

**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**

Examiners must follow the requirements in the Examiner Bulletin addressing Guidelines for Procedures and Work Paper Documentation for Commercial Examinations.

All examiners performing these procedures must be listed above in the "Prepared By" section. 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 should be enough to create an audit trail of the examiner's thought process and all significant findings. Indicate compliance by selecting a response from the list in the dropdown box. Any response other than "YES" will require a comment.

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. Summarize conclusions in the corresponding CORE ANALYSIS comment section.

Information on the Summary of Findings page must tie back to the findings noted within the procedure. The SEIC/EIC will determine which information in the Summary of Findings will be included in the Report of Examination.

**LPAQ**

The LPAQ icon indicates that this section focuses on Law, Policy and Asset Quality (LPAQ) elements within the procedure. This approach was developed to better utilize examiner resources by streamlining the procedures in a more risk-based approach. Examiners may perform the designated sections which address LPAQ when no significant issues are indicated in the prior examination or internal/external audits or identified during the planning and scoping of the examination. An examiner (FE II or higher) who is considered proficient is eligible to perform the LPAQ review. **Performing the LPAQ steps does not mean that other areas are to be ignored. As always, if at any time it becomes apparent that the scope of the work performed should be expanded, then do not hesitate to do so.**

For the LPAQ review, perform the steps with the LPAQ icon; otherwise complete the CORE ANALYSIS PHASE and SAP as applicable. The SOF page should be completed and a summary rating assigned.

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

<b>1. Prior Criticism</b>	
LPAQ	<p><b>1.</b> Determine whether deficiencies were noted in the last examination and most recent internal/external audit. If yes, have deficiencies been addressed and/or corrected by management? Detail how deficiencies were corrected.</p> <p><i>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.</i></p>
<b>Comment:</b>	
<b>2. Reconcile</b>	
LPAQ	<p><b>2.</b> 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.</p> <p>In addition, through sampling, verify the propriety of significant purchases and compliance with <u>§34.002(c)</u> of the Texas Finance Code. <i>Include copy of reconciliation in 21-A of work papers.</i></p>
<b>Compliance with TFC § 34.002(c)?</b> <input style="width: 100px;" type="text" value="Choose an item."/>	
<b>Comment:</b>	
<b>3. Compliance</b>	
LPAQ	<p><b>3a.</b> Determine if the bank's investment in bank premises exceeds 100% of capital and surplus and is a violation of <u>§34.002(a)</u> of the Texas Finance Code. Verify compliance with Federal limits, if applicable. Refer to <b><u>Investment Limit Worksheet</u></b>.</p> <p>Consider the new accounting treatment for operating leases. ASU 2016-02- Leases (ASC Topic 842) 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.</p> <p>For institutions that are public business entities, ASC 842 is effective for fiscal years beginning after December 15, 2018.</p> <p>For institutions that are not public business entities, the new standard is effective for fiscal</p>

## #21 Premises and Equipment

	<p>years beginning after December 15, 2020 and interim reporting periods within fiscal years beginning after December 15, 2021. Refer to <a href="#">CSBS Lease Accounting Fact Sheet</a> and the FRB's <a href="#">SR 19-7</a>.</p>
	<p><b>Compliance</b></p> <p><b>Non-FRB Member (see <a href="#">worksheet</a>):</b></p> <p style="padding-left: 40px;">TFC § 34.002(a) <input type="text" value="Choose an item."/></p> <p><b>FRB Member (see <a href="#">worksheet</a>):</b></p> <p style="padding-left: 40px;">12 USC 371d: <input type="text" value="Choose an item."/></p> <p style="padding-left: 40px;">12 CFR 208.21 (Regulation H): <input type="text" value="Choose an item."/></p>
	<b>Comment:</b>
LPAQ	<p><b>3b.</b> Ensure compliance with <a href="#">§33.109(a)</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 <a href="#">3.22</a>.</p>
	<p><b>Compliance with:</b></p> <p style="padding-left: 40px;">TFC § 33.109(a): <input type="text" value="Choose an item."/></p> <p style="padding-left: 40px;">TAC § 3.22: <input type="text" value="Choose an item."/></p>
	<b>Comment on deficiencies:</b>
LPAQ	<p><b>3c.</b> If the bank has any capitalized/financed leases or sale/leaseback transactions, complete the <a href="#">SAP</a>.</p> <p><i>Include copies of capitalized/financed leases, sale/leaseback agreements, and information on lease, type of equipment, terms in 21-B of the work papers.</i></p>
	<p>Performed SAP? Yes <input type="checkbox"/> No <input type="checkbox"/></p>
	<b>Comment:</b>
LPAQ	<p><b>3d.</b> 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 <a href="#">§34.002(b)</a>. <i>Comment on future expansion property and indicate compliance with TFC.</i></p> <p><i>Include in 21-C of work papers a listing of each property owned, with bank/branch/ATM</i></p>

