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Replaced by Comptroller's Handbook - Bank Premises and Equipment.

Fixed Assets

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

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

LINKS
Program
Questionnaire

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

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

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

Policies, Procedures, and Controls

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

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

Office Premises and Land Acquired for Future Use

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

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

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

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

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

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

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

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

Sharing Office Quarters

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

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

- Maintain separate identities to avoid customer confusion.
- Create physical separation between each institution's cash transactional areas.
- Maintain adequate controls to ensure the integrity of assets, records, computers, currency, checks, safes, and vaults of the institutions.

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

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

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

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

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

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

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Sale/Leaseback

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

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

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

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains a bargain purchase option.

- The lease term equals 75 percent or more of the estimated economic life of the leased property. In addition, the beginning of the lease term does not fall within the last 25 percent of the total economic life of the leased property.

- The present value of the minimum lease payments at the beginning of the lease term is 90 percent or more of the market value to the lessor less any investment credit retained by the lessor.

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

The minimum lease payments generally include the following items:

- The minimum rental payments.

- Any guarantee of the residual value made by the lessee.

- The penalty for failure to renew the lease, if applicable.

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

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

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

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

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

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Computer Software

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

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

Valuation and Accounting Methods

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

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

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

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

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

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

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

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

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

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

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

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

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REFERENCES

Code of Federal Regulations (12 CFR)

§ 545.91	Home Office
§ 545.92	Branch Offices
§ 545.95	Change of Office Location/ Redesignation
§ 545.96	Agency
§ 556.5	Branching by Federal Savings Associations

Part 559	Subordinate Organizations
§ 560.37	Real Estate for Office and Related Facilities
§ 560.172	Re-evaluation of Real Estate Owned
§ 563.41	Loans and Other Transactions with Affiliates and Subsidiaries
§ 563.42	Additional Standards Applicable to Transactions with Affiliates and Subsidiaries
§ 563.80	Borrowing Limitations
Part 564	Appraisals
§ 563.200	Conflicts of Interest

Office of Thrift Supervision Bulletins

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

Financial Accounting Standards Board, Statement of Financial Accounting Standards

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

Other Accounting References

Emerging Issues Task Force

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

Statement of Position

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

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Other References

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

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