Office of Thrift Supervision **April 19, 1999**

Department of the Treasury

Regulatory Bulletin

RB 32-11

Handbook: **Thrift Activities**
Subject: **Various Sections**

Thrift Activities Regulatory Handbook Update

Summary: This bulletin provides updates for the following Thrift Activities Regulatory Handbook sections: 250, Other Assets and Liabilities; 251, Real Estate Owned and Other Repossessed Assets; and 252, Fixed Assets. Please replace the existing handbook sections with the enclosed revised sections. We provide a summary of changes for each section below.

For Further Information Contact: Your Office of Thrift Supervision (OTS) Regional Office or the Supervision Policy Division of the OTS, Washington, DC. You may access this bulletin at our web site: www.ots.treas.gov. If you wish to purchase a handbook and a subscription to the updates, please contact the OTS Order Department at (301) 645-6264.

Regulatory Bulletin 32-11

SUMMARY OF CHANGES

OTS is issuing updates to the following Thrift Activities Handbook Sections. Change bars in the margins of each handbook section indicate revisions. These handbook sections are in plain language to comply with the President's June 1, 1998, memorandum "Plain Language in Government Writing."

250 Other Assets and Liabilities

Other Assets: Adds several items to the other assets list. Discusses classification of other assets.

Cash Value Life Insurance: Streamlines the discussion and refers to new Appendix A.

Other Liabilities: Refers to the TFR Instructions for further guidance.

Appendix A: New; provides further interagency guidance based on OCC's Bulletin 96-51 relating to cash value life insurance.

Program: Examination Procedures; merges review of other assets and other liabilities according to Levels I, II, and III. Adds new procedures Nos. 13 through 16.

Questionnaire: Eliminates; the subject examination program provides sufficient review.

251 Real Estate Owned and Other Repossessed Assets

We reorganized this handbook section to present the information in chronological order and rewrote section headings for clarity.

Introduction: Clarifies definitions of REO and other repossessed assets. Moves definition of in-substance foreclosure to a footnote.

Supervisory Concerns: Adds this new subheading appropriate to text. Discusses additional concerns regarding repossession.

Appraisals: Incorporates a discussion of § 560.172 which requires an appraisal at acquisition of REO.

Accounting at Foreclosure: Clarifies and incorporates language from TFR Instructions inclusive of SFAS Nos. 114 and 121. Deletes paragraph on depreciation due to changes in SFAS No. 121.

Five-Year Holding Period: Discusses the equity investment rule 12 CFR § 567.1. Clarifies that OTS may approve a longer period.

Internal Asset Review: Refers to Thrift Activities Handbook Section 260, Classification of Assets.

Accounting after Foreclosure: Discusses the association's establishment of GVAs on REO and the capital treatment of REO. Eliminates majority of fair value discussion.

Real Estate Owned (REO) Workouts: Revises this section for clarity and deletes two paragraphs as unnecessary.

Gains: Updates and clarifies language according to 12 CFR § 560.93. Removes discussion of RB 30 which was previously incorporated into Handbook Section 211.

References: Revises 12 CFR cites and Statement of Financial Accounting Standards.

Program: Adds new objective and new procedures Nos. 13 and 14.

252 Fixed Assets

We reorganized this handbook section to improve the presentation of information.

Introduction: Identifies additional areas that regulators should review.

Economic Feasibility: Moves section to Valuation and Accounting.

Policies, Procedures, and Controls: References §§ 563.41 and 563.42.

Office Premises and Land Acquired for Future Use: Adds this new section heading. Updates the reference to § 560.37 authority to include "or for rental or sale" in addition to the investment in real estate authority. Includes guidance related to the capital treatment of thrift premises where the thrift (or its subsidiaries or affiliates) uses 25 percent or more of the premises.

Sharing Office Quarters: Provides more information about OTS conditions when leasing office space. Clarifies the authorization for lease of office space. Includes additional guidance related to the need for dual employee and thrift/subsidiary relationship procedures. Refers to additional Handbook guidance and TB 23-2.

Sale/Leaseback: Discusses the new policy to value an investment in real estate for offices.

Computer Software: Adds new section.

Valuation and Accounting Methods: Moves the previously titled Accounting Issues discussion to the end of the Handbook Section. Clarifies the tangible and intangible cost that the institution should consider to properly value fixed assets. Includes additional guidance related to other tax deduction systems, e.g., Alternative Minimum Tax and Adjusted Current Earnings.

References: Revises 12 CFR cites; adds TB 32-2 and additional accounting guidance.

Program: Procedures; Makes minor revisions to No. 10; adds new No. 15.

General Questionnaire: Combines related questions.

—Scott M. Albinson
Managing Director, Supervision

OTHER ASSETS

The term, other assets, represents a balance sheet category for miscellaneous assets not appropriately included in other major asset categories. Such assets are typically nonearning and often represent a small percentage of a savings association's total assets.

Other assets might include the following items:

- Federal Home Loan Bank (FHLB) Stock.
- Stock in the Student Loan Marketing Association, or Farm Credit District Bank.
- Accrued FHLB dividends.
- Federal, state, or other taxes receivable.
- Net deferred tax assets per SFAS 109.
- Insured portion of real estate owned on VA or FHA-HUD loans while title is held pending conveyance.
- Prepaid deposit insurance premiums.
- Prepaid expenses.
- Value of margin accounts held for financial futures and options contracts.
- Deferred net gains and losses on asset hedges.
- Goodwill and other intangible assets.
- Capitalized organization costs.
- Purchased loan servicing rights.
- Excess loan servicing.
- Personal property owned by the savings association and leased to others.
- Accounts receivable.
- Prepaid expenses.
- Accrued income receivable.
- Suspense items.
- Miscellaneous items.
- Cash surrender value of life insurance policies.
- Claims and judgments where collection is likely.
- Premiums (gifts) for business promotions.

The Thrift Financial Report Instructions, Consolidated Statement of Condition, outlines the reporting of other assets.

It is important to review a savings association's other assets and liabilities because you may find a significant level of poor quality assets in associations lacking adequate internal controls and accounting procedures.

Materiality and inherent risk assessments are the major factors in deciding which accounts to review in the examination of a savings association. You should not spend valuable time trying to analyze the nature and quality of each item. This is true especially for small items or assets with little inherent risk of loss and an insignificant effect on the safety and soundness or quality of earnings of the savings association. A savings association with good controls and review systems will periodically purge all uncollectible, unreconcilable suspense items. Depending on the level of risk, you may have to go beyond the general ledger control accounts and scan the underlying subsidiary ledgers. This allows you to determine that posting errors and the common practice of netting certain accounts against each other does not hide significant balances.

Savings associations should maintain sufficient supporting documentation for each item in the other assets category. You should thoroughly review stale or suspense items that remain in an account for extended periods of time. You should ensure that the savings association is following a consistent approach in managing its assets. Review the savings association's policies and practices for the following unsafe and unsound actions:

- Failing to consistently administer adequate procedural controls over items categorized as other assets.

- Continuing to amortize assets after they have lost their value (savings associations should charge off such assets).
- Using suspense accounts to hide or postpone the proper booking of accounts.
- Establishing deferrals for assets that have no future value.
- Using recordkeeping procedures that result in unsupported original entries for asset acquisitions and unsupported amortizations or charge-offs.

In addition, you should review whether the savings association appropriately classifies other assets. Savings associations should charge off or establish a specific reserve for any asset or portion of an asset considered uncollectible. Savings associations should classify assets that exhibit weaknesses but the savings association does not deem uncollectible based on the criteria in Section 260, Classification of Assets.

You should also verify that savings associations account for net deferred tax assets and include them in regulatory capital, according to the limitations of SAS No. 109 and Thrift Bulletin 56.

Cash Value Life Insurance

Some savings associations purchase cash value life insurance to fill various business needs, including the funding of employee compensation plans, insuring loans against the death of a principle borrower, providing key-man coverage, etc. Savings associations should carefully evaluate large investments in cash value life insurance especially if policy expenses are material. See Appendix A for OTS's policy on cash value life insurance.

OTHER LIABILITIES

Other liabilities are a balance sheet category for those accounts that the savings association does not identify individually because of their relative insignificance. The anonymity of the caption may invite misuse, both inadvertent and deliberate. Other liabilities include the following items:

- Declared but unpaid cash dividends on stock.
- Deferred net gains and losses on liability hedges.
- Nonrefundable loan commitment fees.
- Balance in certain U.S. Treasury tax and loan accounts.
- Deferred gains on sale of real estate recorded under percent completion method pursuant to SFAS No. 66.
- Amounts payable under interest rate swap agreements.
- Amounts due brokers between trade and settlement dates on purchased securities.
- Unapplied loan payment that the savings association will credit to the customer's account as of the date of receipt.
- Other similar suspense item liabilities.
- Liability created when a servicer does not expect the benefits of a loan servicing contract to provide adequate compensation.

Refer to the Thrift Financial Report Instructions, Consolidated Statement of Condition, for a more complete list or proper reporting of other liabilities.

As with other assets, the association should maintain sufficient supporting documentation for each item in the other liabilities category. Your major emphasis in the other liabilities area should be the adequacy of the controls and procedures used by the association to promptly record the proper amount of liability. If not properly supervised, the savings association or individual may use other assets and liabilities to conceal shortages. When examining this part of the balance sheet, you may detect the following unsafe and unsound practices or conditions:

- Savings association overdrafts.
- Defalcations.

- Inaccuracies in Thrift Financial Reports.
- Unresolved differences between the general ledger and supporting subsidiary records.
- Contingent liabilities for items such as taxes, legal services, employee compensation and pensions, equipment, and claims for damages.
- Manipulation of net income by recording income or improperly reporting or underaccruing other liabilities.
- Failure to record all material liabilities adequately and accurately.
- Failure to discharge liabilities according to their terms and requirements.

