



Comptroller of the Currency
Administrator of National Banks

Check Credit

Comptroller's Handbook
(Section 211)

Narrative and Procedures - March 1990

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Assets

Introduction	1
Examination Procedures	3
Internal Control Questionnaire	10

Check credit is defined, for purposes of this handbook, as the granting of unsecured revolving lines of credit to individuals or businesses. Check credit services are provided by three basic methods: overdraft system, cash reserve system, and special draft system.

The most common is the overdraft system. In that method, a transfer is made from a pre-established line of credit to a customer's demand deposit account when a check that would cause an overdraft position in that account is presented. Transfers normally are made in stated increments, up to a maximum line of credit approved by the bank, and the customer is notified that the funds have been transferred. In a cash reserve system, the customer must request that the bank transfer funds from his or her pre-established line of credit to his or her demand deposit account, before negotiating a check against them. A special draft system involves the customer negotiating a special check drawn directly against a pre-established line of credit. In that method, demand deposit accounts are not affected. In all three systems, the bank periodically provides its check credit customers with a statement of account activity.

Required minimum payments are computed as a fraction of the balance of the account on the cycle date and are usually made by automatic charges to the demand account.

Delinquencies often are experienced when an account is at or near the maximum credit line. Accordingly, banks should generate comprehensive reports that are reviewed frequently by management. At a minimum, such reports should contain schedules of:

- Delinquent accounts (aged).
- Accounts where payments are made by drawing on reserves.
- Accounts with steady usage.

Banks which have extended their check credit plan to small businesses have found that practice may involve a higher than normal risk unless placed under very stringent controls. Since such loans are basically unsecured lines of credit, the examiner's review should be based on the same factors and criteria used in the review of unsecured commercial loans.

Bank Charge-off Policy

The policy of the Office of the Comptroller of the Currency (OCC) with respect to charge-off of check credit advances is the same as for charge-off of credit card advances.

Check Credit (Section 211) Examination Procedures

1. Complete or update the Internal Control Questionnaire.
2. Based on the evaluation of internal controls and the work performed by internal/external auditors (see separate program), determine the scope of the examination. Select from among the following examination procedures those steps that are necessary to evaluate the check credit practices of the bank.
3. Test for compliance with policies, practices, procedures, and internal controls in conjunction with performing the selected examination procedures. Also, obtain a listing of any deficiencies noted in the latest review done by internal/external auditors from the examiner assigned "Internal and External Audits," and determine if corrections have been accomplished.
4. Perform appropriate verification procedures.
5. Obtain the following:
 - a. Most recent report of all overline accounts.
 - b. Most recent exception trial.
 - c. Most recent stagnant maximum usage report.
 - d. Most recent inactive suspects report (list of accounts on which payments are made by drawing on reserves).
 - e. Month-end account balance and total delinquency for each month since the previous examination.
 - f. Monthly charge-offs, recoveries, accrued interest, and other department income for each month since the previous examination.
 - g. Trial balance of all accounts. It will normally be possible to use the bank's latest trial balance. In those cases where exact figures are needed for report purposes, and trials are not more than 10 days old,

liability may be posted from the latest trial and updated from the daily transactions journals. Using the trial balance:

- Agree or reconcile balances to departmental controls and general ledger.
 - Review reconciling items for reasonableness.
6. Using appropriate sampling techniques, select borrowers for examination. If verification procedures have been performed, use same sample.

(Before continuing, refer to steps 15 and 16. They should be performed in conjunction with steps 7 through 14.)

7. Obtain, for the examiner assigned "Loan Portfolio Management," the following schedules, if applicable to this area.
- a. Past-due loans.
 - b. Extensions of credit to major shareholders, employees, officers, directors, or their interests.
 - c. Extensions of credit to officers and directors of other banks.
 - d. Miscellaneous loan debit and credit suspense accounts.
 - e. Loans considered "problem" loans by management.
 - f. Information on directors, executive officers, principal shareholders, and their interests.
 - g. Specific guidelines in lending policy.
 - h. Each officer's current lending authority.
 - i. Current interest rate structure.
 - j. Any useful information obtained from the minutes of the loan and discount committee or any similar committee.

