INTRODUCTION

All asset and liability accounts, which are not included in a major balance sheet category, are listed in a general other assets or other liabilities category. Even though these assets or liabilities are listed in an "other" category, it does not mean that these accounts are any less important than any of the major balance sheet categories. The following accounts are the most frequently encountered other assets and liabilities, or otherwise deemed worthy of mention. Examination Procedures and other information for these accounts are included in the Examination Documentation (ED) Modules and in the Instructions for the preparation of Consolidated Reports of Condition and Income (Call Report).

OTHER ASSETS

Prepaid Expenses

Prepaid expenses are assets since they are a means of allocating expenditures for services, which will benefit the bank through future time periods. The prepaid amount is amortized over the life of the purchased goods or services; a portion of the cost is charged to current expenses with a corresponding credit to the prepaid expense account. Examples of prepaid expenses are premiums paid for insurance, payments made in advance for maintenance contracts, and advance rental payments for bank premises and/or equipment. Examiners should ensure that management makes the proper adjusting entries to prepaid accounts to reflect the purchased goods or services that are exhausted. Any prepaid expense, that is overstated should be classified Loss; however, a prepaid expense that is properly booked and is accounted for in accordance with generally accepted accounting principles (GAAP) generally should not be adversely classified.

Accrued Income Accounts

The balance typically carried on the bank's books under this designation is a control account representing a number of subsidiary accounts used for the accrual of income receivable from different types of earning assets. In accrual accounting, a bank regularly credits an applicable earnings account for income earned, but not yet collected. Since the income was not actually received at the time it was earned, the bank offsets the income credit with an entry (a debit) to the accrued income receivable account. When the funds are collected, cash or an equivalent is debited, and the receivable account is credited. The examiner should determine whether any of the accrued income receivable posted to the account is contingent upon items in default or otherwise of doubtful collection.

Aside from the question of collectability, the general accuracy of the accrual accounting system is a material consideration that should be reviewed during the examination. The degree of examiner review is essentially governed by the bank's internal control structure and the extent to which the accrual accounting procedures are analyzed during audits. If the income accrual accounts are overstated, then income will be overstated. The overstated amount in the accrued income account would be accorded a Loss classification, and if material, that amount would be depicted in the Report of Examination.

Bankers Acceptances

A bankers acceptance is a draft or bill of exchange, drawn on and accepted by a bank or its agent for payment by that bank at a specified time. Such instruments are readily marketable. The bank's acceptance is a formal obligation acknowledgment and constitutes an unconditional promise by the bank to honor the draft at maturity. Banks may invest in bankers acceptances by purchasing acceptances executed by other banks or the bank may discount acceptances it executed. Acceptances owned by the bank (those which it discounted or purchased regardless of whether they were executed by the bank under examination or another), should be reported either as loans or trading assets in the Call Report. Customers' obligations to a bank for acceptances, which the bank executed (those drawn on and accepted by it and which are still outstanding), should be reported in the asset section of the Call Report as "Customers' liability to this bank on acceptances outstanding."

A bankers acceptance is generally recorded as both an asset and as a liability. The liability is addressed under the Other Liabilities caption later in this section. A general discussion of bankers acceptances is contained in the International Banking section of this Manual. Additionally, examiners can refer to the Bankers Acceptances entry in the Call Report Glossary for additional information regarding the proper reporting of these investments.

Servicing Assets

The right to service assets is represented by the contractual obligations undertaken by one party to provide servicing for mortgage loans, credit card receivables, or other financial assets for another. Servicing includes, but is not limited to, processing principal and interest payments, maintaining escrow accounts for the payment of taxes and

insurance, monitoring delinquencies, and accounting for and remitting principal and interest payments to the holders of beneficial interests in the financial assets. Servicers typically receive certain benefits from the servicing contract and incur the costs of servicing the assets.

Servicing is inherent in all financial assets; however, it becomes a distinct asset or liability only when contractually separated from the underlying financial assets by sale or securitization with servicing retained or by a separate purchase or assumption of the servicing. Whenever an institution undertakes an obligation to service financial assets, a servicing asset or liability must be recognized unless the institution securitizes the assets, retains all of the resulting securities, and classifies the securities as held-to-maturity. Servicing liabilities are addressed under the Other Liabilities caption of this section.

