1938

Audits or Examinations of Savings and Loan Associations

American Institute of Accountants. Special Committee on Savings and Loan Accounts

AUDITS OR EXAMINATIONS OF SAVINGS AND LOAN ASSOCIATIONS

SECTION 1

General

The special committee on savings and loan accounts of the American Institute of Accountants was appointed in the spring of 1936 by the President of the Institute, and the Institute's program of activities for the fiscal year 1936-37 described the duties of such committee as follows:

> "Continue cooperation with Federal Home Loan Bank Board in an effort to devise program of independent audit of savings and loan associations insured by the Federal Government, and recommend forms of financial statements and auditors' certificates which will satisfy requirements of the Board and eliminate necessity for audits of associations by examiners employed by the Board. Cooperate to whatever extent may be possible with the American Savings and Loan Institute."

In accordance with the above program, there has been devised the following procedure for the audit of savings and loan associations. In this connection it must be borne in mind that every auditor must exercise discretion while conducting such audits because conditions vary depending upon size and type of associations, and depending also upon state or Federal requirements.

That which is presented herein cannot be considered as a definite rule, but merely as a guide, and it constitutes neither the maximum nor the minimum of an audit program. Neither is this an attempt to instruct the accountant in the fundamentals of auditing.

It is believed that compliance with the program outlined in this pamphlet will enable the accountant to render a report to savings and loan association clients which will be acceptable to the association and will meet the requirements of the several state authorities as well as those of the Federal Home Loan Bank Board. It is to be hoped that it will make possible more complete coordination between the nation's certified public accountants and government examiners.

In so far as many fundamentals of accounting practice apply to savings and loan associations in the same manner as they would apply to other types of business, it is recommended that the reader of this pamphlet acquaint himself with the bulletin prepared and published by the American Institute of Accountants in January 1936 entitled "Examination of Financial Statements by Independent Public Accountants." Accounting principles as discussed in that bulletin are not changed nor altered in this one, and consequently, all details discussed therein will be omitted from this text.

SECTION 2

Recent Developments

Since the organization of the first savings and loan association in this country over one hundred years ago, there have been many changes in financial procedure and management methods.

In so far as standardization in financial procedure had been impracticable if not impossible, until the educational work of the United States League of Building and Loan Associations and the American Savings and Loan Institute had made an impression on those engaged in this business throughout the country, it was likewise impracticable to attempt to standardize the accounting methods of these institutions.

The Federal Home Loan Bank Act and the creation of the Federal Home Loan Bank Board thereunder, resulted in the rapid crystallization of the best thought on this subject. Each of the three above mentioned groups have been publishing information on accounting problems, so that today there is available to every association throughout the country some very creditable material designed for its guidance in proper accounting.

The Federal Home Loan Bank Board has been very helpful by issuing periodical bulletins on the subject of accounting, and has developed an excellent examination procedure to aid it in its supervision of member associations. Foremost among the publications on the subject of accounting is the "Standard Accounting Manual for Savings and Loan Associations" prepared by the American Savings and Loan Institute, and this work has been supplemented by that body through the preparation of a course in accounting, conducted under its auspices in the larger cities of the nation. In addition, there are some very helpful articles on the same subject of savings and loan accounting to be found in the periodicals published by the several Federal Home Loan Banks, by the United States League of Building and Loan Associations, and by the several state organizations of persons engaged in the savings and loan business.

Problems of accounting peculiar to savings and loan associations are constantly being discussed in the technical magazines and bulletins of these groups. The one job which has not been adequately done is the preparation of a comprehensive audit program, and this is a proper task for the American Institute of Accountants. However, full credit must be given in the preparation of this work to the examination procedure which has been made available to us by the Federal Home Loan Bank Board, and also to the procedures outlined by practicing accountants and state examiners which are applicable to the organizations operating with in the several states.

SECTION 3

Outline of Examinations

When considering the extent of the auditor's examination which is about to be made, there must be taken into consideration the purpose of the examination or audit and the system of internal check in effect. Invariably, the examination becomes an audit when applied to savings and loan associations. It is well known that at least once each year the Federal Home Loan Bank Board examiners examine their member associations, and in almost every commonwealth, the state examiners scrutinize the records of each association incorporated therein in order to make certain that the association is solvent and that it is operating properly under the charter which has been granted to it.

The certified public accountant cannot assume that either of these examinations by others completes any part of the work that he would normally have done had there been no such outside examination. "A system of internal check and control" is defined in the "Examination of Financial Statements." In large associations where such a system is in operation, the detailed tasks of the auditor may properly be curtailed. It is also the duty of the auditor to recommend the installation of such a control if one can be operated without occasioning a great deal of added expense to the client. Where such control is had, a detailed audit is not justified, and the accountant may rely on various test-checks. The extent of these test-checks is a matter of judgment which must be exercised by the accountant.

