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Improving the Bank Profit Picture

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Banking, which has become so progressive in so many ways, still lags behind in planning its own activities, the author says. He outlines a simple series of schedules that will help a bank see just what its true profit picture is at all times —

IMPROVING THE BANK PROFIT PICTURE

Edwin T. Boyle

IN THE WHIRL of discussion, both written and oral, about management services, certain key phrases stand out. Management by exception is one. Investment analysis is another. Flow of funds is a third.

Such phrases—and their even more esoteric companion catchwords—perhaps frighten away more people than they intrigue. Yet if we were to translate many of them into the everyday language of business, into dollars and cents of profit or loss, item by item, we

would find them much easier to deal with, and much more convincing to the average client.

Furthermore, we would be dealing with an area where we—certified public accountants—can create systems that make sense for management purposes, not in terms of vague abstractions but in terms of the hardest of hard realities—dollars and cents.

Business in general places much reliance upon the conventional income and expense statements because these statements report fac-

tually the financial results of operations for a specific period of time. Because of their consistency, they permit us to compare current results with prior results, and, through analysis of the exceptions, to forecast what future results probably will be.

Essential lacking

Yet these statements, useful as they are, nevertheless do not show us the cause and effect relationships that exist in a business. They

actions—they do not identify the different mixes that exist in a business.

We have designed a system for medium-sized commercial banks for the purpose of getting behind the figures as they appear in conventional accounting reports. Most banks traditionally gauge their relative success largely by their periodic profit and loss statements. Yet as one works with a bank, it becomes apparent that the traditional profit and loss statement leaves out the very important factor of "mix" as it relates to a bank. And since there are many mixes that exist in banking (although they are not clearly identifiable as in industry), it is important that they be analyzed.

One important mix has to do with earnings which result from the re-employment of old funds, as contrasted with earnings resulting from the deposit growth of the bank. And unless these sources of revenue are separated, management decisions may suffer.

To clarify the point, if a bank had \$30,000,000 invested in mortgages at 5½ per cent and these mortgages were renewed at 6 per cent, the bank's annual income would increase \$150,000—without one penny of deposit growth required. This \$150,000 increase in annual income could completely conceal losses incurred in employing the new deposit resources of the bank because of the high cost of the deposit growth.

A bank exists in a universe of which it is a very small part; it is controlled by outside factors as well as by its own internal management. To the degree that management can be made aware of the influence of these outside factors, and can react to them, it will be that much more efficient as a management group. The improvement in earnings that results from the re-employment of old funds is, to some extent, based on the money market and is largely outside an individual bank's control. There are periods in which profits will

Computer simplifies breakdown

It's relatively easy these days for a bank, working from figures it already has, to achieve such a distinction between profits from old funds and new. Most banks either have their own computers or deal with a central organization furnishing computer services. Through the medium of the computer they have the opportunity to obtain all necessary data as a by-product of their regular accounting system.

And such data will assist bank management materially in planning a bank's future course of action.

We are all familiar with the computer's capacity to handle large volumes of data such as those required in demand deposit accounting or savings account transactions. But few of us have yet begun to use the computer as a management tool, as a means of evaluating how well we have employed the bank's resources and how effectively we have put to work the high-cost money that we have obtained through our savings accounts. By the same token the computer can be used to compare our bank's current income picture with that of other banks of the same size, in an environment comparable not only as far as asset structure is concerned but types of income as well.

And we can devise computer programs to achieve all these results so that constant updating of all figures is accomplished with little difficulty.

Let's set up hypothetical schedules and see how such a computer program can produce figures meaningful as a management guide. These schedules are based upon a series of reports that we have designed for our bank clients. We work out the figures on our own computer, but any bank with its own machine could do precisely the same thing.

We prepare five schedules for the client which in effect put bank

To clarify the point, if a bank had \$30,000,000 invested in mortgages at 5½ per cent and these mortgages were renewed at 6 per cent, the bank's annual income would increase \$150,000—without one penny of deposit growth required.