The following obligations or circumstances that the savings association may have incurred and not recorded on the association's books could result in direct or contingent liabilities:

- Planned payments of bonuses or special compensation to officers or directors.
- Unpaid federal and other taxes that the savings association disputes.
- Anticipated settlements of pending tax litigation in excess of recorded amounts of liability.
- Employment contracts.
- Inadequate insurance coverage for potential lawsuits or claims for damages.
- Equipment contracts.

REFERENCES

Code of Federal Regulations (12 CFR)

§ 560.160	Classification of Certain Assets
§ 563.41	Loans and Other Transactions With Affiliates and Subsidiaries
§ 563.42	Additional Standards Applicable to Transactions With Affiliates and Subsidiaries
§ 563.43	Loans by Savings Associations to Their Executive Officers, Directors, and Principal Shareholders
§ 563.200	Conflicts of Interest

Office of Thrift Supervision Bulletins

TB 56	Deferred Tax Assets: OTS Guidelines on Regulatory Reporting; Transition Rule

Financial Accounting Standards Board, Statement of Financial Accounting Standard

SFAS No. 106	Employers' Accounting for Post-Retirement Benefits Other Than Pensions
SFAS No. 109	Accounting for Income Taxes
SFAS No. 115	Accounting for Certain Debt and Equity Securities

Accounting Principles Board (APB) Opinions

APB No. 12	Deferred Compensation Contracts
APB No. 21	Interest on Receiveables and Payables

Other Accounting References

Technical Bulletin No. 85-4 Accounting for Purchases of Life Insurance

America’s Community Bankers, Accounting Principles for Savings Associations

OCC Bulletin 96-51 Bank Purchases of Life Insurance

Other Assets and Liabilities
Program

Examination Objectives

To determine and evaluate the association's policies and procedures applicable to the recordkeeping and management of other assets and other liabilities.

To determine whether expenditures for other assets are appropriate to the needs of the association and consistent with its business plan.

To determine the extent of compliance with the savings association's stated policies, procedures, and controls, and with applicable state and federal regulations and restrictions.

To determine if the association has exposure to contingent liabilities and to evaluate its plans for addressing them.

To summarize findings and to initiate corrective action when deficiencies exist that could affect safety and soundness, or when you note violations of laws or regulations.

Examination Procedures

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Level I

1. Review scoping materials applicable to this program. If another examiner(s) reviewed scoping materials, obtain a written or oral summary of the review(s) of items concerning this program. Scoping materials might include: the prior examination report, prior exception sheets and work papers, review of internal and independent audit reports, review of OTS financial analysis reports, supervisory analysis, correspondence, etc.

2. Determine the association's policies and procedures on other assets. Review policy statements, the internal asset review program, procedures manuals, the association's business plan, board and committee minutes, and independent audit reports.

3. Ascertain through observation and interviews with management whether the savings association periodically reviews policies and procedures and communicates changes to the appropriate association personnel. Determine whether they are generally comparable in nature and scope with management's policies and practices on other balance sheet items. Review all asset-related suspense accounts.

Exam Date:
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Reviewed By:
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4. Review correspondence with legal counsel handling litigation to determine if the savings association records contingent liabilities and that they appear reasonable.

5. Determine whether the savings association has policies and procedures for managing other liabilities and whether they are compatible with the findings of prior independent audits and examinations, and state and federal regulations. Determine if the savings association's policies and procedures prevent imprudent practices as discussed in this Handbook Section.

6. Review Level II procedures and perform those necessary to test, support, and present conclusions derived from performance of Level I procedures.

Level II

7. Obtain (or prepare) a complete list of other assets. Obtain a reconciliation of the balancing of the association's subsidiary records to the general ledger. Ascertain whether the savings association reports other asset balances correctly on the Thrift Financial Reports. Correct as necessary.

8. Compare total investments between examinations and determine the reason for significant variances or unusual changes. Determine and evaluate management's justification for material overinvestment in other assets.

9. Review a selected sample of subsidiary ledgers and documentation supporting other assets. Determine whether the savings association appropriately writes down other assets the savings association deems uncollectible. The savings association should charge off or classify as Loss such assets in accordance with 12 CFR § 560.160.

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10. Compare accounts receivable for the current reporting period with receivables 90 days prior. Scrutinize material accounts with unchanged balances over this period for possible write-off or classification.

11. Be alert to the existence of any unrecorded assets; for example, deficiency judgments obtained as a result of foreclosure, or assets charged off that still have substantial value. The savings association should record these items as other assets at nominal book value. Verify a select sample of claims pending for FHA or VA guaranteed loans to determine that the claims are legitimate and that the savings association promptly submits them.

12. Determine if the other assets accounts include a significant investment in cash value life insurance. If so, determine the following:

    - Is the insurance amount reasonable?
    - Does the savings association account for the cash value life insurance correctly?
    - Is such insurance a permissible investment in accordance with OTS policy? (See Appendix A)

13. Review the adequacy of the Board's documentation justifying the amount of cash value life insurance.

14. Review whether the insurance arrangement complies with Federal Reserve Regulation O, as applicable.

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Other Assets and Liabilities Program

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15. Determine whether the insurance policy adequately protects the savings association's interests.

16. Determine if the savings association recorded improper payments between the savings association and affiliated companies under 12 §§ CFR 563.41 and 563.42 or if the payments present a conflict of interest under 12 CFR § 563.200.

17. Review subsidiary records and invoices supporting a selected sample of other liability account transactions. Determine if the savings association recorded all liabilities promptly. Determine and evaluate justifications for not doing so.

18. For each obligation or circumstance identified that could result in direct or contingent liabilities, determine if management is aware of the problem and has plans for disposing of potential liabilities.

19. Obtain a listing of all accounts included in the other liabilities category. For major accounts included in this listing, determine if and why there were significant changes in these accounts since the previous examination and evaluate management's justification for these changes.

20. On a selected sample basis, determine the composition of large other liability accounts. Review the documentation supporting other liabilities. Determine and evaluate the justification for items that appear unusual.

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21. Determine if the savings association has not paid any liabilities for an unreasonable length of time. If so, why? Evaluate management's justification for non-payment and determine when the association expects to make payment. Determine if the savings association has adequate controls to ensure the proper disposition of liabilities remaining unpaid for extended periods of time.

22. If applicable, determine that the tax payments to a parent holding company are in accordance with OTS policy. (Refer to the OTS Holding Company Regulatory Handbook.)

23. Ensure that your review meets the *Objectives* of this Handbook Section. State your findings and conclusions, as well as appropriate recommendations for any necessary corrective measures, on the appropriate work papers and report pages.

Level III

24. Review all evidence supporting significant income tax refund claims the savings association records as a receivable. Such evidence includes the actual claim document, a request for technical advice, protest, or any other material that provides additional support to the claim. You should take particular care when you look at tax refund claims where the amounts are significant relative to either net income or capital.

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CORPORATE OWNED LIFE INSURANCE

The following guidance is from Office of the Comptroller of the Currency Bulletin 96-51, Bank Purchases of Life Insurance. The OCC developed this guidance in coordination with the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of Thrift Supervision. Each agency agreed, in principle, to adopt guidance substantially similar to the guidance contained in Bulletin 96-51.

Corporate-owned life insurance (COLI) includes all life insurance that a corporation, such as a savings association, purchases and owns or has a beneficial interest in. The second part of this appendix includes discussions of the most common uses of COLI and the associated risks.

While there is no specific statutory authority for the purchase of life insurance, the banking agencies consider it legally permissible if it is incidental to banking. That is, useful in connection with the conduct of the savings association’s business. Life insurance might be useful for the following purposes:

- Key-person insurance.
- Life insurance on borrowers.
- Life insurance purchased in connection with employee compensation and benefit plans.
- Cash value life insurance taken as security for loans.

This authority is subject to supervisory considerations outlined in this appendix. State-chartered associations must also comply with any applicable state laws.

Savings associations should complete a thorough analysis before purchasing material amounts of COLI. The supervisory policy, set forth below, includes minimum standards for pre-purchase analyses, applicable to such purchases by thrifts.

Supervisory Policy

The purchase of cash value life insurance is a long-term, illiquid, nonamortizing, and unsecured obligation of the insurance carrier. As such, it subjects the policyholder to credit, liquidity, and interest rate risks.

Savings associations holding life insurance in a manner inconsistent with safe and sound banking practices may be subject to supervisory action. These supervisory actions may include but are not limited to partial surrender or divestiture of affected policies.

Pre-Purchase Analysis

The safe and sound use of cash value life insurance by thrifts depends on effective senior management and board oversight. Regardless of the institution’s financial capacity and risk profile, the board must understand the role institution- owned life insurance plays in the overall business strategies of the institution. The board's role in analyzing and overseeing cash value life insurance should be commensurate with the size, complexity, and risk inherent in the transaction. Although the board may delegate decision-making authority related to purchases of life insurance to management, the board remains responsible for ensuring that such purchases are consistent with safe and sound banking practices.

The objective of the pre-purchase analysis is to help ensure that the savings association understands the risks, rewards, and unique characteristics of COLI. At a minimum, the pre-purchase analysis should consider the following standards.

I. Determination of the Need for Insurance

The institution should determine the need for insurance by identifying the specific risk of loss or obligation against which they are insuring. The existence of a risk of loss or an obligation does not necessarily mean that a savings association can purchase or hold an interest in life insurance. For example, a savings association may not purchase life insurance on a borrower as a mechanism for recovering obligations that the savings association charged off, or expects to charge off for reasons other than the borrower's death. Also, a savings association should surrender or otherwise liquidate permanent life insurance acquired through debts previously contracted (DPC) within a short time frame, generally 90 days, of obtaining control of the policy.