The accountant's work does not include appraisals; property values and the investigation of the status of titles are not within his province. Whenever legal or engineering problems arise, it would be well for the accountant to make reasonable inquiry, and upon ascertaining the facts, suggest to the association that it consult with its legal or engineering advisors. It is requisite for the accountant engaged in this manner of work to acquaint himself with the Federal or state requirements, to be well versed in the latest literature pertinent to accounting procedure for such associations, and to satisfy himself that the association which is being audited has been using these accepted accounting practices throughout the period covered by the audit. If the statement of condition and the statement of operations and reconcilement of undivided profits account and reserves have been prepared by a representative of the association under audit, the auditor should make certain that they are in accepted form. This form is outlined at the conclusion of this outline.

If the accountant prepares these statements, it is recommended that he follow the accepted outline. The association's trial balances should be compared with the accounts in the general ledger and also with the balance-sheet. It is important here to see that no items are offset, one against the other, which would establish a "net" condition in either assets or liabilities unless all assets and all liabilities are fully described. Outstanding changes in the association's condition are reflected by a comparison of the opening and closing statements for the period under audit. Such changes may require more than ordinary attention from the auditor. The minutes of the directors' and the shareholders' meetings should be read, and any items appearing therein which affect the financial transactions of the association should be noted. The accountant should satisfy himself that these transactions have been handled in accordance with the minutes.

In the event that the count of cash, examination of securities and confirmation requests cannot be completed on the balance-sheet date, it will be necessary to make an examination of transactions for the interim period in order to establish the correctness of such items as of the balance-sheet date.

Cash

(1) Cash on hand should be counted and the auditor should be satisfied that the association is using a good system of petty-cash control. Any liquid or negotiable securities should be inspec-

ted or taken under control at the time of the petty-cash count. The auditor should guard against the possibility of the securities being temporarily liquidated for the purpose of covering up shortages in the cash.

(2) When counting cash, it is important to observe that all checks produced as part of the cash balance have been entered in the cash book prior to the close of the period. Any checks or advances made from cash but not recorded on the books should be noted. Scrutinize advances to employees and see that personal checks or checks cashed for others as an accommodation are deposited and paid before the completion of the examination.

(3) Outstanding items representing disbursements prior to the date of the balance-sheet should be thoroughly investigated. Bank balances as of the close of business on the balance-sheet date should be verified by obtaining direct confirmation from the depositories. These balances should be reconciled with the balances shown on the cashbook and check-book stubs or check registers and particulars should be noted of all outstanding items. The checks returned by the banks should be compared with the cashbook disbursements. In the case of small associations, this should be done for the entire year. In the case of large associations having a good system of internal check, this comparison of checks should be made for two or three months taken at random, except that the last month of the period under examination should be covered. Spoiled checks should be investigated. Outstanding checks at the close of the audit period should be compared with the checks returned by the banks in the subsequent month. Any unpaid checks which have been outstanding for a long

interval should be specially investigated.

(4) Compare cash receipts with bank deposits. In small associations, this should be done for the entire period. In associations having a good internal control, the same test may be made as indicated above in the examination of cancelled checks.

(5) Prove footings of cash book columns for the period during which checks are examined.

(6) Compare all checks outstanding at the beginning of the period which were not returned in a previous examination with the cash disbursement entry.

(7) If it is the practice of the association to delegate a person to make distribution or mortgage settlement funds, such person's accounts should be examined to ascertain if the association's checks have been deposited by the disbursing trustee, and second, that the trustee's disbursements are in order.

Securities

Savings and loan associations frequently own stock in the Federal Home Loan Bank and also own Federal Home Loan Bank Bonds as well as United States Government securities including those of the Home Owners Loan Corporation. Occasionally, there may be other securities on hand.

The examination of these securities does not differ materially from that described in the "Examination of Financial Statements" and that portion which applies definitely to the examination of savings and loan associations is listed below:

(1) Obtain or prepare a list of securities owned

showing particulars such as description of security, giving:

Serial numbers of bonds or other securities.

Denomination of bonds or par value of shares.

Interest rate of bonds.

Face value of bonds and number of shares.

Cost of securities and the amount at which carried on the books.

Interest and dividends received during period under review.

Market quotations if such are available, location of securities, and if hypothecated, with whom and for what purpose.

(2) Compare securities listed with the corresponding ledger accounts and ascertain the basis on which the securities are carried on the books. Compare serial numbers of bonds and other securities with records of security purchases in order to obtain positive identification and avoid possibility of substitution.

(3) Examine the securities listed, or obtain confirmation from the holders if any are held by depositories or others for safe keeping or as collateral. This examination should be made as close to the date of the balance-sheet as possible (see paragraph 1 under Cash). It is, of course, more de-

sirable to inspect the actual securities than to account for their disposition subsequent to the date of the balance-sheet.

(4) See that certificates of stock and registered bonds are made out in the name of the association or, if they are in the names of others, that they are so endorsed as to be transferable to the association or are accompanied by Powers of Attorney.

(5) Examine coupons on bonds to ascertain that unmatured coupons are intact.

