OTHER ASSETS AND LIABILITIES

INTRODUCTION

Assets and liabilities that are not reported in major balance sheet categories are generally reported in other asset or other liability categories. Although these items are listed in "other" categories, it does not mean the accounts are of less significance than items detailed in major categories. Intangible assets lack physical substance and are reported separately on the balance sheet. The following pages include descriptions of common other assets, miscellaneous assets, intangible assets, and other liabilities. Additional guidance and information are included in the Call Report Instructions and the Examination Documentation (ED) Module - Other Assets and Liabilities.

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OTHER ASSETS

Accrued Income

All financial institutions, regardless of size, prepare the Call Report on an accrual basis. Accrued income represents the amount of interest earned or accrued on earning assets and applicable to current or prior periods that has not yet been collected. Examples include accrued interest receivable on loans and investments. When income is accrued but not collected, an institution debits a receivable account and credits an applicable income account. When funds are collected, cash or an equivalent is debited, and the receivable account is credited.

The degree to which accrual accounts and practices are reviewed during an examination should be governed by the examination scope. When scoping examination procedures, examiners should consider the adequacy of a bank's internal control structure and the extent to which accrual accounting procedures are analyzed during audits.

When reviewing accrual accounts and practices, examiners should assess the general accuracy of the accrual accounting system and determine if accruals relate to items in default or to items where collection is doubtful. If accrued income accounts are materially overstated, examiners should consider the impact to overall profitability levels, classify overstated amounts as Loss, and recommend management amend Call Reports.

Tax Assets

Institutions must estimate the amount of the current income tax liability (or receivable) to be reported on its tax returns. Estimating this liability (or receivable) may involve consultation with the institution's tax advisers, a review of the previous year's tax returns, the identification of significant expected differences between items of income and expense reflected on the Call Report and on the tax returns, and the identification of expected tax credits.

Deferred tax assets and liabilities represent the amount by which taxes receivable (or payable) is expected to increase or decrease in the future because of temporary differences and net operating losses or tax credit carryforwards that exist at the reporting date. When determining the current and deferred income tax assets and liabilities to be reported in any period, an institution's income tax calculation will contain an inherent degree of uncertainty surrounding the realizability of the tax positions included in the calculation.

A net deferred tax asset is reported if a debit balance results after offsetting deferred tax assets (net of valuation allowance) and deferred tax liabilities measured at the report date for a particular tax jurisdiction. If the result for a particular tax jurisdiction is a net credit balance, then a net deferred tax liability is reported. An institution may report a net deferred tax debit, or asset, for one tax jurisdiction, such as for federal income tax purposes, and report at the same time a net deferred tax credit, or liability, for another tax jurisdiction, such as for state or local income tax purposes.

Temporary differences arise when an institution recognizes income or expense items on the books during one period but records them for tax purposes in another period. For example, a deductible temporary difference is created when a provision for loan and lease losses is expensed in one period for financial reporting purposes, but deferred for tax purposes until the loans are charged off in a subsequent period.

An institution sustains a net operating loss when deductions exceed income for income tax purposes. To the extent permitted under a taxing authority's tax laws and regulations, a net operating loss that occurs in a year following periods when the institution had taxable income may be carried back to recover income taxes previously paid. The tax effects of any loss carrybacks that are realizable through a refund of taxes previously paid is recognized in the year the loss occurs. In this situation, the applicable income taxes on the Call Report will reflect a credit rather than an expense.

Generally, a net operating loss that occurs when loss carrybacks are not available (e.g., when losses occur in a year following periods of losses) becomes a net operating loss carryforward. For tax years beginning before January 1, 2018, an institution may carry operating losses forward 20 years for federal income tax purposes. For tax years beginning on or after January 1, 2018, net operating losses can be carried forward indefinitely for federal income tax purposes; however, for net operating losses arising in such tax years, the amount of loss that can be carried forward and deducted in a particular year is limited to 80 percent of an institution's taxable income in that year.

