

Bank:

Date of Exam:

Charter #:

Prepared By:

#21– PREMISES AND EQUIPMENT (Risk Focused)

ASSIGNMENT OVERVIEW

Bank premises and equipment are reviewed to determine compliance with state banking laws, accounting propriety, and the existence of any transactions which may be considered preferential to insiders or speculative in nature. Texas laws generally provide that a bank shall not acquire real estate other than its domicile, future expansion property, or for satisfaction of debts previously contracted. Also, a bank’s investment in fixed assets may not exceed capital and surplus. For more detailed guidance see the FDIC Examination Manual section on “Premises and Equipment”. The related Reference document for this procedure identifies useful regulations, guidance, and other issuances by various regulatory authorities.

INSTRUCTIONS

All examiners performing these procedures must be listed above in the “Prepared By” section. All of the CORE ANALYSIS PHASE should be completed. Comments and findings for each step should be made in the comment box below each question. Reference to work paper documentation should also be included here. Documentation is to be sufficient to allow an audit trail of the examiner’s thought process and all significant findings.

Based on any weaknesses or risks noted in the CORE ANALYSIS PHASE or as directed by the EIC, the applicable SUPPLEMENTAL ASSESSMENT PHASE (SAP) should also be performed. Responses should be entered in the SAP. All of the important findings/deficiencies identified while performing the SAP should be summarized in the corresponding CORE ANALYSIS comment section.

The EIC/AEIC should review this procedure when complete. Acknowledgement that this procedure has been reviewed by the EIC/AEIC will be noted on the SCOPE FORM.

EXAMINERS ARE RESPONSIBLE FOR EXERCISING SOUND JUDGMENT AND UTILIZING REASONABLE INVESTIGATIVE AND ANALYTICAL SKILLS TO ARRIVE AT AN ACCURATE ASSESSMENT OF THE RISK PROFILE OF THIS SEGMENT OF THE INSTITUTION’S OPERATIONS. PERFORMING ALTERNATE PROCEDURES NOT LISTED WITH THESE GUIDELINES MAY BE NECESSARY TO COMPLETE THIS RISK ANALYSIS.

CORE ANALYSIS PHASE

#21 Premises and Equipment

1. Prior Criticism

1. Determine whether deficiencies noted in the last examination and most recent internal/external audit have been addressed and/or corrected by management. Detail how deficiencies were corrected. *Include copy of exam and/or audit exceptions and management response in work papers, or summarize exceptions/criticisms below or indicate the page number in the last examination report where deficiencies are noted, if applicable.*

Comment:

2. Reconcile

2. If there has been less than a full scope audit of the bank's financial statements in the last 12 months, then obtain subsidiary ledgers of all premises and equipment accounts and reconcile to the general ledger. In addition, through sampling, verify the propriety of significant purchases and compliance with §34.002(c) of the Texas Finance Code. *Include copy of reconciliation in 21-A of work papers. Include TFC compliance in comments.*

Comment:

3. Compliance

3a. Determine if the bank's investment exceeds 100% of capital and surplus and is a violation of §34.002(a) of the Texas Finance Code. Verify compliance with Federal limits, if applicable. Refer to [Investment Limit Worksheet](#). *Comment on compliance with TFC and Federal limits.*

Comment:

3b. Ensure compliance with Section 33.109(a) of the Texas Finance Code with transactions involving management and affiliates. Review the terms of the transactions for potential preferential treatment or conflict of interest in accordance with the Texas Administrative Code Section 3.22. *Comment on compliance with TFC and TAC.*

Comment:

3c. If the bank has any capitalized leases or sale/leaseback transactions, complete the [SAP](#). *Include copies of capitalized leases, sale/leaseback agreements, and information on lease, type of equipment, terms in 21-B of the work papers.*

#21 Premises and Equipment

Comment:

3d. Review the bank's real estate holdings as listed on the general ledger to verify if any holding is deemed future expansion property. If yes, verify compliance with Texas Finance Code §34.002(b). *Include in 21-C of work papers a listing of each property owned, with bank/branch/ATM location and date acquired identified. This information should be brought forward from the prior exam, with detail included for any additions. Consider performing an inspection of future expansion property for verification purposes. Comment on compliance with TFC.*

Comment:

3e. Determine if any property has been acquired since the last examination and verify compliance with Texas Finance Code Section 34.002(c), which states that a bank shall comply with regulatory accounting principles in accounting for its investment in bank facilities. *Refer to the FDIC Risk Management Manual of Examination Policies, Section 3.5 Premises and Equipment. Comment on compliance with TFC.*

Comment:

3f. If the bank has had any changes with the home office, branches or LPOs, verify compliance with Texas Finance Code Sections 32.201-204 and Texas Administrative Code Section 15.42 Corporate Filings. *Comment on compliance with TFC and TAC, if applicable.*

Comment:

4. Final Analysis

4. Complete the [Summary of Findings](#).

SUMMARY OF FINDINGS

#21 - PREMISES AND EQUIPMENT

Describe all strengths evident from the evaluation.

Describe all weaknesses evident from evaluation, including violations of law/regulation/rules; noncompliance with Departmental policies/guidelines; internal policy deficiencies/noncompliance; internal control weaknesses; MIS problems; and deficiencies in management supervision.

Report Worthy:

Not Report Worthy:

Determine why weaknesses exist and comment on management's response and plan of action. Identify bank personnel making the response.

SUMMARY RISK RATING ASSIGNED: Insert rating here

Risk Rating Definitions:

1-Strong; 2-Satisfactory; 3-Less than satisfactory; 4-Deficient; 5-Critically deficient; NR-Not Rated

Provide copy of this page to EIC/AEIC. Receipt and review of this form by the EIC/AEIC will be evidenced by his/her initials in the appropriate column for this procedure on the SCOPE AND WAIVER FORM (Planning and Control Worksheet #1).

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SUPPLEMENTAL ASSESSMENT PHASE

SAP

Document findings within the SAP and summarize (include weaknesses and statements on compliance with regulations or policies) in the corresponding CORE ANALYSIS section.

Compliance (Q3c.)

CAPITALIZED LEASES

Guidance may be found in the [Call Report](#) Glossary entry for “Lease Accounting”.

1. Check for proper accounting on any capitalized leases. The amount capitalized should be the present value of the minimum required payments over the noncancellable term plus the present value of any payment required under the bargain purchase option, if any, less any portion of the payments representing administrative expenses such as insurance. *List all capitalized leases.*
2. Identify which criteria apply. As per FAS 13 (FASB ASC Topic 840- *Leases*), in general, any lease which at its inception meets one or more of the four following criteria and on an accrual basis is entered into on or after January 1977 must be accounted for as a property acquisition financed with a debt obligation:
 - Ownership is transferred to the bank at the end of the lease term.
 - The lease contains a bargain purchase option.
 - The lease term represents at least 75% of the estimated economic life of the leased property. (Does not apply to leases of raw land.)
 - The present value of the minimum lease payments at the beginning of the lease term is 90% or more of the fair value of the leased property. (Does not apply to leases of raw land.)
3. Indicate which, if any, leases do not qualify as a capitalized lease as noted in #1 above and determine if:
 - the amount booked should be expensed,
 - future lease payments should be expensed as incurred (operating lease), and
 - the amount of the asset booked should be classified as Loss in the report.
4. Determine which sale/leaseback transactions should be capitalized or expensed, and that the accounting is appropriate. Sale/leaseback transactions involve the sale of property by the owner and a lease of the property back to the seller. As per FAS 28 (FASB ASC Topic 840- *Leases*), if a bank sells premises or fixed assets and leases back the property, the lease shall be treated as a capital lease if it meets any one of the four criteria above for capitalization. Otherwise, it is

SAP

accounted for as an operating lease, with rental payments charged to expense over the lease term.