Boyle: Improving the Bank Profit Picture

Schedule 2

ABC BANK
Average Earnings Report—April 19—

Acct. No.	Account Description	January 19—	February 19—	March 19—	April 19—	Year to Date
xxx	U.S. Govt. Obligations					
	Income	xxxx	xxxx	xxxx	xxxx	xxxx
	Average Balance	xxxx	xxxx	xxxx	xxxx	xxxx
	Average Yield	xxxx	xxxx	xxxx	xxxx	xxxx
xxx	Federal Agencies and Corps.					
	Income	xxxx	xxxx	xxxx	xxxx	xxxx
	Average Balance	xxxx	xxxx	xxxx	xxxx	xxxx
	Average Yield	xxxx	xxxx	xxxx	xxxx	xxxx
xxx	State, County, Municipal, and Pub. Hous.					
	Income	xxxx	xxxx	xxxx	xxxx	xxxx
	Average Balance	xxxx	xxxx	xxxx	xxxx	xxxx
	Average Yield	xxxx	xxxx	xxxx	xxxx	xxxx
	Converted Average Yield	xxxx	xxxx	xxxx	xxxx	xxxx
xxx	Bills Discounted					
	Income	xxxx	xxxx	xxxx	xxxx	xxxx
	Average Balance	xxxx	xxxx	xxxx	xxxx	xxxx
	Average Yield	xxxx	xxxx	xxxx	xxxx	xxxx
xxx	Demand Loans—Secured and Unsecured					
	Income	xxxx	xxxx	xxxx	xxxx	xxxx
	Average Balance	xxxx	xxxx	xxxx	xxxx	xxxx
	Average Yield	xxxx	xxxx	xxxx	xxxx	xxxx
	Total:					
	Income	xxxx	xxxx	xxxx	xxxx	xxxx
	Average Balances	xxxx	xxxx	xxxx	xxxx	xxxx
	Average Yield	xxxx	xxxx	xxxx	xxxx	xxxx

operations under a magnifying glass, reveal the breakdown between bank uses of old money—money which it had in its available funds at the start of any period—and new money, money gained from increases in demand, savings, and time deposits during the period.

The schedules also show very clearly how a client bank has handled its operations during the period in comparison with other banks of similar size in the Federal Reserve System.

To achieve all this, our very first schedule departs from customary banking practice. It is an Average Balances Report: A bank's financial statement is usually based on monthly closing dates. This is useful for comparison of current overall financial status with previous periods, but it's not good enough to evaluate the interactions of the

various earning asset accounts. Neither does it provide us with a sound enough basis for good audit control of income, for earnings depend on average balances rather than pointed closing date balances. So our first schedule for a bank shows both the monthly closing date balances for each of a bank's earning accounts and the daily average balances throughout the month as well. It is the latter figure that is significant in learning what our earnings have been on a net yield basis. (Friday totals are duplicated for Saturdays and Sundays, when there are no transactions but interest-earning accounts go right on accumulating interest; this gives an accurate set of figures for the entire month when an average daily balance is calculated.)

The column to the extreme right on this schedule (not shown here) shows the cumulative average for

the year to date. In addition to the earning assets, we show also the closing and average balances for the different classifications of depositors' funds—demand accounts, deposit accounts, certificates of deposit, etc. The average balance makes it possible for us to measure the cost of depositors' money employed. The closing date balances coincide with the regular financial reports.

With little difficulty we could prepare an average balance sheet



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We can determine how well the new resources resulting from increases in . . .