- k. Reports furnished to the loan and discount committee or any similar committee.
 - l. Reports furnished to the board of directors.
8. Review the information received and perform the following for:
- a. Extensions of credit to officers and directors of other banks:
 - Investigate any circumstances that indicate any preferential treatment.
 - b. Miscellaneous loan debit and credit suspense accounts:
 - Discuss with management any large or old items.
 - Perform additional procedures as deemed appropriate.
9. For those loans selected in step 6 and for any other loans selected while performing the above steps, review the loans, preparing line sheets or worksheets where appropriate, and:
- a. If the loan was granted since the preceding examination, ascertain that:
 - Application form is on file and properly completed.
 - Customer's signature is on file.
 - Credit check has been performed.
 - Established credit limit is properly authorized and in compliance with credit policies.
 - b. Test the accuracy of the schedules obtained at step 5 by:
 - Tracing the loan for proper inclusion in the overline report. For those included, review the files to determine whether:
 - The line was originally established in compliance with bank policy.
 - The overline status was the result of deficiencies in policy or procedures.
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- Action has been taken to prohibit additional advances until account is within established credit line.
 - Based upon available credit information, borrower has the ability to repay.
- Tracing the loan for proper inclusion in the exception trial. For those included, determine if appropriate action is being taken to resolve the situation and if collectability is questionable.
 - Tracing the loan for proper inclusion in the stagnant maximum usage report. For those included, determine if appropriate action is being taken to resolve the situation and if collectability is questionable.
 - Trace the loan for proper inclusion to the past-due loans report.
- c. Review accounts selected to determine adequacy of and compliance with bank policy and procedures for:
- Granting of extensions.
 - Recycling accounts.
 - Placing accounts on reduced payments schedule.
 - Placing accounts on non-accrual status.
- d. Review the files to determine compliance with any applicable state laws or regulations including:
- Revolving credit billing laws.
 - Laws on permissible late charges.
10. Review current past-due loans report, and determine if charge-off is being made in line with bank policy. In those banks with a periodic charge-off policy which generally conforms to OCC policy (delinquent with seven zero billings), discussion and request for charge-off is not necessary. Accounts delinquent four zero billings to six zero billings should be classified substandard. Individual accounts that have not been charged off in line with the general policy should be reviewed and discussed with management.

11. If the bank does not have a periodic charge-off policy, or if the number of accounts delinquent seven zero billings is material, prepare a listing for discussion with management and request charge-off as appropriate.
12. Review past-due loans reports since the previous examination and investigate any significant variations.
13. Review monthly income and unearned discount totals since the previous examination and investigate any sudden or large increases or decreases.
14. Review listing of charged off loans and recoveries. If the bank does not have a regular charge-off policy, compute the ratio on a quarterly or semiannual basis as appropriate. Investigate any significant change.
15. Determine compliance with laws, rulings, and regulations pertaining to check credit lending by performing the following steps for:

- a. 12 USC 375a, 12 CFR 215, and 12 USC 375b — Loans to Executive Officers, Directors and Principal Shareholders and Their Interests:

While reviewing information received from the examiner assigned "Loan Portfolio Management," including participations and loans sold:

- Test the accuracy and completeness of list. Check credit loans by comparing it to the loans sampled.
- Review credit files to determine that required information is available.
- Determine that loans to executive officers, directors, principal shareholders, or their related interests do not contain terms more favorable than those afforded other borrowers.
- Determine that loans to executive officers and principal shareholders, each combined with their respective related interests, do not exceed the limits imposed by 12 USC 84.

- b. 31 CFR 103.33(a) — Records to be Retained by Financial Institutions:

Review operating procedures and credit file documentation, and determine whether the bank retains records of each extension of credit over \$5,000, specifying the name and address of the borrower,

the amount of the credit, the nature and purpose of the loan, and the date thereof.

16. Determine whether the most recent compliance examination uncovered any violations of law or regulation in this department. If violations were noted, determine whether corrective action was taken. Extend test to determine subsequent compliance with any law or regulation so noted.
17. Discuss with appropriate officer(s), and prepare in appropriate report form:
 - a. Summary of delinquent loans, including breakout of "bad debts" as defined in 12 USC 56.
 - b. Violations of laws, rulings, and regulations.
 - c. Extension of credit to employees, officers, directors, and/or their interests.
 - d. Other matters regarding condition of the department.
18. Prepare a memorandum to the examiner assigned "Loan Portfolio Management" stating your findings with regard to:
 - a. The adequacy of written policies relating to check credit loans.
 - b. The manner in which bank officers are conforming to established policy.
 - c. Adverse trends within the check credit department.
 - d. Accuracy and completeness of the schedules obtained from "Loan Portfolio Management."
 - e. Recommended corrective action where policies, practices, or procedures are found to be deficient.
 - f. The quality of departmental management.

- g. Other matters of significance.
19. Prepare a memorandum, and update work programs with any information that will facilitate future examinations.

Check Credit (Section 211)

Internal Control Questionnaire

Review the bank's internal controls, policies, practices, and procedures for making and servicing check credit loans. The bank's system should be documented in a complete and concise manner and should include, where appropriate, narrative descriptions, flowcharts, copies of forms used, and other pertinent information. Items marked with asterisks require substantiation by observation or testing.

Check Credit Policies

1. Has the board of directors, consistent with its duties and responsibilities, adopted written check credit policies that:
 - a. Establish procedures for reviewing check credit applications?
 - b. Establish standards for determining credit lines?
 - c. Establish minimum standards for documentation?
2. Are check credit policies reviewed at least annually to determine if they are compatible with changing market conditions?

