

Tax update—recent changes affect financial institutions

by Bill Rasmussen, Kansas City

In an effort to stimulate economic growth and business investment, the Job Creation and Worker Assistance Act of 2002 was signed into law earlier this year. The new law contains important tax changes beneficial to financial institutions.

Bonus depreciation

Businesses are allowed to deduct more of their new equipment purchases in the first year. Specifically, financial institutions can deduct an additional 30% of the cost of the purchased equipment.

This “bonus depreciation” applies to most types of business property, except for real estate pur-

chased between September 11, 2001, and September 10, 2004.

In addition, financial institutions can benefit from the bonus depreciation for new vehicle purchases. Luxury auto limits currently restrict first-year depreciation on qualified passenger automobiles to \$3,060. The new law temporarily increases the ceiling on first-year depreciation for qualifying autos from \$3,060 to \$7,660.

Since these changes apply only for a limited time, taxpayers should consider their asset needs for the next few years and determine if it's cost effective to replace old assets or accelerate any expansion plans to take advantage of the “bonus depreciation.”

Used property is not eligible for the bonus depreciation deduction. Therefore, if the price differential between a used or new asset is relatively small, the additional depreciation deduction in the first year could favor purchase of the new asset.



Extended carryback period

Another temporary change under the new tax law changes the period for which net-operating losses can be car-

ried back. The new provision allows taxpayers with a net operating loss in any tax year ending during 2001 or 2002 a five-year carryback.

The provision could have a positive effect on Tier One capital, and suspends the 90% annual income limitation on utilization of net operating loss carryovers for alternative minimum tax purposes.

Reinstated credits

Certain credits that expired at the end of 2001 are retroactively reinstated and extended for two years. These include the work opportunity tax credit and the welfare-to-work credit.

The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of eight targeted groups. The maximum credit per employee is \$2,400 (40% of the first \$6,000 of qualified wages).

The welfare-to-work tax credit also is available on an elective basis for employers for the first \$10,000 of eligible wages paid to qualified long-term family assistance recipients during each of the first two years of employment. The maximum credit is \$8,500 per qualified employee.

Accounting methods

Aside from the new tax law, the Internal Revenue Service also issued final regulations allowing qualified financial institutions, with average annual gross receipts under \$10 million, to use the cash method of accounting.

This exception does not apply to taxpayers prohibited from using the cash method under Section 448 (generally C corporations).

Nonetheless, those financial

institutions that qualify may be entitled to a tax benefit that can be recognized during the first year in which the taxpayer changes methods.

For more information on how we can help you identify tax-planning strategies to implement these new tax law changes, contact your BKD Financial Institutions Group advisor. □

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Recruit & retain a productive work force

by Sarah Farrell, Kansas City

Recruiting is a challenge every financial institution knows well. Indeed, it was *the challenge* throughout the 1990s and continues into the millennium. Everyone is fighting to attract the same candidates.

Employers who want their institution to run smoothly and stay competitive must become adept at recruiting and retaining the best, most qualified and most productive workers.

Recruiting

Keys to effective recruiting and retention include:

- ▲ Identify needs as far in advance as possible
- ▲ Address appropriate staffing levels for your facility
- ▲ Assess demographics and skills of the applicants
- ▲ Design innovative, quality recruiting and selection programs
- ▲ Run ads that target your audience
- ▲ Know what and what not to ask during interviews
- ▲ Hire selectively, not out of desperation
- ▲ Spice up your new hire orientation programs

Retaining

Keeping the best employees begins with finding and hiring the best. Once hired, a number of strategies and options can help retain your quality hires, including:

- ▲ Leadership
- ▲ Fun and celebration
- ▲ Effective performance management
- ▲ Training and retraining staff, supervisors and management

- ▲ Honesty and candidness with employees
- ▲ Effective communication programs
- ▲ Flexible schedules
- ▲ Compensation
- ▲ Benefits
- ▲ Personnel policies addressing work and family issues
- ▲ Positive workplace attitudes

Benefits to you

A successful recruiting and retention program should benefit your company in several ways. It can help:

- ▲ Retain best staff
- ▲ Attract higher quality recruits
- ▲ Develop higher quality supervisors
- ▲ Create positive work environment

- ▲ Motivate staff
- ▲ Encourage more participatory management style
- ▲ Resolve work and family issues through alternative work options

Leadership is key

Perhaps, the most important element in the retention process is leadership. Leadership has never been more important in business than today.