(6) If certificates are out for transfer, confirm with transfer agents.

(7) See that income from securities shown in the profit-and-loss account is clearly reported by comparison of the totals of dividends and interest received therefrom as set forth on the list under paragraph 1 above.

(8) Stocks and bonds should be shown separately on the statement of condition and should not be confused with mortgage loans and share loans.

(9) If securities are stated at prices other than market, the quoted market values should also be shown on the balance-sheet. If the total

market value of stocks and bonds which might represent temporary investments is less than the total book value by any material amount, it would be well to provide a reserve for the shrinkage in value.

Mortgage Loans

Mortgage loans are the most important assets of a savings and loan association and should be classified as follows:

1. First Mortgage Loans:
   - (a) First Mortgage Direct Reduction Loans.
   - (b) First Mortgage Share Accounts Sinking Fund Loans.
   - (c) First Mortgage Straight Loans.
   - (d) Accrued Interest Receivable on First Mortgage Loans (unless included in balance of first mortgage loans).
   - (e) Advances for Taxes, Insurance, etc., on First Mortgage Loans (unless included in balance of first mortgage loans).

2. Second Mortgage Loans:
   - (a) Second Mortgage Loans.
   - (b) Accrued Interest Receivable on Second Mortgage Loans.
   - (c) Advances for Taxes, Insurance, etc., on Second Mortgage Loans.

Formerly, some states permitted the placing of such loans, but at the present time, most loans of this description are acquired by the associations upon action taken by them for the purpose of protecting their interest infirst mortgage loans.

1. The accountant should obtain or prepare a list of mortgage loans which would set forth all of the information required in the previous section which refers to securities.

2. The papers supporting mortgage loans should be examined.

3. It is preferable to confirm mortgage loans outstanding directly with the mortgagors, and if this cannot be done, a qualification to that effect should be included in the accountant's report.

4. The accountant should familiarize himself with the requirements of savings and loan association mortgage loans and should see that the required number of shares have been assigned to the association by the mortgagor in conformity with the agreement between mortgagor and association.

5. All loans granted and foreclosures commenced during the period under review should be compared with the authorization in the minutes.

6. The accountant should familiarize himself with state and Federal provisions under which the audited association is operating in order to determine if its loan policy is in compliance therewith. Arrearages should be scrutinized and confirmed by correspondence at the same time that a mail verification is requested of mortgagors.

7. The accountant should also inquire into unpaid taxes and assessments pertaining to mortgaged properties.

8. The following papers supporting mortgage loans should be seen when a detailed examination of such loans is made.

    Mortgage.
    Note or Bond and Warrant
    Title insurance policy, guaranteed search, or solicitor's search or abstract.
    Property insurance policy - fire tornado, etc.
    Loan application properly signed by mortgagor.
    Loan approval signed by proper committee.

In some cases, a separate assignment of shares signed by the mortgagor is necessary. If the minutes or the property committee report requires additional collateral, the assignment of such collateral and the collateral itself should be examined by the accountant. If it is a second mortgage, the amount of the first lien should be listed, and if it is the practice of the association to acquire Sheriff's or Marshall's Certificates, the accountant should see to it that the certificates are included among the second mortgage papers.

SHARE LOANS

1. Share loans should be classified as follows:
    - (a) Loans secured by shares of this association.
    - (b) Loans on deposit accounts and certificates of investment.
    - (c) Accrued interest receivable (unless included above).

2. Papers supporting share loans should be examined.

3. It is preferable to confirm share loans outstanding directly with the borrowers, and if this cannot be done, a qualification to that effect should be included in the accountant's report. The authority for the creation of share loans should be found in the minutes. The shareholder's note should be examined as well as his pledged certificate (or pass book if the association issues no certificate).

4. The accountant should make certain that sufficient payments have been made to warrant the amount loaned and he should also ascertain if the amount borrowed by the shareholder is within the limitation permitted by law.

5. Credits appearing on the loan accounts of shareholders during the year under review should be carefully checked.

Other Loans

1. These loans are classified as follows:

    (a) Loans on other security.

    (b) Unsecured loans.

    (c) Accrued interest receivable on above.

2. The same procedure as that followed in the examination of papers supporting mortgage and share loans should be followed in the case of other loans, and written confirmations should be obtained.

Real Estate Sold on Contract

1. This should be listed and classified as follows:

    (a) Real estate sold on contract.

    (b) Accrued interest receivable on real estate sold on contract (unless included above).

    (c) Advances for taxes, insurance, etc., on real estate sold on contract (unless included above).

2. These contracts should be examined closely and complete details of each parcel of property should be retained in the accountant's working papers.

3. If the property has been sold at a profit, there are three methods which may be used to take up such profit:

   (a) The first cash funds received might be considered realized profit.

   (b) The profits arising from the sale of real estate might be taken into earnings in the proportionate amount consistent with the cash paid by the purchaser.

   (c) The profit might be deferred until the last payment is received from the purchaser.