## #21 Premises and Equipment

	<i>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.</i>
	<b>Compliance with TFC §34.002(b):</b> <input type="text" value="Choose an item."/>
	<b>Comment:</b>
LPAQ	<b>3e.</b> Determine if any property has been acquired since the last examination and verify compliance with Texas Finance Code § <u>34.002(c)</u> , 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, <u>Section 3.5 Premises and Equipment</u> . <i>Comment on property acquired since last exam and indicate compliance with TFC.</i>
	<b>Compliance with TFC §34.002(c):</b> <input type="text" value="Choose an item."/>
	<b>Comment:</b>
LPAQ	<b>3f.</b> If the bank has had any changes with the home office, branches or LPOs, verify compliance with Texas Finance Code §§ <u>32.201-204</u> and Texas Administrative Code Section <u>15.42</u> regarding Corporate Activities related to Bank Offices. <i>Comment on changes and indicate compliance with TFC and TAC, if applicable.</i>
	<b>Compliance with:</b> <b>TFC §§ 32.201 – 204:</b> <input type="text" value="Choose an item."/> <b>TAC §15.42:</b> <input type="text" value="Choose an item."/> .
	<b>Comment:</b>
	<b>4. Final Analysis</b>
LPAQ	<b>4.</b> Complete the <u>Summary of Findings</u> .

## 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.**

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

**SUMMARY RATING ASSIGNED:** Choose an item.

*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 in the SAP. Summarize conclusions in the corresponding CORE section.**

#### **Compliance (Q3c.)**

#### **CAPITAL/FINANCE LEASES**

ASC 840, Leases, is the current lease accounting standard for non-public entities and entities that have not adopted ASC 842, Leases.

ASC 842 is effective for public business entities (as defined in U.S. GAAP) and will become effective for banks that are not public business entities, for fiscal years beginning after December 15, 2020, and interim reporting periods within fiscal years beginning after December 15, 2021. Early adoption is permitted

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.”

LPAQ

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.*

LPAQ

2. Identify which criteria apply to meet the definition of a capital lease. As per ASC Topic 840-10-25-1 , 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

## SAP

	<p style="text-align: center;">apply to leases of raw land.)</p>
<div style="border: 1px solid #002060; border-radius: 10px; background-color: #c6e0b4; padding: 5px; display: inline-block;">LPAQ</div>	<p>3. Indicate which, if any, leases do not qualify as a capitalized lease as noted in #1 above and determine if:</p> <ul style="list-style-type: none"> <li>• the amount booked should be expensed,</li> <li>• future lease payments should be expensed as incurred (operating lease), and</li> <li>• the amount of the asset booked should be classified as Loss in the report.</li> </ul>
<div style="border: 1px solid #002060; border-radius: 10px; background-color: #c6e0b4; padding: 5px; display: inline-block;">LPAQ</div>	<p>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 840- 40-<i>Leases-Sale-Leaseback Transactions</i>), 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.</p>
<div style="border: 1px solid #002060; border-radius: 10px; background-color: #c6e0b4; padding: 5px; display: inline-block;">LPAQ</div>	<p>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.</p> <p style="margin-left: 40px;">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.</p>
	<p><b>Compliance with FASB ASC 840-Leases:</b> <input style="border: 1px solid black; padding: 2px 10px;" type="text" value="Choose an item."/></p>
	<p><b>Comments:</b></p>
	<p><a href="#">Return to Core Analysis</a></p>



## SAP

**Document findings in the SAP. Summarize conclusions in the corresponding CORE section.**

### 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:

[Return to Worksheet](#)

## SAP

**Document findings in the SAP. Summarize conclusions in the corresponding CORE 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

**SAP**

investment and expense of premises.

**Comments:**

[Return to Worksheet](#)

## 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**

**Capital and Surplus**

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](#)

(A)

(B)

*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:**

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](#)

(C)

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