Schedule 3

ABC BANK
Activity in Earning Asset Accounts—August 19—

Asset Classification	Balance at Beginning			Additions During Month		
	Principal Amount	% Yield	Annual Income Index	Principal Amount	% Yield	Annual Income Index
Time Loans:						
@ 5%	\$ 46,800	5.00	\$ 2,340	\$ 2,000	5.00	\$ 100
5¼%	286,500	5.25	15,041	—0—	—	—
5½%	3,587,962	5.50	197,337	246,000	5.50	13,530
5¾%	2,416,982	5.75	138,976	946,000	5.75	54,395
6%	2,092,782	6.00	125,566	1,114,000	6.00	66,840
6½%	584,680	6.50	38,004	88,000	6.50	5,720
7%	215,892	7.00	15,112	28,000	7.00	1,960
	<u>9,231,598</u>	<u>Aver. 5.77*</u>	<u>532,376</u>	<u>2,424,000</u>	<u>Aver. 5.88*</u>	<u>142,545</u>
Bills Discounted:						
@ 5%	476,000	5.00	23,800	46,000	5.00	2,300
5¼%	528,000	5.25	27,720	114,000	5.25	5,985
5½%	2,264,000	5.50	124,520	414,000	5.50	22,770
5¾%	528,472	5.75	30,387	532,000	5.75	30,590
6%	472,600	6.00	28,356	376,000	6.00	22,560
6½%	214,965	6.50	13,972	20,000	6.50	1,300
	<u>4,484,037</u>	<u>Aver. 5.55*</u>	<u>248,755</u>	<u>1,502,000</u>	<u>Aver. 5.69*</u>	<u>85,505</u>
Total—Above Earning Assets	<u>\$13,715,635</u>	<u>Aver. 5.70*</u>	<u>\$781,131</u>	<u>\$3,926,000</u>	<u>Aver. 5.81*</u>	<u>\$228,050</u>

Historical Summary

(1) Principal Sums Invested			
January 19—	\$14,168,238		\$2,060,000
February 19—	13,713,238		2,902,813
August 19— Current Month	13,715,635		3,926,000
Total	<u>14,168,238</u>		<u>xxxxxx</u>
(2) Average Yield—Above Assets			
January 19—		5.68	5.62
February 19—		5.68	5.68
August 19— Current Month		5.70	5.81
Total		<u>5.68</u>	<u>xxxx</u>
(3) Annual Income Index:			
January 19—		\$804,066	\$115,772
February 19—		779,501	164,880
August 19—		781,131	228,050
Total		<u>\$804,066</u>	<u>xxxxx</u>

Note: The starred percentage is a weighted average computed by dividing the Annual Income Index by the Principal Sum Invested.

from the figures produced under the computerized system.

Average earnings report

Schedule 2 on page 49 relates the average balances of the different earning asset accounts, as they

were developed in Schedule 1, to the income reported in the bank's operating statements for the same asset categories. The yield is shown on the third line for each month and also the cumulative average to date. Any fluctuations in yield are analyzed, so that a high degree of

audit control is exercised. It will be noted that the yield on tax-free government securities has been converted to the equivalent of a before-tax yield.

Schedule 2 indicates the actual yield on the various asset accounts and is based upon the factual mix

... interest-bearing deposit accounts have been invested and whether it all makes sense.

Reductions During Month			Balance at End		
Principal Amount	% Yield	Annual Income Index	Principal Amount	% Yield	Annual Income Index
\$ 24,000	5.00	\$ 1,200	\$ 24,800	5.00	\$ 1,240
182,000	5.25	9,555	104,500	5.25	5,486
918,000	5.50	50,490	2,915,962	5.50	160,377
816,000	5.75	46,920	2,546,982	5.75	146,451
366,000	6.00	21,960	2,840,782	6.00	170,446
92,000	6.50	5,980	580,680	6.50	37,744
14,000	7.00	980	229,892	7.00	16,092
<u>2,412,000</u>	<u>Aver. 5.68*</u>	<u>137,085</u>	<u>9,243,598</u>	<u>Aver. 5.82*</u>	<u>537,836</u>
254,000	5.00	12,700	268,000	5.00	13,400
228,000	5.25	11,970	414,000	5.25	21,735
665,000	5.50	36,575	2,013,000	5.50	110,715
386,000	5.75	22,195	674,472	5.75	38,782
104,000	6.00	6,240	744,600	6.00	44,676
88,627	6.50	5,760	146,338	6.50	9,512
<u>1,725,627</u>	<u>Aver. 5.53*</u>	<u>95,440</u>	<u>4,260,410</u>	<u>Aver. 5.61*</u>	<u>238,820</u>
<u>\$4,137,627</u>	<u>Aver. 5.62*</u>	<u>\$232,525</u>	<u>\$13,504,008</u>	<u>Aver. 5.75*</u>	<u>\$776,656</u>
\$2,515,000			\$13,713,238		
2,867,416			13,748,635		
4,137,627			13,504,008		
<u>xxxxxx</u>			<u>13,504,008</u>		
	5.58			5.68	
	5.66			5.69	
	5.62			5.75	
	<u>xxxx</u>			<u>5.75</u>	
		\$140,337			\$779,501
		162,296			782,085
		232,525			776,656
		<u>xxxxx</u>			<u>\$776,656</u>