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. However, an institution can only recognize the benefit of a net operating loss, or a tax credit carryforward, to the extent the institution determines that a valuation allowance is not necessary. A valuation allowance must be recorded, if needed, to reduce the amount of deferred tax assets to an amount that is more likely than not to be realized. Examiners should obtain management's analysis and support for any deferred tax asset and valuation allowance reported for financial reporting purposes. Examiners should refer to the Call Report Glossary for guidance on income taxes and may contact the regional accounting specialist for further guidance in cases involving significant amounts of net deferred tax assets.

Part 324 of the FDIC Rules and Regulations, Capital Adequacy of FDIC-Supervised Institutions (Part 324), establishes limitations on the amount of deferred tax assets that can be included in Common Equity Tier 1 capital. Institution's must deduct from Common Equity Tier 1 capital, deferred tax assets that arise from net operating loss and tax credit carryforwards, which may be net of any valuation allowance and net of deferred tax liabilities. Further, an institution must deduct from Common Equity Tier 1 capital the amount of deferred tax assets arising from temporary differences that the institution could not realize through net operating loss carrybacks, net of any associated valuation allowance, and deferred tax liabilities, which exceeds 25 percent of the sum of the institution's common equity tier 1 capital elements. Refer to Part 324 for more details, including for the capital rules for institutions using advanced approaches.

Interest-Only Strips

Accounting standards for interest-only strips receivable are set forth in ASC Topic 860, Transfers and Servicing. ASC Topic 860 defines an interest-only strips receivable as the contractual right to receive some or all the interest due on a bond, mortgage loan, collateralized mortgage obligation, or other interest-bearing financial asset.

Financial assets such as interest-only strips receivable, that can contractually be prepaid or otherwise settled in such a way that the holder of the financial asset would not recover substantially all its recorded investment do not qualify to be accounted for at amortized cost. After their initial recording on the balance sheet, interest-only strips must be subsequently measured at fair value like available-for-sale debt securities and are reported as other assets. Alternatively, interest-only strips may be reported as trading securities. Refer to the Call Report Instructions for additional details.

Equities without Readily Determinable Fair Values

An equity security does not have a readily determinable fair value if sales or bid-and-asked quotations are not currently available on a securities exchange registered with the U.S. Securities and Exchange Commission or in the over-the-counter market, provided that those prices or quotations for the over-the-counter market are not publicly reported by the National Association of Securities Dealers Automated Quotations systems or by OTC Markets Group, Inc. Equity securities that do not have readily determinable fair values may have been purchased by an institution or acquired for debts previously contracted, and may include items such as paid-in stock of a Federal Reserve Bank, stock of a Federal Home Loan Bank, and stock of a bankers' bank. Refer to the Call Report Instructions for additional details.

Bank-Owned Life Insurance Policies

The purchase of bank-owned life insurance (BOLI) can be an effective way for institutions to manage exposures arising from commitments to provide employee compensation and pre- and post-retirement benefits, and to protect against the loss of key persons.

Consistent with safe and sound banking practices, institutions must understand the risks associated with BOLI and implement a risk management process that provides for the identification and control of such risks. A sound pre-purchase analysis, meaningful ongoing monitoring program, reliable accounting process and accurate assessment of risk-based capital requirements are all components of a comprehensive risk management process.

The ability of state-chartered banks to purchase life insurance is governed by state law. The safe and sound use of BOLI depends on effective senior management and board oversight. A prudent board of directors will gain a full understanding of the complex risk characteristics of the institution's insurance holdings and the role this asset plays in the institution's overall business strategy.

