TEXAS DEPARTMENT OF BANKING	Bank Name/City:
	Charter #:
	Exam Date:
	Performed By:

#21 – Premises and Equipment

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.

Refer to the FDIC Examination Manual, Section 3.5, "Premises and Equipment" for more detailed guidance. Also refer to the TDB Reference Material file for Premises and Equipment which identifies useful regulations, guidance, and other issuances by various regulatory authorities . In addition, Texas statutes, rules, and TDB policies can also be found in the online Law & Guidance Manual.

Instructions

IMPORTANT! These procedures are designed to promote critical thinking. As you complete this procedure, keep in mind that your comments should include what you looked at, what you found, and your conclusions. It is your narrative that should tell the story for a reader who may not be familiar with this bank. The reader/reviewer should have a thorough understanding of what was performed and conclusions made.

Examiners must follow the instructions below and the requirements in the Examiner Bulletin addressing Guidelines for Procedures and Work Paper Documentation for Commercial Examinations. **If there is a conflict between these Instructions and the Examiner Bulletin, the Instructions prevail**. Documentation should support weaknesses and criticisms. All examiners performing these procedures must be listed above in the "Prepared By" section.

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.

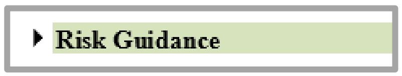
Evaluation Factors, Risk Guidance, and Comments

The focus of this procedure is to evaluate and address each of the Evaluation Factors.

The Risk Guidance is provided to guide the examiner in developing a full and complete analysis for the Evaluation Factor. Examiners should consider the items under Risk Guidance and will use their discretion to determine when to comment on a risk guidance item. Examiners should consider what data or findings merit emphasis and which are secondary or of little importance.

The examiner is expected to write a comment in the Conclusions box that is complete and supportive of findings, recommendations, and ratings.

The examiner may also address areas not included in the Risk Guidance section as it is not intended to be all inclusive.



To view the Risk Guidance, click on the arrow to the left of the "Risk Guidance" text.
To Hide the Risk Guidance, click on the arrow again.

Documentation

Supporting documentation should include the standard required documents identified in the Reference Documents section for each Evaluation Factor.

- Embedded documents should be named such that the reviewer will know the contents.
- If a required document will not be included for any reason, DO NOT DELETE the document title, instead, check either:
    - "Not Included" and add a reason why
    - "N/A" if a document is not applicable.
- Any other relevant documents may be added to fully support the examiner's findings. These documents may be embedded in the Reference Documents section.
- **If a document needs to be referenced in more than one Evaluation Factor comment, include a reference in the comment indicating the Evaluation Factor where the document can be found**.

Documentation is to be sufficient to allow an audit trail of the examiner's thought process and all significant findings.

Violations of Regulations

Violations of regulations should be addressed under the appropriate Evaluation Factor. Indicate compliance using the drop-down box next to the regulation in the Compliance section. Address non-compliance in the Comment section.

> ***Yes*** = In compliance
>
> ***No*** = Not in compliance
>
> ***Not Applicable*** = Requirements in the regulation do not apply. For example, if there were no dividends paid, then the regulation related to approval of dividends would reflect "Not Applicable".

Nonconformance with Policy

Adherence with best practices identified in Department and federal financial regulatory policy/guidance should be addressed under the Comments for the appropriate Evaluation Factor. Indicate if the bank adheres to the best practices using the drop-down box next to the appropriate policy in the Adherence to Policy section. Comments regarding best practices should be summarized in the Summary Comments.

Summary Comments and Conclusions

The Summary Comments and Conclusions should be a high-level summary that highlights the examiner's material findings and conclusions. A description of what to include in the Summary Comments and Conclusions is provided. These comments are not intended to be a report ready comment and will contain comments that may not be report worthy. Summary comments must support the Summary Rating. The EIC will determine if the use of bullet points is appropriate for completing the Summary Comments and Conclusions. *The SEIC/EIC will have discretion in determining what is included in the Report of Examination.*

Navigating this Procedure

This procedure can be easily navigated by clicking on View from the Word menu bar then selecting Navigation Pane found in the Show section. All headings in this document will appear on the left side of the screen, for easy navigation through the document.