that exists in each one of these accounts. Inasmuch as one of the objectives of our analysis will be to determine how effectively we are employing growth resources of the bank, it becomes necessary to get behind the *average* yield. It is important to see the yield at which

new money is being invested as contrasted with the yield that existed on the money being paid off. We then can determine how well the new resources resulting partly from increases in the savings accounts and other interest-bearing deposit accounts have been in-

vested and whether or not it all makes sense.

Activity in earning asset accounts

Schedule 3 on page 50 analyzes the activity in each earning asset account and shows the amount of

Schedule 4

ABC BANK

Changes in Average Employment of Funds August 19—
vs July 19—

	Average Balances		Current Period		Average Yield	Net Changes in Annual Income Projection	
	July 19—	August 19—	Increases	Decreases		Increases	Decreases
Flow of Funds From:							
State, Municipal and Public Securities Under R/P Agreement	\$25,567,605	\$24,952,619		\$614,986	7.32%		\$45,016
Instalment Loans—Dealer Wholesale	1,204,619	1,102,567		102,052	4.02		4,102
	11,045,617	10,204,617		841,000	7.90		66,439
Flow of Funds To:							
Demand Loans	8,284,116	9,434,357	\$1,150,241		6.00	\$ 69,014	
Mortgages—Net	20,516,020	20,856,482	340,462		5.62	19,133	
Time Loans	9,247,654	9,467,918	220,264		5.88	12,951	
Bills Discounted	4,476,514	4,678,542	202,028		5.69	11,495	
Other Bonds and Stocks	1,246,518	1,476,517	229,999		3.68	8,463	
No Changes During Period:							
U. S. Gov't. Obligations	4,854,819	4,854,819	—	—			
Federal Agencies	2,406,518	2,406,518	—	—			
Federal Reserve Bank Stock	150,000	150,000	—	—			
Brokers Loans	1,800,000	1,800,000	—	—			
Totals	\$90,800,000	\$91,384,956	2,142,994	1,558,038		121,056	115,557
			<u>1,558,038</u>			<u>115,557</u>	
Net Increase, Decrease			<u>\$ 584,956</u>			<u>\$ 5,499</u>	

money invested at each rate of interest at the beginning of the month; the amount of new loans or new investments made during the month, again classified by rate of return; the amount of reductions in assets as a result of pay-offs and redemptions during the month; and the balances at the end of the month, showing principal sums outstanding and the rate at which invested. From this statement, we are able to compare the amount of money being paid off during the month with the amount reinvested during the month; the average yield on the investment of new funds as contrasted with the average yield on the funds paid off during the month; and the carry forward amount of principal invested at the different yields and also the average rate of return. Increases and decreases of income that may have resulted from fluctuations in the money market become apparent.

The rate at which new money is being invested has special significance when compared with the cost of new money on deposit.

At the bottom of Schedule 3, we are able to summarize past activity and show trends that are taking place in the three components of the study: the principal account, the net yields, and the annual income index. For example, in the schedule shown, \$14,168,238 was invested on January 1st, and this figure has declined to \$13,504,008 at the end of the period; the monthly comparison of money reinvested as compared to reductions in money outstanding is also shown—to show whether the reinvestments are keeping pace with the reductions.

The average yield on the assets under study was 5.68 per cent on January 1st and has increased to an average yield of 5.75 per cent on money currently outstanding—

but, equally important, the variations that have taken place each month are shown. During August, new loans and bills yielded 5.81 per cent as compared to 5.62 per cent average yield on money paid off.

The annual income index on January 1st was \$804,066 and this figure has decreased to \$776,656. During the month of August, however, new investments almost maintained the income lost through reductions; that is, income generated was \$228,050 on an annual basis as compared to \$232,525 annual reduction in income as a result of the redemptions that occurred during the month.