Examiners should assess the adequacy of each institution's internal policies and procedures governing its BOLI holdings, including guidelines that limit the aggregate cash surrender value (CSV) of policies from, any one insurance company, as well as the aggregate CSV of policies from all insurance companies. In general, it is not prudent for an institution to hold BOLI with an aggregate CSV that exceeds 25 percent of its Tier 1 capital. Therefore, an institution that plans to acquire BOLI in an amount that results in an aggregate CSV more than this concentration limit, or any lower internal limit, will typically need prior approval from its board of directors or the appropriate board committee. In this situation, examiners should determine whether management adequately justified any increase in BOLI that resulted in an aggregate CSV above 25 percent of Tier 1 capital does not constitute an imprudent asset concentration.

Examiners should assess whether management conducts a thorough pre-purchase analysis to help ensure that the institution understands the risks, rewards, and unique characteristics of BOLI. Examiners should also determine whether the nature and extent of this analysis is commensurate with the size and complexity of the potential BOLI purchases and considers existing BOLI holdings.

A comprehensive assessment of BOLI risks on an ongoing basis is especially important for an institution whose aggregate BOLI holdings represent a concentration. Examiners should determine whether management analyzes the financial condition of BOLI insurance carriers, reviews the performance of BOLI products, and reports their findings to the board at least annually. More frequent reviews may be necessary if management anticipates additional BOLI purchases, a decline in an insurance carrier's financial condition, policy surrenders, or changes in tax laws that could affect BOLI products or performance.

Examiners should review the Interagency Statement on the Purchase and Risk Management of Life Insurance (Interagency Statement) when assessing an institution's BOLI program. Examiners should closely scrutinize risk management policies and controls associated with BOLI assets when an institution holds BOLI in an amount that approaches or exceeds 25 percent of Tier 1 capital. An institution holding life insurance in a manner inconsistent with safe and sound banking practices is subject to supervisory action. Where ineffective controls over BOLI risks exist, or the exposure poses a safety and soundness concern, supervisory action against the institution, may include requiring the institution to divest affected policies, irrespective of potential tax consequences.

ASC Subtopic 325-30, Investments—Other – Investments in Insurance Contracts, addresses the accounting for BOLI. 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 an institution records amount more than the net CSV of the policy, then the excess should be classified Loss.

BOLI can be structured in three ways. In a general account life insurance policy, the general assets of the insurance company issuing the policy support the policy's CSV. In a separate account policy, the policy's CSV is supported by assets segregated from the general assets of the insurance carrier. A hybrid account combines aspects of general and separate accounts. For risk-based capital purposes, an institution that owns general account permanent insurance should generally apply a 100 percent risk weight to its claim on the insurance company. If an institution owns a separate account policy and can demonstrate that it meets certain requirements, it may choose to apply a look-through approach to the underlying assets to determine the risk weight. Refer to Call Report Instructions, the ED Module - Bank-Owned Life Insurance (BOLI), the Interagency Statement, and Part 324 (including BOLI risk weights for institutions using advanced approaches) for further details.

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MISCELLANEOUS ASSETS

Miscellaneous assets that are not reported in major Balance Sheet or Other Asset categories should be reported separately under all other assets in the Call Report. Examples include derivative instruments held for purposes other than trading that have a positive fair value, computer software, and bullion. Some of the more common miscellaneous assets are described below.

Prepaid Expenses

Prepaid expenses are the costs that are paid for goods and services prior to the periods in which the goods or services are consumed or received. When the cost is prepaid, the payment is recorded as an asset because it represents a future benefit to the bank. In subsequent periods, the asset is reduced (expensed) as the goods or services are used or rendered. At the end of each accounting period, the institution makes adjusting entries to reflect the portion of the cost that has expired during that period. The prepayment is often for a service for which the benefit is spread evenly throughout the year. As the service is provided, the prepaid expense is amortized to match the cost to the period it benefits. Examples of prepaid expenses include premiums paid for insurance, advance payments for leases or asset rentals, payments for stationery or other supplies that will be used over several months, and retainer fees paid for legal services to be provided over a specified period.