   The plan described in (b) above is preferable. The association should be consistent in its method of handling the profits on the sale of all parcels of real estate owned.

4. Real estate sold on contract may also be confirmed by written request for verification addressed to the purchasers.

Real Estate Owned

1. Prepare schedule of real estate owned.

2. Scrutinize carefully all new acquisitions in the real estate account checking the cost of each parcel.

3. Check the sales prices of all real estate disposed of during year.

4. Examine deed, certificate of counsel as to title, guaranteed search, or title insurance policy pertinent to each parcel of real estate owned.

5. Check property insurance policies. Is the association protected against the most common hazards which include fire, tornado, and owners liability?

6. Check rental income from the real estate agent's records, if any, and by confirmation from the tenant on each property as noted under Item 4 of Income.

7. Check by direct communication accounts of rents in arrears of each tenant and prepare a schedule of such arrearages. It would be very informative and helpful to the association if a list of income and expenses on each property were made part of the detailed schedule of real estate owned. Such a schedule might be further augmented by the inclusion of such data as percentages of yield and comparative vacancies during the period under review.

FIXED ASSETS

1. An analysis of the accounts for such assets as the office building and the furniture and fixtures of the association should be prepared. Such an analysis should set forth:

(a) Asset value at beginning of period under review.

(b) Cost of new acquisitions.

(c) Accumulated depreciation allowance at beginning.

(d) Depreciation for year under examination.

(e) Encumbrances on each asset.

(f) Insurance carried covering each asset.

(g) Appraisal value, if any.

(h) Assessed value of real estate.

(i) Income from other tenants and operating costs of real estate used to house the Association's offices.

2. Sales of fixed assets should be scrutinized and profits or losses therefrom, when determined, should be recorded separately in the statement of operations.

SHARE ACCOUNTS

1. The accounts of shareholders are classified as follows:

(1) Repurchasable or free shares.

a. Installment shares dues credited

Deduct - Delinquent dues (if carried)
Add - Dividends (unless included in dues credited above)

b. Optional shares (payments and dividends)

c. Prepaid shares (or income shares)

Add - Dividends (unless included with shares)

d. Full - Paid shares

e. Matured shares

(2) Mortgage pledged shares.

Deduct - Delinquent dues (if carried)
Add - Dividends

2. The accountant should abide by the classifications set forth above as they are defined by the Standard Accounting Manual of the American Savings and Loan Institute. These definitions are accepted by the savings and loan business and by the Federal Home Loan Bank Board.

3. If the association is operating on a serial plan, the above distinction between free and mortgage pledged shares may not be appropriate because the value of shares is set forth according to series and the statement which records the progress of shares toward maturity merely indicates the number of free and of pledged shares in each series but does not compute the value of each class. In the lists of arrearages and of advance payments which are frequently used in such cases, the delinquencies or advances on free shares are scheduled with those on pledged shares. While it has not been customary to segregate these items, it is nevertheless considered to be advisable to do so because it is more informative. Mortgage pledged shares exist in an association which makes share account sinking fund loans.

4. In making an examination of share accounts, the following precautions should be taken:

(1) The general-ledger controls must be in agreement with the footings of the balances in the subsidiary ledgers.

(2) Confirmation of shareholders' accounts by direct communication is desirable.

(3) Such confirmation should include the accounts repurchased or withdrawn and matured during the period under review.

(4) Check the dividends paid or credited to shareholders during the period under review.

(5) Ascertain if the association has been paying the rate of dividend which most nearly conforms to its earnings.

DEPOSITS AND INVESTMENT CERTIFICATES

1. Where these exist they may be verified by direct confirmation letter forwarded to the depositor.

2. A list of such deposits should be obtained from the association and retained by the accountant. Interest accrued on such deposits should be checked by the accountant.

ADVANCES FROM FEDERAL HOME LOAN BANK AND OTHER BORROWED MONEY

These should be scheduled and confirmed by direct communication. Interest accrued thereon should be checked and likewise confirmed. It should be noted in the description of this item that such advances are secured in accordance with the Federal Home Loan Bank Act.

OTHER ASSETS AND OTHER LIABILITIES

Full details should be obtained and checked in connection with all miscellaneous assets. Pertinent data describing such items should be included in the comments of the accountant's report. The following liabilities should be scheduled and checked to the satisfaction of the accountant:

1. Mortgages on real estate owned.
    - (a) Accountant should confirm this item with mortgagee.
    - (b) List all information concerning the mortgage including date made, date due, name of mortgagee and amount.
    - (c) Check interest charges and interest accrued.
    - (d) If such a mortgage is not permitted by the state law under which the association is operating, the accountant should so advise the Board of Directors.

2. Dividends declared, unpaid and uncredited.
    - (a) Check authenticity of such dividends.
    - (b) Determine why they have neither been paid or credited.

3. Taxes accrued and unpaid on real estate owned.
    - (a) Obtain list of such items and compare with tax bills.
    - (b) These may be confirmed.
    - (c) In those cases where tax delinquencies existed prior to the Association's acquisition of the property and where it was acquired without foreclosure, a tax search should be recommended.