Additionally, the purchase of insurance to indemnify a savings association against a specific risk does not relieve it from other responsibilities related to managing that risk. For example, a savings association may purchase life insurance to indemnify itself from the loss of a “key person.” However, savings associations should not use “key-person” life insurance in place of, nor does it diminish the need for, adequate management or “key-person” succession planning. Therefore, it may not be necessary to purchase a cash value product.

The savings association's authority to hold life insurance on a key person lapses if the individual is no longer a key person for the association. Specifically, the key person's retirement, resignation, discharge, or a change in the person's responsibilities will cause the association to lose its insurable interest in a key person.

II. Quantifying the Amount of Insurance Needed

The thrift should estimate the size of the obligation or the risk of loss and ensure that they do not purchase an excessive amount of insurance in relation to the estimate. For such estimates, savings associations may include the cost of insurance and the time value of money in determining the amount of insurance needed. The savings association should base the estimate of the amount of insurance needed on reasonable financial and actuarial assumptions. In situations where a savings association purchases life insurance on a group of employees or a homogenous group of borrowers, it can estimate the size of the obligation or the risk of loss for the group on an aggregate basis. The savings association can then compare the aggregate obligation or risk of loss to the aggregate amount of insurance purchased.

Purchasing or holding excessive permanent insurance may be an unsafe and unsound practice if it subjects the institution to unwarranted risks.

III. Vendor Selection

The thrift does not have to use a vendor. In deciding whether or not to use a vendor or what type of vendor to use, the institution should consider the following items:

- The savings association’s knowledge of COLI.
- The resources the savings association can, and is willing to spend, servicing and administering the COLI.
- The benefits a vendor may provide.

Depending on the vendor’s role, the vendor's services can be extensive and critical to successful implementation and operation of a COLI plan. If the institution uses a vendor, it should make appropriate inquiries to satisfy itself about the vendor's ability to honor its commitments, general reputation, experience, and financial capacity. The institution should base their review on the size and complexity of the potential COLI purchase.

IV. Carrier Selection

COLI plans are typically of long duration and may represent significant risks for the institution. Therefore, carrier selection is one of the most critical steps in a COLI purchase. The institution should review the product design, pricing, and administrative services of the carrier(s) and compare them with the institution's needs. In addition, the institution should also review the carrier's ratings, general reputation, experience in the market place, and past performance. A broker or consultant, if used, may assist the institution in this regard.

Furthermore, before purchasing life insurance, the institution should perform a credit analysis on the selected carrier(s) in a manner consistent with safe and sound banking practices for commercial lending.

V. Review the Characteristics of the Available Insurance Products

There are a few basic types of life insurance products in the marketplace. However, providers can combine and modify these products in many different ways. The resulting final product can be quite complex. The institution should review the characteristics of the various insurance products available. It should select the product or products with characteristics that match the institution's objectives and needs. To do this, the institution should thoroughly analyze and understand the products under consideration.

When purchasing insurance on “key persons” and individual borrowers, the institution should consider that the institution's need for the insurance will likely disappear before the insured individual dies. In such cases, term or declining term insurance is often the most appropriate form of life insurance.

VI. Analyze the Benefits of COLI

The institution should analyze the benefits of COLI purchases under consideration. The analysis should include an assessment of how the purchase will accomplish the objective specified in (I), Determination of the Need for Insurance. It should also include an analysis of the anticipated performance of the insurance, including the interest crediting rate and the policy’s net accumulation rate.[1] While the projected yield on some single-premium life insurance policies may seem attractive, the actual yield may be much lower. Also, insurance and administrative costs the issuer builds into the policy further reduce such yields and life insurance becomes more expensive as the insured person ages. Often insurance costs will greatly reduce a high stated yield on a cash value product.

VII. Determine the Reasonableness of Compensation Provided to the Insured Employee if the Insurance Results in Additional Compensation

Split-dollar insurance arrangements typically provide additional compensation and/or other benefits to the employee. Before a savings association enters into a split-dollar arrangement, it should identify and quantify the compensation objective, and ensure that the arrangement is consistent with the stated objective. Also, the institution should combine the compensation provided by the split-dollar arrangement with all other compensation to ensure that total compensation is not excessive. OTS prohibits excessive compensation as an unsafe and unsound practice. There are guidelines for determining excessive compensation in Appendix A to 12 CFR Part 570, Interagency Guidelines Establishing Standards for Safety and Soundness.

VIII. Analyze the Associated Risks and the Institution's Ability to Monitor and Respond to those Risks

Ownership of or beneficial interests in COLI may subject a savings association to several risks. These risks include: transaction, credit, interest rate, liquidity, compliance, and price. A savings association's pre-purchase analysis should include a thorough evaluation of these risks. Furthermore, the pre-purchase analysis should allow a savings association to determine whether the transaction is consistent with safe and sound banking practices. In making this determination, a savings association should consider, among other things:

- The complexity of the transaction.
- The size of the transaction relative to the institution's capital.
- The diversification of the credit risk.
- The financial capacity of the institution.
- The financial capacity of the insurance carrier(s).
- The institution's ability to identify, measure, monitor, and control the associated risks.

In assessing the size of the transaction, a savings association should consider the cash surrender value (CSV)[2] relative to its capital levels at the

[1] The interest crediting rate refers to the gross yield on the investment in the insurance policy. That is the rate at which the cash value increases before considering any deductions for mortality cost, load charges, or other costs the issuer periodically charges against the policy's cash value. Insurance companies frequently disclose a current interest crediting rate and a guaranteed minimum interest crediting rate. The guaranteed rate may be less than the current rate. As a result, the potential exists for future declines in the interest crediting rate. The net accumulation rate is the rate at which the policy increases after all costs are deducted, which may be materially less than the interest crediting rate.

[2] The liquidation value of the insurance policy if the policyholder terminates it. In the first few policy years there may be a significant difference between the stated policy value and the cash surrender value due to early cancellation penalties.

time of purchase. The institution should also consider projected increases in the CSV and projected changes in capital levels for the duration of the contract.

Consistent with prudent risk management practices, a savings association should establish internal quantitative guidelines. These guidelines generally limit the aggregate CSV of policies from any one insurance company and the aggregate CSV of policies from all insurance companies. A savings association should limit investment in life insurance from any one issuer to the lending limits prescribed in 12 CFR §560.93. The savings association should limit total concentration of investment in life insurance to 100 percent of capital.

IX. Evaluate Alternatives

Some COLI purchases involve indemnifying the institution against a specific risk. For example, savings associations sometimes purchase COLI to indemnify the institution against the potential for loss arising from the untimely death of a “key person.” As an alternative to purchasing COLI, an institution may choose to self-insure against this risk. Other uses for COLI purchases are to recover costs or provide for employee benefits. In these cases, instead of purchasing COLI, an institution may choose to invest the money in other assets. Regardless of the purpose of COLI, a complete pre-purchase analysis will include an analysis of the alternatives.

X. Document Decision

A savings association should maintain documentation adequate to show that the institution made an informed decision. The institution should continue to monitor that decision based on the standards set forth in this Handbook Section.

Financial Considerations

Institution management should also understand and analyze how COLI will affect the institution's financial condition. Given the anticipated performance of the insurance, management should analyze the effect on the institution's earnings, capital, and liquidity. Management should also consider the impact on the institution's earnings and capital should the institution, for any reason, surrender the insurance before maturity at the death of the insured.

Accounting Considerations

Savings associations should follow generally accepted accounting principles (GAAP) for financial reporting and Thrift Financial Report purposes. Financial Accounting Standards Board (FASB) Technical Bulletin 85-4, Accounting for Financial Purchases of Life Insurance, discusses how to account for investments in life insurance. The guidance set forth in Technical Bulletin 85-4 is generally appropriate for all forms of COLI.

The savings association should follow FASB Technical Bulletin No. 85-4 when accounting for insurance policies where the association receives all the cash value benefits. Sometimes the association receives all the benefits, but separately agrees to provide those benefits to the employee as deferred compensation. In this case, the savings association should account for the cash surrender value in accordance with FASB Technical Bulletin No. 85-4. Also, they should record a deferred liability for the deferred compensation arrangements in accordance with Accounting Principles Board Opinion No. 12, as amended by SFAS No. 106.

Under employee benefit split-dollar policies, the association and the employee agree to share in the policy's cash surrender value and death benefits. Also, the savings association is not accruing a separate liability for the employee benefit. In this situation, the association should record an asset for its investment in the policy equal to the lower of one of the following values:

- The policy's cash surrender value, determined in accordance with FASB Technical Bulletin No. 85-4.
- The present value of the future cash flow(s) the savings association expects to receive discounted at an appropriate interest rate in accordance with Accounting Principles Board Opinion No. 21.

The savings association should immediately record the amount exceeding the investment as an employee benefit expense. The savings association may also, where appropriate, record it in other assets as a deferred charge. The savings association must amortize the asset as an employee benefit expense in a systematic and rational manner over the time remaining until the employee's full eligibility date. The association should update its interest in the CSV at least quarterly.

Other Considerations

A savings association should evaluate the financial condition of the insurance company before purchasing a life insurance policy. The association should continue to monitor its condition while the policy is in force.

The association should consider the tax and economic consequences of surrendering a cash value insurance policy before its maturity should that become necessary. The savings association should also consider the effect of any significant holdings of cash value life insurance (considered a long-term investment) on its capital and liquidity.