Examiners should assess whether management accurately adjusts prepaid expenses to reflect exhausted purchased goods or services. Prepaid expenses that are recorded and amortized in accordance with U.S. generally accepted accounting principles should not be adversely classified.

However, any prepaid expense that is overstated should be classified Loss.

Repossessed Personal Property

Repossessed personal property such as automobiles, boats, equipment, and appliances, represents assets acquired for debts previously contracted. An institution that receives assets from a borrower in full satisfaction of a loan, such as a receivable from a third party, an equity interest in the borrower, or another type of asset (except a long-lived asset that will be sold), will account for the asset at its fair value. An asset received in partial satisfaction of a loan should be accounted for as described above and the recorded amount of the loan should be reduced by the asset's fair value less the cost to sell. Examiners should assess repossessed assets individually for possible adverse classification.

Suspense Accounts

Suspense accounts, also known as interoffice or clearing accounts, are temporary holding accounts in which items are carried until they can be identified and their disposition to the proper account is made. For example, items are included in suspense accounts when a transaction is coded incorrectly and cannot be processed immediately, when an account number is missing on a loan or deposit transaction, or when a check drawn on a deposit account at the institution is not properly endorsed. Most suspense items are researched and cleared the following day. The balances of suspense accounts as of the report date should not automatically be reported as Other Assets or Other Liabilities. Rather, the items included in these accounts should be reviewed and material amounts should be reported appropriately in the Call Report. Examiners should determine if institutions regularly reconcile suspense accounts and charge off stale suspense items. Any stale suspense items determined to be uncollectible during the examination should be classified Loss in the Report of Examination.

Cash Items Not In Process Of Collection

In contrast to those cash items that are in process of collection, cash items that are not paid when presented are referred to as cash items that are not in the process of collection. In general, cash items that are not in the process of collection occur when the paying institution has refused payment after being presented with the cash item. Once payment has been refused, the cash item immediately becomes not in process of collection and is reclassified as an Other Asset. Cash items not in the process of collection are frequently held in a suspense account. Examiners should determine that the institution promptly charges off cash items when it becomes clear that the items will not be paid even as collection efforts continue. It is common for the payee institution to refuse payment if the customer's deposit account had insufficient funds, the check was improperly endorsed, the checking account on which the check is drawn has been closed, or for some other acceptable reason.

Other Accrued Interest Receivables

Accrued interest on securities purchased (if accounted for separately from accrued interest receivable in the institution's records) and retained interests in accrued interest receivable related to securitized credit cards is reported in all other assets in the Call Report. Accrued interest receivable amounts that are overstated should be classified Loss.

In a typical credit card securitization, an institution transfers a pool of receivables and the right to receive the future collections of principal (credit card purchases and cash advances), finance charges, and fees on the receivables to a trust. If a securitization transaction qualifies as a sale, then the selling institution removes the receivables that were sold from its reported assets and continues to carry any retained interests in the transferred receivables on its balance sheet. Any accrued interest receivable asset should be treated as a retained (subordinated) beneficial interest and should be reported in all other assets in the Call Report and not as a loan receivable. For further guidance, refer to the Interagency Advisory on the Accounting Treatment of Accrued Interest Receivable Related to Credit Card Securitizations and the Call Report Instructions.

Indemnification Assets

Indemnification assets represent the carrying amount of the right to receive payments from the FDIC for losses incurred on specified assets acquired from failed insured depository institutions or otherwise purchased from the FDIC that are covered by loss-sharing agreements. Despite the linkage between them, the acquired covered assets and the indemnification asset, are treated as separate units of account. Each covered asset is reported in the appropriate category on the balance sheet. The indemnification asset is recorded at its acquisition-date fair value and is reported in all other assets in the Call Report.

Examiners should determine whether the acquiring institution's financial and regulatory reporting is appropriate for the covered assets and the indemnification asset. Refer to the Call Report Instructions for further details.

