

FFIEC

Federal Financial Institutions Examination Council

Washington, D.C. 20006

CALL REPORT DATE: March 31, 2002

FIRST 2002 CALL, NUMBER 219

SUPPLEMENTAL INSTRUCTIONS

March 2002 Call Report Materials

A sample set of the March 31, 2002, report form applicable to your bank is enclosed. Banks with domestic offices only must file the FFIEC 041 report form. Banks with domestic and foreign offices must file the FFIEC 031 report form.

Please retain the enclosed sample report form for reference. Sample forms also are available on both the FFIEC's Web site (www.ffiec.gov) and the FDIC's Web site (www.fdic.gov). A paper copy of the Call Report forms, including the cover (signature) page, can be printed from the Web sites. In addition, banks that use Call Report software generally can print paper copies of blank forms from their software.

Submission of Completed Reports

All banks must submit their Call Reports electronically to the banking agencies' electronic collection agent, Electronic Data Systems Corporation (EDS), using one of the two methods described in the agencies' cover letter for the March 31, 2002, report date. For assistance in submitting Call Reports to EDS, contact EDS toll free at (800) 255-1571.

Banks are required to maintain in their files a signed and attested record of the completed Call Report that has been submitted to EDS showing at least the title of each Call Report item and the reported amount. Either the cover page of the enclosed sample set of report forms, a photocopy of the cover page, or a copy of the cover page printed from Call Report software or from the FFIEC's or the FDIC's Web site should be used to fulfill the signature and attestation requirement. The signed cover page should be attached to the Call Report that is placed in the bank's files.

Currently, Call Report preparation software products marketed by DBI Financial Systems, Inc.; Financial Architects US; FRS, an S1 Corporation Business; Information Technology, Inc.; The InterCept Group; Jack Henry & Associates, Inc. (Banker-II Data Center); Milas LLC; and Sheshunoff Information Services have been certified for electronic submission by EDS. The addresses and telephone numbers of the vendors with EDS-certified Call Report software are listed at the end of these Supplemental Instructions.

FFIEC Instruction Books

Enclosed with this quarter's Call Report materials is an update to your Call Report instruction book. Please follow the filing instructions on the inside of the cover page of the update package.

Copies of the Call Report instructions may be obtained from the FDIC's Reports Analysis and Quality Control Section (telephone toll free at 800-688-FDIC) or from your Federal Reserve District Bank. The Call Report instructions are also available on both the FFIEC's and the FDIC's Web sites.

Final Rule on Recourse and Direct Credit Substitutes

On November 29, 2001, the agencies published a final rule revising the regulatory capital treatment of recourse arrangements and direct credit substitutes, including residual interests and credit-enhancing interest-only strips, as well as asset-backed and mortgage-backed securities. This final rule took effect on January 1, 2002. Any transactions settled on or after that date are subject to the rule. However, for

transactions settled before January 1, 2002, that result in increased capital requirements under the final rule, banks may delay the application of the final rule to those transactions until December 31, 2002.

Included in this quarter's Call Report instruction book update are revised instructions for Schedule RC-R, Regulatory Capital, which incorporate the provisions of this final rule. In addition, for transactions settled before January 1, 2002, that would be subject to higher capital requirements under the final rule, each bank should decide whether to apply the revised instructions or the previous reporting requirements to these transactions during the transition period that runs until December 31, 2002.

For further information, please refer to the revised Schedule RC-R instructions and to the agencies' final capital rule.

Reporting of Funds Invested Through Bentley Financial Services, Inc.

On October 30, 2001, the agencies issued a joint release advising depository institutions that the Securities and Exchange Commission (SEC) had filed suit against Robert L. Bentley, Entrust Group, and Bentley Financial Services, Inc. Specifically, the SEC alleged that the defendants were representing to investors that they were selling federally-insured certificates of deposit when, in fact, they were selling uninsured securities issued by the defendants. In addition, a temporary restraining order was issued against the defendants, freezing the defendants' accounts and appointing a receiver to exercise control over the defendants' assets. In light of these events, banks that have invested funds through Bentley Financial Services should report these funds as "Other" assets in Schedule RC-F, item 5, *not* as "Interest-bearing balances" due from depository institutions in Schedule RC, item 1.b. In addition, these funds should be placed in nonaccrual status and reported as nonaccrual assets in Schedule RC-N, item 9, column C. Previously accrued but uncollected interest on these funds should be reversed through a charge to interest income (for any amounts accrued in 2002) and a charge to other noninterest expense (for amounts accrued prior to 2002). In addition, these funds should be risk-weighted at 100 percent in item 42, column F, in Schedule RC-R, Regulatory Capital.