Accounting

Accounting and reporting standards for asset and liability servicing rights are set forth in Statement of Financial Accounting Standards No. (FAS) 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, and FAS 65, *Accounting for Certain Mortgage Banking Activities*, as amended by FAS 140. Servicing assets result from contracts to service financial assets for which the servicing benefits (revenues from contractually specified servicing fees, late charges, and other ancillary sources) are expected to more than adequately compensate the servicer for performing the servicing. Servicing liabilities result when such contracts are not expected to adequately compensate the servicer for performing the servicing. FAS 140 defines contractually specified servicing fees as all amounts that, per contract, are due to the servicer in exchange for servicing the financial assets and which would no longer be received by a servicer if the contract for servicing were shifted to another servicer. Servicing receivables that exceed contractually specified servicing fees are classified as interest-only strips receivable.

When a bank sells or securitizes financial assets and retains the right to service the assets, the bank allocates the financial asset cost to the servicing assets and the financial assets (without the servicing) based on their relative fair values. If it is not practicable to estimate the fair values of the servicing assets and the financial assets (without the servicing), the entire cost should be allocated to the financial assets (without the servicing) and no cost to the servicing assets. If a bank purchases servicing assets in a transaction (other than through the sale or securitization of the financial assets serviced), the asset should be recorded at fair value, which is presumptively the price paid to acquire the servicing.

Servicing assets should be amortized in proportion to, and over the period of, estimated net servicing income. The servicing assets should be stratified into groups based on one or more of the predominant risk characteristics of the underlying loans for purposes of determining whether impairment exists. If the book value of a servicing asset stratum exceeds its fair value, the servicing asset is considered impaired, and the book value should be reduced to fair value through a valuation allowance for that stratum. FAS 140 provides a more detailed definition of fair value, but in general, the fair value of a servicing asset is the amount at which the asset could be bought or sold in a bona-fide transaction between willing parties.

Institutions that sell only a limited number of financial assets with servicing retained and do not otherwise actively purchase or sell servicing rights may find it impractical to capitalize and periodically value the servicing asset. Typically, these institutions will have a relatively low volume of financial assets serviced for others and the value of any servicing assets and liabilities will be relatively immaterial. If management provides a reasonable basis for not allocating cost to servicing assets, examiners should normally refrain from taking exception to their decision.

Valuation

Quoted market prices in active markets are the best evidence of fair value and should be used as a basis for measurement, if available. When quoted market prices are not available, the estimate of fair value should be based on the best information available under the circumstances. The estimate should consider prices of similar assets, and the valuation technique used should be consistent with the objective of measuring fair value. Examples of other valuation techniques are discounted cash flow analysis (present value calculations), option-pricing models, and matrix pricing. Discounted cash flow analysis is the most common valuation method employed.

When the discounted cash flow approach is used to measure the fair value of servicing assets, a number of factors and assumptions are considered when projecting the potential income stream (net of servicing costs) generated by the servicing rights. This income stream is present valued using appropriate market discount rates to determine the estimated fair value of the servicing rights. These factors and assumptions, which should be adequately documented, include:

- Average loan balance and coupon rate;
- Average portfolio age and remaining maturity;

- Contractual servicing fees;
- Estimated income from escrow balances;
- Expected late charges and other possible ancillary income;
- Anticipated loan balance repayment rate (including estimated prepayment speeds);
- Direct servicing costs and appropriate allocations of other costs, as well as the inflation rate effect; and
- Delinquency rate and estimated out-of-pocket foreclosure and collection costs that will not be recovered.

Estimated fair values for servicing assets may vary greatly from one portfolio to another. For example, a portfolio of loans whose contractual interest rates are well above current market interest rates generally would experience a higher prepayment as borrowers refinance to lower rate loans. Servicing fee rates also vary and depend on the terms of the servicing agreement.

The book value of each stratum of servicing assets should be reviewed at least quarterly. For purposes of determining whether servicing assets are impaired, FAS 140 specifies that the portfolio of servicing assets needs to be stratified based on one or more of the predominant risk characteristics of the underlying loans. The characteristics may include loan type (such as conventional versus government-guaranteed and adjustable-rate versus fixed-rate), investor (such as Federal National Mortgage Association {FNMA}, Federal Home Loan Mortgage Corporation {FHLMC}, Government National Mortgage Association{GNMA}, private), size, contractual interest rate, date of origination, term, and geographic location. Although institutions are only required to stratify the portfolio based on one predominant risk characteristic for purposes of evaluating and measuring impairment, examiners may find it appropriate to encourage institutions to further break down their strata into substrata to expand the number of risk characteristics used when estimating the fair value of each stratum.

