Comptroller of the Currency
Administrator of National Banks

Bank Premises and Equipment

Comptroller's Handbook
(Section 218)

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Assets

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Bank Premises and Equipment (Section 218) — Introduction

Bank premises and equipment includes land, buildings, furniture and fixtures and other equipment, either owned or leased, and any leasehold improvements. This section covers the fair valuation, general propriety, and legality of the bank's investment in premises and equipment. Other real estate owned and insurance coverage on fixed assets are discussed in other sections.

There are three primary means by which banks obtain premises and equipment for their use:

- Direct investment of bank funds in the form of cash outlays and/or by incurring debt, such as a mortgage.

- Indirect investment in the corporation holding title to bank premises. That corporation may or may not be affiliated with the bank. Indirect investment of this type may be in the form of purchases of stocks, bonds, debentures, or similar obligations of the corporation, or of loans to, or upon, the security of that stock.

- Negotiation of lease agreements.

Federal regulations require that all bank fixed assets, acquired subsequent to June 30, 1967, be stated at cost, less accumulated depreciation or amortization. Depreciation or amortization of assets or leasehold improvements, acquired prior to June 30, 1967, may be computed by applying any generally accepted depreciation method. The book values of such assets should not exceed, but may be less than, the nonaccelerated depreciation value for income tax purposes.

Bank premises and equipment should be booked at cost. Cost is determined by the method of acquisition, for example:

- Cash purchase cost is invoice cost plus freight, installation, and other related costs less cash discounts.

- Credit purchase cost is the cash amount required to settle the obligation at the purchase date, plus any freight, installation costs, and the like.

- Construction cost is the cost of survey, materials, labor, overhead, capitalized interest, and such items as building permits.

- Issuance of securities cost is the fair market value of securities given on the date the asset is acquired.

- Exchange cost is the market value of assets given, cash transferred, and/or obligations assumed.

- Donation cost is the fair market value of the asset at the date of acquisition.

When newly acquired assets need a period of time to prepare them for use, the cost of the funds expended during that period should be included as part of the assets' cost. A bank contracting the construction of its premises would capitalize the contractor's construction costs, his profit, and the cost of the funds used during the construction period. If the bank borrows funds specifically to construct or acquire the asset, the cost of the borrowed funds is capitalized. However, if the acquisition costs are funded internally, the bank must use the weighted average rate for all interest-bearing liabilities in determining the amount to be capitalized. Interest is not to be capitalized for assets that are already in use or that are ready for their intended use when acquired.

The book and tax values of bank premises and equipment often will not be the same, particularly for newly acquired assets. For book purposes, banks should depreciate assets over their useful life, using a straight line or accepted accelerated method. For tax return purposes, the following methods of depreciation are allowable for assets acquired between June 30, 1967 and December 31,1980:

- The straight line method (non-accelerated).

- The declining balance method, using a rate not exceeding twice the rate applicable under the straight line method.

- The sum-of-the-years digits method.

- Any other consistent accelerated method which produces an annual allowance that, when added to all allowances for the period commencing with the taxpayer's use of the property and including the taxable year, does not, during the first two- thirds of the property's useful life, exceed the total of such allowances that would have been used under other accelerated methods.

For assets acquired after January 1, 1981, recovery (depreciation) deductions will normally be based on the Accelerated Cost Recovery System (ACRS). Recovery deductions are determined by reference to accelerated recovery tables. Thus, the recovery periods (lives) of the assets used for tax purposes may vary from the lives used for book purposes. Under 12 CFR 7.7505, once dual treatment (i.e., different treatment for book and tax) is used for a given asset, it must be continued until the asset is fully depreciated. If book and tax depreciation differences exist, 12 CFR 7.7505 requires recognition of deferred income taxes, if the amount is material.