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INTANGIBLE ASSETS

Goodwill and Other Intangible Assets

Goodwill is an intangible asset that is commonly recognized because of a business combination. Other intangible assets resulting from a business combination, such as core deposit intangibles, purchased credit card relationships, servicing assets, favorable leasehold rights, trademarks, trade names, internet domain names, and non-compete agreements, should be recognized as an asset separately from goodwill. This discussion will focus on intangible assets acquired through business combinations.

Goodwill represents the excess of the cost of a company over the sum of the fair values of the tangible and identifiable intangible assets acquired less the fair value of liabilities assumed in a business combination accounted for in accordance with ASC Topic 805, Business Combinations.

Push down accounting is the establishment of a new accounting basis for an institution in its separate financial statements because of it becoming substantially wholly owned via a purchase transaction or a series of purchase transactions. When push down accounting is applied, any goodwill is reflected in the separate financial statements of the acquired institution as well as in any consolidated financial statements of the institution's parent.

When measuring Common Equity Tier 1 capital for regulatory capital purposes, institutions generally must deduct goodwill and other intangible assets (other than mortgage servicing assets eligible for inclusion in core capital). Refer to Part 324 for further information on the regulatory capital treatment of goodwill and intangible assets.

Accounting for Goodwill

After initial recognition, goodwill must be accounted for in accordance with ASC Subtopic 350-20, Intangibles-Goodwill and Other – Goodwill, which requires that goodwill be tested for impairment at least annually, unless an institution meets the definition of a private company, as defined by U.S. generally accepted accounting principles, and elects either or both of the goodwill accounting alternatives.

ASC Subtopic 350-20 generally permits a private company to elect an accounting alternative for goodwill under which goodwill is amortized on a straight-line basis over a period of ten years, or less than ten years if more appropriate, and a simplified impairment model is applied to goodwill. For a public business entity, as defined by U.S. generally accepted accounting principles, goodwill is not permitted to be amortized, instead requiring goodwill to be tested for impairment at the reporting unit level. Goodwill is considered impaired when the amount of goodwill exceeds its implied fair value at the reporting unit level. 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. Examples of such events or circumstances include a significant adverse change in the business climate, unanticipated competition, a loss of key personnel, and an expectation that a reporting unit or a significant portion of a reporting unit will be sold or otherwise disposed. In addition, goodwill must be tested for impairment after a portion of goodwill has been allocated to a business to be disposed.

An institution may not remove goodwill from its balance sheet, for example, by selling or upstreaming this asset to its parent holding company or another affiliate.

Other intangible assets that have indefinite useful lives should not be amortized but must be tested at least annually for impairment. Intangible assets that have finite useful lives must be amortized over their useful lives and must be reviewed for impairment.

Refer to the Call Report Instructions for further details.

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 rights and responsibilities. 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 the resulting securities, and classifies the securities as held-to-maturity.

Accounting for Servicing Assets

Accounting and reporting standards for asset and liability servicing rights are set forth in ASC Subtopic 860-50, Transfers and Servicing – Servicing Assets and Liabilities, and ASC Topic 948, Financial Services-Mortgage Banking. 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. Contractually specified servicing fees are all amounts that, per contract, are due to a 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.

An institution must recognize and initially measure at fair value a servicing asset or a servicing liability each time it undertakes an obligation to service a financial asset by entering a servicing contract in either of the following situations:

- The institution's transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset that meets the requirements for sale accounting; or
- An acquisition or assumption of a servicing obligation that does not relate to financial assets of the institution or its consolidated affiliates included in the Call Report.

If an institution sells a participating interest in an entire financial asset, it only recognizes a servicing asset or servicing liability related to the participating interest sold. Examiners should determine that the institution measures each class of servicing assets and servicing liabilities using either the amortization method or the fair value measurement method. Once an institution elects the fair value measurement method for a class of servicing, that election must not be reversed.

