

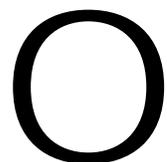


Comptroller of the Currency
Administrator of National Banks

Consigned Items and Other Customer Services

Comptroller's Handbook

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Consigned Items and Other Customer Services

Table of Contents

Introduction	1
Background	1
Risks Associated with Consigned Items and Other Customer Services	1
Common Activities	2
Internal Controls	5
Accounting	5
Examination Objectives	7
Examination Procedures	8
Internal Control Questionnaire	10
Safe Deposit Boxes	10
Items in Safekeeping	12
Custody Accounts	13
Collection Items	15
Consigned Items	17
Verification Procedures	19
Safe Deposit Boxes	19
Safekeeping and Custody Accounts	19
Collection Items	20
Consigned Items	21
Other Nonledger Control Items	21
References	22

Background

Banks historically have offered a variety of customer services that do not result in the recording of an asset or liability on the general ledger of the bank. These services include the issuance of consigned items, such as U.S. savings bonds and commemorative coins; customer safekeeping activities, such as the rental of safe deposit box facilities and the safekeeping of collateral; and collection department services.

Although these customer services do not affect a bank's general ledger, they do result in the assumption of a contingent liability. Accordingly, banks must have in place proper internal controls, strong operating procedures and safeguards, and sound audit coverage if they are to offer these services prudently. Although not always profitable, these services enable banks to offer customers a full range of banking services and provide an additional source of noninterest income.

Risks Associated with Consigned Items and Other Customer Services

For purposes of the Office of the Comptroller of the Currency's (OCC) discussion of risk, the OCC assesses banking risk relative to its impact on capital and earnings. From a supervisory perspective, risk is the potential that events, expected or unanticipated, may have an adverse impact on the bank's capital or earnings. The OCC has defined nine categories of risk for bank supervision purposes. These risks are: credit, interest rate, liquidity, price, foreign exchange, transaction, compliance, strategic, and reputation. These categories are not mutually exclusive; any product or service may expose the bank to multiple risks. For analysis and discussion purposes, however, the OCC identifies and assesses the risks separately.

The applicable risk associated with consigned items and other customer services is transaction risk. Transaction risk is the risk to earnings or capital arising from problems with service or product delivery. This risk is a function of internal controls, information systems, employee integrity, and operating processes. Transaction risk exists in all products and services.

Transaction Risk

Transaction risk, also known as operational risk, can adversely impact earnings as related to consigned items and other customer services because of the

typically heavy volume and record keeping nature of the activity. It is imperative for the bank to have controls and systems in place to ensure the accuracy of records and to guard against fraud. In addition, customer safekeeping and holding items on consignment or for resale requires stringent physical and inventory controls, as well as prudent dollar limits on inventory.

Risk Management

All banks must employ sound fundamental principals which identify risks, establish controls, and provide for monitoring systems for consigned items and other customer services. In many cases, banks may choose to establish and communicate these sound principles in writing. The OCC fully endorses putting these principles in writing to better ensure effective communications throughout the bank. If, however, management follows sound fundamental principles and governs the risk in these areas, the OCC does not require a bank to have a written policy for consigned items and other customer services. If management does not practice sound principles, however, the OCC may require management to establish written policies in order to formally communicate risk parameters and controls to the appropriate levels of the bank.

Sound fundamental principles for consigned items and other customer services include proper internal controls, operating procedures and safeguards, and audit coverage. These principles are explained throughout this booklet.

Common Activities

The following paragraphs provide a brief description of common activities associated with consigned items and customer services.

Customer Safekeeping

Safe Deposit Boxes

In this activity, a bank and a customer contract to rent safe deposit boxes of various sizes for a fee. In return for that fee, the bank assumes the responsibility of exercising reasonable care and precaution against loss of the box's contents. If a loss occurs, the bank may be liable unless it can demonstrate it has acted in accordance with the required standard of care. The required standard of care is defined as that which would be taken by a reasonably prudent and careful person engaged in the same business. The bank must also preserve privacy of entry into the boxes. Two different keys are required to open the box; the customer and the bank each have one key. The customer is not required to disclose the contents of the box to the bank.

Only upon a court order may the bank gain access to the box without the consent of the customer.