FASB Statements Nos. 141 and 142

In July 2001, the FASB issued Statement No. 141, *Business Combinations*, and Statement No. 142, *Goodwill and Other Intangible Assets*. Statement No. 141 supersedes the previous accounting standard on business combinations (i.e., mergers and acquisitions), Accounting Principles Board (APB) Opinion No. 16, and requires that all business combinations initiated after June 30, 2001, (except for combinations between two or more mutual enterprises) must be accounted for by the purchase method. The use of the pooling-of-interests method for those business combinations is prohibited. Statement No. 141 also changes the requirements for recognizing intangible assets as assets apart from goodwill in business combinations accounted for by the purchase method for which the date of acquisition is July 1, 2001, or later. The statement specifically identifies core deposit intangibles as one type of intangible that must be recognized as an asset separate from goodwill.

Statement No. 142 supersedes the previous accounting standard on intangible assets, APB Opinion No. 17. This new standard addresses how intangible assets that are acquired individually or with a group of other assets (but not in a business combination) should be accounted for upon their acquisition. It also explains how goodwill and other intangible assets should be accounted for after they have been acquired.

Under Statement No. 142, goodwill acquired in a business combination for which the acquisition date is after June 30, 2001, should not be amortized, but should be tested for impairment in accordance with the provisions of this accounting standard. Goodwill acquired in a business combination for which the acquisition date is before July 1, 2001, should continue to be amortized until an institution first applies all of the provisions of Statement No. 142 in accordance with the effective date of the standard. Statement No. 142 is effective for fiscal years beginning after December 15, 2001. For banks with a calendar year fiscal year, Statement No. 142 takes effect January 1, 2002.

Banks must adopt FASB Statements No. 141 and 142 for Call Report purposes in accordance with the effective dates of these standards based on their fiscal years. This quarter's Call Report instruction book update includes a revised Glossary entry for "business combinations;" revised instructions for Schedule RC, item 10.a, "Goodwill," and Schedule RC-M, item 2, "Intangible assets other than goodwill;" and instructions for new Schedule RI, item 7.c.(1), "Goodwill impairment losses," all of which incorporate relevant provisions of these new standards. For a bank that is a subsidiary of a holding company or other company, this includes applying the provisions of Statement No. 142 on goodwill impairment testing by a subsidiary. These provisions require all goodwill recognized by such a bank on its Call Report balance sheet to be accounted for in accordance with Statement No. 142 and to be tested for impairment at the bank level.

Upon the adoption of Statement No. 142, banks should report any impairment losses on goodwill and other intangible assets that must be recognized as a result of the standard's required transitional impairment testing as the effect of a change in accounting principle. The effect of the accounting change and related income tax effects should be reported in the Call Report income statement, Schedule RI, item 11, "Extraordinary items and other adjustments, net of income taxes," and disclosed in Schedule RI-E, item 3.

Although the accounting rules for goodwill and other intangible assets are changing, there has been no change in the regulatory capital treatment of these assets. The existing regulatory capital limits on servicing assets and purchased credit card relationships remain in effect, and goodwill and other intangible assets continue to be deducted from capital and assets in determining a bank's capital ratios.

Questions about the application of Statement Nos. 141 and 142 for Call Report purposes may be directed to the FDIC's Reports Analysis and Quality Control Section (telephone toll free at 800-688-FDIC) or your Federal Reserve District Bank. Banks also are encouraged to consult with their outside accountants concerning their implementation of these two new accounting standards.

Overnight Federal Home Loan Bank Advances

The Call Report revisions that take effect this quarter include changes to the definition of "Federal funds purchased," which are reported on the Call Report balance sheet in Schedule RC, item 14.a. As a result, immediately available funds borrowed from a Federal Home Loan Bank for one business day no longer meet the definition of federal funds purchased. Accordingly, these so-called overnight advances should be reported on the Call Report balance sheet in Schedule RC, item 16, "Other borrowed money." In addition, overnight Federal Home Loan Bank advances must be included in Schedule RC-M, item 5.a.(1), Federal Home Loan Bank advances "With a remaining maturity of one year or less."