4. Accounts payable.

Ordinary obligations such as those incurred by any other business may result in trade accounts payable, particularly for expense bills rendered to the Association. These should be chedked in the manner prescribed by the bulletin, Examination of Financial Statements, published by the American Institute of Accountants.

5. Loans in process.

These include loans which have been approved but for which funds are either entirely or partially withheld. The minutes of the board and the cash advances made prior to the date of examination determine the liability.

6. Advance payments.

These comprise the following:

(a) Advance payments by borrowers for taxes and insurance (if carried separately).

(b) Unapplied mortgage credits.

Both of these classes may be confirmed by direct communication with borrowers. The source of each liability, however, can be traced through the cashbook. A list of such items should be prepared and retained by the accountant. Details, of course, should be reconciled with general-ledger balances.

PERMANENT, RESERVE OR GUARANTY STOCK

Wherever such stock exists, examine the stock records, the authorization for its issue by the Board of Directors, the propriety of the stock under state law. Confirmation by direct communication with shareholders is recommended.

DEFERRED CREDITS TO FUTURE OPERATIONS

This may include many different items, the most common of which will be (a) income collected in advance and (b) unearned profit on real estate sold.

The accountant should:

(1) Check mathematical accuracy of all computations.

(2) Ascertain the Association's policy as to the amortization of all such credits.

RESERVES

1. These are placed into two main groups with subordinate classes. Details of all changes in reserves for the current year should be included among the accountant's papers.

(a) Specific reserves.

    (1) For uncollected interest

    (2) For junior liens.

(b) General reserves.

    (1) Legal reserve.

    (2) Federal insurance reserve (if insured).

(3) Contingencies.

(4) Real estate.

2. While uncollected interest is included as an asset under First Mortgage Loans, conservative practice in the savings and loan business dictates that it should not be included as part of the association's undivided profits. The accountant should check the reserve with the total of uncollected interest receivable.

3. It is common practice to create a reserve in full for all junior liens. If this is the desire of the association's board, the accountant should call attention to the existence of any errors or omissions. If the reserves are obviously too low, the accountant should say so. The accountant, however, is not an appraiser and should not attempt to value real estate or mortgage loans.

4. Federal and state supervising authorities have legal requirements for creation of reserves. These must be adhered to and the accountant should see to it that such legal provisions are properly observed by the association.

5. If the association is insured, the accountant should ascertain if it has created the reserves required by Federal Insurance Corpcration.

6. Reserves for contingencies should be scrutinized not only to determine if they appear to be sufficient but also to ascertain if they are excessive.

7. Real-estate reserves should be created whenever the

appraisal values are lower than book values of real estate owned. The accountant should make use of up-to-date reports of competent appraisers in checking the amount of such reserve.

BONUS ON SHARES AND RESERVE FOR ESTIMATED DIVIDEND REQUIREMENTS

1. Bonus on shares is a portion of profits which was formerly available (in Federal Home Loan Bank Member Associations) for those shareholders who had established a prompt payment policy. Any increase or decrease in such bonus should be carefully examined by the accountant and checked with the Association's charter and with Federal Home Loan Bank practice.

2. The reserve for estimated dividend requirements is merely the ear-marking of an approximate portion of undivided profits which are to be made available to shareholders on the next dividend date.

UNDIVIDED PROFITS

1. Analyze undivided profits for the period covered by the examination. Reconcile the opening balance with the undivided profits in the previous balance-sheet.

2. Check dividends declared paid or credited to the minutes of the board of directors meetings.

3. The accountant should consider the propriety of all entries in the undivided-profits account.

STATEMENT OF OPERATIONS

GENERAL

1. The accountant should satisfy himself that the income received and the expenditures made are properly classified in so far as the facts are known to him or are ascertainable by reasonable inquiry. The extent of the examination of profit-and-loss operations during the period under examination is dependent upon the factors discussed at the beginning of section 3.

2. The statement should be prepared as nearly as possible along the lines set forth by the Federal Home Loan Bank Board. This form of statement is considered to be most informative by both management and supervising authority.

3. Comparative statements are recommended.

INCOME

1. Much of the auditing of the items of income would probably be covered in other parts of the program. Nevertheless the following outline is given here.

2. The main operating income of savings and loan associations consists of interest on mortgage loans. This item should be verified by an examination of each mortgage account and an actual check-up with the cash receipts to see that the payments have been received in accordance with the terms of the mortgage, or if the payments have not been received, that the amount not paid is set up as interest arrears.

3. Another item of interest income consists of interest on loans secured by the shares in the association. This should be treated in a similar manner.

4. Rents collected on properties owned make up a large item of income. This should be verified by examination of the record in connection with each particular property, checking back the monthly receipts of each tenant as indicated by the collector's duplicate receipt books or collector's monthly report. The monthly rent and the arrears of rent, if any, should be verified by direct confirmation with the tenant.

