hours you or your staff spends in an effort to make assumptions of dollars to allocate specifically. Whether it is training, job responsibility, meetings, education, etc. Time study is important for institutions that have “multi-hatters” performing the audit/compliance duties. There is no limit to the employee’s that may fit this role in some fashion or another.
 - IT Manager/Staff
 - Lending Staff
 - Accounting Staff
 - Back Office Staff
 - CEO, CFO, or Compliance Committee
 - Collections Staff
 - Marketing Staff
 - Branch Staff
4. Continually look for ways to make a process more efficient. Learn from a peer; ask questions, research, etc.
5. Continually be on the lookout for “pass-thru” items as they relate to CUSO’s (Commercial Alliance, CO-Op, CU Answers, etc...)
6. Consider evaluating larger monetary contract “start dates” for a calendar year so you have the ability to better budget. Often times you can work through a couple months of roll.
7. What once was but is no longer due to system upgrades – annual evaluation?
8. Other Considerations:
 - Fixed Costs/Variable Costs
 - Economies of Scale
 - Sunk / Historical Costs
 - Avoidable Costs
9. Assumption Tables:
 - Member Inconvenience
 - The “Unnecessary Cost of Compliance”