Performing alternate or expanded procedures not listed with these guidelines may be necessary to complete this risk analysis.

SUMMARY OF FINDINGS

#21 Premises and Equipment – Summary Comment and Conclusions
Document conclusions regarding policies, procedures, internal controls, and management oversight. Include recommendations for implementing best practices from policies and management's responses to weaknesses. *The SEIC/EIC will determine what to include in the report of examination.*
Summary Rating: **Click Here to Select Rating**

Violations
Prepare a comment for any violation cited. Include management's response.

Premises and Equipment Analysis

EVALUATION FACTOR 1:
Review the last examination, most recent internal/external audits, and correspondence to identify any recommendations, violations, Matters Requiring Attention, or regulatory enforcement actions relating to Premises activities. Determine Board and management's efforts to comply with or correct noted deficiencies or concerns.

Reference Documents	Conclusions – Evaluation Factor 1
Prior Examination Criticisms and/or Audit Exceptions ☐ N/A ☐ Not Included ☐ Include w/ Conclusions Copy of management response/corrective action ☐ N/A ☐ Not Included ☐ Include w/ Conclusions	

EVALUATION FACTOR 2:
Review all premises and equipment accounts and determine compliance with regulatory accounting principles and the Texas Finance Code(TFC) for significant purchases since the last examination.

Risk Guidance

1. If there has been less than a full scope audit of the bank's financial statements in the last 12 months, obtain subsidiary ledgers of all premises and equipment accounts and reconcile to the general ledger.

a. Verify (through sampling) the propriety of significant purchases and compliance with regulatory accounting principles in accounting for its investment in and depreciation of bank facilities, furniture, fixtures, and equipment per TFC §34.002(c).

   i. 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.

   ii. 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.

b. Review evidence of bank ownership for bank owned vehicles and real property.

2. Determine if any property has been acquired since the last examination and verify compliance with TFC §34.002(c),

3. Review the bank's real estate holdings as listed on the general ledger to verify if any holding is deemed future expansion property. Determine whether real estate held for future expansion still qualifies as bank premises per TFC §34.002(b). Real property not improved and occupied by the bank ceases to be a bank facility on the third anniversary of the date of its acquisition unless an extension is granted by the banking commissioner. *Consider performing an inspection of future expansion property for verification purposes.*

Compliance with Regulations	
Compliance with TFC §34.002(c) regarding the propriety of significant purchases and compliance with regulatory accounting principles in accounting for its investment in and depreciation of bank facilities, furniture, fixtures, and equipment.	**Select Response**
Real estate held for future expansion qualifies as bank premises per TFC §34.002(b).	**Select Response**

Reference Documents	**Conclusions – Evaluation Factor 2**
Reconcilements or Transcripts ☐ N/A ☐ Not Included Listing of All Real Estate Property Owned (Request	

List item 21-B) ☐ N/A ☐ Not Included Schedule of All Leases ☐ N/A ☐ Not Included	

EVALUATION FACTOR 3:
Determine compliance with accounting standards for capitalized/financed leases of sale/leaseback transactions, if applicable.

Risk Guidance

Under ASC 842, lessees are required to classify a lease as either a finance lease or an operating lease and, in most cases, identify and report them on the balance sheet. Although the term finance lease replaced the term capital lease that was previously used in ASC 840, the substance of recording and reporting the transactions remains the same.

Guidance may be found in the Call Report Glossary entry for "Lease Accounting.

1. **Check for proper accounting on any capitalized/financed leases.** The amount capitalized should be the present value of the minimum required payments over the noncancelable 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 in the comment box.*
2. **Identify which criteria apply to meet the definition of a capital lease.** As per ASC Topic 842-10-25-2 , 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:
    a. Ownership is transferred to the bank at the end of the lease term.
    b. The lease contains a bargain purchase option.
    c. The lease term represents at least 75% of the estimated economic life of the leased property. (Does not apply to leases

of raw land.)

   d. 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. **If any, leases do not qualify as a capitalized lease as noted above and determine if:**

   a. the amount booked should be expensed,

   b. future lease payments should be expensed as incurred (operating lease), and

   c. 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 ASC Topic 842- 40-*Leases-Sale and Leaseback Transactions*, 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 in #2 above for capitalization. Otherwise, it is accounted for as an operating lease, with rental payments charged to expense over the lease term.