5. Other income consists of dividends or interest on investments, premiums on loans, appraisal fees, fines, membership fees, transfer fees, etc. These should be checked in the usual manner.

6. The non-operating income consists of dividends or apportioned profits retained on withdrawals, profit on sale of real estate, and profit on sale of investments. These, of course, should be checked in the usual manner.

EXPENSES

1. The expenses consist in part of the cost of operating the real estate, which at the present time would probably be a most important item. This item should be checked very carefully, every disbursement should be represented by a bank voucher or other appropriate voucher and should be checked to the invoice rendered

to the association, and each invoice should bear the approval of the manager of the real estate or the members of the special real-estate committee, depending upon the rules and regulations in the particular state.

2. Other important expenses consist of compensation to directors, officers and employees. These should be checked to see that proper authorization has been given by the board for the amounts paid. If the association owns its own building, there would be, of course, disbursements for its maintenance, which should be verified in the usual manner.

SECTION 4

Accountant's Report and Statements

The statement of condition, the statement of operations, reconcilement of undivided profits, and statement of reserves are set forth below in the form which has been found to be most acceptable to the examining division of the Federal Home Loan Bank Board and to students of accounting in the entire savings and loan field. The statements are rendered in sufficient detail to give all required information to the management and to the shareholders of the association under review. Condensed statements may of course be prepared for dissemination to the general public.

STATEMENT OF CONDITION Exhibit A

Name of Institution____________________________

as of close of business on____________, 193__

ASSETS

1. First mortgage loans:		
a. First mortgage direct reduction loans	$______	
b. First mortgage share account sinking fund loans	______	
c. First mortgage straight loans	______	
d. Accrued interest receivable on first mortgage loans (unless included above)	______	
e. Advances for taxes, insurance, etc., on first mortgage loans (unless included in above).	______	$______
2. Second mortgage loans:		
a. Second mortgage loans	$______	
b. Accrued interest receivable on second mortgage loans	______	
c. Advances for taxes, insurance, etc., on second mortgage loans	______	$______
3. Share loans:		
a. Loans secured by shares of this association	$______	
b. Loans on deposit accounts and certificates of investment	______	
c. Accrued interest receivable on items 3-a and 3-b (unlessincluded in 3-a and 3-b)	______	______
4. Other loans:		
a. Loans on all other security	$______	
b. Unsecured loans	______	
c. Accrued interest receivable on items 4-a and 4-b.	______	______
5. Real estate sold on contract:		
a. Real estate sold on contract	$______	
b. Accrued interest receivable on real estate sold on contract (unless included in 5-a)	______	
c. Advances for taxes, insurance, etc., on real estate sold on contract (unless included in 5-a)	______	______
6. Real estate owned (exclusive of office bldg.)		______
7. Real estate equitably owned (in dummy holder)		______
8. Real estate in judgment and subject to redemption		______
9. Investments:		
a. Stock in Federal Home Loan Bank	$______	

STATEMENT OF CONDITION (Cont'd.) Exhibit A (Cont'd.)

b. Federal Home Loan Bank Bonds		
c. U.S. Government obligations (including H.O.L.C.)		
d. Other investment securities		
10. Accrued interest receivable on investments		
11. Cash on hand and in banks		
12. Office building (if owned):		
a. Office building	$	
b. Less allowance for depreciation		
13. Furniture, etc.:		
a. Furniture, fixtures and equipment	$	
b. Less allowance for depreciation		
14. Deferred charges		
15. Other assets		
16. Current expenses		
17.		
18.		
TOTAL ASSETS		$

CAPITAL AND LIABILITIES

20. Repurchasable or free shares:		
a. Installment share dues credited	$	
Deduct - Delinquent dues (if carried)		
Sub-total	$	
Add - Dividends (unlessincluded in 20-a)		
Net free installment shares		$
b. Optional shares (payments and dividends)		
c. Prepaid shares	$	
Add - Dividends (unless included in 20-c)		
Net prepaid shares		
d. Full-paid shares		
e. Matured shares		
f.		
g.		
Total repurchasable or free shares		$
21. Mortgage pledged shares	$	
Deduct - Delinquent dues (if carried)		
Sub-total	$	
Add - Dividends		
Net mortgage pledged shares		

STATEMENT OF CONDITION (Cont'd.) — Exhibit A (Cont'd.)

22. Deposits, investment certificates (by classes);
   a. $
   b.
   c.
   d.

23. Interest accrued on item 22
24. Advances from Federal Home Loan Bank
25. Borrowed money:
   a. From banks and other associations $
   b. From others

26. Mortgages on real estate owned
27. Interest accrued on items 24, 25 and 26
28. Dividends declared, unpaid, and uncredited
29. Taxes accrued and unpaid on real estate owned
30. Accounts payable
31. Loans in process
32. Advance payments:
   a. Advance payments by borrowers for taxes and insurance (if carried separately) $
   b. Unapplied mortgage credits
33. Other liabilities
34. Permanent, reserve or guaranty stock
35. Deferred credits to future operations:
   a. For unearned profit on real estate sold
   b. For income collected in advance
   c.