5. For any sale/leaseback transactions, as a general rule, the bank shall defer any gain resulting from the sale. The unamortized deferred gain is to be reported in Schedule RC-G, item 4, "Other" liabilities. Ensure that the gain on the sale is accounted for properly.

(Exceptions to the general rule on deferral that permit full or partial recognition of a gain at the time of the sale may occur if the leaseback covers less than substantially all of the property that was sold or if the total gain exceeds the minimum lease payments.)

Comments:

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SAP

Document findings in the SAP and summarize (include weaknesses and statements on compliance with regulations or policies) in the corresponding CORE ANALYSIS comment section. CORL

Investment Limit

ACCOUNT TRANSCRIPTS (SUPPLEMENTAL TO WORKSHEET) (Q3A.)

1. Obtain the account transcripts since the last examination. Review and note purchases and sales activity.
2. Coordinate with the examiner reviewing the minute book to determine that all material purchases and sales have been approved by the board of directors.
3. Determine that assets are carried on the basis of cost, less accumulated depreciation, by reviewing a sample of the purchase invoices. Identifiable costs associated with bringing a fixed asset into productive use should be included in its historical cost.
4. Review, through sampling, the propriety of depreciation schedules. In general, an asset should be depreciated over its expected life span, with some instances of accelerated depreciation on certain types of assets.
5. Review evidence of bank ownership for bank owned vehicles and real property.

Comments:

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SAP

Document findings in the SAP and summarize (include weaknesses and statements on compliance with regulations or policies) in the corresponding CORE ANALYSIS comment section.

Investment Limit

REASONABLENESS (SUPPLEMENTAL TO WORKSHEET)

1. Evaluate the reasonableness of the bank's investment in fixed assets in terms of:
 - Present annual earnings.
 - The nature and volume of its operations.
2. Review pertinent schedules in the UBPR to see how the bank compares to its peers in terms of investment and expense of premises.

Comments:

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WORKSHEET

Section 34.002(a) of the Texas Finance Code restricts investment in fixed assets to 100% of capital and surplus. Calculate:

INVESTMENT LIMIT

Direct investment in bank facilities;	+		
Any investment in equity or investment securities of a company holding title to a facility used by the bank for premises;	+		
Any loan made by the bank to or on the security of equity or investment securities issued by a company holding title to a facility used by the bank;	+		
Any indebtedness incurred on bank facilities by a company that: (i) holds title to the facility; (ii) is an affiliate of the bank; or (iii) in which the bank is invested (or has made a loan on the security of);	=		
Total Investment in Fixed Assets			(A)
Capital and Surplus			(B)

Is (A) > (B)? If yes:

- a) Cite a violation of the above-referenced section;
- b) Obtain subsidiary ledgers of all premises and equipment accounts and reconcile them to the general ledger.
- c) Complete the [Account Transcripts SAP](#).
- d) Complete the [Reasonableness SAP](#)

For Fed member banks, also review for compliance with the limit under [12 USC 371d](#) and [12 CFR 208.21](#) (Regulation H). A well-rated and well-capitalized state member bank may invest an amount above 150 percent of its perpetual preferred stock and related surplus plus common stock plus surplus, and a bank that is not well rated and well capitalized may invest an amount above 100 percent of its perpetual preferred stock and related surplus plus common stock plus surplus, so as long as it provides the appropriate Reserve Bank at least 15 days' advance notice and has not received notice that the investment is subject to further review by the end of the 15-day period.

INVESTMENT LIMIT – FRB Member Bank

100% of Capital Stock and Surplus: _____ (C)

Is (A) > (C)? If yes:

- e) Cite a violation of the above-referenced section;
- f) Obtain subsidiary ledgers of all premises and equipment accounts and reconcile them to the general ledger.
- g) Complete the [Account Transcript SAP](#)
- h) Complete the [Reasonableness SAP](#)

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