

FEDERAL RESERVE BOARD

476

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

November 16, 1927
St. 5571.

SUBJECT: Bank Premises Accounting and
Functional Expense Reports.

Dear Sir:

On June 29 the Board forwarded to the Governor of each Federal reserve bank, for comment and recommendations, a report on bank premises accounting and functional expense reports submitted by representatives of six Federal reserve banks, who met with a representative of the Board at Chicago on June 2 and 3, 1927. After carefully considering the replies of the Governors, the Board has decided to approve the report, a copy of which is enclosed herewith, as submitted with the exception of recommendation 2A - Alterations for tenants. In lieu of recommendation 2A, the Board has approved the following: "The cost of repairs and alterations made for the use of tenants should be amortized against earnings (rent received) over the period of the lease for the premises affected, unless the amount involved is relatively small, in which case the cost may be charged directly against rent received. Rental commissions should be amortized over the period of the lease, unless paid monthly or of a relatively small amount, when they may be charged directly against rent received."

It will be appreciated if, before the closing of books at the end of the year, your bank will make any adjustments in its accounts which may be necessary in order that they may conform to the recommendations contained in the enclosed report as modified by the above-quoted substitute for section 2A. It is also requested that the cost of all alterations for tenants made during the present calendar year be handled in accordance with the above substitute for recommendation 2A.

Very truly yours,

Walter L. Eddy,
Secretary.

Enclosure.

LETTER TO GOVERNORS OF ALL F R BANKS

The Committee appointed to discuss certain questions in connection with accounting of bank premises and functional expense reports, met at the Federal Reserve Bank of Chicago on June 2nd and 3rd, 1927. The members of the Committee present were:

| | |
|--------------------|-------------------------------------|
| E. L. Smead, | Federal Reserve Board |
| L. R. Rounds, | Federal Reserve Bank of New York |
| M. J. Fleming, | Federal Reserve Bank of Cleveland |
| J. S. Walden, Jr., | Federal Reserve Bank of Richmond |
| J. H. Dillard, | Federal Reserve Bank of Chicago |
| F. C. Dunlop, | Federal Reserve Bank of Minneapolis |
| J. W. White, | Federal Reserve Bank of St. Louis |

The meeting was also attended by G. H. Wagner and A. C. Black, of the Federal Reserve Banks of Cleveland and Chicago, respectively.

Previous to the discussion of the specific topics referred to the Committee, Mr. James of the Federal Reserve Board, and Messrs. Heath, Blair and McKay of the Federal Reserve Bank of Chicago, discussed in a general way the subjects to be considered by the conference, and expressed their opinions regarding various phases of bank premises accounting.

After this informal discussion the Committee considered the following questions:

1. Should the annual depreciation allowances on bank buildings and on fixed machinery and equipment be set up as depreciation reserve or should they be actually charged off?

It was the consensus of opinion that the present procedure of carrying the annual depreciation allowances on buildings and on fixed machinery and equipment as a reserve be continued. The net results obtained under that plan or that of actually reducing the buildings and fixed machinery and equipment accounts each year are practically the same, but it was thought advisable to preserve the replacement cost of buildings and the cost of fixed machinery and equipment on the daily balance sheet of each bank, and deduct the reserve carried against each account showing the net result.

2. What should be the accounting procedure with reference to replacements of fixed machinery and equipment?

It was decided to continue crediting to the reserve account the annual depreciation allowances on fixed machinery and equipment, and to charge the cost of replacements less salvage, if any, to this reserve account. Should the cost of replacements materially exceed the cost of original equipment consideration should be given to the advisability of charging the excess cost to fixed machinery and equipment. When purchases of equipment not included in the original installation are made the cost of such items should be charged to fixed machinery and equipment account.

When the use of any fixed machinery and equipment is discontinued and is not replaced but sold for salvage, the original cost should be credited to fixed machinery and equipment account, and the difference between the original cost and the amount of salvage obtained should be charged to reserve for depreciation account.

Under ordinary conditions some of the Federal Reserve Banks will accumulate within the next ten years a reserve account equal to fixed machinery and equipment account. When they equal each other depreciation allowances should be discontinued until an increase in the fixed machinery and equipment account or a decrease in the reserve for depreciation account occurs. Provision should then be made for annual depreciation allowances in order to increase or restore the reserve account upon a fair depreciation basis.

The classification of certain items as replacements or as repairs and alterations was thoroughly discussed. The Committee appreciated the fact that the amount involved often affects to a great extent the classification determined, but it was the consensus of opinion that if a whole unit is replaced, such an item should usually be considered as a replacement even though the amount involved may seem small. Similar classification should be given to the replacement of part of a unit if the amount involved is large.

2 A - Alterations for tenants.

It was the consensus of opinion that the cost of repairs and alterations made for the use of tenants should be amortized over the period of the lease for the premises affected, as provided in the functional expense manual.

Mr. Dillard did not concur in this opinion, but recommended, in view of the fact/^{that} the cost of repairs and alterations for tenants does not add to the value of the building, that the cost of these items be charged to current expense, particularly if the amount is relatively small when compared with the amount of rent to be received; or if the expense incurred in making repairs and alterations for a tenant is large enough to materially affect the current expense account from a comparative standpoint, that this item be carried in a special account and charged direct to profit and loss at the end of the current year in the same manner that we now charge furniture and fixtures.

3. How much, if any, of the data shown in the functional expense reports is it advisable to make public?

It was the opinion of the Committee that it is not advisable to publish data with regard to functional expense reports, but the Committee appreciated the fact that this subject is a matter of policy, and makes no recommendation.

4. Are the indices shown in Memorandum St. 5359 dated May 7, 1927, from the Federal Reserve Board a satisfactory means of measuring the trend in operating efficiency of the Federal reserve banks?

The Committee thought that the indices presented showed a fairly good picture of the trend of expenses in the individual Federal reserve banks and that it would be worth while to prepare such information periodically. It was thought inadvisable to publish figures similar to those shown in the memorandum, but that the memorandum may be used as a basis for general discussion of the System's operating efficiency.

The suggestion to discontinue or simplify functional expense report Form E was presented to the Committee, and this subject was thoroughly discussed.

It was the opinion of each member of the Committee that the functional expense plan had undoubtedly accomplished many beneficial results, and although additional benefits might be derived from the comparison of expenses of the various Federal reserve banks, report Form E would probably not be as valuable in the future as it has been for the past few years.

All of the Federal reserve banks now have in operation a budget for expenses, and in some banks the budget plan has been in operation for some time with the result that as far as those individual banks are concerned the information obtained from the budget is adequate, but it was agreed that the system of budgeting expenses could not be substituted for the functional expense plan at this time.

It was also agreed that the work necessary for the preparation of Form E is a negligible item and its simplification would not provide much of a saving in labor.

It was likewise thought advisable to continue some form of functional expense report and, therefore, the Committee agreed that for the present the functional expense plan now in operation should be continued.

Respectfully submitted,

(signed) M. J. Fleming
L. R. Rounds
J. H. Dillard
F. C. Dunlop
J. W. White
J. S. Walden, Jr.