In addition, savings associations should determine the applicability of, and ensure compliance with, 12 CFR §§ 563.41, 563.42, and 563.43. For example, split-dollar arrangements may be subject to 12 CFR § 563.41 when a savings association purchases an insurance policy and the beneficiary is its holding company or a management official of the holding company. You must consider this an unsecured extension of credit. This is because the association pays the holding company's portion of the premium and the holding company will not fully reimburse the savings association for its payment until some time in the future. Federal savings associations may not make unsecured loans to affiliates.

In other cases, the parent holding company may actually own the insurance policy and pay the entire premium. A subsidiary association may make annual loans to the holding company in an amount equal to the premiums paid or, equal to the annual increase in the cash surrender value of the policy, with the insurance policy serving as collateral for the loan. The holding company repays the loans upon either the termination of employment or death of the insured employee. These loans are subject to the quantitative restrictions of 12 CFR § 563.41, including the collateral requirements, 130 percent of the amount of the loan in this case. Therefore, the transactions must also comply with the provisions of 12 CFR § 563.42.

Because the holding company is the beneficiary of the insurance policy, it is a participant in a transaction between a savings association and a third party.

Moreover, certain insurance arrangements may be subject to Regulation O. In cases where the savings association purchases the insurance to provide a fringe benefit to an executive officer of the savings association and the association pays the cost of the policy, the employee must perform one of the following actions:

- Reimburse the association for the amount of the premiums.
- Report the economic value of the insurance benefit to IRS as additional taxable income.

If the employee fails to take action, the value of the insurance represents a loan by the association to the executive officer and is subject to Regulation O.

The savings association should ensure execution of the appropriate policy endorsements, assignments, and related agreements. The savings association should also ensure that the policy provides adequate safeguards and controls to protect its interest in the policy. You should determine whether the association's share of any cash surrender value and death benefits was appropriately endorsed or assigned to the association.

You should evaluate all significant holdings and future purchases of life insurance by savings associations in light of the above guidelines. You should consider any formal or informal contracts with the executives for deferred compensation or other benefit payments linked to the insurance arrangements. Review related contracts with the insurance policies.

INTRODUCTION

When a savings association repossesses property, there is a distinct possibility of loss on the liquidation of the property otherwise the borrower would not have defaulted. Real estate owned (REO) is real property that a savings association holds as a consequence of defaults on loans. It is typically a poor or non-earning asset and a savings association's acquisition of a limited amount of REO is an unavoidable result of normal business operations.

REO includes real estate acquired in the following ways:

- Real estate in judgment.
- Real estate acquired through foreclosure.
- In-substance foreclosures. [1]
- Real estate acquired through deed in lieu of foreclosure.
- Any real property exchanged for foreclosed real estate.

If a question arises as to whether the savings association should report a parcel as REO, you should look to economic substance rather than to the legal form in which the property is held.

Other repossessed assets are non-real estate property the savings association takes possession of to satisfy some or all of a borrower's debt.

[1] If the savings association does not expect full payment of all amounts due for an impaired, collateral-dependent loan, the savings association should measure the impairment based on the fair value of the collateral less costs to sell. Pursuant to SFAS No. 114, the lender should report the impaired loan as an in-substance foreclosure if it has physical possession of the collateral. Other collateral-dependent loans that the lender does not possess remain categorized as loans.

The usual types of other repossessed assets include the following properties:

- Personal property: vehicles, mobile homes, boats, airplanes, etc.
- Commercial goods: equipment, furniture, fixtures, inventories, accounts receivable, lease receivables, etc.
- Investments: stocks, bonds, certificates of deposit, etc.
- Other: intangible assets, cash surrender value of life insurance policy, etc.

Throughout this Section, we use the terms foreclosure and repossession (and other forms of those terms) interchangeably.

Supervisory Concerns

An increase in a savings association's REO and repossessed assets portfolios should serve as red flags to both you and management. Increases in these portfolios may indicate deteriorating economic conditions, lax adherence to loan underwriting standards, or deficient loan administration. The historical absence of REO may be indicative of overly restrictive loan underwriting criteria or a lax foreclosure policy.

You should perform the following steps:

- Review the savings association's internal asset review program.
- Evaluate the adequacy of internal controls.
- Interview management concerning:
  - the detection of potential problem credits.

— the effectiveness of resolutions (workouts) and collection of problem loans.

The savings association should evaluate the likelihood of repossessing an asset for all seriously delinquent loans. The savings association should also consider other alternatives to repossession. Prior to foreclosure or repossession, management should check with the proper authorities to verify the existence of a valid recorded lien. At that time, the savings association should determine the market value of the collateral. The savings association should also obtain sufficient insurance coverage on the asset after the savings association takes possession.

Appraisals

In accordance with 12 CFR §560.172, savings associations must appraise each parcel of REO at acquisition, consistent with the requirements of Part 564. A savings association must appraise each parcel of real estate owned at the earlier of an in-substance foreclosure or at the time of the savings association's acquisition of the property. Thereafter, prudent management policy dictates the timing of appraisals. The regional director (or designee) may require subsequent appraisals if they deem necessary under the circumstances. Savings associations must carry REO on the books at the lower of recorded cost or fair value less costs to sell. Therefore, OTS does not require an appraisal upon disposition of the property; however, the savings association's policies may require one.

Accounting at Foreclosure

Statement of Financial Standards No. 15 (SFAS 15), SFAS No. 114, and SFAS No. 121 generally provide the accounting treatment for REO including in-substance foreclosures.

Savings associations must initially record foreclosed assets deemed held for sale at the lower of one of the following amounts:

- Recorded investment (that is, carrying value before deduction for valuation allowances) in the loan.
- Fair value less costs to sell the foreclosed asset.

  The costs to sell an asset include the estimated incremental direct costs to transact the sale of the asset. This includes such costs as broker commissions, legal and title transfer fees, and closing costs. Costs to sell generally exclude insurance, security service, and utility costs.

Upon foreclosure (including in-substance foreclosure), the savings association must compare the recorded investment in the loan (carrying value before deduction for valuation allowances) to the fair value less costs to sell the foreclosed property.

The savings association must classify as Loss and charge off any amount in excess of recorded investment over fair value less costs to sell. The savings association cannot represent this Loss classification by a valuation allowance.

Savings associations must expense, as incurred, legal fees and direct costs of acquiring title to foreclosed assets.

Hold or Sell Decision

Once a savings association acquires a property through foreclosure or repossession, management should begin the decision-making process of whether to hold the property or sell it (possibly in an unfavorable market). A primary consideration when selling the asset is whether the savings association will have to make a loan to facilitate the sale. The savings association must consider the overall cost if it regains the property by later having to foreclose on the loan to facilitate. If a subsequent foreclosure becomes necessary, the condition of the property may be worse than when the savings association initially took possession. Moreover, if the most recent borrower failed to service the debt at all, the savings association has sacrificed any income it could have received from an interim use of the property.

In making the decision when and if to sell the repossessed property at the least cost to the savings association, management should attempt to quantify, at a minimum, the following costs and benefits:

- Loss on an encumbered quick sale of property "as is."
- Cost of completing, restoring, and enhancing the project.
- Cost to prevent deterioration of the asset during the anticipated holding period:
  - Insurance
  - Physical security (fencing, security service, etc.)
  - Maintenance (mowing, utilities, structural repair, etc.)
  - Intangible (lost goodwill, etc.).
- Cost of selling the property (advertising, broker's commission, defects observed at inspection, etc.).
- Opportunity costs to the savings association, for example, based on the alternative uses of the sales proceeds.
- Cost of providing favorable financing (discount future and probable cash flows to present value).
- Anticipated appreciation or depreciation during the holding period.
- Benefit when property sold at end of holding period (discount proceeds to present value, determine yield based on current market rates).
- Benefit of interim use of the property in a lease or rental arrangement.
- Requirements imposed by 12 CFR § 567.1 to dispose of equity investments in real property within a specified time period to maintain capital rule treatment as REO. This period is generally five years unless OTS approves a longer period.

The above analysis should assist management in making an informed decision on the disposition of the savings association's REO and repossessed assets.

Five-Year Holding Period

OTS defines an equity investment in 12 CFR § 567.1 to exclude real property the savings association obtained in satisfaction of a debt or acquired under a judgment or mortgage. This is true if the savings association does not intend to hold the property for real estate investment purposes and plans to dispose of the property within five years. If requested, OTS may approve a longer period. OTS considers the extension of time a supervisory decision. For OTS to consider such extensions, the savings association should address the following items in its request letter:

- The term of the extension and the reason for the request.
- Whether the savings association, in good faith, tried to dispose of the property.
- How the accountants regard the property for GAAP purposes.

Internal Asset Review

As a sound banking practice, savings associations should conduct periodic reappraisals and reassessments of REO and other repossessed assets. We noted exceptions to this requirement in the Appraisals section presented earlier. The classification of assets regulation does not mandate that the institution automatically classify all foreclosed property. Handbook Section 260, Classification of Assets, discusses situations where savings associations need not classify REO. REO is sometimes an unsound asset even when recorded at fair value. The savings association's acquisition of the property normally indicates a lack of demand. As time passes without disposition, the lack of demand becomes more apparent and the quality of the asset becomes more doubtful.

The savings association should consider each repossessed item on an individual basis and, if necessary, classify it adversely on the basis of facts supporting your evaluation. For instance, if a developed parcel of REO is receiving steady cash flows at a market yield, an adverse classification may not be necessary.

Accounting after Foreclosure

For periodic evaluations of REO for impairment, *after* foreclosure, the savings association must classify as Loss, and charge off or represent by a specific valuation allowance, any excess of recorded investment over current fair value less cost to sell. Savings associations must deduct valuation allowances from the recorded investment to arrive at carrying value.