Institutions should document the predominant risk characteristics used to stratify a portfolio, and examiners should review the appropriateness of such. Typically, an institution should be consistent from one period to the next in selecting the risk characteristics used to stratify a portfolio, estimate the fair value of each stratum, and measure impairment. In those instances where risk characteristics are further refined to enhance the valuation through the use of substrata, these risk characteristics may be adjusted over time as the composition of the portfolio strata evolves.

If quoted market prices are used to estimate the fair value of a stratum or substratum, institutions will need to know the portfolio characteristics underlying the quoted market price to ensure that these characteristics are comparable to those of the institution. Depending on the servicing portfolio's volume and complexity, institutions may use more than one means of estimating fair values. For example, an institution may verify the reasonableness of a discounted cash flow analysis with a quoted market price. The methods and assumptions used by an institution in estimating fair value should be reviewed for reasonableness by examiners, especially if significant discrepancies exist between quoted market prices and the fair value estimates that are determined using the discounted cash flow approach.

Each stratum of servicing assets is to be valued separately. If a stratum is refined into various sub-stratums, the valuation for the stratum is determined by summing the fair value of each sub-stratum. The combined values for the sub-stratums then becomes the fair value of the stratum. If the fair value of a servicing asset stratum is less than its amortized cost, a valuation allowance equal to this difference is established for that stratum. However, if the fair value of a servicing asset stratum exceeds its carrying value, a gain is not recognized. In no circumstances are servicing asset strata to be valued in the aggregate with market depreciation in one stratum offsetting market appreciation in another. Institutions are able to eliminate or reduce the valuation allowance for a stratum if the stratum's fair value subsequently increases.

While FAS 140 does not address when a permanent write-down of servicing assets should be recorded, it is appropriate for an institution to reduce the recorded investment in the servicing assets if the decline in fair value is other than temporary. Declines in value due to such factors as a significant increase in the level of defaults or prepayments could result in the need for a bank to record a direct write-down of the servicing asset rather than an increase in the valuation allowance.

For servicing contracts in existence before January 1, 1997, previously recognized servicing rights and "excess servicing" receivables that do not exceed contractually specified servicing fees shall be combined, net of any previously recognized servicing obligations under that contract, as a servicing asset or liability. Previously recognized servicing receivables that exceed contractually specified servicing fees should be reclassified as interest-only strips receivable.

Regulatory Capital

Under the FDIC's regulatory capital rules, servicing assets (arising both from mortgages and from financial assets other than mortgages) are subject to a quarterly valuation requirement and a restriction limiting the amount of servicing assets that may be recognized for Tier 1 capital purposes to the lesser of 90 percent of fair value or 100 percent of book value (net of any valuation allowances). The quarterly valuation should include adjustments for any significant changes in the original valuation assumptions, including changes in prepayment estimates or attrition rates.

The total amount of mortgage servicing assets, nonmortgage servicing assets, and purchased credit card relationships recognized for regulatory purposes (i.e., not deducted from assets and capital) is limited to no more than 100 percent of Tier 1 capital. In addition to the aggregate limitation on such assets, the maximum allowable amount of purchased credit card relationships and nonmortgage servicing assets, when combined, is limited to 25 percent of Tier 1 capital. These limitations are calculated before deduction of any disallowed servicing assets, disallowed purchased credit card relationships, disallowed credit-enhancing interest-only strips, and disallowed deferred tax assets. In addition, banks may elect to deduct disallowed servicing assets on a basis that is net of any associated deferred tax liability.

As indicated previously, servicing receivables that exceed contractually specified servicing fees are classified as interest-only strips. Examiners should be aware that these credit-enhancing interest-only strips, whether purchased or retained as part of asset sales and securitizations, are also subject to a separate 25 percent of Tier 1 capital limitation.

Servicing Risk

Examiners should be aware of the risks that can impact an institution from the failure to follow the servicing rules related to securitized assets. While credit risk may appear to be of little or no concern, the mishandling of procedures in these transactions can affect a holder's ability to collect. Financial institutions perform roles as sellers, buyers, servicers, trustees, etc., in these types of transactions. Examiners should evaluate the potential risks that might arise from one or more of these roles. In most cases, the government agency that provided the guarantee or insurance against ultimate default will also impose guidelines and regulations for the servicer to follow. If the servicer or another fails to follow these rules and guidelines, then the government agency that is providing the guarantee or insurance may fail to honor its commitment to insure all parties against loss due to default. It is necessary for the financial institution to have adequate policies and procedures in place to control and limit the institution's liability and exposure in this regard.

Examination Procedures

When assessing asset quality during onsite examinations and when reviewing merger applications, examiners and supervisory personnel should review the valuation and accounting treatment of servicing assets. Examination procedures are contained in the ED modules within the module on mortgage banking.