Safekeeping

In addition to items held as collateral for loans, banks occasionally hold customers' valuables for short periods of time. Although the bank's commercial department may administer safekeeping services, most banks choose to offer these services through a separate trust department. Regardless of the way in which such customer services are offered, management should establish a specific fee schedule for safekeeping services. In exchange for payment of the fee, customers receive assurance that their assets will be protected. Customers may also use safekeeping services to hold assets under escrow.

Controls over items placed in safekeeping generally should be the same as those for handling collateral. Two employees should work together to inventory items the bank will store. They should then keep the items under dual control in the bank's vault. They should also prepare safekeeping receipts with a full description of the items accepted. The bank should never accept sealed packages with contents unknown for safekeeping.

If the items held for safekeeping are U.S. government securities, 17 CFR 450 requires special handling, record keeping, and auditing procedures.

Custody Accounts

Banks may act as custodians for customers' investments, such as stocks, bonds, or precious metals such as gold or silver. This involves merely holding the investments and recording sales and purchases, and collecting dividend and interest payments. A bank offering custody accounts should use signed agreements that clearly define the functions it will perform, in order to limit its potential liability. If the bank offers any additional service, such as managing the customer's assets or providing investment advice, it has established a fiduciary relationship, which requires the bank to have the authority to engage in fiduciary activities.

All national banks that hold or safekeep U.S. government securities for customers must comply with 17 CFR 450. These regulations apply when a national bank holds the customers' securities directly or maintains the customers' securities through another institution.

The Treasury Department has determined that the rules and standards of the OCC that otherwise apply to government securities held in a fiduciary capacity are adequate to meet the requirements of 17 CFR 450. Thus, a

national bank will be exempt from 17 CFR 450 requirements provided two conditions are met. First, the bank must adopt policies and procedures that subject its custodial holdings to all the requirements of 12 CFR 9. Second, the bank's custodial holdings must be subject to examination by the OCC for compliance with these fiduciary requirements. (See 17 CFR 450.3(a).) For more information on the requirements relating to the custodial holding of government securities, see the section on bank dealer and brokerage activities in the Comptroller's Handbook.

Collection Items

The collection department is one of the most diversified areas in the bank. It engages in receiving, collecting, and liquidating items which generally require special handling. The customer normally receives credit only after the bank receives final payment. Some of the common types of collection items include drafts, notes, acceptances, bonds, or bond coupons presented for payment, and contracts in which the bank, on behalf of the holder, collects proceeds. As far as collection items are concerned, the bank acts as agent for its customers or correspondents and receives a fee for that service. General ledger accounts rarely are used in the collection process. The importance and value of customer assets under bank control, however, demand the use of accounting procedures adequate to provide a step-by-step historical summary of each item processed. The bank must also maintain an audit trail to substantiate the proper handling of all items and to reduce the bank's potential liability.

Consigned Items

The most common items held on consignment by banks are unissued traveler's checks, food stamps, U.S. savings bonds, and U.S. commemorative coins. Traveler's checks have gained widespread popularity because of the possibility of refund if they are lost or stolen. A bank issuing traveler's checks shares a fee or commission for issued checks with the consignor. Although the bank does not receive a fee for issuing United States savings bonds or food stamps, it does have use of the sale proceeds which it deposits in the Treasury tax and loan account until such time as a Federal Reserve Bank calls for them. Stocks of U.S. savings bonds are found only in a very few banks that provide payroll processing service to a large number of customers. The bonds are on computer printable stock and are generally stored in the computer operations area. Physical security and inventory controls should be sound; they should be similar to the controls in place for the bank's own supply of negotiable forms.

National banks may not speculate by purchasing coins, such as rare coins, the value of which is based upon such factors as rarity, age, condition, a mistake

in the minting, or other intangible factors. They may, however, hold commemorative coins on consignment or purchase them for resale. Commemorative coins are minted by the Bureau of the Mint for the Treasury Department. The price of commemorative coins is based on the value of the metal and production and distribution costs. Banks may take these coins on consignment and act as selling agent for the Treasury. The bank may also purchase an inventory of this type of coin for sale to its customers.

Banks generally maintain a working supply of all consigned items at the teller line or selling station. They also maintain a reserve supply under dual control in the bank's vault. The bank is responsible for all unissued items and must maintain accurate inventories and accounting records on sales. Management should strive to maintain an inventory which provides customers with adequate selection, without being excessive.

A law specifically prohibits banks from handling lottery tickets. As defined in 12 USC 25a, this prohibition includes making, taking, buying, selling, redeeming, or collecting lottery tickets. Banks may, however, accept deposits of state-sponsored lottery ticket sales proceeds.

