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## FIVE LESSONS FOR LENDERS FROM TAX AUDITS

Rule #1: Learn when to shut the heck up, blabbermouth!

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The recent passing of our national income tax return due date brought out many seasonal articles on tax matters. One dealing with what to do if you're audited resonated with me, as there are many suggestions and tips in common with situations many bankers face on a regular basis.

Here are the rules as set forth in a recent Wall Street Journal article on audits. See how many of them fit banking contexts too.

Rule 1: Stop Talking. Maybe all the tax man wants is a yes or no answer, while you respond with a ten-minute justification on not only what you did but why you did it.

This is good advice to bankers responding to attorneys' questions in depositions or in court testimony.

The rule here is "Don't volunteer information." It may not be what the questioner wanted-but could create an opening for more questions not otherwise within the original scope of the questioner's interest or quest.

This is also excellent advice for lenders responding to regulators' questions during safety and soundness exams.

Many examiners, like experienced attorneys, are skilled questioners, as well as skilled listeners. They can pick up on contradictions, inconsistencies, and defensive attitudes even if you don't intend to convey these things.

Those old enough to remember television's Sgt. Joe Friday should consider his laconic advice: "Just the facts, Ma'm."

Rule 2: Be humble. Tax agents and examiners are simply government employees who have a job to do. While you and I might occasionally become irked at one who seems to relish certain aspects of the job too much, he or she is still deserving of a basic respect.

Condescending attitudes are hard to conceal on the giving end-and very hard to abide if you're on the receiving end.

How many bank examinations have we seen go off track due to the personal chemistry gone bad?

This can involve an examiner, a banker, or even a management member. Courtesy and good manners are what are

expected and that will never get you or your bank into trouble.

Haughtiness or a "legend in one's own mind" demeanor is a one-way street in absolutely the wrong direction.

Rule 3: Don't rush to pay. This is a recommended strategy for tax audits, but it can apply to bankers too.

There's often an opportunity to negotiate with examiners on how severely a criticism will be written up. Calm, cautious, and full disclosure by the banker in a way that creates in the listener a sense of confidence that the banker understands his or her credit will soften many blows.

Not as many situations are as black or white as we might imagine. So some discussion that is informative and sensible can be very helpful in some circumstances.

Rule 4: Use documents. The tax man wants to see documentation-receipts, evidence of mileage, and the like.

How different is this from loan review or the bank examiners?

If an important piece of information is not in the file, then it's either an exception or it's possibly negative information.

I've been through more than one examination in a long career where the file reviewer (loan review, auditor, or examiner) took the position that if it's not in the file, it can't be considered.

This is a harsh conclusion. But we should anticipate these sorts of mini-confrontations and be proactive about documentation. It's easier to do on the front end than chasing around after the fact when the trail is cold or perhaps when your leverage over the buyer in terms of providing information has been impaired by a deteriorating credit situation.

Rule 5: Remember who's in control. The Wall Street Journal article concludes by reminding tax payers who are being audited that the burden is on you, not the other way around.

I find that it's the same with a credit review. It's a lender's job to keep the files in such a way that the story is material and complete to anyone who comes in and reviews it.

That's the standard and it's a hard one. But the more diligent each of us is day by day, then how much easier our job becomes when it is essential to assemble a credible story in a difficult environment.

A thought for due diligence in the third-person

As noted in a recent column, I've participated in a number of due diligence examinations of possible bank acquisitions, generally by participating in a detailed review of loan files.

My colleagues and I would run across comments and observations that we would share with each other during these reviews that would occasionally produce chuckles or outright laughter.

I wish I could remember them all, but here are a couple of examples:

Method of repayment: "In the usual fashion."

Source of repayment: "The sale of collateral, the source or location of which has yet to be determined."

The best advice for dealing with the tax man is also the best advice for dealing with bank auditors and examiners: Yes or no answers to questions, where possible; be courteous and polite; openness to some negotiation opportunities; document what you do as you do it; and remember who is in charge.

It's hard to fault this list or to improve on it whether you are being examined on your taxes or on your handling of a loan account.

About Ed O'Leary:

Veteran lender and workout expert O'Leary spent more than 40 years in bank commercial credit and related functions, working with both major banks as well as community banking institutions. He earned his workout spurs in the dark days of the 1980s and early 1990s in both oil patch and commercial real estate lending.

O'Leary began his banking career at The Bank of New York in 1964, and worked at banks in Florida, Texas, Oklahoma, and New Mexico. He served as a faculty member and thesis advisor at ABA's Stonier Graduate School of Banking for more than two decades, and served as long as a faculty member for ABA's undergraduate and graduate commercial lending schools.

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