New funds costs, earnings

Schedule 4 on this page places under the magnifying glass a different perspective of a bank's operation, that is, as indicated earlier,

Schedule 4

Page 2

ABC BANK

Changes in Average Deposits August 19—
vs July 19—

	Average Balances		Current Period		Average Cost of Deposits	Average	
	July 19—	August 19—	Increases	Decreases		Cost of Increases	Savings on Decreases
Savings Accounts:							
Regular	\$43,956,719	\$44,126,945	\$170,226)			
Dormant	462,892	448,916		\$ 13,976)	\$4.02	\$ 6,116	
School	48,918	44,815		4,103)			
Christmas Club	654,916	726,854	71,938		—0—	—	—
Time Deposits:							
Trust Funds—Time Open	350,000	350,000	—	—	—0—		
Time Deposits—Open	400,000	400,000	—	—	5.00		
Time—C of Ds	2,000,000	2,104,689	104,689	—	4.50	4,711	
Savings Certificates	6,618,518	6,418,840	—	199,678	5.00		\$9,983
Other Savings Accounts	5,418,942	5,815,780	396,838	—	5.00	19,841	
Demand Deposits—(Net of "Due from Banks" and "Items in Process of Collection")	<u>38,818,946</u>	<u>38,914,518</u>	<u>95,572</u>	<u>—</u>	<u>—0—</u>	<u>—</u>	<u>—</u>
Total	<u>\$98,729,851</u>	<u>\$99,351,357</u>	<u>839,263</u>	<u>217,757</u>		<u>30,668</u>	<u>9,983</u>
			<u>217,757</u>			<u>9,983</u>	
Net Increase, Decrease			<u>\$621,506</u>			<u>\$20,685</u>	

Summary

August 19—vs July 19—

Increase or (Decrease) in annual
income projection based upon
Changes in the employment of
funds during period

\$ 5,499

Additional (Cost) or Savings
based upon changes in
money on deposit
during period(20,685)Net Gain or (Loss)—Estimated—
on an Annual Basis\$(15,186)

how well the bank is employing the new deposit funds as compared to the cost of these new funds.

It must be remembered, as stated earlier, that a bank's income may be increased or decreased as a result of increases and decreases in the money market itself, without any overall increase in the principal sum of the bank's investments. There are times when this results in increased income to the bank, and there are times when the money market fluctuations cause decreases in the bank's revenue. It thereby becomes important that we separate the new income result-

ing from the bank's growth from the increased or decreased earnings resulting from the re-employment of old funds.

In order to accomplish this, Schedule 4 compares average balances for the current month with average balances of the prior month. Any average balance that decreased during the current month as contrasted with the prior month represents a "flow of funds from"; any average balance that increased during the current month represents a "flow of funds to." The accounts in which average balances remain the same are shown in the

last section of this statement. By applying to the increases the amount at which current funds are being invested, we are able to determine the amount of money that these new funds will earn for the bank on an annual basis; any decreases represent losses of income as compared to prior periods. On page 2 of Schedule 4 (this page), we show the cost of the new money.

It is significant to note that a bank's earnings may increase as a result of the re-employment of old funds and that this increase may completely conceal losses that are incurred as a result of the employ-

Schedule 4 shows clearly the profile of the bank's growth, where the new . . .

