

EITF ABSTRACTS

Issue No. 87-22

Title: Prepayments to the Secondary Reserve of the FSLIC

Dates Discussed: May 21, 1987; July 9, 1987; August 20, 1987

References: FASB Statement No. 5, *Accounting for Contingencies*
APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*
AcSEC Practice Bulletin 3, *Prepayments into the Secondary Reserve of the FSLIC and Contingencies Related to Other Obligations of the FSLIC*

ISSUE

Between 1962 and 1969, to increase the total amount of its cash reserves, the Federal Savings and Loan Insurance Corporation (FSLIC) required insured institutions to make annual prepayments of their regular future insurance premiums. The prepayment constituted a secondary reserve of the FSLIC for possible industry-wide losses of the FSLIC. The FSLIC also maintained a primary reserve, which was to be depleted before the secondary reserve would be charged with such losses.

In recent years, the FSLIC fund has encountered financial difficulty. The audit of the FSLIC as of December 31, 1986 reported a deficit of more than \$6 billion. Because of the financial condition of the FSLIC, the Federal Home Loan Bank Board, pursuant to Section 404(e) of the National Housing Act, eliminated the secondary reserve of the FSLIC as of December 31, 1986. Notification to member institutions was made in May 1987.

The issues are (1) what is the appropriate period in which the loss should be recognized by member institutions and (2) how the charge should be classified in the financial statements of the member institutions.

EITF DISCUSSION

The Task Force reached a consensus that savings and loan institutions should consider the impairment of the secondary reserve of the FSLIC as a Type 1 subsequent event. Accordingly, the write-off of amounts related to the secondary reserve should be recognized in the next issued financial statements. The Task Force also reached a consensus that the loss does not meet the criteria of Opinion 30 for classification as an extraordinary item and, therefore, the loss should be reported as a component of operating income. The Task Force acknowledged that separate disclosure of the loss may be warranted by individual institutions.

The Task Force also discussed potential legislation related to the FSLIC secondary reserve. At that time, a congressional joint conference committee was considering proposed legislation to recapitalize the FSLIC and agreed to include in that legislation a provision allowing those savings and loan associations that had an interest in the secondary reserve of the FSLIC to recover an amount equal to their December 31, 1986 balance in the secondary reserve. The manner in which the amount would be realized had not yet been determined at the time of that Task Force discussion. The Task Force acknowledged that it was premature to speculate on specific legislative provisions or whether any proposed legislation would result in an asset that could be recognized by a savings and loan association.

An FASB staff representative subsequently reported that, because of the time constraints faced by publicly held thrift institutions, the FASB staff was asked in early August by the Chief Accountant of the SEC to consider the accounting issues relating to legislation enacted in the Competitive Equality Banking Act of 1987. Form 10-Q for the quarter ended June 30, 1987 was required to be filed with the SEC by August 14, 1987, prior to the next scheduled meeting of the Task Force on August 20, 1987.

The scope of the FASB staff's review was limited solely to the determination of (1) whether the enacted legislation results in an asset as of the date of enactment and (2) the accounting by institutions that have not recorded the write-off of the secondary reserve.

The staff concluded that the enacted legislation does *not* result in an asset to be recognized by savings and loan institutions under generally accepted accounting principles. In addition, the staff supported the consensus reached by the Task Force that required institutions to write off amounts related to the FSLIC secondary reserve and to report it as a component of ordinary income rather than as an extraordinary item. Therefore, any institution that did not write off the secondary reserve balance in accordance with the Task Force consensus should do so.

The staff's conclusions were discussed at an open meeting of the Board on August 12, 1987. The Board did not object to the conclusions reached by the staff and authorized the staff to send a letter in response to the Chief Accountant of the SEC.

When the letter described above was discussed with the Task Force at the August 20, 1987 meeting, a Task Force member commented that certain industry constituents questioned the relative authority of the staff letter and whether that position is enforceable for nonpublic companies. The Task Force Chairman indicated that the letter to the SEC reflected a staff position, but the FASB staff would consider issuing a Technical Bulletin if the staff believes that sufficient divergence in practice would otherwise be present. The FASB Chairman noted that the Board unanimously concurred with the staff position. The SEC Observer indicated that the SEC staff reviewed the legislation independently and also concluded that the enacted legislation does not establish a recognizable asset. The Task Force agreed that the FASB staff letter resolved the issues discussed previously.

STATUS

In November 1987, the AICPA's Accounting Standards Executive Committee (AcSEC) issued Practice Bulletin 3, which concludes that thrift institutions should write off amounts related to prepayments to the FSLIC secondary reserve, that the loss does not meet the criteria of Opinion 30 for classification as an extraordinary item, and that unissued financial statements for periods prior to May 13, 1987 should reflect the loss as a Type 1 subsequent event. In addition, the Practice Bulletin concludes that institutions with notes receivable and other assets that represent rights against FSLIC should evaluate those assets for the likelihood of loss in accordance with Statement 5.

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) dissolved the FSLIC. As a result of this Act and current circumstances, AcSEC voted in June 1990 to withdraw Practice Bulletin 3.

Related issues were discussed in Topics No. D-47, "Accounting for the Refund of Bank Insurance Fund and Savings Association Insurance Fund Premiums," and No. D-57, "Accounting Issues Relating to the Deposit Insurance Funds Act of 1996." See Topics D-47 and D-57 for details regarding the related issues.

No further EITF discussion is planned.