An effective leader must be technically competent and combine a tough mind set with compassion and empathy. He/she needs values, an interest in people and a drive to get the job done.

Effective leaders know that to attract and retain the best people, their organization must develop a



distinct culture, which they understand and are able to communicate to employees.

Answers vary

There's no "one size fits all" methodology for successful recruiting and retention. Employers must be aware of challenges facing their work force and develop programs flexible enough to accommodate the needs of the organization and the worker.

For human resources solutions for your organization, contact your BKD Financial Institutions Group advisor. □

Secure your information assets with BKD

Increased regulation and new technologies have raised

security concerns about information systems to new levels.

Fortunately, your financial institution can be compliant, provide the access customers want and protect information assets.

The first step in securing your system is to understand its strengths and vulnerabilities. An e-security assessment from BKD Technologies, a division of BKD providing solutions to the information technology

needs of organizations like yours, can analyze your system to identify threats.

Studies show financial institutions customers are as concerned about the security of their information as they are about their financial assets. We can help through penetration testing of your system to identify and define threats to your

information and systems.

Whatever your e-security needs, BKD Technologies' team of information technology consultants, certified information systems security profession-

als, auditors and certified fraud examiners can help you identify

Bank tightens problems before

Following a series of acquisitions, mergers and the introduction of various new electronic banking services, a large bank called on BKD Technologies to help it evaluate the security of the technology behind the new services.

BKD Technologies' security team went to work. Working closely with bank management, we analyzed the bank's network and each electronic delivery system, identified specific concerns and recommended solutions to the



Improve loan quality & enhance your financial institution's profitability

by Pam Turner, Kansas City

Credit risk is the principal exposure most financial institutions face. Therefore, the quality of your loan portfolio is an excellent barometer of your institution's overall financial health and viability.

The quality of your loan portfolios, policies and practices has a dramatic impact on your bottom line. There are steps you can take to improve loan quality.

Loan request

The loan approval document should contain enough information to make an informed credit decision. In addition to purpose, terms, source of repayment, collat-



eral analysis and cash flow, it should examine the borrower's strengths and weaknesses. Do the strengths outweigh the weaknesses? Are there ways to mitigate weaknesses?

The request also should point out any exceptions to the loan policy. Is justification adequate to waive the exception? Exceptions to policy should be part of the loan approval.

Loan structure

Structure loan repayment terms properly. Consider when the source of repayment becomes available, *e.g.*, crop sales for agricultural loans. Also consider the life of assets such as equipment. Structure development loans so the loan is paid off well before the last lot is sold.

Know when it is appropriate to consider requests for single pay, annual pay and interest-only notes.

Collateral

Do not rely too heavily on collateral when evaluating loans. Unless it's a real estate loan you'll probably lose money in liquidation regardless of the advance rate. Remember cash flow, not collateral, repays loans.

Higher risk

Thoroughly understand a higher risk loan or don't make it. For example, development loans are large and attractive, but can be a disaster during an economic downturn.



Some lenders make loans without

understanding the market, the risk involved, how to analyze the loans or how to properly structure them. Construction loans can fall into this category without proper controls regarding inspections, title updates and advances.

Credit reports

It's important to obtain credit reports for all new loan requests from existing, as well as new borrowers. This will help ensure there are no significant changes in a borrower's credit outside of your institution that would influence your credit decision.

Monitor existing credits

Carefully review current outstanding loans to reduce surprises from your borrowers. If you find a problem, address it immediately. Work with your borrower and try to mitigate the impact on your institution.