Under the amortization method, all servicing assets or servicing liabilities in the class should be amortized in proportion to, and over the period of, estimated net servicing income for assets (servicing revenues more than servicing costs) or net servicing loss for liabilities (servicing costs in excess of servicing revenues). The servicing assets or servicing liabilities should be assessed for impairment or increased obligation based on fair value at each quarter-end Call Report date. The servicing assets within a class should be stratified into groups based on one or more of the predominant risk characteristics of the underlying financial assets. If the carrying amount of a stratum of servicing assets exceeds its fair value, an impairment should be recognized for that stratum by reducing the carrying amount to fair value through a valuation allowance for that stratum. The valuation allowance should be adjusted to reflect changes in the measurement of impairment after the initial measurement of impairment. For the servicing liabilities within a class, if subsequent events have increased the fair value of the liability above the carrying amount of the servicing liabilities, the increased obligation should be recognized as a loss in current earnings.

Under the fair value measurement method, all servicing assets or servicing liabilities in a class should be measured at fair value at each quarter-end report date. Changes in the fair value of these servicing assets and servicing liabilities should be reported in earnings in the period in which the changes occur.

Institutions that sell only a limited number of financial assets with servicing retained and do not otherwise actively purchase or sell servicing rights may determine that the servicing activity is immaterial. Typically, these institutions will have a relatively low volume of financial assets serviced for others and the value of any servicing assets and liabilities would likewise be immaterial. Management must provide a reasonable basis for not reporting servicing activity. Refer to the Servicing Liabilities section below and the Call Report Instructions for further details.

Valuation for Servicing Assets

The fair value of servicing assets and liabilities is determined in accordance with ASC Topic 820, Fair Value Measurements and Disclosures that defines fair value and establishes a framework for measuring fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the asset's or liability's principal (or most advantageous) market at the measurement date. This value is often referred to as an exit price. ASC Topic 820 establishes a three-level fair value hierarchy that prioritizes inputs used to measure fair value based on observability. The highest priority is given to Level 1 (observable, unadjusted) and the lowest priority to Level 3 (unobservable).

Valuation techniques consistent with the market approach, income approach, and/or cost approach should be used to measure fair value, as follows:

- The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

Valuation techniques consistent with the market approach include matrix pricing and often use market multiples derived from a set of comparables.

- The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts. Valuation techniques consistent with the income approach include present value techniques, option-pricing models, and the multi period excess earnings method.

  When the discounted cash flow approach is used to measure the fair value of servicing assets, several 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.

- The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (often referred to as current replacement cost). Fair value is determined based on the cost to a market participant (buyer) to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence.

Regulatory Capital for Servicing Assets

Part 324 limits the volume of intangible assets includable in regulatory capital. An institution must deduct intangible assets that are not mortgage servicing assets from the sum of its Common Equity Tier 1 capital elements. Mortgage servicing assets, net of associated deferred tax liabilities, are subject to a threshold deduction that is based on asset size and operational complexity. Refer to Part 324 for more details, including for the capital rules for institutions using advanced approaches.

Servicing Risk

Examiners should be aware of the risks that can affect an institution from the failure to follow the servicing rules related to financial assets sold or securitized, with servicing retained, or by a separate purchase or assumption of the servicing rights. An institution’s non-compliance with servicing requirements can affect its ability to collect payments from the servicing, servicing fees, or associated guarantees, such as in the case of government guaranteed loans that have been sold, with servicing retained. 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 others involved in the servicing function fail to follow these rules and guidelines, then the government agency that is providing the guarantee or insurance may refuse to honor its commitment to insure all parties against loss due to default. Appropriate controls to ensure compliance with servicing requirements help to limit the institution's liability and exposure related to servicing risk. Refer to Other Liabilities for further information on contingent liabilities associated with loans sold with servicing retained.

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. The ED Module - Mortgage Banking contains various examination procedures and references for reviewing mortgage-servicing assets.