Suspense Accounts

Various temporary holding accounts may be included within the designation of suspense accounts, such as interoffice, teller, transit, and bookkeeping differences having debit balances. These accounts should only be used for temporary recording until the offsetting entry is received or fully identified and posted to the proper account. Outdated items carried in suspense are likely uncollectible and should be classified Loss in the examination report. Items that the bank holds in a suspense account may need to be reallocated to the categories where they belong for Call Report classification purposes.

Cash Items Not In Process Of Collection

This caption is comprised of such items as checks returned by other banks, checks not posted by bookkeepers for various reasons, and any other unpaid items, which do not conform to the definition of "Cash items in process of collection." Checks held by a bank to avoid showing overdrafts in depositors' accounts, even though paid or otherwise disposed of during the examination, should not be shown as in process of collection.

Maintenance of detailed records of all cash items is essential. Inadequate records have facilitated concealment of shortages through manipulation of cash items. Cash items should not be kept as part of tellers' cash, but instead should be charged to a general ledger account and handled as collection items, with responsibility assigned to one person who preferably does not handle cash. All entries to the account should require officer approval and this officer should not be custodian of the items. When reviewing cash item transactions, examiners should ensure that adequate records exist and appropriate accounting procedures are followed. Cash items and related entries should be thoroughly investigated, especially cash item transactions occurring immediately before and after the current examination date and for a period following the close of the previous examination.

Tax Assets

Tax asset accounts may be encountered under such captions as Future Tax Benefits, Deferred Tax Assets, Deferred Income Tax Charges, and Prepaid Income Taxes. Future tax benefit accounts must be evaluated in light of the bank's ability to realize the future benefits and the documentary evidence and support on which they rest. Assets falling within the future tax benefits category arise from two distinct types of circumstances: temporary differences, and operating loss and other carryforwards. Temporary differences result in amounts of income or expense being reported in the Report of Income in one period, but in another period in the tax returns.

A common example of a temporary difference would be a bank's provision for loan and lease losses being expensed for financial reporting purposes in one period, but not being deducted for tax purposes until the loans are actually charged off in a subsequent period. This difference will "reverse" when the loans are actually charged off.

Operating loss carrybacks and carryforwards and tax credit carryforwards occur when a bank sustains a net operating loss. An operating loss that occurs in a year following periods when the bank had taxable income may be carried back to recover income taxes previously paid in the year the loss occurs. In this situation, the applicable income taxes in the Call Report will reflect a credit rather than an expense. Banks may carryback operating losses for two years. Generally, an operating loss that occurs when loss carrybacks are not available (i.e. occurs in a year following periods of losses) becomes an operating loss carryforward. Banks may carry operating losses forward 20 years. Tax credit carryforwards are tax credits that cannot be used for tax purposes in the current year, but which can be carried forward to reduce taxes payable in a future period. Deferred tax assets are recognized for operating loss and tax credit carryforwards just as they are for deductible temporary differences. As a result, a bank can recognize the benefit of a net operating loss for tax purposes or a tax credit carryforward to the extent the bank determines that a valuation allowance is not considered necessary.

The realization of the tax carryforward may be questionable, since it is dependent upon future taxable income. Accordingly, the tax effects of loss carryforwards should only be recognized when realization of the benefit is more likely to occur than not. Examiners should obtain management's analysis and support depicting that it is more likely than not that the bank will be able to realize the carryforward before it expires. Examiners should refer to the Call Report Glossary for guidance on income taxes and may further want to refer to the regional accounting specialist in cases involving significant amounts of deferred tax assets related to carryforwards.

There are limitations on the amount of deferred tax assets dependent upon future taxable income that can be included in Tier 1 capital. The maximum allowable amount of deferred tax assets that are dependent upon future taxable income, net of any valuation allowance for deferred tax assets, will be limited to the lesser of: the amount of deferred tax assets dependent upon future taxable income expected to be realized within one year of the calendar quarter-end date, based on projected future taxable income for that year; **or** ten percent of the amount of Tier 1 capital that exists before the deduction of any disallowed mortgage servicing assets, nonmortgage servicing assets, purchased credit card relationships, credit-enhancing interest-only strips, deferred tax assets, and any nonfinancial equity investments.

Bank-Owned Life Insurance Policies

A purchase of Bank-Owned Life Insurance (BOLI) can be an effective way for an institution to manage exposures arising from commitments to provide employee compensation and pre- and post-retirement benefits. Because the cash flows from a BOLI policy are generally income tax-free if the institution holds the policy to full term, BOLI can provide attractive tax-equivalent yields to help offset the rising cost of providing employee benefits.