Internal Controls

Because the bank assumes a contingent liability for engaging in these activities, it must maintain proper internal controls, strong operating procedures and safeguards, and sound audit coverage. Banks accomplish the necessary control and review of consigned items through the use of nonledger control or memorandum accounts. These nonledger control accounts may consist of ledger cards for customer safekeeping and safe deposit box facilities; inventory listings for traveler's checks, U.S. savings bonds, and commemorative coins; and registers for collection items. In all cases, employees must generate control totals and balance the function(s) daily. Periodically, employees must perform a physical inventory of the items to prove the control totals.

Banks must maintain adequate bonding on all employees wherever contingent liabilities exist. This coverage will include protection against claims arising from mishandling, negligence, mysterious disappearance, or other unforeseen occurrences.

Accounting

In accordance with the instructions for the Consolidated Reports of Condition and Income (call reports), a bank should report fee income from customer safekeeping and safe deposit, consigned items, and collection services as "other noninterest income," in the subcategory "other fee income." The

instructions require commemorative coins purchased for resale by a national bank be recorded as "other assets." The bank's books should reflect the lower of cost or market value with adjustments made at least quarterly. This is consistent with the accounting treatment of bullion and bullion-type coins.

Consigned Items and Other Customer Services

Examination Objectives

1. To determine whether the policies or practices, and internal controls regarding consigned items and other customer services, are adequate.
2. To determine whether bank officers and employees are operating in conformance with the established policies or practices.
3. To determine whether audit scope and coverage are satisfactory.
4. To determine compliance with applicable laws, rulings, and regulations.
5. To determine the quantity of risk and the quality of risk management.
6. To determine examination procedures necessary to achieve stated objectives.
7. To initiate corrective action when policies or practices, or internal controls, are deficient, or when violations of laws, rulings, or regulations are noted.

1. Review previous consigned items and other customer services examination findings. Review bank management's response to those findings.
2. Obtain from the examiner assigned internal/external audit a copy of any significant deficiencies for this area. If internal/external audit is not part of the overall scope of the examination, review the work performed by internal/external auditors in this area and obtain a list of any deficiencies noted in their latest review. Determine whether management has taken appropriate corrective action.
3. Review the supervisory strategy in the Supervisory Monitoring System and Scope Memorandum issued by the bank examiner-in-charge (EIC).
4. Review internal bank reports on the consigned items and other customer services department. Determine any material changes in types of products, volumes, and changes in market focus.
5. Review consigned items and other customer services operating policies or practices, paying particular attention to any changes since the previous examination.
6. Based on performance of the previous steps, combined with discussions with the bank EIC and other appropriate supervisors, determine whether the scope of this examination should be adjusted. Set examination objectives. **Select from among the following examination procedures the necessary steps to meet those objectives. All steps are seldom required in all examinations.**
7. As examination procedures are performed, test for compliance with established policies or practices and the existence of appropriate internal control measures. (Refer to the Internal Control Questionnaire, as necessary.) Identify any area with inadequate supervision and/or undue risk, and discuss with bank EIC the need to perform verification procedures.
8. Obtain the following items:
 - A listing of consigned items and other control accounts.
 - Remittance records for unissued traveler's checks, food stamps, and,

- if applicable, U.S. savings bonds.
9. Scan any existing control accounts for any significant fluctuations, and determine the cause of fluctuations.
 10. Compare bank control records to remittance records for unissued traveler's checks, food stamps, and U.S. savings bonds.
 11. Determine compliance with 12 USC 25a.
 12. If the bank holds U.S. government securities in safekeeping or custodial accounts, determine compliance with 17 CFR 450. (Confer with the examiner performing the examination procedures for government securities activities, bank dealer and brokerage activities, or perform that section, as applicable.)
 13. Report to the bank EIC and discuss with appropriate officer(s):
 - Violations of laws, rulings, and regulations.
 - Recommended corrective action when policies or practices are deficient.
 - The quantity of risk and the quality of risk management in all areas reviewed.
 14. Prepare a memorandum, complete working papers, and update the work program with any information that will facilitate future supervisory activities.

The following questionnaire is provided as a tool to assist examiners in assessing the bank's internal controls, policies, practices, and procedures for consigned items and other customer services. Where appropriate, documentation may include narrative descriptions, flowcharts, copies of forms used, and other pertinent information. Items marked with asterisks should be substantiated by observation or testing.