Allowance for Credit Losses on Off-Balance Sheet Credit Exposures

Since 1996, the *Audit and Accounting Guide – Banks and Savings Institutions*, published by the American Institute of Certified Public Accountants, has stated that credit losses related to off-balance sheet financial instruments should be accrued and reported separately as liabilities "if the conditions of FASB Statement No. 5 are met." Consistent with this accounting guidance, the Call Report instructions state (on Glossary page A-3) that "each bank should also maintain, as a separate liability account, an allowance sufficient to absorb estimated credit losses associated with off-balance sheet credit instruments." Off-balance sheet credit instruments include off-balance sheet loan commitments, standby letters of credit, and guarantees.

On the Call Report, a bank must report its "Allowance for credit losses on off-balance sheet credit exposures" in item 3 of Schedule RC-G, Other Liabilities, *not* as part of its "Allowance for loan and lease losses" in Schedule RC, item 4.c. However, for risk-based capital purposes, the "Allowance for credit losses on off-balance sheet credit exposures" is combined with the "Allowance for loan and lease losses" and the total of these two allowances is included in Tier 2 capital up to a limit of 1.25 percent of a bank's gross risk-weighted assets. For further information on the inclusion of these allowances in Tier 2 capital, please refer to the instructions for Call Report Schedule RC-R, item 14.

Investments in Trust Preferred Securities

A number of banks have invested in trust preferred securities, which are hybrid instruments possessing characteristics typically associated with debt obligations. Although each issue of these securities may involve minor differences in terms, under the basic structure of trust preferred securities a corporate issuer, such as a bank holding company, first organizes a business trust or other special purpose entity. This trust issues two classes of securities: common securities, all of which are purchased and held by the corporate issuer, and trust preferred securities, which are sold to investors. The business trust's only assets are deeply subordinated debentures of the corporate issuer, which the trust purchases with the proceeds from the sale of its common and preferred securities. The corporate issuer makes periodic interest payments on the subordinated debentures to the business trust, which uses these payments to pay periodic dividends on the trust preferred securities to the investors. The subordinated debentures have a stated maturity and may also be redeemed under other circumstances. Most trust preferred securities are subject to a mandatory redemption upon the repayment of the debentures.

Trust preferred securities meet the definition of a security in FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Because of the mandatory redemption provision in the typical trust preferred security, investments in trust preferred securities would normally be considered debt securities for financial accounting purposes. Accordingly, regardless of the authority under which a bank is permitted to invest in trust preferred securities, banks should report these investments as debt securities for Call Report purposes (unless, based on the specific facts and circumstances of a particular issue of trust preferred securities, the securities would be considered equity rather than debt securities under Statement No. 115). If not held for trading purposes, trust preferred securities issued by U.S. business trusts should be reported in Schedule RC-B, item 6.a, "Other domestic debt securities."

Optional Tax Worksheet

For assistance in calculating year-to-date applicable income taxes in accordance with FASB Statement No. 109, *Accounting for Income Taxes*, an **optional** worksheet geared toward smaller banks is available upon request. For a copy of this worksheet, state member banks should contact their Federal Reserve District Bank. National and FDIC-supervised banks should telephone the FDIC's Reports Analysis and Quality Control Section in Washington, D.C., toll free at (800) 688-FDIC or call (202) 898-6607. The optional tax worksheet for March 31, 2002, also is expected to be available on the FDIC's Web site by that date.

Call Report Software Vendors

For information on available Call Report software, banks should contact:

DBI Financial Systems, Inc.
P.O. Box 90360
Santa Barbara, California 93190
Telephone: (800) 774-3279
www.e-dbi.com

Financial Architects US
80 Slocum Avenue
Bronxville, New York 10708
Telephone: (914) 376-5405
www.finarch.com

FRS, an S1 Corporation Business
2815 Coliseum Centre Drive,
Suite 300
Charlotte, North Carolina 28217
Telephone: (704) 423-0394
frs.s1.com

Information Technology, Inc.
1345 Old Cheney Road
Lincoln, Nebraska 68512
Telephone: (402) 423-2682
www.itiwnet.com

The InterCept Group
27200 Agoura Road, Suite 100
Calabasas Hills, California 91301
Telephone: (800) 825-3772
www.intercept.net

Jack Henry & Associates, Inc.
Banker-II Data Center
2405 Schneider Avenue, Suite A
Menomonie, Wisconsin 54751
Telephone: (715) 235-8420

Milas LLC
2936 Graceland Way
Glendale, California 91206
Telephone: (888) 862-7610

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