Check Credit Records

3. Is the preparation and posting of subsidiary check credit loan records performed or reviewed by persons who do not also: *
 - a. Issue official checks or drafts singly?
 - b. Handle cash?
4. Are the subsidiary check credit records reconciled daily to the appropriate general ledger accounts, and are reconciling items investigated by persons who do not also handle cash? *
5. Are delinquent account collection requests and past-due notices checked to the trial balances used in reconciling check credit subsidiary records to general ledger accounts, and are they handled only by persons who do not also handle cash? *

6. Are inquiries about loan balances received and investigated by persons who do not also handle cash? *
7. Are documents supporting recorded credit adjustments checked or tested subsequently by persons who do not also handle cash (if so, explain briefly)? *
8. Is a daily record maintained summarizing transaction details, i.e., loans made, payments received and interest collected, to support applicable general ledger account entries?
9. Are frequent note and liability ledger trial balances prepared and reconciled with controlling accounts by employees who do not process or record loan transactions?
10. Are suspense accounts reviewed daily for timely disposition of all items?
11. Are authorized signatures required to effect a status change regarding individual customer accounts?
12. Is an exception report produced and reviewed by operating management that encompasses extensions, renewals and any factors that would result in a change in customer account status?
13. Is an overdue accounts report generated frequently (if so, how often _____)?

Loan Interest and Service Fees

14. Is the preparation and posting of interest or service fee records performed or reviewed by persons who do not also: *
 - a. Issues official checks or drafts singly?
 - b. Handle cash?
15. Are any independent interest and service fee computations made and compared or tested to initial interest and service fee records by persons who do not also:

- a. Issue official checks or drafts singly?
- b. Handle cash?

Other

16. Are statements of reserve balances and payments due issued at least monthly?
 17. If the check credit plan is in conjunction with a demand account, are combined demand deposit and reserve statements issued?
 18. If the check plan is separate from the customer's demand account, but is paid through the demand account, are notices of transfer from the cash reserve to the demand account mailed immediately to the customer?
 19. Are all internally prepared entries affecting customer account records approved by an officer?
 20. Are customers prohibited from exceeding their maximum approved lines?
 - If not, is the allowed overline amount prefigured as a percentage of their maximum approved credit line (if so, state percentage _____)?
 21. Are the following reports prepared for internal use in the department and monitored:
 - a. Overlimit balances?
 - b. Stagnant maximum usage balances?
 - c. Inactive suspect accounts (accounts where payments are made by drawing on reserve)?
 22. Are the above reports reviewed for accuracy periodically by someone independent of the check credit function?
 23. Are customers forbidden to make payments by drawing against the check credit reserve?
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- If not, how many payments may be made by drawing against the check credit reserve before a warning is issued to the customer _____?
24. Do operating procedures require that simultaneous drawing and payment postings to the same account be reported to department management?
 25. Is a completed application obtained from each potential borrower which includes:
 - a. Name?
 - b. Address?
 - c. Number of dependents?
 - d. Occupation?
 - e. Length of employment?
 - f. Income?
 26. Are credit limits varied according to the customer's repayment ability?
 - If so, is that limit held to an amount that is no greater than 3 times the customer's monthly salary?
 27. Are credit limit approvals made by an officer or employee granted loan authority by the board of directors?
 28. Are credit investigations performed on every applicant before a line is approved?
 29. Are credit reports and investigations updated on a periodic basis?
 30. Is each credit line evidenced by a properly completed loan agreement?
 31. Are credit lines periodically reviewed for appropriateness of the amount of the line?
 32. Is additional credit review undertaken if the customer requests an increase of the credit line?
 33. Are procedures in effect to review credit lines if the bank becomes aware of a change in financial status or creditworthiness of borrower?
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34. Do controls exist to prohibit the opening of more than one account for any one customer?
35. Are exception reports reviewed and initialed by an officer on a daily basis?
36. Is a regular review made of all past due accounts?
37. Is a customer contact record maintained for each collection account with brief comments and date of contact?
38. Are collectors required to issue pre-numbered receipts when payments are received?
39. Is customer contact rotated between collectors?
40. Are procedures in effect for the establishment of employee accounts?
41. Are employee accounts periodically reviewed?
42. If employees are permitted to maintain check credit accounts, are procedures in effect to determine that accounts are not being utilized to conceal shortages during audits of those employees?

Conclusion

43. Is the foregoing information an adequate basis for evaluating internal control in that there are no significant additional internal auditing procedures, accounting controls, administrative controls, or other circumstances that impair any controls or mitigate any weaknesses indicated above (explain negative answers briefly, and indicate conclusions as to their effect on specific examination or verification procedures)?
44. Based on a composite evaluation (as evidenced by answers to the foregoing questions), internal control is considered _____ (good, medium, or bad).

Verification Procedures

1. Test the addition of the trial balance and the reconciliation of the trial balance to the general ledger.
2. Using appropriate sampling techniques, select accounts from the trial balance and:
 - a. Prepare and mail confirmation forms to borrowers confirming balances and credit limit as of the last statement date.
 - b. After a reasonable time, mail second requests.
 - c. Follow-up on any no-replies and exceptions, and resolve differences.
3. If the bank charges a fee for check credit services:
 - a. Using the accounts selected above, check computation of the latest charges.
 - b. Trace charges to posting in appropriate general ledger income account.
 - c. Review monthly income amounts posted to the general ledger for reasonableness relative to the number of check credit accounts handled.
4. Obtain or prepare a schedule showing the amount of monthly interest income and the check credit loan balances at the end of each month since the preceding examination, and investigate significant fluctuations or trends.