Because the nature and scope of these services differ among banks, not all of the questions will be relevant in every bank. Similarly, a negative answer to a particular question does not necessarily indicate a weakness in the bank's policies or procedures if other equally effective controls are in place or there are other circumstances that mitigate the risk.

Examiners should use their own judgement in deciding which internal control questions are relevant for a particular bank and whether a negative answer to any particular question should be a matter of supervisory concern.

Yes No

Safe Deposit Boxes

1. Has bank counsel reviewed and approved the lease contract which covers the rental, use, and termination of safe deposit boxes?
- * 2. Is a signed lease contract on file for each safe deposit box in use?
3. Has a standard fee schedule for this service been adopted?
4. Are receipts for keys to the safe deposit box obtained?
5. Are officers or employees of the bank prohibited from having access to safe deposit boxes except their own or one rented in the name of a member of their family?
6. Is the guard key to safe deposit boxes maintained under absolute bank control?
7. Does the bank refuse to hold any safe deposit box keys for

- customers renting such boxes?
8. Is each admittance slip signed in the presence of the safe deposit clerk and the time and date of entry noted?
 9. Are admittance slips filed numerically?
 10. Are vault records noted for joint tenancies and co-rental contracts requiring the presence of two or more persons at each access?
 11. Are the safe deposit boxes locked, the renter's key removed and returned to the customer, and the guard key removed while permitting access to the contents?
 12. Is the safe deposit clerk prohibited from assisting the customer in looking through the contents of a box?
 13. Does the safe deposit clerk participate in the relocking of the box to make sure the number of the box corresponds to that of the one that was opened?
 14. Are all coupon booths examined by an attendant after being used but before being assigned to another renter, to be sure the previous person did not leave behind anything of value?
 15. Are all collections of rental income recorded when received?
 16. Are all safe deposit boxes in which the lessee is delinquent in rent, flagged or otherwise marked so that access will be withheld until the rent is paid?
 17. Does the procedure manual or policy address collection activity and appropriate corrective action in the case of default, e.g., when bank management can open the box?
 18. Is there a file maintained of all attachments, notices of bankruptcy, letters of guardianship, and letters testamentary (court-issued authority empowering a person named an executor in a will to act in that capacity) served on the bank? Are affected safe deposit boxes flagged?
 19. Is an acknowledgment of receipt of all property and a

release of liability signed upon termination of occupancy?

20. Are locks changed when boxes are surrendered, whether or not keys are lost?
21. Is drilling of boxes witnessed by two individuals?
22. Are the contents of drilled boxes inventoried, packaged, and placed under dual control?
- * 23. Are all extra locks and keys maintained under dual control?

Conclusion

24. Is the foregoing information an adequate basis for evaluating internal control in that there are no significant additional internal auditing procedures, accounting controls, administrative controls, or other circumstances that impair any controls or mitigate any weaknesses indicated above? (Explain negative answers briefly, and indicate conclusions as to their effect on specific examination or verification procedures.)
25. Based on the answers to the foregoing questions, internal routines and controls are considered _____ (good, satisfactory, or unsatisfactory).

Items in Safekeeping

1. Has bank counsel reviewed and approved the type and content of the contracts being used?
- * 2. Does the bank have written contracts on hand for each item that clearly define the functions to be performed by the bank?
3. Is there a set charge or schedule of charges for this service?
- * 4. Are such items segregated from bank-owned assets and maintained under dual control?
5. Are duplicate receipts issued to customers for items deposited in safekeeping?

6. Are blank, pre-numbered, multicopy receipts kept under dual control and periodically audited?
- * 7. Is a safekeeping register maintained to show details of all items for each customer?
- * 8. Is a record maintained of all entries to custodial boxes or vaults?
9. Does the bank refuse to accept sealed packages when the contents are unknown?
10. When safekeeping items are released, are receipts obtained from the customer?

Conclusion

11. Is the foregoing information an adequate basis for evaluating internal control in that there are no significant additional internal auditing procedures, accounting controls, administrative controls, or other circumstances that impair any controls or mitigate any weaknesses indicated above? (Explain negative answers briefly, and indicate conclusions as to their effect on specific examination or verification procedures.)
12. Based on the answers to the foregoing questions, internal routines and controls are considered _____ (good, satisfactory, or unsatisfactory).