Schedule 5				
ABC BANK				
Comparison of ABC Earning Assets and Deposit Accounts with Averages of Other Member Banks in Federal Reserve District				
Asset Classification	ABC Bank		Other Banks	
	Average Balances August 19--	% of Assets Listed Herein	Average %	Amount Applied to ABC Bank
Securities:				
U.S. Government Obligations	\$ 4,854,819	4.6	13.5	\$ 14,310,000
Federal Agencies and Corps.	2,406,518	2.3	1.2	1,272,000
State, County and Public	24,952,619	23.5	14.9	15,794,000
Other Securities:				
Federal Reserve Bank Stock	150,000	0.1	0.1	106,000
Other Bonds and Stocks	1,476,517	1.4	0.3	318,000
Total Securities	33,840,473	31.9	30.0	31,800,000
Loans and Discounts—Other than Mortgage Loans:				
Demand Loans	9,434,357			
Time Loans	9,467,918			
Bills Discounted	4,678,542			
Securities Under R/P Agreement	1,102,567			
Sub total	24,683,384	23.3	21.7	23,002,000
Brokers Loans	1,800,000	1.7	0.8	848,000
Instalment Loans	10,204,617	9.6	10.2	10,812,000
Total	36,688,001	34.6	32.7	34,662,000
Mortgage Loans—Net:				
Conventionals	8,204,618	7.7	10.9	11,554,000
FHAs, VAs	11,416,290	10.8	6.8	7,208,000
Construction and Warehouse, Other	1,235,574	1.2	6.3	6,678,000
Total Mortgage Loans	20,856,482	19.7	24.0	25,440,000
Total Earning Assets	91,384,956	86.2	86.7	91,902,000
Cash and Due from Banks:				
Cash	3,545,918	3.3	2.0	2,120,000
Federal Reserve	5,247,854	5.0	4.4	4,664,000
Due from Banks	2,285,614	2.2	2.8	2,968,000
Cash Items in Process of Collection	3,535,658	3.3	4.1	4,346,000
Total Cash and Due from Banks	14,615,044	13.8	13.3	14,098,000
Total Earning Assets and Cash and Due from Banks	\$106,000,000	100.0	100.0	\$106,000,000

ment of new funds of the bank. A large principal sum reinvested at a slight increase in rate may yield sufficient annual income to offset any loss occasioned in the investment of new money at current deposit account costs. Schedule 4 would uncover such distortions.

Schedule 4 also shows clearly the
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profile of the bank's growth; whether or not the new money is going into broker's loans, mortgages, demand loans, securities, and so forth. It shows basic policy results and makes management aware of the nature of the bank's growth. It causes an awareness of where the bank is going and how well

it is carrying out its functions.

Where exact percentages are not known, reasonable estimates may often be made. These estimates may still indicate trends and contain a message relative to the activity in the various asset accounts.

In the example shown in Schedules 4, if, conceivably, it had been

... money is going. It shows basic policy results.

ABC Bank Assets			ABC Bank Income	
Over Guidelines	Under Guidelines	Average Yield on Assets	Over Guidelines	Under Guidelines
	\$9,455,181	4.36		\$412,245
\$1,134,518		4.70	\$ 53,322	
9,158,619		7.02	642,935	
44,000		6.00	2,640	
1,158,517		3.50	40,548	
Net 2,040,473			327,200	Net
1,681,384		5.80	97,520	
952,000		5.62	53,502	
	607,383	7.82		47,497
Net 2,026,001			103,525	Net
	3,349,382			
4,208,290				
	5,442,426			
	Net 4,583,518	5.52	Net	253,010
	Net 517,044		177,715	
1,425,918				
583,854				
	682,386			
	810,342			
517,044	Net			
-0-	-0-		Net \$177,715	

possible for the *total* average balances at work during the month of August to have been exactly the same figure, \$90,800,000, as the total average balances at work during the month of July, changes in the bank's earnings still would have occurred dependent upon the mix of assets held during each pe-

riod. These changes would have occurred without any growth required in the bank's total deposit funds. Since, in our example, the average balances in earning assets increased from \$90,800,000 to \$91,384,956, we are able to see, by exception, where an additional \$584,956 of resources ended up

and also see the net yield on these additional resources—in our example, \$5,499 annually.

Schedule 4, page 2 shows that an average \$621,506 of new deposit funds were available for investment during the month and these deposits project an annual interest cost of \$20,685. The difference be-

Schedule 5

Page 2

ABC BANK

Comparison of ABC Earning Assets and Deposit Accounts Structure
with Averages of Other Member Banks in Federal Reserve District

Deposits	ABC Bank		Other Banks	
	Average Balances August 19—	% of Total Deposits	% of Total Deposits	Amount Applied to ABC Bank
Demand	\$38,914,518	39.2	48.9	\$48,582,814
Savings:				
Regular	44,126,945			
Dormant	448,916			
School	44,815			
Other Savings	5,815,780			
Total Savings Accounts	50,436,456	50.8	41.2	40,932,759
Time:				
Trust Funds—Time open	350,000			
Time Deposits—Open	400,000			
Time C of D's	2,104,689			
Savings Certificates	6,418,840			
Christmas Club	726,854			
Total Time	10,000,383	10.0	9.9	9,835,784
Total Deposits	\$99,351,357	100.0	100.0	\$99,351,357
Net Income—Over—Under Guidelines:				
Current Month				
Prior Months:				
January 19—	—	—	—	—
February	—	—	—	—
July	—	—	—	—

tween the interest cost and the income generated represents a net loss, on an annual basis, of \$15,186.