FDIC-supervised banks may acquire BOLI for purposes permitted under applicable State law; however, bank management should not purchase BOLI as part of an asset/liability management strategy in an attempt to increase earnings during periods of low interest rates and reduced loan demand, as some institutions have done. Some institutions commit a significant amount of capital to BOLI without having an adequate understanding of the full array of risks involved, especially risks that are difficult to measure, such as liquidity, transaction/operational (e.g. tax), reputation, and compliance/legal risks. Institutions should implement appropriate risk management processes including meaningful risk limits before implementing or adding to a BOLI program. A sound pre-purchase analysis, meaningful ongoing monitoring program, reliable accounting process, and accurate assessment of risk-based capital requirements are all components of the type of risk management process institutions should employ. Senior management and board oversight of BOLI should include both a thorough pre-purchase analysis of risks and rewards and post-purchase risk assessment. An institution holding life insurance in a manner inconsistent with safe and sound banking practices is subject to supervisory action.

The safe and sound use of BOLI depends on effective senior management and board oversight. Regardless of the bank's financial capacity and risk profile, the board must understand the complex risk characteristics of the insurance holdings and the role this asset plays in the institution's overall business strategy. Before entering into a BOLI contract, institutions should have a prudent risk management process that includes:

- Effective senior management and board oversight;
- Comprehensive policies and procedures, including appropriate limits;
- A thorough pre-purchase analysis of BOLI products; and
- An effective ongoing system of risk assessment, management, monitoring, and internal control processes, including appropriate internal audit and compliance frameworks.

The objective of the pre-purchase analysis is to help ensure that the institution understands the risks, rewards, and unique characteristics of BOLI. The analysis should be commensurate with the size and complexity of the BOLI purchases and should take into account existing BOLI holdings. Records concerning pre-purchase analyses, including documentation of the purpose and amount of insurance needed, should be maintained. In addition to conducting a risk assessment as part of a thorough pre-purchase analysis, monitoring BOLI risks on an ongoing basis is important especially for an institution whose aggregate BOLI holdings represent a capital concentration. Management should review the insurance assets' performance with the board at least annually. More frequent reviews are appropriate if there are anticipated changes to the BOLI program such as additional purchases, a decline in the insurance carrier(s) financial condition, anticipated policy surrenders, or changes in tax laws or interpretations that could have an impact on BOLI performance.

Consistent with prudent risk management practices, each institution should establish internal policies and procedures governing BOLI holdings, including guidelines that limit the aggregate cash surrender value (CSV) from any one insurance company, as well as the aggregate CSV of policies from all insurance companies. Management should consider its legal lending limits, the capital concentration threshold, and any applicable State restrictions on BOLI holdings when establishing limits. Given the liquidity, transaction/operational, reputation, and compliance/legal risks associated with BOLI, it is generally not prudent for an institution to hold BOLI with an aggregate CSV that exceeds 25 percent of Tier 1 capital.

An institution that plans to acquire BOLI in excess of concentration guidelines or any lower internal limits, should gain prior approval from the board of directors or appropriate committee thereof. Management should justify that any increase in BOLI resulting in an aggregate CSV above 25 percent of Tier 1 capital does not constitute an imprudent capital concentration. Examiners should review risk-based supervision guidelines when assessing BOLI, and should closely scrutinize risk management policies and controls associated with BOLI assets when an institution holds BOLI in an amount that approaches or exceeds the 25 percent of Tier 1 capital concentration threshold. Where examiners encounter deficient risk management practices, corrective action should be required.

FASB Technical Bulletin No. 85-4, *Accounting for Purchases of Life Insurance*, discusses how to account for holdings of life insurance. Under Bulletin 85-4, only the amount that could be realized under an insurance contract as of the balance sheet date (that is, the CSV reported by the carrier, less any applicable surrender charges not reflected in the CSV) is reported as an asset. If the bank has booked amounts in excess of the net CSV of the policy, the excess should be classified Loss.

Examiners should review the Interagency Statement on the Purchase and Risk Management of Life Insurance when assessing an institution's BOLI program.