5. **As a general rule, for any sale/leaseback transactions, 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.

Compliance with Accounting Standards	
Compliance with FASB's ASC Topic 842-Leases	**Select Response**

Reference Documents	**Conclusions – Evaluation Factor 3**
Copies of Capitalized /Financed Leases, Sale / Leaseback Agreements with Information on lease, type of equipment, terms,	

if applicable ☐ N/A ☐ Not Included	

EVALUATION FACTOR 4:
Determine whether the investment in premises and equipment is reasonable, complies with applicable laws and regulations, and receives proper oversight by management and the board of directors.

Risk Guidance

1. **Determine if the bank's investment in bank premises exceeds 100% of capital and surplus and is a violation of TFC §34.002(a).**
   See the Investment Limit worksheet (Optional)

   Invesmtent Limit Worksheet.xlsx

   Consider the accounting treatment for operating leases. ASU 2016-02- Leases (ASC Topic 842- Leases) requires finance or operating leases to be reported on the balance sheet. Specifically, ASC 842 requires all lessees, including institutions leasing premises and other fixed assets to recognize a right-of-use asset and the lease liability on its balance sheet for all leases, including operating leases with terms of more than 12 months. Refer to CSBS Lease Accounting Fact Sheet and the FRB's SR 19-7 *Statement on the Implications of the New Lease Accounting Standard on Regulation H* .

2. ***For Fed member banks*** :**Verify compliance with Federal investment limits. Review for compliance with the limit under 12 USC 371d (Investment in bank premises or stock of corporation holding premises) 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. Refer to Investment Limit Worksheet.

3. **Ensure compliance with TFC §33.109(a) relating to transactions involving management and affiliates.** Review the terms of the transactions for potential preferential treatment or conflict of interest in accordance with the Title 7, Texas Administrative Code (TAC) §3.22.

4. **Evaluate the reasonableness of the bank's investment in fixed assets in terms of:**
   a. Present annual earnings.
   b. The nature and volume of its operations.

5. **Review pertinent schedules in the UBPR to see how the bank compares to its peers in terms of investment and expense of premises.**

6. **If the bank has had any changes with the home office, branches or LPOs, verify compliance with TFC §§ 32.201-204 and TAC Chapter 15 Corporate Activities: 7 TAC §15.41 regarding Written Notice or Application for Change of Home Office and 7 TAC §15.42 regarding Establishment and Closing of a Branch Office.**

7. **Coordinate with the examiner reviewing the minute book to determine that all material purchases and sales have been adequately reported and properly approved by the board of directors.**

Compliance with Regulations	
Compliance with TFC §34.002(a) regarding investment in bank facilities. (a) Without the prior written approval of the banking commissioner, a state bank may not directly or indirectly invest an amount in excess of its unimpaired capital and surplus in bank facilities, furniture, fixtures, and equipment.	**Select Response**
Fed Member Bank only: Compliance with 12 CFR 208.21(a) (Regulation H) investments in premises and securities.	**Select Response**
Fed Member Bank only: Compliance with 12 USC 371d Investment in bank premises or stock of corporation holding premises.	**Select Response**
Compliance with TFC §33.109(a) relating to transactions involving management and affiliates.	**Select Response**

Compliance with Regulations	
Compliance with TAC §3.22. regarding terms of the transactions with officers, directors, or affiliates and Board approval.	**Select Response**
Compliance with TFC §32.201 regarding the conduct of banking at its home office, branch, and through electronic terminals; treatment of drive-in facility as branch.	**Select Response**
Compliance with TFC §32.202 relating to location of home office.	**Select Response**
Compliance with TFC § 32.203 regarding branch offices.	**Select Response**
Compliance with TFC § 32.204 regarding deposit or loan production offices.	**Select Response**
Compliance with TAC §15.41 regarding Written Notice or Application for Change of Home Office.	**Select Response**
Compliance with TAC §15.42 regarding Establishment and Closing of a Branch Office.	**Select Response**

Reference Documents	Conclusions – Evaluation Factor 4 *Comment on noncompliance, concerns, weaknesses, or changes in bank premises.*
Correspondence with Bank Commissioner, if applicable ☐ N/A ☐ Not Included	