Custody Accounts

(Omit this section if the bank's trust department handles such accounts.)

1. Has bank counsel reviewed and approved the type and content of the contracts being used?
- * 2. Does the bank have written contracts on hand for each account that clearly define the functions to be performed by the bank?

3. Has a standard fee schedule for this service been adopted?
4. Does the bank give customers duplicate receipts with detailed descriptions, including dates of coupons attached, if applicable, for all items accepted?
5. Are blank, pre-numbered, multicopy receipts kept under dual control and periodically audited?
- * 6. Are all negotiable items handled in this area maintained under dual control?
7. For coupon securities held by the bank:
 - Is a tickler file or other similar system used to ensure prompt coupon redemption on accounts for which the bank has been authorized to perform that service?
 - Are procedures in effect to prevent clipping of coupons when the bank is not so authorized?
 - Have procedures been adopted to ensure prompt customer credit when coupon proceeds or other payments are received?
8. Have procedures been established for withdrawal and transmittal of items to customers?
- * 9. Does an officer review and approve all withdrawals prior to the transaction?

Conclusion

10. Is the foregoing information an adequate basis for evaluating internal control in that there are no significant additional internal auditing procedures, accounting controls, administrative controls, or other circumstances that impair any controls or mitigate any weaknesses indicated above? (Explain negative answers briefly, and indicate conclusions as to their effect on specific examination or verification procedures.)
11. Based on the answers to the foregoing questions, internal

routines and controls are considered _____ (good, satisfactory, or unsatisfactory).

Collection Items

- * 1. Is access to the collection area controlled (if so, indicate how)?
- 2. Has a standard fee schedule for this service been adopted?
- 3. Is the fee schedule always followed?
- 4. Is a permanent record maintained for registered mail?
- * 5. Are permanent registers kept for incoming and outgoing collection items?
- 6. Are all collections indexed in the collection register?
- 7. Do such registers furnish a complete history of the origin and final disposition of each collection item?
- 8. Are receipts issued to customers for all items received for collection?
- 9. Are serial numbers or pre-numbered forms assigned to each collection item and all related papers?
- * 10. Are all incoming tracers and inquiries handled by an officer or employee not connected with the processing of collection items?
- 11. Is a record kept to show the various collection items which have been paid and credited as a part of the day's business?
- 12. Is an itemized daily summary made of all collection fees, showing collection numbers and amounts?
- 13. Are employees handling collection items rotated

periodically, without advance notification, to other banking duties?

14. Is the bank required to make settlement with the customer on the same business day that payment of the item is received?
15. Does the bank have established policies or practices of not allowing the customer credit until final payment is received?
16. Have procedures been established, including supervision by an officer, for sending tracers and inquiries on unpaid collection items in the hands of correspondents?
17. In the event of nonpayment of a collection item, is the customer notified and the item promptly returned?
18. Are the files of notes entered for collection clearly and distinctly segregated from bank-owned loans and discounts?
19. Are the collection notes described above maintained under memorandum control, and is the control balanced regularly?
20. Are collection files locked when the employee handling such items is absent?
21. Are vault storage facilities provided for collection items carried over to the next day's business?
- * 22. Does the collection teller turn over all cash to the paying teller at the close of business each day, and start each day with a standard change fund?

Conclusion

23. Is the foregoing information an adequate basis for evaluating internal control in that there are no significant additional internal auditing procedures, accounting controls, administrative controls, or other circumstances that impair any controls or mitigate any weaknesses indicated above?

(Explain negative answers briefly, and indicate conclusions as to their effect on specific examination or verification procedures.)

24. Based on the answers to the foregoing questions, internal routines and controls are considered _____ (good, satisfactory, or unsatisfactory).

Consigned Items

- * 1. Is the reserve stock of consigned items maintained under dual control?
- 2. Are inventory dollar limits assigned? Are they prudent?
- 3. Are working supplies kept to a reasonable minimum, e.g., two or three days' supply, and adequately protected during banking hours?
- * 4. Is a memorandum control maintained of consigned items?
- 5. Are separate accounts with the consignor maintained at each issuing location (branch), if applicable?
- * 6. Is the working supply put in the vault at night and over weekends or holidays, or is it otherwise protected?
- 7. Are remittances for sales made on a regularly scheduled basis, if not daily?