Delinquency trends

Pay attention to trends in your delinquent and nonaccrual loans. Compare current numbers to those of the past few months and the same period last year.



If you see negative trends, react immediately. Is there a problem with loan quality or your collection efforts? Monitoring each loan officer's results will reduce problems with collection efforts.

Open communication

Create an environment that promotes early identification of problems. Your loan officers should proactively focus on financial data, conversations or information that can help solve a potential problem as soon as possible.

If loan officers hesitate to alert you to financially deteriorating loan customers for fear of being penalized on performance reviews, you are not likely to hear about problems until it's too late.

Enhancing profitability

A large volume of loans looks good and builds excitement. However, sound underwriting and controls are especially important during times of rapid loan growth.

You will gain more from smart credit decisions on the front end than by solving problem credits on the back end. Don't sacrifice credit quality in favor of loan volume.

Conclusion

It's critical to understand your risk profile relative to the economy when making lending decisions. Loan review programs give management and directors objective, timely assessments of portfolio quality.

Contact your BKD Financial Institutions Group advisor for information on loan review solutions. □

Technologies

threats and provide recommendations to protect against them. □

security, avoids they happen

problem identified.

Most importantly, our security consultants helped educate management about the technical security issues related to their electronic systems.

As a result, bank management immediately implemented many of BKD Technologies' recommendations. This proactive approach to identifying, understanding and correcting information technology concerns helped the bank pass its latest regulatory examination. □

FASB shows some goodwill with Statement 142

by Jim Morris, Indianapolis

The Financial Accounting Standards Board (FASB) issued Statement No. 142, **Goodwill and Other Intangible Assets**, in 2001 and many banks adopted this new accounting standard in reporting results for the first quarter of 2002.

In addition to understanding the impact of newly required goodwill impairment tests, many bankers are struggling with the fact that the new standard doesn't apply to most branch acquisitions.

Why not branch acquisitions?

Though banks have been studying the implications of the new goodwill standard for the better part of a year, confusion and disagreement over its treatment of branch transactions came to a head in October 2001.

That month FASB clari-

fied that a nearly two-decades-old statement, Statement No. 72, **Accounting for Certain Acquisitions of Banking or Thrift Institutions**, still applied to all acquisitions of financial institutions whether troubled or not, including certain branch acquisitions. As a result, the impact of no longer amortizing goodwill when buying branches will be less than anticipated.

Statement 72, issued during the 1983 savings and loan crisis, was considered by many banks to apply only to troubled institutions. The problem is, under Statement 72 goodwill does not exist. Instead, included with other intangible assets is an "unidentifiable intangi-

ble asset." For years, banks treated this nebulous item as goodwill and did not identify other intangibles in the acquisition.

Request to re-examine

Many banks and trade organizations requested FASB revisit the anomaly that some goodwill is covered by Statement 142 and other goodwill is not. The argument is branch acquisitions can generate goodwill, and this goodwill should be treated like that created through any other acquisition.

Instead of taking a broad-brush approach to all intangibles arising from a branch acquisition, it was argued transactions could be viewed individually allowing banks to appropriately record core deposit and other intangibles, as well as goodwill.

Relief on the way?

FASB is revisiting this issue. On May 10, it issued an Exposure Draft, **Acqui-**

sitions of Certain Financial Institutions, amending Statement 72, among others. The proposed change would allow most financial institution acquisitions to be accounted for prospectively in accordance with Statements 141 and 142.

The proposed change would require unidentifiable intangible assets previously recognized under Statement 72 to be reclassified and accounted for as goodwill if both of the following criteria are met:

- ▲ The transaction in which the unidentifiable intangible assets arose was a business combination
- ▲ Intangible assets required to be separately recognized under Statement 141 were recognized apart from the unidentifiable intangible asset in that transaction and accounted for separately after the date of acquisition

Contact your BKD Financial Institutions Group advisor for information on this proposed standard as it moves toward finalization. □



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