Banks frequently lease their premises and equipment rather than owning them outright. These leases may represent significant commitments which could materially affect earnings. The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 13 in 1976, which established generally accepted accounting principles regarding lease transactions. That FASB statement requires, among other things, that the lessee capitalize certain leases. The instructions for preparation of consolidated reports of condition contain details for the capitalization of leases. The amount capitalized would be the present value of the minimum required payments over the noncancelable term, as defined, of the lease, plus the present value of the payment required under the bargain purchase option, if any, less any portion of the payments representing executory expenses such as insurance, maintenance and taxes to be paid by the lessor. The amortization period should be the life of the lease or a period established in a manner consistent with the lessee's normal schedule of depreciation for owned assets. The requirements of FASB Statement No. 13 are somewhat complex, and examiners who have questions on capitalization of leases are referred to that statement for necessary details.

Banks will occasionally sell premises or fixed assets and lease such property back from the buyer. The accounting standards for such transactions are defined in FASB 28, "Accounting for Sales with Leasebacks." Generally, gains on these sale-leaseback transactions are not recognized immediately but are deferred in accordance with the terms of the underlying lease. In the case of a capital lease, the gain is accreted in proportion to the depreciation of the leased asset. If the lease does not meet the criteria for a capital lease, then it is an operating lease, and the gain is amortized in proportion to the rental payments made over the lease term. In the event that a loss is realized on the sale, the losses are deferred and accreted in the same manner as the gain. An exception is when the fair value of the property is less than the book value. In this case, the loss is recognized immediately. Examiners should refer to FASB No. 28 when reviewing these types of transactions.

Title 12 USC 371(d) forbids national banks to invest an amount greater than its capital stock in their banking premises, directly or indirectly, without the approval of the Comptroller of the Currency. In addition to direct investments in premises presently used by the bank, computation of the legal limitation must include:

- Property acquired for future expansion.

- Any investment in stocks, bonds, debentures, or similar obligations, in a corporation holding title to bank premises, whether affiliated with the bank or not.

- Indebtedness incurred by any bank premises holding corporation affiliated with the bank through stock ownership, as defined by 12 USC 221(a).

- Indirect investments in the form of loans to, or upon, the security of the stock of any corporation holding title to bank premises, whether affiliated with the bank or not.

Investments in furniture and fixtures are not subject to the legal limitations; however, the amount of such investments will be considered by the District Deputy Comptroller if the bank requests permission to exceed the legal limitation on investment in bank premises. Capitalized leases of bank premises are subject to the limitations of 12 USC 371(d). Any excess investment resulting from capitalization of leases entered into on or after November 15,1977 must have OCC approval.

National banks are encouraged to plan for future needs, and examiners should not arbitrarily classify real estate acquired for future use. However, when a bank acquires such realty, it should be utilized within a reasonable time. Reasonable time, as defined in 12 CFR 7.3025, normally will not exceed 3 years; however, it is the examiner’s responsibility to determine the reasonable time and the feasibility of intended use in each individual case. After real estate acquired for future expansion has been held for 1 year, a board resolution detailing plans for its use must be available for inspection. Real estate acquired for future expansion is considered “other real estate owned” from the date when its use for banking is no longer contemplated. In addition, former banking premises are considered “other real estate owned” from the date of relocation to new banking quarters.

As indicated earlier, the examiner responsible for this area should assess the appropriateness of the bank’s investment in premises and equipment and the overall impact of occupancy expense on the bank. Even if a bank’s total investment in bank premises is within legal limits and all of its fixed assets are valued fairly for book purposes, its total expenditures for, or investment in, premises and equipment may be inappropriate relative to its earnings, its total capital structure, or the nature and volume of its operations.

Bank Premises and Equipment (Section 218) Examination Procedures

General Procedures

Many of the steps in these examination procedures require gathering information from, or reviewing information with, examiners in other areas. Since many other areas (such as earnings, capital, and funds management) include examination procedures that address bank premises, you should discuss your review with them to reduce any burden on the bank and avoid duplication of effort. Sharing examination data also can be an effective cross check of compliance and help examiners assess the integrity of management information systems.