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OTHER LIABILITIES

Other Borrowed Money

Mortgages, liens, and other encumbrances on premises and other real estate owned, and obligations under finance leases, which the institution is legally obligated to pay, are reported as other borrowed money in the Call Report. Regardless of the mortgage amount outstanding on bank premises, the asset should be carried on the general ledger at historical cost, net of accumulated depreciation. ASC Topic 842 establishes U.S. generally accepted accounting principles regarding lease transactions that must be accounted for as a property acquisition financed with a debt obligation.

Additional information on premises and leases is included in the Premises and Equipment section of this Manual.

Accrued Expenses

Expenses are also reported in the Call Report on the accrual basis of accounting that records revenues when realized or realizable and earned, and expenses when incurred. This attempt to match expenses incurred during a period to the revenues that they helped generate is known as the matching principle. At the end of each reporting period, but no less frequently than quarterly, institution management needs to make appropriate entries to record accrued expenses. Interest on deposits accrued through charges to expense during the current or prior periods, but not yet paid or credited to a deposit account, are reported as Other Liabilities in the Call Report. Likewise, the amount of income taxes, interest on nondeposit liabilities, and other expenses accrued through charges to expense during the current or prior periods, but not yet paid, are reported as Other Liabilities.

Servicing Liabilities

As noted under Servicing Assets, servicers typically receive certain benefits from a servicing contract and incur costs of servicing the assets. The accounting and reporting standards addressing servicing rights (i.e., assets and liabilities) are set forth in ASC Subtopic 860-50. Servicing liabilities result from contracts to service financial assets for which the benefits of servicing are not expected to adequately compensate the servicer. Institutions must initially measure a servicing liability at fair value and subsequently measure each class of servicing liabilities using either the amortization method or the fair value measurement method. The election of the subsequent measurement method should be made separately for each class of servicing liabilities. Refer to the Call Report Instructions for further details.

Deferred Tax Liabilities

As noted under Tax Assets, a net deferred tax liability is reported if a net credit balance results after offsetting deferred tax assets (net of valuation allowance) and deferred tax liabilities measured at the report date for a particular tax jurisdiction. An institution may report a net deferred tax debit, or asset, for one tax jurisdiction, and report at the same time a net deferred tax credit or liability, for another tax jurisdiction.

Deferred tax liabilities are recognized for taxable temporary differences. For example, depreciation can result in a taxable temporary difference if an institution uses the straight-line method to determine the amount of depreciation expense to be reported in the Call Report but uses an accelerated method for tax purposes. In the early years, tax depreciation under the accelerated method will typically be larger than book depreciation under the straight-line method. During this period, a taxable temporary difference originates. Tax depreciation will be less than book depreciation in the later years when the temporary difference reverses. Other taxable temporary differences include the undistributed earnings of unconsolidated subsidiaries and associated companies and amounts funded to pension plans that exceed the recorded expense.

Allowance for Off-Balance Sheet Credit Exposures

Examiners should determine that an allowance is maintained as a separate liability account, at a level that is appropriate to cover expected credit losses associated with off-balance sheet credit instruments such as loan commitments, standby letters of credit, and guarantees. This separate allowance should be reported as an Other Liability, not as part of the Allowance for Credit Losses (ACL) related to loans and leases but should exclude off-balance sheet credit exposures that are unconditionally cancellable by the institution. The allowance for credit losses for off-balance sheet credit exposures should be established in accordance with ASC Topic 326, Financial Instruments—Credit Losses. The allowance for off-balance sheet credit exposures is reported in Schedule RC-G – Other Liabilities, item 3, "Allowance for credit losses on off-balance sheet credit exposures.",

Recourse Liability Accounts for Loan Sales

Institutions may have to recognize a contingent liability when dealing with loan sales even when the assets are not on their balance sheet. If a loan sold on the secondary market qualifies as a sale under ASC Topic 860, ASC Subtopic 860-10 requires an institution to recognize a liability at the time of the sale for the fair value of the recourse obligation. This recourse obligation is recorded as an Other Liability rather than as part of the ACL, considering that these loans have been sold by the institution and are no longer part of its loan portfolio. Recourse liability accounts are accounted for at the time of the loan sale under ASC Topic 860 because the amount factors into the calculation of the gain or loss on the loan sale.