36. Specific reserves:
   a. For uncollected interest $
   b. For junior liens
   c.

37. General reserves:
   a. Legal reserve $
   b. Federal insurance reserve (if insured)
   c. For contingencies
   d. Real estate reserve
   e.

38. Bonus on shares
39. Undivided profits
40. Reserve for estimated dividend requirements
41. Current earnings (if interim statement)

TOTAL CAPITAL AND LIABILITIES $

Exhibit B

STATEMENT OF OPERATIONS

Name of Institution ______________________________

	For the Year From 193 to 193		Previous Year Ended 193	
1. GROSS OPERATING INCOME:				
1. Interest				
a. On mortgage loans - ordinary cash collections	$ ____		$ ____	
b. On mortgage loans - all other	____		____	
c. On loans on shares, passbooks and certificates	____		____	
d. On real estate sold on contract	____		____	
e. On investments and bank deposits	____		____	
f. Other	____	$ ____	____	$ ____
2. Premium or commission on loans (current installment and amortizations only)		____		____
3. Appraisal fees, legal fees & initial service charges		____		____
4. Other fees and fines		____		____
5. Real estate operations				
a. Gross income from operation of real estate owned	$ ____		$ ____	
b. Less - Cost of repairs, taxes and maintenance	____		____	
Net income or loss from R.E.O. (Black or red)		____		____
6. Gross income from office building		____		____
7. Dividends				
a. On stock in Federal Home Loan Bank	$ ____		$ ____	
b. Other dividends	____	____	____	____
8. Miscellaneous operating income		____		____
9. Gross operating income		$ ____		$ ____

STATEMENT OF OPERATIONS (Cont'd.)

Exhibit B
(Cont'd.)

	For the Year From 193 to 193			Previous Year Ended 193		
II. LESS OPERATING EXPENSE						
10. Salaries, etc.						
a. Compensation to directors, officers, employees, etc.	$ ______			$ ______		
b. Collection expense (agents, etc.)	______	$ ______		______	$ ______	
11. Legal services - retainer, traveling expenses & special services		______			______	
12. Expense accounts of directors, officers and employees		______			______	
13. Rent, light, heat, etc.		______			______	
14. Office building expense (if owned,						
a. Repairs, taxes and maintenance of office building	$ ______			$ ______		
b. Depreciation of office building	______	______		______	______	
15. Furniture, fixtures and equipment, including depreciation		______			______	
16. Advertising		______			______	
17. Stationery, printing and office supplies		______			______	
18. Telegraph, telephone, postage and express		______			______	
19. Insurance and bond premiums		______			______	
20. Federal insurance premium (if insured)		______			______	
21. Audit		______			______	
22. Supervising examinations and assessments		______			______	
23. Organization dues		______			______	
24. Other operating expense		______			______	
25. Total operating expense			$ ______			$ ______

Exhibit B
(Cont'd.)

STATEMENT OF OPERATIONS (Cont'd.)

	For the Year From 193 to 193		Previous Year Ended 193	
III. Net Operating Income Before Interest and Other Charges		$______		$______
IV. LESS INTEREST CHARGES:				
26. On deposits, investments, certificates, etc. ______%	$______		$______	
27. On advances from Federal Home Loan Bank	______		______	
28. On borrowed money	______		______	
29. Total interest		______		______
V. Net Operating Income		$______		$______
VI. ADD NON-OPERATING INCOME:				
30. Dividends retained on repurchases and withdrawals	$______		$______	
31. Profit on sale of real estate	______		______	
32. Profit on sale of investments	______		______	
33. Other non-operating income	______		______	
34. Total non-operating income		______		______
VII. Net Income After Interest and Before Charges		$______		$______
VIII. LESS NON-OPERATING CHARGES (do not use lines herein for items charged direct to reserves):				
35. Foreclosure costs and back taxes on real estate acquired	$______		$______	
36. Loss on sale of real estate	______		______	
37. Loss on sale of investments	______		______	
38. Other non-operating charges	______		______	
39. Total non-operating charges		______		______
IX. Net Income for Period		$______		$______

RECONCILEMENT OF UNDIVIDED PROFITS

Exhibit C

	For the Year From 193 to 193			Previous Year Ended 193		
1. Balance at beginning of period			$			$
2. Add:						
(a) Net income for period (Item IX, Exhibit B)						
(b)						
(c)						
(d)						
(e)						
(f)						
(g)						
3. Total additions						
4. Totals of items 1 and 2			$			$
5. Deduct:						
(a) Additions to reserves -						
(1) For bonus on shares	$			$		
(2) Legal reserve						
(3) Federal insurance reserve						
(4) For contingencies						
(5) Real estate reserve						
(6)		$			$	
(b) Dividends (%)						
(c)						
(d)						
(e)						
(f)						
(g)						
6. Total deductions						
7. Balance at end of the period (Item 39, Exhibit A)			$			$