OTS policy does not automatically require general valuation allowances (GVA's) on REO. The institution should establish GVAs when it is likely to experience losses when disposing of REO or is likely to incur holding costs that are not reflected in the fair value estimate. The savings association should base the level of any required GVAs on REO on its historical net loss experience, adjusted for current conditions and trends.

OTS does not recognize loss allowances (general or specific) on foreclosed (REO) assets held for sale as a component of Tier 1 (core) or Tier 2 capital. The regulatory capital standard only includes GVAs related to loans and leases in Tier 2 capital up to a certain limit.

Real Estate Owned (REO) Workouts

Management must assess the level of in-house expertise available to manage REO workouts. Management should consider the possibility of looking outside the association for the necessary level of expertise. This should include recruiting and employing real estate workout specialists and using real estate workout companies on a contract basis.

Management is responsible for reviewing the economic merits of out-sourcing REO disposition plans. If any savings association identifies any regulatory issues of concern during its process of selecting an outside REO workout program, it should raise these issues with the appropriate examination or supervisory personnel. They will provide advice on whether the vendor's proposal conforms with regulatory procedures and safe and sound practices. Savings associations should be aware that OTS neither approves nor endorses specific REO workout proposals. Savings associations should bring to OTS's attention any representations by any organization to the contrary.

Accounting for Sales of Real Estate

Accounting for the sale of real estate requires the determination of the following two issues:

- The point at which a sale actually occurs.
- How the savings association recognizes the gain on the sale.

When an association does not recognize a sale they should classify the asset as REO. Generally, the savings association may consummate a sale once the following events occur:

- The terms of a contract bind the parties.
- The exchange of all consideration.
- The seller, if responsible, arranges for any permanent financing.
- The parties perform on all conditions precedent to the closing.

See SFAS 66, Accounting for Sales of Real Estate, paragraph (6).

Gains

Generally, a savings association does not recognize a gain for accounting purposes if the seller retains some type of continuing involvement in the property without transferring the risks and rewards of ownership to the buyer. Continuing involvement includes any of the following situations:

- The seller makes an obligation to repurchase the property.
- The seller retains an equity interest in the property.
- The seller guarantees an investment return to the purchaser.
- The seller must initiate or support operations or continue to operate the property at the seller’s own risk.

If, after the transaction, the savings association retains some type of continuing involvement in the property, the transaction may not qualify for gain recognition. The savings association should defer any gain and credit to an account descriptive of unearned gain on the sale of real estate.

Savings associations must account for all gains under generally accepted accounting principles (GAAP). SFAS No. 66 specifies the amount and timing of gains the seller of real estate may recognize when the sale depends upon the seller's continuing involvement and retention of risks. The savings association may recognize all gains at the time of sale as long as the sale meets the following conditions:

- The savings association did not finance the sale.
- The savings association has no continuing involvement with the property.

In the more common situation where the savings association makes a loan to facilitate the sale of REO, the savings association may recognize the full gain if the sale meets all of the following conditions:

- The savings association and buyer consummate the sale.
- The buyer has adequate initial and continuing investments that demonstrate a commitment to pay for the property.
- The seller's receivable is not subject to future subordination.
- The seller transfers to the buyer the usual risks and rewards of ownership in a transaction that is, in substance, a sale and does not have a substantial continuing involvement with the property.

Loans to facilitate the sale of real estate do not fall under the loans to one borrower rule if the association takes a purchase money mortgage note from the purchaser and meets the following two conditions:

- The savings association does not advance any new funds to the borrower.
- The association is not in a more detrimental position as a result of the sale.

Handbook Section 211 describes circumstances where a savings association may use its salvage powers to exceed the Loans to One Borrower rules.

Losses

GAAP requires that if the sale of REO results in a loss, the savings association shall account for the loss in the period it sustained the loss. It is an unsafe and unsound practice for a savings association to fail to recognize losses from the sale of REO where the price is inflated above the market value. The inflated price may be a result of favorable terms the savings association provided in a loan to facilitate. GAAP requires discounting sales prices to reflect market interest rates for loans of similar terms and risk. You should take exception and prompt supervisory action when savings associations finance significant amounts of their REO by loans at interest rates substantially below the current market rates.

REFERENCES

Code of Regulations (12 CFR)

§ 560.30	General Lending and Investment Powers
§ 560.93	Lending Limitations
§ 560.100-101	Real Estate Lending Standards
§ 560.160	Asset Classification
§ 560.172	Re-Evaluation of Real Estate Owned
§ 567.1(i)(4)	Definition of Equity Investment in Real Property

Financial Accounting Standards Board, Statement of Financial Accounting Standards

No. 5	Accounting for Contingencies (amended, in part, by SFAS No. 114)
No. 15	Accounting By Debtors and Creditors for Troubled Debt Restructurings (amended, in part, by SFAS No. 114 and SFAS No. 121).
No. 66	Accounting for Sales of Real Estate (amended, in part, by SFAS No. 121)
No. 114	Accounting by Creditors for Impairment of a Loan (amended and superseded, in part, by SFAS No. 118) (Amends SFAS No. 5 and SFAS No. 15, in part)
No. 118	Accounting by Creditors for Impairment of a Loan –Income Recognition and Disclosures (amends and supersedes, in part, SFAS No. 114)
No. 121	Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of (amends, in part, SFAS No. 15 and SFAS No. 66)

Real Estate Owned and Other Repossessed Assets Program

Examination Objectives

To determine if the savings association's policies, procedures, practices, internal controls, and accounting treatment regarding REO and repossessed assets are adequate to maintain safe and sound operations at the following stages:

- Acquisition
- Valuation
- Management and maintenance
- Completion and improvement
- Disposition.

To determine the extent of the savings association's compliance with applicable state and federal regulations and its own policies.

To evaluate the quality of the saving association's REO and repossessed assets.

To determine the adequacy of the internal asset review and audit functions in this area.

To determine whether the current or anticipated level of REO and repossessed collateral is consistent with the savings association's business plan and safe and sound banking practices.

To determine the extent of the repossessed assets' effect on operations.

To determine whether the savings association continues to pursue repayment from the borrowers after it sells the collateral.

To determine management's and the board's willingness and ability to initiate corrective action when policies, procedures, practices, and internal controls are deficient.

To summarize findings and to initiate corrective action when deficiencies exist that could affect safety and soundness, or when you note, and bring to their attention, violations of laws or regulations.

Examination Procedures

Wkp.Ref.

Level I

1. Review scoping materials applicable to this program. If another examiner performed the review of scoping materials, obtain a written or oral summary of the information in the scoping materials relating to this program. Refer to the examiner in charge (EIC) or EIC-designee for instruction, if needed.

   Scoping materials might include the following items:

   - Prior examination report.
   - Exception sheets and work papers.
   - Internal and independent audit reports.
   - OTS financial analysis reports.
   - Supervisory analysis.
   - Correspondence.
   - Business plan.
   - Minutes of the meetings of the board of directors.
   - PERK information.
   - Review of market area economic conditions.

2. Determine the adequacy of the savings association's policies and procedures on REO and other repossessed assets by thoroughly reviewing pertinent items such as: policy statements, the internal asset review program, procedure manuals, the savings association's business plan, and board and committee minutes.

3. Conduct interviews with management and ascertain compliance with policies and procedures. Determine whether management reviews policies and procedures periodically and communicates changes to the appropriate savings association personnel.

4. Determine if the savings association's procedures, controls, and objectives in this area are safe and sound and in compliance with applicable laws and regulations.

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5. Ascertain the major causes of repossessions and foreclosures (for example, inadequate credit or collection policies, loan concentrations, unsound construction lending procedures, poor appraisal policies or inadequate appraisal reports, depressed economic conditions, reacquisitions). Determine if management is aware of the underlying causes. Determine if they, when necessary, improve or correct policies and procedures.

6. Determine if the savings association has adequate staff to manage its current and projected levels of REO. Ascertain if management informs the employees responsible for managing these assets of relevant policies and procedures.

7. Determine if management has realistic plans for disposing of the REO and other repossessed assets portfolios. Determine whether management has considered the need for professional consulting or management firms to manage its more sophisticated acquisition, development, or construction type projects. If management is opting to retain the property, the analysis and documentation justifying such a decision should be on file.

8. Determine whether the savings association's real estate workout personnel have sufficient expertise to effectively manage the savings association's REO. Additionally, consider whether the savings association uses REO workout consultants or other third-party professionals to assist in this area, and whether the savings association's management adequately scrutinized these arrangements.

9. Review Level II procedures and perform those necessary to test, support, and present conclusions derived from performance of Level I procedures.

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Level II

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10. Obtain a detailed listing of the assets and reconcile to the general ledger balances. Determine if the savings association correctly reports REO and other repossessed asset balances on the Thrift Financial Reports. Have the savings association make corrections to the Thrift Financial Reports (or correct reporting on the next Thrift Financial Report) if you determine that they incorrectly report REO and other repossessed asset balances.

11. Determine whether the savings association established any specific loss reserves and made charge-offs where warranted. In establishing valuation allowances, determine if management reviews the following considerations:

- Vandalism to the property.
- Anticipated demolition or razing.
- Additional construction costs to complete, restore, or improve.
- Obsolescence.
- Compliance with zoning requirements.
- Failure to sell at asking prices.
- The costs of managing and maintaining REO.

12. Prepare the proposed asset classification write-ups (if warranted) and determine management's concurrence. Leave a list of all proposed REO and repossessed asset classifications with management.