Subsequently, the institution periodically assesses whether there has been a change in probable and reasonably estimable losses (or "loss contingency") related to its recourse obligation in accordance with ASC Subtopic 450-20 Contingencies - Loss Contingencies and Call Report Instructions.[1] These resources indicate the institution should adjust its other liability amount to the extent that probable and reasonably estimable losses related to its recourse obligations, based on historical experience adjusted for current trends, are different from the carrying amount of the related liability.

For example, the institution makes certain contractual representations and warranties within a loan sale regarding whether the loans comply with established underwriting criteria or meet certain characteristics. If there were a breach in those representations and warranties, investors, insurers, or government guarantors have the right to demand the institution provide a remedy such as repurchasing the defective loan or indemnifying the investor, or government guarantor. The potential obligation related to representation and warranty liabilities is sometimes referred to as repurchase liability. In these situations, an institution would determine an estimate of "probable" repurchase activity on an ongoing basis. If an amount were to be reasonably estimable, there will be an increase or decrease in a repurchase liability.

Recourse liability accounts that arise from recourse obligations for any transfers of financial assets that are reported as sales should not be included in the ACL. These accounts are separate and distinct from ACLs; and, from the ACL on off-balance sheet credit exposures. Recourse liability accounts are reported in Schedule RC-G – Other Liabilities, item 4, "All other liabilities."

Contingent Liabilities for Loan Servicing

Institutions may also have to recognize a contingent liability when dealing with loan servicing activities even when the assets are not on their balance sheet. When an institution sells a loan and retains servicing, the institution as servicer is subject to off-balance sheet risk, including servicing risk, associated with loans or portions of loans sold. For institutions that service loans for others, examiners should determine if the establishment of a liability for contingent losses is necessary.

Institution management is responsible for determining whether a loss contingency exists. Like recourse liabilities, ASC Subtopic 450-20 and Call Report Instructions are the authoritative sources for determining whether a loss contingency exists. These resources indicate that an institution is to recognize a contingent liability when it is probable that a loss has been incurred and the amount of the loss is reasonably estimable based on information that is available as of the date the financial statements are issued. ASC Subtopic 450-20 outlines a range of considerations and possible complexities involved in making this determination. For example, a letter of denial of guarantee from an agency does not automatically indicate that accrual of a loss contingency is appropriate but would be a factor among others to be considered.

Like recourse liabilities, loss contingencies that arise from servicing or other off-balance sheet risk are reported in Schedule RC-G – Other Liabilities, item 4, "All other liabilities". A recourse liability is a form of a loss contingency. If examiners believe that a loss contingency related to loans that have been sold exists, but has not been identified by the institution, they should confer with the Case Manager and Regional Accountant. Discussion may include determining whether a Category II contingent liability should be reflected in the Report of Examination. If such a determination is made, examiners would discuss the contingency on the Examination Conclusions and Comments page under the CAMELS component(s) most significantly affected (for example, capital, management, earnings, or liquidity).[2]

All Other Miscellaneous Liabilities

Examiners will encounter other miscellaneous liabilities not reported in major Balance Sheet or Other Liability categories that should be reported separately in all other liabilities in the Call Report. Examples include accounts payable, deferred compensation payable, dividends

[1] Refer to Call Report Glossary entry for "Loss Contingencies".

[2] Refer to Section 2.1 – Capital, Contingent Liabilities for a discussion of potential and estimated losses and common forms of contingent liabilities, and Section 16.1 – Report of Examination (ROE) Instructions for proper handling of Category II liabilities in the ROE.

declared but not paid, and derivative instruments held for purposes other than trading that have a negative fair value.