Conclusion

- 8. Is the foregoing information an adequate basis for evaluating internal control in that there are no significant additional internal auditing procedures, accounting controls, administrative controls, or other circumstances that impair any controls or mitigate any weaknesses indicated above? (Explain negative answers briefly, and indicate conclusions as to their effect on specific examination or verification procedures.)

Yes No

9. Based on the answers to the foregoing questions, internal routines and controls are considered _____ (good, satisfactory, or unsatisfactory).

Safe Deposit Boxes

1. Obtain the following:
 - Rental contracts.
 - Inventory control records.
 - Records of safe deposit boxes used for bank property.
 - Documentation of drilled boxes.
2. Compare the number of rental contracts in force to the total number of safe deposit boxes. Reconcile any differences.
3. Determine the current status of rental payments on a sample of boxes rented.
4. Determine the reasons for any deviation from established fee schedules.
5. Using an appropriate sampling method, test check vault entry records for proper signature(s) of authorized persons.
6. In the presence of a bank official, inspect and reconcile the following to inventory control records maintained by the bank:
 - Keys for unrented boxes.
 - Extra locks and keys kept for replacement purposes.
 - Contents of any drilled safe deposit boxes.
7. For the safe deposit boxes used by the bank, prepare a working paper detailing all items they contain.
8. Review the reasonableness of documentation associated with any drilled boxes. (Boxes may be drilled for nonpayment of rent; upon written request of lessee; and for a special administrator, with proper legal authority, in search of a will.)

Safekeeping and Custody Accounts

1. Obtain control, through use of seals or otherwise, of items held in
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safekeeping and custody accounts.

2. Obtain the safekeeping register, verify that receipt forms are issued in numerical sequence and that all numbers are accounted for, and check unused forms for the next number to be issued. Also, test the completeness of the numerical sequence of unissued forms.
3. Using an appropriate sampling technique, select items for testing, and:
 - Examine the contract and check for the customer signature for each account selected.
 - In the presence of a bank official, examine the items selected, agreeing the vault contents to the receipt copies on hand.
 - Review transactions, and determine compliance with written contractual authorizations.
 - If any items selected for examination are held in safekeeping elsewhere, confirm their existence by direct communication.
 - If any of the items selected for examination appear altered or there appears to be a discrepancy between the receipt and what is held in the vault, confirm the items with customers.
4. Using an appropriate sampling technique, select certain closed accounts (released items) for examination, and:
 - Examine the register form and the customer's release.
 - Compare the customer's signature on release to the other signature copy on file.
 - If any of the items appear altered or unusual, confirm the correctness of information with owners.
5. Review the policies or practices for the collection of fees for these services, and perform appropriate tests to ensure compliance.

Collection Items

1. In the event that memorandum control accounts are maintained, prepare or request that the bank prepare, under your supervision, a trial balance of each account controlled.
2. In the case of unusual, altered, or longstanding items, prepare and mail confirmation requests to customers.
3. Using an appropriate sampling technique, select representative items, and:

- Review all supporting documents.
 - Satisfy yourself about the authenticity of each item selected, and trace and clear each item through final payment including the posting of the appropriate credit to the customer.
4. Test postings of collections on detailed records to determine that disbursement of funds collected is in accordance with customers' instructions.
 5. Determine that credit is given promptly, on the same day received, for all collections settled.
 6. Test appropriate records to determine that collection of fees for this service is in accordance with established policies or practices and that bank income accounts are being credited on a daily basis.

Consigned Items

1. Obtain control, through the use of seals or otherwise, of all items held on consignment.
2. In the presence of a bank official, inventory unissued and spoiled items on hand, and agree totals to memorandum controls maintained at each issuing location.
3. Compare and reconcile memorandum records to latest consignor statement.
4. Prepare and mail to consignor a confirmation request on items inventoried.
5. Follow up and clear satisfactorily any confirmation exceptions.

Other Nonledger Control Items

1. If the bank maintains any other items in nonledger, or memorandum accounts, perform the following verification procedures considered appropriate:
 - Review nonledger accounts to determine the maximum elapsed time for closing out entries or clearing items. Compare to the department's stated policies, practices, or procedures.
 - Determine the status and reasonableness of old memorandum account items.

Consigned Items and Other Customer Services

References

Custodial Holdings of Government Securities

Regulations	12 CFR 9 17 CFR 450
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General Power

Laws	12 USC 24(7)
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Penalty Provisions

Laws	12 USC 25a 18 USC 1306
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Prohibited Activities

Laws	12 USC 25a 31 USC 5118
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