STATEMENT OF RESERVES

Exhibit D

	For the Year From ___ 193 to ___ 193		Previous Year Ended ___ 193	
Legal Reserve				
1. Balance at beginning of period		$____		$____
2. Additions during period:				
(a) From net profit	$____		$____	
(b)	____		____	
(c)	____		____	
(d)	____		____	
3. Total additions		____		____
4. Totals of items 1 and 2		$____		$____
5. Deductions during period				
(a)	____		____	
(b)	____		____	
(c)	____		____	
(d)	____		____	
(e)	____		____	
(f)	____		____	
(g)	____		____	
6. Total deductions		____		____
7. Balance at end of period		$____		$____
Federal Insurance Reserve				
1. Balance at beginning of period		$____		$____
2. Additions during period		____		____
3. Totals of items 1 and 2		$____		$____

STATEMENT OF RESERVES (Cont'd.)

Exhibit D
(Cont'd.)

	For the Year From 193 to 193		Previous Year Ended 193	
Federal Insurance Reserve (Cont'd.)				
4. Deductions during period:				
(a)	$		$	
(b)				
(c)				
5. Total deductions				
6. Balance at end of period		$		$
Reserve for Contingencies				
1. Balance at beginning of period		$		$
2. Additions during period:				
(a) From net profit	$		$	
(b)				
(c)				
(d)				
3. Total additions				
4. Totals of items 1 and 2		$		$
5. Deductions during period:				
(a)	$		$	
(b)				
(c)				
(d)				
(e)				
(f)				
(g)				
6. Total deductions				
7. Balance at end of period		$		$

Exhibit D
(Cont'd.)

STATEMENT OF RESERVES (Cont'd.)

	For the Year From 193 to 193		Previous Year Ended 193	
Real Estate Reserve				
1. Balance at beginning of period		$____		$____
2. Additions during period		____		____
3. Totals of items 1 and 2		$____		$____
4. Deductions during period:				
(a)	$____		$____	
(b)	____		____	
(c)	____		____	
(d)	____		____	
5. Total deductions		____		____
6. Balance at end of period		$____		$____
Other Reserves				
1. Balance at beginning of period		$____		$____
2. Additions during period:				
(a)	$____		$____	
(b)	____		____	
(c)	____		____	
3. Total additions		$____		$____
4. Totals of items 1 and 2		$____		$____
5. Deductions during Period:				
(a)	$____		$____	
(b)	____		____	
(c)	____		____	
(d)	____		____	

Exhibit D
(Cont'd.)

STATEMENT OF RESERVES (COnt'd.)

	For the Year From 193 to 193	Previous Year Ended 193
Other Reserves (Cont'd.)		
6. Total deductions		
7. Balance at end of period	$	$

Accountant's Report

The accountant's report in the audit or examination of a savings and loan association should embody the same principles as those recommended in the American Institute of Accountants bulletin, "Examination of Financial Statements." It should be concise, it should be fully explanatory and consequently should disclose all fiscal policies in use by the association under review. Qualifications, if any, should be reported clearly and concisely, and distinction should be made between comments which are intended to be merely informative and those which indicate dissent from the particular practices of the association.

The accountant should be cautious in making any statements which are not literally true or which might arouse unwarranted implications. A suggested form of accountant's report follows:

> To the Board of Directors of the
> A B C Savings and Loan Association:
>
> We have made an examination of the statement of condition of the A B C Savings and Loan Association as at December 31, 1937, and of the operating statement of income and expense for the year 1937. In our opinion, based upon such examination, the accompanying statements and related schedules clearly set forth, in accordance with accepted principles of accounting consistently maintained by the A B C Savings and Loan Association during the year under review, its position at December 31, 1937, and the results of its operations for the year then ended.

Notes

1. The above certificate would be appropriate only if the accounting for the year is consistent with that for the preceding year; if not, the nature of the change should be indicated.

2. The form of report must, of course, be modified when and as necessary to include any qualifications, reservations or explanations.

3. Specifically, the accountant should disclose the practice of the association in evaluating property charges taken into the real-estate account when a real-estate contract is forfeited. When accrued interest is added to the balance of the contract, is the amount of the accrued interest set up in the reserve for uncollected interest or is such interest included as income?

4. The accountant should disclose if the reserve for uncollected interest is credited when accrued interest receivable is set up on mortgage loans and such interest taken into income only when cash is received.

5. The accountant's comments should state the practice of the association in setting up the account for real estate owned, that is, has it been included at the cost or appraised value, whichever is lower at the date of acquisition and has the difference been carried in the reserve for loss on real estate owned?

6. Generally, there is no provision for depreciation on real estate acquired by an association except on its office building. The reasoning behind this is that real estate is part of the

investment account in the case of a savings and loan association and is not considered as fixed capital. If the association does depreciate real estate which has been acquired through foreclosure in the course of its regular lending operations, the accountant should disclose the practice.