13. Review a list of all loans to facilitate the sale of REO or significant other repossessed assets.

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14. Determine if the terms of sale are realistic, and that the savings association structured the loan to a creditworthy borrower such that reacquisition is unlikely. Determine if the savings association overstates sales and prices to defer losses. Analyze the effective cost of below-market financing and whether the savings association recorded the proper profit or loss.

15. On a selected sample of asset files, check source documents (receipts, invoices, etc.) against general ledger entries. Ensure the association made accurate accounting entries to capitalize certain REO costs. Appropriate capitalizations limited to fair value might include the following items:

   - Unpaid loan balances, excluding accrued uncollected interest.
   - Taxes and assessments advanced and due, or those accrued up to the time of acquisition.
   - Insurance premiums advanced.
   - All other unpaid advances due at the time of acquisition.
   - Improvements or enhancements that add to value.

16. Determine whether the savings association capitalizes expenses of REO operations in an attempt to defer operating losses. Have the savings association correct the entries where necessary.

17. From a selected sample, determine whether the savings association holds a valid title for REO and other repossessed assets.

18. Determine that the savings association paid any taxes due on REO parcels as required by local law.

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19. Determine if the savings association obtained adequate hazard and public liability insurance for REO selected for review.

20. Review a selected sample of REO acquisition appraisal reports for conformance with the savings association's appraisal policies and determine whether the savings association obtained the appraisals promptly upon foreclosure. Ensure that the savings association obtains annual reappraisals when appropriate and in conformance with the savings association's appraisal policies. Calculate fair values when necessary.

21. Reconcile foreclosed and repossessed property totals for this examination to totals from the previous examination using the following documents:

- Current listing of foreclosed and repossessed assets.
- Summaries of assets sold.
- Attorneys' letters.
- Minutes of the board of directors and applicable committees.
- Work papers from the previous examination.

22. Review the sales of all foreclosed and repossessed property since the previous examination. (A sampling is acceptable if there are a large number of transactions.) Determine if management is pursuing personal liability judgments against borrowers, if allowed by law. Obtain management's response if it is not.

23. Prepare a summary income statement dealing only with REO operations to determine the carrying cost of the REO portfolio. The statement should cover the period since the previous examination and be comparable with similar analyses performed during prior examinations. Where significant, determine net operating income (NOI) (or net operating loss (NOL)) from REO operations. Note that the savings association must consider the cost of funds attributable to the average monthly balance of REO. Use the actual composite cost of money for the period being reviewed. That means apply the weighted average rate payable on deposits and borrowings to the balance of the REO

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account. Determine whether the savings association modified objectives, policies, and procedures for REO operations (acquisition, management, and disposition) based on the levels of income or loss reported.

24. Ascertain the effectiveness of management's efforts to prudently dispose of REO and other repossessed assets by determining if the savings association performs the following procedures:

- Sets reasonable sales (asking) prices compared with appraised values.
- Lists and advertises properties with brokers.
- Maintains reasonable selling expenses.
- Maintains sales volume commensurate with market conditions.
- Documents whether and why it holds properties off the market.
- Analyzes the overall cost of previously sold REO now brought back into the portfolio, noting the increased cost, if any, to reclaim the property and restore it to its previous condition.
- Modifies disposition objectives (as stated in the business plan) and policies based on sales experience and market characteristics.

25. Ensure that your review meets the *Objectives* of this Handbook Section. State your findings and conclusions, as well as appropriate recommendations for any necessary corrective measures, on the appropriate work papers and report pages.

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Level III

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26. Consider the following and determine the need for property inspections:

- Comparisons of book values and appraised values.
- A review of the asset files.
- Interviews with management.

Inspect appropriate properties to determine the following:

- Marketability.
- Reasonableness of appraised values.
- Quality of property maintenance.
- Whether OTS should require independent appraisals.

27. In the event the independent auditor's work papers are not available, you should take the following actions:

- Test check accounting entries for any property disposed of since the previous examination.
- Review bids on sold assets for propriety.
- Review any transactions with insiders or affiliates.
- Ensure that the savings association properly recognized gains and losses on sales.
- Review sales made on the basis of loan terms that were unreasonably favorable to the purchaser or borrower.
- Determine whether the savings association gave excessive commissions, fees, or other preferential treatment to dealers, brokers, or attorneys involved in handling foreclosures or repossessions.

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Real Estate Owned and Other Repossessed Assets Questionnaire

General Questionnaire	Yes	No
1. Does the institution give proper notification to the borrower prior to foreclosure or repossession?		
2. Does the institution promptly foreclose or repossess to minimize the risk of loss?		
3. Does the institution hold valid title to REO?		
4. Does the institution review REO it acquires by deed in lieu of foreclosure for encumbrances of prior liens?		
5. Does the institution appraise real estate it acquires subsequent to its acquisition?		
6. Does the institution use a current appraisal to establish the asking price of property?		
7. Are there maintenance procedures in effect to ensure that properties will retain their market value?		
8. Are procedures in effect to ensure that the institutions maintains and updates hazard insurance as necessary?		
9. Does the institution maintain separate subsidiary records and files for each parcel showing items capitalized, expenses, rentals, etc.?		
10. Does the institution reconcile subsidiary ledgers for the individual properties to the general ledger at least monthly?		
By whom? ____________		
11. Does the institution control rental income received from REO?		
12. Do any unbonded agents collect rents and/or manage properties?		
13. Does the board of directors periodically review the status of each REO parcel and repossessed asset?		
How frequently? ____________		
14. Does an officer that reports to the board of directors approve sales of REO and other repossessed assets?		

Comments

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INTRODUCTION

Fixed assets are investments in property and equipment that contribute indirectly to a savings association's operations and have economic lives of greater than one year. These assets usually consist of savings association offices, leasehold improvements, and equipment. Savings associations invest in fixed assets directly through the purchase of assets or indirectly by lease. A savings association may also combine these ownership techniques in a sale/leaseback arrangement.

Fixed assets do not constitute a large percentage of total assets, but they can involve the commitment of substantial dollar amounts. You should assess the propriety of the savings association's investment in premises and equipment and determine the effect of the related expenses on the savings association's operations.

This Section of the Handbook assists you in your review of a savings association's fixed asset policies, procedures, and transactions.

You should consider the following areas in your review of fixed assets:

- The policies, procedures, and controls used in the acquisition, management, and disposition of fixed assets.
- Any investments in real estate to establish offices and related facilities and subsequent capital deductions as required.
- Any shared office lease agreements.
- Any sale/leaseback arrangements.
- The valuation and accounting method used.

Policies, Procedures, and Controls

The savings association should establish policies, procedures, and controls to ensure that fixed asset investments are prudent. The association should also have controls to ensure that the association periodically conducts physical inventories and maintains adequate insurance coverage on all fixed assets. The board minutes should document the approval of material fixed asset acquisitions and dispositions. Policies should require documentary proof that acquisitions fulfill a demonstrated need, are cost effective, and fit the overall goals of the savings association. Procedures should contain controls to prevent insider dealings, conflicts of interest, and misappropriation of assets.

Sections 563.41 and 563.42 of the regulations place restrictions on the purchase, sale, and lease of assets to or from an affiliate. Such transactions generally must be at arm's length and based on market value. Quantitative limitations also apply with respect to purchases of assets.

Office Premises and Land Acquired for Future Use

Section 560.37 authorizes a federal savings association to invest in real estate for the purpose of establishing offices and related facilities or for rental or sale. The aggregate investment in office and related facilities, improved or unimproved, may not exceed the association's total capital without approval by the OTS.

The OTS capital regulation generally requires savings associations to deduct equity investments from capital. This rule does not cover interests in real property that the savings association, its subsidiaries, or its affiliates intend to use primarily as offices or related facilities for the conduct of its business. OTS considers a building to be a savings association's premises if it (or its subsidiaries or affiliates) uses 25 percent or more of the building.

On a case-by-case basis, regional directors may allow a savings association using less than 25 percent of a building to consider that building a premise.” In such instances, regional directors should consider whether the building is significant to the operations of the savings association and any other extenuating circumstances that pertain to the use of the building.

The association should develop land acquired for future expansion of the association's facilities as its directorate intended within one to three years. You should be alert to any deviation from the intended use of land held for future expansion. Management should thoroughly explain any instances where the association holds property and does not develop it for the association's use beyond three years. You should include the explanation in the report of examination. Ordinarily, an association must file an application for an office or related facility before it develops the site.

An association that acquires real estate for an office(s) or related purpose(s), but no longer intends to use it for that purpose may no longer account for it as a fixed asset. The institution should account for the asset as REO and must dispose of the asset within five years, or longer period as approved by OTS, after any one of the following events:

- Management determines not to file an application for approval of a proposed facility.
- OTS disapproves an application, and the association decides not to reapply for a facility at the same site.
- The association does not develop the asset for its own use within three years of acquisition.

The asset then becomes a non-earning, nonproductive asset. See Handbook Section 251, Real Estate Owned and Repossessed Assets. An association must account for any subsequent sale of a savings association's former office property in accordance with GAAP. We describe the GAAP accounting treatment later in this Handbook Section under Valuation and Accounting Methods.

The Home Owners' Loan Act substantially limits a federally chartered savings association's direct equity investment authority. However, holding real estate for investment, development, or resale is a permissible activity for service corporations of federally chartered savings association. This activity is subject to the limitations of 12 CFR § 559.5. Many federally chartered savings associations use service corporations to invest in real estate. The Federal Deposit Insurance Act, at 12 USC § 1831e(c), limits state-chartered savings associations' real estate held for investment to the amount permissible for a federally chartered savings associations. See the Equity Investments and Real Estate Development Handbook Sections for additional guidance.