Goodwill and Other Intangible Assets

Goodwill is an unidentifiable intangible asset that is commonly acquired in business combinations, or where a substantive change in control has occurred. Other intangible assets are also commonly acquired through the same means. Other intangible assets are distinguished from goodwill when they are identifiable and can be recognized as a specific asset under applicable accounting standards. Examples of other intangible assets include core deposit intangibles, purchased credit card relationships, servicing assets, favorable leasehold rights, trademarks, trade names, internet domain names, and non-compete agreements. While goodwill and other intangible assets may be developed internally, this discussion will focus mainly on intangible assets acquired through business combinations.

Institutions generally must deduct goodwill and other intangible assets, except for limited amounts of servicing assets and purchased credit card relationships, when measuring Tier 1 capital for regulatory capital purposes. Examiners should refer to the Capital section of this Manual and Part 325 of the FDIC Rules and Regulations

for further information on the regulatory capital treatment of goodwill and intangible assets.

The accounting for business combinations is guided by FAS 141, *Business Combinations*. FAS 141 requires that all business combinations initiated after June 30, 2001, except for combinations between two or more mutual enterprises, be accounted for by the purchase method. Combinations initiated prior to this date that qualified for and used the pooling-of-interests accounting should continue to be accounted for as such.

Intangible assets acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for upon their acquisition in accordance with FAS 142, *Goodwill and Other Intangible Assets*. FAS 142 also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements.

Like FAS 141, FAS 142 is currently not applicable to goodwill and other intangible assets arising from combinations between mutual enterprises.

Goodwill and Other Intangible Assets Acquired in Business Combinations (FAS 141)

Generally, under the purchase method, an acquiring company must allocate the cost of an acquired entity to the assets acquired and liabilities assumed based on their estimated fair values at the date of the acquisition. Goodwill is recognized when the cost of an acquired entity exceeds the fair value of tangible and identifiable intangible assets acquired less liabilities assumed. Goodwill is normally acquired in a business combination where the purchase method of accounting is used. In addition, goodwill is typically obtained when a substantive change in control has taken place and push down accounting is used.

FAS 141 provides general guidance for assigning amounts to assets acquired and liabilities assumed. Acquired assets may be tangible or intangible. Under FAS 141, an intangible asset must be recognized as an asset apart from goodwill if it arises from contractual or other legal rights. Also, an intangible asset must be recognized as an asset apart from goodwill if it is separable. For example, FAS 141 specifically identifies core deposit intangibles as one type of intangible that must be recognized as an asset separate from goodwill. However, in a purchase business combination completed before July 1, 2001, if a bank did not separately recognize core deposit intangibles or other intangible assets that must be recognized as assets apart from goodwill under FAS 141, and has accounted for these identifiable intangibles as part of goodwill, the bank is not required to separate these intangibles from goodwill and reflect them as identifiable intangible assets.

Accounting for Goodwill and Other Intangible Assets After Initial Recognition (FAS 142)

Goodwill should not be amortized, but should be tested for impairment at least annually. However, until interpretive guidance concerning the application of the purchase method of accounting for business combinations between two or more mutual institutions is issued by the FASB, goodwill acquired in such a combination must continue to be amortized over its estimated useful life, generally not to exceed 25 years, and tested for impairment in accordance with Accounting Principles Board Opinion No. 17.

Goodwill (if it is not subject to Opinion No. 17) is considered impaired when the amount of goodwill exceeds its implied fair value at the reporting unit level. If the carrying amount of reporting unit goodwill exceeds its implied fair value, an impairment loss must be recognized in earnings. After a goodwill impairment loss is recognized, the adjusted carrying amount of goodwill shall be its new accounting basis. Subsequent reversal of a previously recognized goodwill impairment loss is prohibited once the measurement of that loss is completed. Goodwill of a reporting unit must be tested for impairment annually and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount.

FAS 142 requires intangible assets with finite lives (other than servicing assets) to be amortized over their useful lives and to be reviewed for impairment in accordance with FAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. Where an intangible has a finite useful life, but the precise length of that life is not known, that intangible asset shall be amortized over the best estimate of its useful life. Intangible assets with indefinite useful lives should not be amortized until such time that it is determined that their useful lives are no longer indefinite. If an intangible asset that is not being amortized is subsequently determined to have a finite useful life, the asset should be tested for impairment and, after any impairment loss is recognized, the asset's carrying amount should be amortized prospectively over its estimated remaining useful life. The estimate of the useful life of an intangible asset to an entity shall be based on an analysis of all pertinent factors such as the expected use of the asset by the entity and any legal, regulatory, or contractual provisions limiting its useful life.

