

EITF ABSTRACTS

Issue No. 88-25

Title: Ongoing Accounting and Reporting for a Newly Created Liquidating Bank

Dates Discussed: November 17, 1988; January 12-13, 1989

References: FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*
FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*
FASB Staff Position FIN46-6, "Effective Date of FASB Interpretation No. 46"
APB Statement No. 4, *Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises*
AICPA Auditing Interpretation 8, *Reporting on Financial Statements Prepared on a Liquidation Basis of Accounting*, of Statement on Auditing Standards No. 2
AICPA Audit and Accounting Guide, *Audits of Investment Companies*
SEC Financial Reporting Release No. 16, *Uncertainty about an Entity's Continued Existence*
SEC Accounting Series Release No. 118, *Accounting for Investment Securities by Registered Investment Companies*
SEC Staff Accounting Bulletin No. 82, *Certain Transfers of Nonperforming Assets*

ISSUE

A bank with a substantial amount of nonperforming assets may transfer some or all of those assets to a newly created bank whose stock will be distributed to existing shareholders or to new investors. The newly created bank will be a liquidating bank; that is, it will manage the assets it receives and collect cash from loan repayments or dispositions of assets. All cash remaining after paying expenses and debt service, if any, will be distributed to the shareholders of the liquidating bank. The liquidating bank will likely be in the process of liquidation for several years.

The issues are:

1. Whether the ongoing financial statements of the liquidating bank should be presented on a historical cost, fair value, or lower-of-cost-or-market value basis of accounting

2. If the ongoing financial statements are presented on a fair value basis, whether the liquidating bank should continue to use the initial valuation method to determine reported asset and liability values in subsequent reporting periods
3. If the ongoing financial statements are presented on a fair value basis, whether the financial statements should recognize all unrealized changes in value or only negative unrealized changes in value.

EITF DISCUSSION

The Task Force reached a consensus that a liquidating bank should report assets and liabilities at fair values at the date of the financial statements and should recognize in the results of each current period subsequent decreases and increases in those values. [Note: See STATUS section.] The Task Force agreed that, in the absence of a change in facts and circumstances as to the anticipated timing and manner of disposition, the method used to develop the initial fair values should continue to be used for subsequent valuations. Task Force members noted that fair values provide users of financial statements with the most relevant information for a liquidating entity.

The SEC Observer noted that ASR 118 provides guidance, including language for the auditor's report, for what may be an analogous situation.

STATUS

On July 5, 1989, the SEC staff issued SAB 82, which expresses the SEC staff's views regarding the accounting for transfers of nonperforming assets by financial institutions, and disclosure of the impact of financial assistance from regulators. The SAB states that determining whether nonperforming assets have been disposed of in substance requires an assessment as to whether the risks and rewards of ownership have been transferred. The SEC staff believes that a transfer should not be accounted for as a sale or disposition if (1) the transfer of nonperforming assets to the new entity provides for recourse by the new entity to the transferor; (2) the financial institution directly or indirectly guarantees debt of the new entity in whole or in part; (3) the

financial institution retains a participation in the rewards of ownership of the transferred assets; or (4) the fair value of any material noncash consideration received by the financial institution cannot be reasonably estimated. Additionally, the SEC staff believes that accounting for the transfer as a sale or disposition generally is not appropriate where the financial institution retains rewards of ownership through the holding of significant residual equity interests or where third-party holders of such interests do not have a significant amount of capital at risk.

The SAB also states the SEC staff's belief that if a transaction is accounted for as a sale, the transfer should be recorded by the financial institution at the fair value of assets transferred. The SAB refers to the consensus reached in Issue 88-25 that the liquidating bank should report its assets and liabilities at fair values at the date of the financial statements.

Interpretation 46 and Interpretation 46(R) address consolidation by business enterprises of variable interest entities, which include corporations that are thinly capitalized or in which shareholders lack certain rights and obligations traditionally associated with corporate shareholders. Interpretation 46 and Interpretation 46(R) require a variable interest entity to be consolidated by an enterprise if that enterprise will absorb a majority of the entity's expected losses or is entitled to receive a majority of the entity's expected residual returns or both.

Interpretation 46 was issued in January 2003. The consolidation requirements of Interpretation 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period beginning after June 15, 2003. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established.

FSP FIN46-6 deferred the effective date for applying the provisions of Interpretation 46 for:

1. Interests held by a public entity in variable interest entities created before February 1, 2003, if the public entity has not issued financial statements reporting that interest in

accordance with Interpretation 46. The application of Interpretation 46 to those interests is deferred until the end of the first period ending after December 15, 2003.

2. Nonregistered investment companies accounting for their investments in accordance with the specialized accounting guidance in the investment company Guide.

Interpretation 46(R) was issued on December 24, 2003, and replaced Interpretation 46. An enterprise with an interest in an entity to which the provisions of Interpretation 46 were not applied as of December 24, 2003, must apply the effective date and transitions provisions in Interpretation 46(R) to that entity. Application by public companies of Interpretation 46 or Interpretation 46(R) to entities commonly referred to as special-purpose entities is required no later than as of the end of the first reporting period that ends after December 15, 2003. Public enterprises must apply Interpretation 46(R) to all entities no later than the end of the first reporting period that ends after March 15, 2004 (public enterprises other than small business issuers) or December 15, 2004 (small business issuers). Nonpublic enterprises must apply Interpretation 46(R) to entities created after December 31, 2003, immediately and to all other entities by the beginning of the first annual period beginning after December 15, 2004. An enterprise that has applied Interpretation 46 to an entity prior to the effective date of Interpretation 46(R) shall either continue to apply Interpretation 46 until the effective date of Interpretation 46(R) or apply Interpretation 46(R) at an earlier date.

No further EITF discussion is planned.