Information from other areas should be appropriately cross-referenced in working papers. Information that is not available from other examiners should be requested directly from the bank.

Objective: Determine the scope of the examination of bank premises and equipment.

1. Review the following to identify if previous problems require follow-up. Determine if planned corrective action was effected, and if not, why not.

   - Bank correspondence involving bank premises.
   - EIC's scope memorandum.
   - Supervisory strategy in the OCC's Electronic Information System.
   - Overall summary comments.
   - Previous examination report and working papers.
   - Audit reports, and working papers, as necessary.

2. From the EIC, obtain the results of his/her analysis of the UBPR, BERT, and other OCC reports. Identify any concerns, trends, or changes involving bank premises and equipment.

3. From the examiner assigned Internal/External Audit, obtain a copy of any significant deficiencies with bank premises and equipment. Determine if appropriate corrections have been made.

4. Obtain and review reports management uses to supervise bank premises and

equipment. Some examples include:

- ☐ Subsidiary asset and depreciation ledger(s).
- ☐ A reconciliation of bank premises since the last exam.
- ☐ A listing of any nonperforming (idle, abandoned, or useless) bank premises.
- ☐ Most recent internal audit and regulatory compliance reports.
- ☐ Board reports, etc.

5. Determine if any material changes have occurred since the last examination that would influence the level and direction of bank premises risk.

6. Determine the following from discussions with management:

   - How management supervises bank premises and equipment.
   - If there have been any significant changes in policies, procedures, practices, internal controls, or personnel responsible for managing and supervising bank premises and equipment.
   - If any additional internal or external factors exist that could affect bank premises and equipment.

7. While performing examination procedures, determine if officers and employees are operating in conformance with bank policies, procedures, practices, and applicable laws, rules and regulations.

8. Based on the completion of the general procedures and discussions with the bank EIC, set the objective(s) and scope of the examination.

Select from among the following examination procedures the necessary steps to meet those objectives. Seldom will it be necessary to perform all of the steps in an examination.

Quantity of Risk

Conclusion: The quantity of risk is (low, moderate, high).

Objective: Determine the adequacy and reasonableness of the bank's present and planned investment in bank premises.

1. Analyze the reasonableness of the bank's investment in fixed assets and the annual expenditures required to carry them. Consider the bank's investment relative to:

   - Total capital structure.
   - Current earnings.
   - Projected earnings.
   - Nature and volume of operations.

2. Analyze the bank's strategic short-term (1—5 year) and long-term (5—10 year) bank premise needs. Consider:

   - Are future needs adequately planned for?
   - Are significant bank premise needs incorporated into the strategic planning process?
   - Are planned investment amounts reasonable in relation to operating projections?

3. For any bank premises transactions involving insiders or affiliates, determine that they are at arms-length, reasonable, approved by the board of directors, and in compliance with *12 U.S.C. 371c* for affiliates and *12 U.S.C. 375* for insiders.

4. Agree all major acquisitions and disposals of fixed assets and equipment to the general ledger.

5. On a test basis, foot transactions from subsidiary fixed asset and depreciation ledgers and agree to the general ledger control accounts.

6. Determine that the bank's books have been properly adjusted to reflect significant assets that are idle, abandoned, or useless (see guidance in the Introduction section).

7. Determine that sufficient amounts of fire and hazard insurance are in place for all bank premises.

Bank Premises—Bank as Lessee

1. For bank premises which are leased (bank as lessee) with an initial lease period of more than one year, obtain from the bank the following:

   - Name of lessor.
   - Expiration date.
   - Payment schedule including amounts and due dates.
   - Current status.
   - Expiration and renewable option provisions.
   - Major responsibilities of both the lessor and lessee.

2. Determine whether the lease has been properly categorized and booked as either an operating or capitalized lease (refer to Introduction section and GAAP).