Sharing Office Quarters

A federal savings association may lease office space to a financial institution or other company. OTS does not consider the association engaged in the activities of that other institution or company if the lease agreement does not constitute a <u>de facto</u> joint venture. The nature of the lease payments can sometimes help to determine whether the association and the other company established a joint venture or <u>bona fide</u> lease. For example, in some instances, the lease may require that a portion of the rent be fixed and another portion calculated as a percentage of the lessees revenues. Because the sharing of revenues may indicate a joint venture, the amount of any rent based on the lessee's revenue should be substantially less than 50 percent of the lessee's revenues. OTS would generally consider a percentage of less than 25 percent to be reasonable. In addition, the association must receive regular fixed payments that are substantially equivalent to the fair rental value of the property for OTS to deem the agreement a <u>bona fide</u> lease.

Any savings association that shares office space with another financial institution should follow certain guidelines to avoid conflicts of interest and usurpation of corporate opportunity. Institutions sharing common quarters must implement the following criteria:

- Maintain separate identities to avoid customer confusion.
- Create physical separation between each institution's cash transactional areas.

- Maintain adequate controls to ensure the integrity of assets, records, computers, currency, checks, safes, and vaults of the institutions.

The potential for customer confusion is greater when employees have dual responsibilities and customer contact on behalf of both institutions in a sharing arrangement. Therefore, the association should impose appropriate safeguards to address such risk. Policies and employee training material should include activities, restrictions, and responsibilities that apply to both functions of dual employees. Both parties must make a conscious effort to demonstrate to the public their separate corporate existence.

Certain areas should not be accessible to the employees of the institution sharing office quarters. These areas include restricted office areas such as vaults or teller counters, and records or equipment with no security controls. Access by employees of an institution sharing office space should be no different from the limited access available to the general public.

Each entity that shares common quarters should also have a plan to avoid conflicts of interest and usurpation of corporate opportunity. Such plans should address the following issues:

- Specific areas where conflicts and abuses may occur.
- Policies and actions that avoid potential conflicts and abuse.
- Procedures to deal with individuals who violate such policies.

Any savings association that shares office space with another financial institution should follow these guidelines. The guidelines apply regardless of whether the other financial institution is an affiliate or the association engages in tandem branching or agent banking. If the institutions involved in the sharing arrangement are affiliates, they must comply with the provisions of 12 CFR §§ 563.41 and 563.42.

Similar guidelines apply to lease arrangements between savings associations and their subsidiaries. The Subordinate Organizations handbook section contains a detailed discussion of the regulations and restrictions that address the savings association/subsidiary relationship. This handbook section includes standards on the maintenance of separate corporate identities and how to avoid potential conflicts and the usurpation of corporate opportunity. In addition, the policy standards contained in Thrift Bulletin 23-2 (Interagency Statement on Sales of Nondeposit Investment Products) applies to savings associations that lease office space to companies engaged in securities brokerage or certain insurance activities. Refer to the Nondeposit Investment Sales and Insurance sections for additional information.

Sale/Leaseback

Management may consider a sale/leaseback arrangement when the savings association is experiencing cash flow or financing problems or the arrangement provides income or tax advantages. A sale/leaseback is an agreement whereby the savings association (seller-lessee) sells the property and immediately leases all or part of it back from the new owner (buyer-lessor). The savings association makes lease payments and continues to use the asset.

A sale/leaseback is a variation of a capital lease. Capital leases provide a lessee with many advantages associated with direct ownership. In a capital lease, the lessee must make a stream of payments to the lessor; the amount must equal or exceed the price of the asset leased. The period of the lease often approximates the remaining economic life of the asset. In effect, a capital lease provides a financing vehicle for the lessee and accountants regard it as an asset.

Financial Accounting Standards Board Statement of Financial Accounting Standards (SFAS) No. 13 stipulates that if the owner transfers substantially all the benefits and risks of ownership to the lessee, then the owner should record the lease as a capital lease. FASB considers that the owner substantially transferred the risks or benefits of ownership if the transaction meets any one of the following criteria:

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains a bargain purchase option.
- The lease term equals 75 percent or more of the estimated economic life of the leased property. In addition, the beginning of the lease term does not fall within the last 25 percent of the total economic life of the leased property.
- The present value of the minimum lease payments at the beginning of the lease term is 90 percent or more of the market value to the lessor less any investment credit retained by the lessor.

If the sale/leaseback agreement qualifies as a capital lease, generally accepted accounting principles (GAAP) require the lessee to record the leasehold improvement as an asset and the obligation to make payments under the lease agreement as a liability. OTS considers a lease recognized as a capital lease under SFAS No. 13 to be an investment in real estate for office and related facilities. See 12 CFR § 560.37. A capital lease obligation is subject to the borrowing limitations of 12 CFR § 563.80. The lessee should initially record a capital lease as an asset and an obligation at an amount equal to the present value at the beginning of the lease term, as described in SFAS No. 13. In addition, for other arrangements, such as a sale/leaseback, also refer to SFAS No. 13.

The minimum lease payments generally include the following items:

- The minimum rental payments.
- Any guarantee of the residual value made by the lessee.
- The penalty for failure to renew the lease, if applicable.

The discount rate in determining present value of the minimum lease payments is the interest rate implicit in the lease or the lessee's incremental borrowing rate.

Because the parties generally negotiate the terms of a sale and the terms of a leaseback as a package, the accounting treatment for a sale/leaseback is to treat the sale/leaseback as a single transaction. SFAS Nos. 13, 28, 66, 98, and 121 further discuss sale/leaseback transactions. If a lease agreement does not meet at least one of the four criteria specific to a capital lease, accountants classify it as an operating lease by the lessee. An operating lease is a month-to-month temporary rental of property.

The accounting treatment accorded an operating lease is relatively simple. Charge the rental payment to expense as the lessor makes the payments or as they become payable. This assumes that the lease payments are paid on a straight-line basis. There is no balance sheet recognition of the leased asset.

Management should compare the cost of a sale/leaseback arrangement with that of other acquisition or disposition strategies. In simplest terms, the after-tax cost of a leaseback is the present value of the payments to the lessor plus the present value of the reversion price. This means that as lease payments increase relative to the sale price, the cost of the lease transaction increases.

The lease accounting for book purposes can differ significantly from the lease accounting for tax purposes. Therefore, a prudent lease decision should consider the timing of the after-tax funds flow. Estimate cash flows on an after-tax basis by comparing book and tax income and expense.

Computer Software

The costs of computer software that the savings association develops or obtains for internal use should be capitalized and amortized pursuant to AICPA Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use.

The savings association should charge to expense as incurred costs specifically associated with modifying internal-use computer software for the year 2000 (regardless of whether such costs are external or internal). This treatment is outlined in EITF Issue No. 96-14, Accounting for the Costs

Associated with Modifying Computer Software for the Year 2000.

Valuation and Accounting Methods

The valuation of the fixed asset will rely in part on the accounting treatment that the savings association applies to the asset and such factors as depreciation, tax effects, and discounting to present values. (Refer to Thrift Activities Regulatory Handbook Section 440, Present Value Analysis.)

Investments in fixed assets that the savings association makes within regulatory limitations and valued properly on the savings association's books should be consistent with the association's earnings, capital structure, operations, and business plans and strategies. To properly value their fixed assets the savings association should consider the tangible ownership costs such as maintenance and depreciation. In addition, the savings association should consider the intangible opportunity costs that can result from the diversion of funds from alternative income-producing investments.

The acquisition of fixed assets should be for sound economic reasons. The savings association should consider the following items:

- Opportunity costs associated with investments in fixed assets after determining the method and direct costs of the acquisition.
- Income tax consequences.

The savings association should establish the following specific records at the time they acquire an asset:

- A record of all their fixed assets at cost as required by GAAP.
- Individual accounts of property and equipment with descriptive records for each item.
- An audit trail for property and equipment sold, exchanged, or otherwise disposed.

The savings association may use groupings within equipment such as furniture, fixtures, teller equipment, automated teller machines, and automobiles. The savings association, however, should segregate land records from building records, even if consolidated for reporting purposes, because land is a non-depreciable asset.

The institution should calculate the amortization of productive fixed assets, commonly referred to as depreciation, separately for financial reporting and tax purposes. The method of depreciation must result in the systematic and rational allocation of the cost of the asset, less its residual value, over the asset's expected useful life.

For financial reporting purposes, a savings association may use several methods of depreciation, such as straight-line, declining-balance, or sum-of-the-years-digits.

For tax purposes, savings associations with property acquired after December 31, 1980, and before January 1, 1987, must depreciate it in accordance with the Accelerated Cost Recovery System (ACRS). Savings associations with property acquired after December 31, 1986, must depreciate it in accordance with the Modified Accelerated Cost Recovery System (MACRS). The resulting difference between book and tax depreciation is a timing difference that will reverse over the depreciable life of the asset. ACRS and MACRS are generally quicker depreciation methods than the methods used for financial reporting. In addition to these tax deduction systems, some savings associations may also compute depreciation separately for the Alternate Minimum Tax and for Adjusted Current Earnings when it is applicable. For additional information on the methods of depreciation for tax purposes, you should consult a regional accountant or tax specialist.

When equipment is idle and no longer productive (and the remaining book value of the asset is material), the savings association should report the asset at the lower of carrying amount or fair value less cost to sell. The savings association should not depreciate the equipment while it is held for sale or abandoned. SFAS No.121 allows reclassification to other assets if the savings association meets certain disposal requirements.

When the savings association disposes of fixed assets, the association should eliminate the balance in both the asset account and the accumulated depreciation account, then record any value received in exchange. The savings association should record depreciation on the asset up to the earlier of the date the savings association sells it or takes it out of use as a productive asset. Savings associations should carry fully depreciated fixed assets on the general ledger at their residual value.