Sales, Disposals, and Write-off of Goodwill

Goodwill ordinarily cannot be disposed of separate and apart from a reporting unit or a business as a whole. However, if an institution sells a reporting unit or business, then all or a portion of the related goodwill, if any, should be included in the carrying amount of the reporting unit or business. Banks may not dispose of goodwill except in these limited circumstances. Any request by a bank to sell goodwill as a stand-alone asset or to distribute it to a parent holding company as a property dividend should be denied. A bank may attempt to "sell" goodwill in order to increase its Tier 1 capital.

If a bank "sells" its goodwill to its parent, the transaction in substance represents a capital contribution by the parent rather than a sale. The bank normally should amend any Call Reports filed since the "sale" to the extent necessary. The cash received by the bank should be reflected as a capital contribution. Similarly, any Call Reports submitted since a bank's disposal of goodwill through a property dividend to its parent normally should be amended. In both cases, the carrying amount of the goodwill at the time of the transaction should be restored to the bank's balance sheet and any annual impairment tests that were not conducted subsequent to the "sale" or dividend should be performed to ensure that any impairment loss is recognized in the appropriate income statement period.

Ordinarily, goodwill should not be written off unless required based on the results of impairment testing under FAS 142. Therefore, a bank generally should not charge off goodwill in the year that this asset is acquired and any request by a bank to write off goodwill in this period should be denied. If a bank has written off goodwill in the year of acquisition and the write-off was not warranted by the results of impairment testing, the bank should amend any Call Reports filed since the write-off.

All Other Miscellaneous Assets

It is virtually impossible to develop a complete list of miscellaneous assets that the examiner may encounter. The more common types of miscellaneous assets are detailed in the paragraphs that follow.

Accrued interest receivable on bonds purchased results when a bank purchases fixed-income securities between coupon dates. It is customary at settlement to add to the purchase price an amount equaling interest from the date of the previous coupon to the date of sale, which the purchaser records as a receivable. Upon receipt of the interest payments on the first coupon date subsequent to the purchase, the corresponding accrued interest receivable should be eliminated. If an institution records this entire coupon interest payment as income, as opposed to eliminating the accrued interest receivable account, then the accrued interest receivable would be overstated and should be classified Loss.

Reimbursable insurance claims should be supported by factual evidence of the claim. No adverse classification should be made if the bank has a bona fide reimbursement due from an insurance company. Items subject to litigation or negotiation prior to settlement should be appraised on their individual merits, and any adverse classification must be supported by factual and convincing comments.

Bonding company claims arising from acts involving bank directors, officers, or employees, however, often pose complex legal problems, which cast a cloud of uncertainty on their validity or collectability. Capitalization of such claims before their realization is rarely justified, unless the surrounding factual situation is such that realization is assured beyond any reasonable doubt. As a general rule, examiners should consult with the Regional Office when material claims of this nature are encountered.

To determine whether a pending claim has merit, examiners should review:

- bank documentation that demonstrates fraud;
- bond coverage terms;
- bank counsel's opinion as to the claim's legality, collectability, and amount;
- internal and external auditors' opinion concerning proper accounting (if available);
- bank compliance with the insurance company's filing requirements, and
- communications from the insurance company.

Repossessed Property represents assets for which the bank took title in full or partial satisfaction of debt. The property could be automobiles, appliances, trucks, boats, recreation vehicles, or heavy construction equipment. A bank that receives from a borrower in full satisfaction of a loan either receivables from third party, an equity interest in the borrower, or another type of asset (except a long-lived asset that will be sold) shall account for the asset received at its fair value at the time of the restructuring. Repossessed property should be assessed for possible adverse classification. Each repossessed item should be considered individually and, if necessary, adversely classified based on facts supporting the examiner's appraisal.

OTHER LIABILITIES

Mortgages Payable

Mortgages, liens, and other encumbrances on premises, which the bank is legally obligated to pay, are reported as “Other borrowed money” in the Call Report. Regardless of the mortgage amount outstanding on the bank premises, the asset should be carried on the general ledger at historical cost net of accumulated depreciation.

A common method used by banks to carry fixed assets indirectly is to transfer property title to a real estate subsidiary with a leaseback arrangement to the bank. The mortgage or lien becomes the affiliate’s or subsidiary’s liability; however, the Call Report requires consolidation of majority-owned subsidiaries. Therefore, the property and associated liability are reflected in consolidated statements.