Bank Premises—Bank as Lessor

1. For bank premises which are leased (bank as lessor), determine if the bank relies on rental income to contribute to the payment of occupancy expenses and if that income is material.

2. If the rental income is material, analyze the bank's potential exposure from:

   - Concentrations among lessees.
   - The impending expiration of major leases.
   - A lack of creditworthiness of lessee.
   - Noncompliance with lease terms.

Acquisitions and Sales

1. Using an appropriate sampling technique, select a sample of property acquisitions and sales since the last examination.

2. For each sample property, review the following to test the accuracy of the summary of changes in the bank premises account since the last examination:

   - Invoices.
   - Disbursement checks.
   - Title data.
   - Asset file.

3. For each acquisition or sale, determine if the files contain evidence of proper officer/board approval.

4. Test the propriety of significant asset acquisitions by:

- Comparing their cost to that of other similar assets.
- Reviewing the method used to select a vendor.
- Physical inspection of the asset.

5. Test the propriety of the sale price of fixed assets by:

   - Comparing the price to that of similar assets.
   - Reviewing the method used to establish the selling price.

6. Check the computation of any gain or loss on fixed asset sales and trace the proceeds to the appropriate general ledger account.

7. If the bank has engaged in a sales-leaseback transaction, determine whether gains or losses on the sales are deferred and accreted or amortized in accordance with GAAP.

Depreciation

1. Perform a limited test of the records to verify that depreciation methods are consistent with bank policy, prior years' calculations, GAAP, and applicable laws, regulations, and IRS interpretations.

2. Investigate and explain any significant charges to the accumulated depreciation accounts other than for the current year's depreciation expense or for the retirement or sale of assets.

3. Review the construction-in-process account, if any, to determine that any fully completed items are being depreciated at the proper rate.

4. Reconcile tax values of fixed assets acquired and tax depreciation since the last examination.

5. Inspect tax receipts on real and personal property, where applicable, and confirm paid or accrued amounts by tracing them to appropriate general ledger expense and/or liability accounts.

6. Inspect the bank's books to determine that any deferred taxes resulting from the use of dual deprecation methods are accurately reflected.

Objective: Determine the level of strategic risk associated with the bank's present and planned investment in bank premises and equipment.

1. Through discussion with the EIC, determine that strategies for managing fixed

asset and equipment needs are reasonable and compatible with the bank's overall strategic goals.

2. Determine whether management has considered the following in their strategic/contingency planning process:

- External factors that could impact bank premises?
- Potential obsolescence of bank premises?
- Under or over utilization of existing bank premises and equipment?
- Adequacy of communication channels and delivery systems?
- Adequacy of operating systems?

Objective: Determine the level of compliance risk arising from violations of, or nonconformance with laws, rulings, and regulations.

1. Test compliance with laws, rulings, and regulations. Ensure that:

- The bank's investment in premises conforms to the limits in *12 U.S.C. 371d.*
- Approval for an excess investment in bank premises was obtained in accordance with *12 U.S.C. 371d and 12 C.F.R. 5.37.*
- Bank premises are used in accordance with *12 U.S.C. 29 and 12 C.F.R. 7.1000.*
- For transactions involving real estate, an appraisal was obtained in accordance with *12 C.F.R. 34*.

Quality of Risk Management

Conclusion: The quality of risk management is (strong, satisfactory, weak).

Policy

Conclusion: The board (has/has not) established effective policies regarding bank premises and equipment.

Objective: Determine the adequacy of the bank's policies regarding bank premises and equipment.

1. Review the adequacy of the bank's policies for acquiring and disposing of fixed assets and major pieces of equipment. Do they:

   - Establish responsibilities and accountability?
   - Include written guidelines? If not, should they be written given the bank's complexity?
   - Address fair pricing, selection of vendors or buyers, and a prohibition against self-dealing?
   - Include the requirement that the board must give prior approval for all major fixed asset sales and disposals?