REFERENCES

Code of Federal Regulations (12 CFR)

§ 545.91	Home Office
§ 545.92	Branch Offices
§ 545.95	Change of Office Location/ Redesignation
§ 545.96	Agency
§ 556.5	Branching by Federal Savings Associations
Part 559	Subordinate Organizations
§ 560.37	Real Estate for Office and Related Facilities
§ 560.172	Re-evaluation of Real Estate Owned
§ 563.41	Loans and Other Transactions with Affiliates and Subsidiaries
§ 563.42	Additional Standards Applicable to Transactions with Affiliates and Subsidiaries
§ 563.80	Borrowing Limitations
Part 564	Appraisals
§ 563.200	Conflicts of Interest

Office of Thrift Supervision Bulletins

TB 23-2	Interagency Statement on Sales of Nondeposit Investment Products

Financial Accounting Standards Board, Statement of Financial Accounting Standards

No. 13	Accounting for Leases
No. 28	Accounting for Sales with Leasebacks
No. 66	Accounting for Sales of Real Estate
No. 98	Accounting for Leases
No. 121	Accounting for the Impairment of Long-Lived Assets and for Assets to be Disposed of Emerging Issues Task Force

Other Accounting References

Emerging Issues Task Force

EITF No. 96-14	Accounting For the Costs Associated with Modifying Computer Software for the Year 2000

Statement of Position

SOP 98-1	Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, American Institute of Public Accountants (AICPA)

Other References

Chs. 6 & 12	Standard Accounting Manual for Savings and Loan Institutions

Fixed Assets
Program

Examination Objectives

To determine whether the savings association has adequate policies, procedures, and controls for the acquisition, maintenance, and disposition of fixed assets.

To determine whether the current and planned levels of fixed assets are consistent with the savings association's business plan.

To determine whether the current and planned levels of fixed assets are detrimental to the savings association.

To evaluate the scope and adequacy of accounting procedures and auditing functions for fixed assets.

To summarize findings and to initiate corrective action when deficiencies exist that could adversely affect safety and soundness or when you note violations of laws or regulations.

Examination Procedures

Wkp.Ref.

Level I

1. Review examination scoping material related to fixed assets.

______________________________ __________

2. Analyze the savings association's policies and procedures regarding the acquisition and disposition of, and total investment in, fixed assets and the related annual expenditures. Determine the reasonableness relative to the following items:

   - Business plan
   - Capital structure
   - Earnings
   - Nature and volume of operations
   - Future goals and objectives
   - Future earnings
   - Conflicts of interest
   - Affiliate or insider transactions.

______________________________ __________

3. Determine if the board of directors approved material acquisitions and dispositions.

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4. Discuss major planned capital expenditures with management.

____ __________

5. Review Level II procedures and perform those necessary to test, support, and present conclusions derived from performance of Level I procedures.

____ __________

Level II

6. Obtain a schedule of fixed assets and their accumulated depreciation. Balance the schedule to the general ledger. Determine if the association properly reported fixed assets on the Thrift Financial Report.

____ __________

7. For major purchases, determine if the association obtained independent appraisals, or competitive bids, and whether the transactions meet regulatory requirements.

____ __________

8. Determine whether accounting treatment and reporting of fixed assets are correct.

____ __________

9. Determine the adequacy of feasibility and cost analysis studies supporting the association's:

   - Investment in large new projects where the savings association will expect rental income to reduce substantially its cost of occupancy.
   - Branch operation expansions.

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10. Review leases pertaining to fixed assets. (Update the Continuing Examination File, if applicable.)

    - Determine if lease terms are having an adverse effect on the savings association's profitability and operations.
    - Determine if the association granted affiliates or insiders favorable lease terms to the detriment of the association.

11. Determine whether association personnel are improperly using the association's fixed assets for their own benefit.

12. For sales, determine if the association financed the sale consistent with the conditions and terms offered the general public, and if the association received market value for the property.

13. Review documentation and determine whether the savings association made prudent decisions regarding assets sold and subsequently leased back; use present value techniques to determine cost to the savings association. (Refer to Thrift Activities Regulatory Handbook Section 440 for a review of present value.) Ascertain the effectiveness of sale/leaseback agreements and whether the association accounts for them according to GAAP and OTS guidelines.

14. Obtain an explanation for the extended holding period of the site(s) if the association acquired real estate for use as an office or related facility more than three years ago but has not developed it obtain an explanation. Document the explanation in the examination report.

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15. Determine if the association accounts for any real estate they no longer intend to develop for their own use as REO.

16. For savings associations that share facilities with other financial institutions, determine whether the association has adequate guidelines to avoid conflicts of interest and usurpation of corporate opportunity. This should include a plan that addresses the following items:

    - Specific areas where conflicts and abuses can occur.
    - Policies and actions that avoid potential conflicts and abuse.
    - Procedures to deal with individuals who violate such policies.

17. Ensure that your review meets the *Objectives* of this Handbook Section. State your findings and conclusions, as well as appropriate recommendations for any necessary corrective measures, on the appropriate work papers and report pages.

Level III

18. For sales judged to be below market value, determine need for reappraisals.

19. Determine whether the association carries property and equipment being held for sale, or no longer in use, at the lower of adjusted cost or market value. If there is evidence the association does not expect to recover the adjusted cost of major facilities still in service (that is, items that the savings association uses and not held for sale) determine if the savings association has written down or classified such items.

20. Relate any funding commitments under lease agreements and fixed asset expenditures, if significant, to the review of liquidity.

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21. Determine that the association makes adequate provision for the following items:

- Maintenance of adequate hazard insurance, public liability insurance, non-owner automobile protection insurance, and automobile property damage insurance, as applicable.
- Arrangements for sharing equipment or facilities (for example, electronic data processing) with others.
- Periodic physical inventories of other fixed assets and reconciliations to fixed asset records.

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Fixed Assets Questionnaire

General Questionnaire	Yes	No
Acquisition, Disposal, and Record Keeping		
1. Does an officer who does not also control related disbursement or receipt of funds sign for the acquisition or disposal of property?		
• By whom? ______		
2. Does the association have procedures that require the board of director's approval for all major acquisitions or dispositions of property? (If so, indicate the dollar threshold that constitutes a major transaction.) Does the board of directors approve all major transactions?		
• Amount: $______		
3. Do the association's procedures require an independent appraisal of an asset to determine the propriety of the proposed purchase or sale price?		
• Frequency? ______		
4. Do the association's procedures require that regular charges be made for depreciation expense?		
5. Does someone who does not also have sole custody of the property prepare, execute, post, and adequately review records for the acquisition, disposition, or depreciation of property?		
• By whom? ______		
6. Does someone who does not have sole custody of the property balance all applicable property and depreciation records to the appropriate general ledger accounts? (The association should do this at least quarterly.)		
• By whom? ______		
• Frequency? ______		
7. Does someone who does not also have sole custody of the property post subsidiary property and applicable depreciation records?		
8. Does someone who does not also have sole custody of the property balance subsidiary property and applicable depreciation records to the appropriate general ledger accounts? (The association should do this at least quarterly.)		
Association as Lessor (Association Premises and Association Equipment Only)		
9. Do association policies provide for division of the duties involved in billing, collecting, and posting of rental payments?		
10. Does the association monitor the lease agreement terms (that is, accounting of payments and tenant expenses)?		
11. Does the association perform credit checks on potential lessees?		
12. Do association policies provide for periodic review of lessees to identify concentrations of affiliated or related concerns?		
Association as Lessee (Association Premises and Association Equipment Only)		
13. Does the association have a clearly defined method of determining whether they should own or lease fixed assets? Does the association maintain supporting documentation?		
14. Does the association have procedures to determine whether a lease is a capital or an operating lease as defined by GAAP under SFAS 13?		
15. Do the association's operating procedures for capital leases provide for the review of the amount recorded for accuracy?		

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Fixed Assets
Questionnaire

	Yes	No
Shared Facilities		
16. Are the association's personnel aware of the existence of guidelines for shared facilities?		
• Do personnel adhere to these guidelines?		
17. Are the personnel of the other entity aware of the association's guidelines for shared facilities?		
• Do they have their own guidelines?		
• Do personnel adhere to both sets of guidelines?		
Other		
18. Do the association's procedures preclude persons who have access to property from having sole custody of property, in that:		
• Its physical character or use would make any unauthorized use or disposal readily apparent?		
• Inventory control methods sufficiently limit accessibility?		
19. Do the association's procedures require review of additions to fixed assets to determine whether they represent replacement? Does the association clear any replacement items from the accounts?		
20. Do the association's procedures require signed receipts for removal of equipment?		
21. Does the association periodically perform a physical inventory of association equipment?		
• If so, does someone who does not also have sole custody of the property review any differences from inventory records?		

	Yes	No
22. Do the association's procedures provide for serial numbering of equipment for inventory purposes?		
23. Does the association maintain separate property files that include invoices (including settlement sheets and bills of sale, as necessary), titles (on real estate, vehicles), and other pertinent ownership data as part of the required documentation?		
24. Does the association have adequate physical safeguards for the property?		
25. Does the association account for property and equipment individually?		
26. Do association personnel improperly use the association's fixed assets for their own benefit?		
27. Does the association have written procedures for selecting a seller, servicers, insurer, or purchaser of major assets (through competitive bidding, for example) to prevent any possibility of a conflict of interest or self-dealing?		
28. Does the association obtain the benefit of expert tax advice from internal or external auditors before making final decisions on material transactions involving fixed assets?		
29. Do officers and directors periodically review the adequacy of insurance coverage?		

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Fixed Assets
Questionnaire

Comments

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