By comparing average balances of the current month with average balances of other prior periods, such as a year ago or the beginning of the fiscal year, we are able to expand the period under review and thereby eliminate any distortions that may be created because of time lag in the employment of new funds.

Conventional schedule expanded

In basic principle Schedule 5 on page 54 is familiar to all of us. It starts with the types of assets held by the bank (except that average rather than closing date balances are used) and computes the percentage that each asset represents

of the total. Column 3 is based upon average statistics taken from Federal Reserve Board releases or from other outside statistics that may be available to the bank. Column 4 applies these percentages to the footings of the ABC bank to show what the composition of the assets would be for an average bank of ABC size footings. Columns 6 and 7 are self explanatory.

At this point, the statement goes one step beyond the conventional accounting format by applying average yields on the different assets to show the effect on income resulting from the ABC Bank's variations from the average bank.

Page 2 (this page) applies this same principle to the deposit structure of the bank. It shows not only the variations from the average bank in deposit structure but also

the effect on income resulting from this variation. A bank heavy in interest-bearing deposit accounts is able to measure the cost of this money versus other banks of different deposit structures.

The fact that a bank is different from the norm in asset or deposit structure is not the important consideration; what is important is that it know when and where it is different so that management may challenge its own policy decisions, in their full environment and either assure itself that it is on a proper course or alter its course.

The statement becomes a catalyst in management policy discussions. Its importance is not in the last line alone—each line has a story of its own to convey.

In our example, the ABC Bank's earnings on productive assets are

ABC Bank Deposits		Average Cost of Deposits	ABC Bank Income	
Over Guidelines	Under Guidelines		Over Guidelines	Under Guidelines
—	\$9,668,296	—0—	—	—
—	—	—	—	—
\$9,503,697	—	4.14	—	\$393,453
—	—	—	—	—
164,599	—	4.58	—	7,538
—	—	—	—	\$400,991
—	—	—	—	—
—	—	—	—	\$223,276
—	—	—	—	278,962
—	—	—	—	264,316
—	—	—	—	240,670

\$177,715 greater than the average of other banks of comparable size and environment, but the cost of its money on deposit is \$400,991 in excess of the average of these same comparable banks.

The above statements in their entirety are an invaluable guide to management in making the largest possible profit for the bank in the present and making the wisest possible plans for the bank's future. If a merger is contemplated, is it wise to merge with a bank strong in branches in residential areas, where there might be plenty of money available in savings deposits? These may be good, but in a time of poor investment possibilities and high interest rates on savings accounts, they may be disastrous. Opening new branches? The same reasoning applies. Is it best to do it in a

substantial, middle-class residential neighborhood, where savings accounts are a certainty, or in a commercial district where business and personal loans—a source of income to the bank—are equally certain?

Guide to promotion emphasis

The same reasoning applies to every phase of a bank's promotion activities. Do you emphasize savings accounts, checking accounts, or attractive loan procedures in your advertising? Look at the comparisons first. Then you have a clue as to which makes most sense.

As expressed by Charles Age-mian, executive vice president of New York's Chase Manhattan Bank, many banks today are "high-volume low-profit" operations. This

makes it all the more imperative that the true profit picture be accurately mirrored in every step of a bank's operations.

The simple reports we have outlined in this article can do—and have done—this. Actually, they are merely an extension of the traditional profit and loss statement. As such, they give a new perspective to bank management and an automatic alarm system to signal if anything has gone wrong. They can be compiled on the bank's own punched cards or electronic equipment for an investment of a few hours of machine time a month.

They can pay off in the best possible investment of the clients' assets at all times and avoidance of overcommitment to any one investment at any time.