2. Determine if policies are approved by the board or a designated committee.

3. Determine if policies are reviewed and updated at least annually by the board.

4. Determine if policies are appropriately communicated to those persons having custody of property or who have responsibility for the acquisition, sales, disposal, or record keeping of property.

Processes

Conclusion: Management and the board (have/have not) established effective risk management processes regarding bank premises and equipment.

Objective: Determine the adequacy of the bank's planning processes regarding bank premises and equipment.

1. Evaluate how management determines fixed asset and equipment needs in the strategic planning process.

2. Review the bank's contingency planning process for bank premises and equipment and determine how management plans for the possibility of current premises becoming unusable.

Objective: Determine the adequacy of the bank's internal control processes for bank premises and equipment.

1. Evaluate the adequacy of internal control procedures. Consider the following:

Records, Control and Custody of Property

- Do the bank'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 disposal readily apparent?
- Do inventory control methods sufficiently limit accessibility?
  - Are subsidiary property records posted by persons who do not also have sole custody of property?
  - Are subsidiary property records reconciled, at least annually, to the appropriate general ledger accounts by persons who do not also have sole custody of property?
- Is the physical existence of bank equipment periodically checked or tested, such as by a physical inventory, and are any differences from property records investigated by persons who do not also have sole custody of property?
- Are there procedures that provide for serial numbering of equipment?
- Are there separate property files that consist of invoices (including settlement sheets and bills of sale, as necessary), titles (on real estate, vehicles, etc.), and other pertinent ownership data as part of the required documentation?

Additions, Sales, and Disposals

- Is the benefit of expert tax advice obtained prior to final decision-making on significant fixed asset transactions?
- Does management have a clearly defined method of determining whether fixed assets should be owned or leased, and is supporting documentation maintained by the bank?
- Do policies or procedures provide for selecting a seller, service, insurer, or purchaser of major assets (through competitive bidding, etc.) to prevent any possibility of conflict of interest or self-dealing?
- Do review procedures provide for an appraisal of an asset to determine the propriety of the proposed purchase or sales price?
- Is the addition, sale, or disposal of property approved by the signature of an officer who does not also control the related disbursement or receipt of funds?

- Is the approval of the board of directors, or its designated committee, required for all major additions, sales, or disposals of property (if so, indicate the amount that constitutes a major addition, sale, or disposal $____).
- Is the preparation of general ledger entries for additions, sales, and disposals of property, prepared by persons or adequately reviewed by persons, who do not also have sole custody of property?
- Are any property additions, sales and disposals records balanced, at least annually, to the appropriate general ledger accounts by persons who do not also have sole custody of property?
- Do policies or procedures require that all additions be reviewed to determine whether they represent replacements and that any replaced items are cleared from the accounts?
- Do procedures require signed receipts for removal of equipment?

Depreciation

- Are the preparation, addition, and posting of periodic depreciation records performed and adequately reviewed by persons who do not also have sole custody of property?
- Do procedures require that depreciation expenses be charged at least quarterly?
- Are the subsidiary depreciation records balanced, at least annually, to the appropriate general controls by persons who do not also have sole custody of property?

Leased Property

Bank as Lessor:

- Do policies and procedures provide for the division of duties involved in billing and collection of rental payments?
- Are lease agreements subject to the same direct verification program applied to other bank assets and liabilities?
- Are credit checks performed on potential lessees?
- Do policies provide for a periodic review of lessees for undue concentrations of affiliated or related concerns?

Bank as Lessee:

- Are procedures in effect to determine whether a lease is a “capital” or an “operating” lease as defined by GAAP?
- For “capital” leases, do operating procedures provide that the amount capitalized is computed by more than one individual and/or reviewed by an independent party?

Personnel

Conclusion: The board, management, and effected personnel (do/do not) display a fundamental understanding of risk concepts and risk management practices related to bank premises and equipment.