Capital Leases Outstanding

A lease is an agreement that transfers the right to use land, buildings, or equipment for a specified time period. This financing device is essentially a credit extension evidenced by an obligation between a lessee and a lessor. FAS 13, *Accounting for Leases*, governs when leases will be accounted for either as an operating lease or as a capital lease. FAS 13 requires that a lease transaction, which substantially transfers all the benefits and risks of property ownership, be accounted for by the lessee as an acquisition of the asset and the incurrence of a liability. Depending upon the lease terms, a bank that leases branch facilities or equipment may have to record these as assets and book a corresponding liability. Additional information on this subject and sale-leaseback transactions is included in the Premises and Equipment section of this Manual.

Accrued Taxes and Expenses

Call Report instructions require all banks, regardless of size, to prepare financial reports on the basis of accrual accounting. General categories of other liabilities common to banks on an accrual system are accrued taxes and other expenses, which represent periodic charges to income for expenses not immediately payable, but which have yielded benefits in the current period. Examples of such items include Federal income taxes, taxes on premises or equipment, interest on savings and time deposits, and salary expense. Accounts that consist of amounts accrued for taxes and other expenses, regardless of how they are labeled on a bank's general ledger, should be treated as liabilities.

Bankers Acceptances

As described in the Other Assets section, a bankers acceptance is a draft or bill of exchange, accepted by a bank, drawn by an individual or business firm on a bank, ordering it to pay to the bearer or a designated party a certain sum of money at a specified time.

If an acceptance executed by a bank or by others acting as its agent is outstanding (unmatured), it is a direct liability. The use of this instrument arises primarily from the financing of foreign trade, but may also be used to finance the movement and storage of goods in domestic trade. An acceptance often originates under a letter of credit, but is not treated as an acceptance until drafts or bills drawn against the letter of credit are accepted by the bank. A bank's liability for drafts and bills of exchange outstanding and accepted by the bank or accepted by others for the bank's account should be reported in the Liabilities section of the Call Report as “Bank's liability on acceptances executed and outstanding.”

Bankers acceptances as assets are addressed in the Other Asset caption of this section. Additional information on bankers acceptances is included in the International Banking section of this Manual and the Call Report Glossary.

Servicing Liabilities

As noted under Servicing Assets, the rights to service financial assets are represented by the contractual obligations undertaken by one party to provide servicing for mortgage loans, credit card receivables, or other financial assets for another. Servicing includes, but is not limited to, the processing of principal and interest payments, the maintenance of escrow accounts for the payment of taxes and insurance, monitoring delinquencies, and accounting for and remitting principal and interest payments to the holders of beneficial interests in the financial assets. Servicers typically receive certain benefits from the servicing contract and incur the costs of servicing the assets. Servicing is inherent in all financial assets; however, it becomes a distinct asset or liability when contractually separated from the underlying financial assets by sale or securitization with servicing retained or by a separate purchase or assumption of the servicing. Whenever an institution undertakes an obligation to service financial assets, a servicing asset or liability must be recognized (unless the institution securitizes the assets, retains all of the resulting securities, and classifies the securities as held-to-maturity debt securities). Servicing assets are addressed under the Other Assets caption of this section.

The accounting and reporting standards addressing servicing rights (assets and liabilities) are set forth in FAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. Servicing liabilities result from contracts to service financial assets for which the benefits of servicing are not expected to adequately compensate the servicer for performance. The benefits of servicing include revenues from contractually specified servicing fees, late charges, and other ancillary sources.

Servicing liabilities undertaken in a sale or securitization of financial assets should initially be recorded at fair value, if practicable. If it is not practicable to estimate the servicing liability's fair value, no gain should be recognized on the transaction, and examiners should refer to the Transfer of Financial Assets entry in the Call Report Glossary for more specific guidance as to how servicing liabilities should be recorded. If a bank assumes a servicing liability in a transaction other than in a sale or securitization of financial assets being serviced, the liability should initially be recorded at fair value. The fair value is the amount at which that liability could be incurred or settled in a current transaction between willing parties, other than in a forced or liquidation sale. All servicing liabilities shall be amortized in proportion to, and over the period of, estimated net servicing loss (servicing costs in excess of servicing revenue). The book value of servicing liabilities should be reviewed at least quarterly. If the fair value of a servicing liability increases above the book value, the increased obligation shall be recognized as a loss in current earnings. The fair value of servicing liabilities is the amount at which the liabilities could be incurred or settled in a bona-fide transaction between willing parties.

All Other Miscellaneous Liabilities

Other miscellaneous liabilities will be encountered by examiners. Examples include dividends payable, representing cash dividends declared but not yet paid, and net deferred tax liabilities (amount after offsetting deferred tax assets less any valuation allowance). Additionally, if management established an allowance for credit losses on off-balance sheet credit exposures, they would be reported as other liabilities.