Objective: Given the size and complexity of the bank, determine if bank management/personnel possess and display acceptable knowledge and technical skills in managing and performing duties related to bank premises and equipment.

1. Determine significant current and previous work experience of significant personnel involved in bank premises and equipment management and decision making. Consider:

   - Previous bank premises management experience.
   - Previous administrative experience.

2. Determine formal education and planned continuing education by management.

3. Assess management's technical knowledge and ability to manage bank premises based on conclusions developed while performing these procedures.

Controls

Conclusion: Management (has/has not) established effective control systems.

Objective: Determine that effective control systems are in place to monitor compliance with established policies and processes.

1. Determine the effectiveness of the audit function in identifying risk in bank premises and equipment. Consider the following:

   - Scope and coverage of review(s).
   - Frequency of review(s).
   - Qualifications of audit personnel.
   - Comprehensiveness and accuracy of findings/recommendations.
   - Adequacy and timeliness of follow up.

2. Evaluate the effectiveness of the regulatory review function in identifying compliance risk in bank premises and equipment. Consider the following:

- Scope and coverage. Does the review test for compliance with the following?
  - *12 U.S.C. 371d—Investment Limits for Bank Premises.*
  - *12 U.S.C. 371d and 12 C.F.R. 5.37—Approval for an Excess Investment in Bank Premises.*
  - *12 U.S.C. 29 and 12 C.F.R. 7.1000—Use of Bank Premises.*
  - *12 C.F.R. 34—Appraisals for Real Estate Transactions.*
- If violations/exceptions were noted, determine if the bank took appropriate corrective action.
- Adequacy and timeliness of follow up.

3. Determine the effectiveness of any other control systems used by management and the board in the risk management of bank premises and equipment.

Conclusion

Objective: To communicate findings and initiate corrective action when policies, procedures, processes, or controls are deficient or when violations have been noted.

1. Provide the EIC with a conclusion memo stating your findings regarding the propriety and adequacy of the bank's present and projected investment in bank premises. Consider:

   - The size of the bank.
   - Cash flow forecasts.
   - Existing fixed asset investments
   - Anticipated growth potential.
   - Bank programs to maintain assets at their most useful capacity.
   - The adequacy of policies, procedures, practices, and controls.
   - How bank officers conform to established policy and practices.
   - Significant internal control deficiencies.
   - Any recommended corrective actions needed to correct deficiencies.

2. Determine the impact on the aggregate and direction of risk assessments for any applicable risks identified by performing the above procedures. Examiners should refer to guidance provided under the OCC's large and community bank risk assessment programs. Consider:

   - Risk Categories: Compliance, Credit, Interest Rate, Liquidity, Reputation, Strategic, Transaction.
   - Risk Conclusions: High, Moderate, or Low.
   - Risk Direction: Increasing, Stable, or Decreasing.

3. Determine, in consultation with EIC, if the risks identified are significant enough to merit bringing them to the board's attention in the ROE. If so, prepare items for inclusion under the heading Matters Requiring Board Attention. Consider:

   - MRBA should cover practices that:
     - Deviate from sound fundamental principles and are likely to result in financial deterioration if not addressed.
     - Result in substantive noncompliance with laws.
   - MRBA should discuss:
     - Causative factors contributing to the problem.
     - Consequences of inaction.
     - Management's commitment for corrective action.
     - Time frames and person(s) responsible for corrective action.

4. Discuss the following findings with management including conclusions regarding applicable risks:

    - Any internal control deficiencies.
    - Any policy or procedural deficiencies.
    - Any violations of law or regulation.

5. As appropriate, prepare a brief bank premises and equipment comment for inclusion in the ROE. Consider:

    - Deficiencies noted.
    - Violations of law.
    - Recommended corrective action.
    - Management's commitments.

6. Prepare a memorandum or update the work program with any information that will facilitate future examinations.

7. Update the OCC's electronic information system and any applicable report of the examination schedules or tables.

8. Organize and reference working papers in accordance with OCC guidance.