Financial Accounting Standards Board

April 15, 1987

The Honorable John D. Dingell, Chairman
Subcommittee on Oversight and Investigations
Committee on Energy and Commerce
2125 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Chairman:

In connection with your subcommittee's hearing to be held on April 23, 1987 to discuss differences between generally accepted accounting principles and regulatory accounting in the thrift industry, the Financial Accounting Standards Board (FASB) is pleased to submit this letter discussing FASB involvement in evaluating initiatives by regulators to establish regulatory accounting requirements that differ from generally accepted accounting principles.

On three occasions, July 22 and November 7, 1985 and April 24, 1986, representatives of the FASB have submitted statements or testified before your subcommittee on differences between generally accepted accounting principles and regulatory accounting. In addition, the staff of the FASB met with the staff of the subcommittee on June 7, 1985 to discuss these issues.

<u>Roles of Regulatory and General Purpose Financial Reporting</u>

The FASB's objective is to establish and improve standards for general purpose financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial information. Accounting standards are essential to the efficient functioning of the economy because decisions about the allocation of resources rely heavily on credible, concise, and understandable financial information. Business enterprises, including thrift institutions, that present financial statements that purport to be in accordance with generally accepted accounting principles must comply with the pronouncements of the FASB.

The development of different regulatory and general purpose reporting requirements has been a result of the differing needs and objectives of regulators and other users of financial information. The objective of general purpose financial statements is to provide useful, representationally faithful information to a wide group of investors, creditors, and other users. While recognizing that the special needs of regulators may differ from those of investors, creditors, and other users of general purpose financial statements, the FASB has consistently maintained that general purpose financial statements should be neutral and unbiased.

Many financial institutions provide users with financial statements prepared in accordance with generally accepted accounting principles. Still others furnish users with financial statements prepared in accordance with generally accepted accounting principles that include supplemental disclosure of certain amounts determined in accordance with regulatory accounting practices. However, some financial institutions provide users, including depositors, with only financial statements prepared in accordance with regulatory accounting practices.

If regulators require additional information or wish to have enterprises account for certain transactions in a manner differently than would be permitted under generally accepted accounting principles, the FASB believes that the resulting adjusted financial information should be furnished separately to regulators and should not be included in the basic financial statements. Financial statements furnished to the public must be prepared under common ground rules if users are to base economic decisions and actions on that financial information. Modifying financial statements--even if designed for only regulatory purposes--so that they are no longer a faithful representation of an enterprise's financial position and results of operations is likely to confuse or mislead users and impair the credibility of financial reporting by financial institutions.

<u>FASB actions on regulatory assistance proposals</u>

In the past, the FASB or its staff has reviewed and commented on a number of proposals by agencies to prescribe regulatory accounting practices to provide a means for enterprises to meet minimum capital adequacy requirements that would not be met under generally accepted accounting principles. FASB representatives also have testified before Congressional committees on the differences between generally accepted accounting principles and regulatory accounting. Each response has acknowledged that Congress and regulatory agencies have the authority, either through legislation or through their own volition, to modify or provide temporary or extended relief from existing laws and rules to tolerate financial conditions of regulated enterprises that in times of less economic stress might not be acceptable. However, the FASB has objected consistently to proposals to include in financial statements issued to or otherwise available to the public, representations that are not in accordance with generally accepted accounting principles because they would be confusing and misleading.

Many of the letters that are described on the following pages have been furnished previously to the subcommittee. In order for the public record to be complete, copies of all letters have been included as an appendix.

o In response to a proposed rule concerning the accounting for gains and losses from the sale of mortgage assets that was released for comment by the Federal Home Loan Bank Board (FHLBB) on August 13, 1981, Mr. J.T. Ball of the FASB staff in a letter dated September 11, 1981 discussed the FASB staff's views on this matter. In a letter dated September 16, 1981, FASB Chairman Donald J. Kirk indicated that the staff response had been discussed at the September 16, 1981 Board meeting and that the Board endorsed the views expressed in the staff letter.

o In response to a request from Mr. James O. Sivon, Minority Staff Director of the Committee on Banking, Finance and Urban Affairs of the U.S. House of Representatives, Mr. J.T. Ball of the FASB staff in a letter dated May 19, 1982 discussed the staff's conclusions on the provisions of the Net Worth Guarantee Act.

o Mr. J.T. Ball of the FASB staff in a letter dated October 12, 1982 responded to a proposed rule regarding amendments to net worth and statutory reserve requirements issued for comment by the FHLBB. Such proposed rules would have permitted a savings and loan association to include "Appraised Equity Capital" as an off-balance-sheet item in computing statutory reserves.

o In February 1983, the FASB issued FASB Statement No. 72, Accounting for Certain Acquisitions of Banking or Thrift Institutions, which addresses the accounting for regulatory-assisted business combinations. It also prescribes accounting for the amortization of intangible assets resulting from acquisitions of financial institutions in which the fair value of liabilities assumed exceeds the fair value of assets acquired.

- In response to a letter from the AICPA's Accounting Standards Executive Committee (AcSEC), Mr. J.T. Ball in a letter dated November 23, 1983 discussed the staff's conclusions on the net worth certificate program of the Federal Savings and Loan Insurance Corporation. The staff conclusions were considered and endorsed by the Board at its November 16, 1983 Board meeting.

- In response to a request from the staff of the Securities and Exchange Commission concerning the appropriate accounting for the issuance of an instrument termed a permanent income capital certificate (PICC), Mr. James J. Leisenring of the FASB staff in a letter dated March 28, 1986 discussed the FASB staff's views on this matter. In a letter dated March 28, 1986, FASB Chairman Donald J. Kirk indicated that the staff response had been discussed at the March 27, 1986 Board meeting and that the Board endorsed the views expressed in the staff letter. The staff letter was the basis for a portion of the FASB's April 24, 1986 testimony before your subcommittee.

- In response to a proposed rule concerning the definition of regulatory capital that was released for comment by the FHLBB on April 24, 1986, Mr. James J. Leisenring of the FASB staff in a letter dated July 29, 1986 discussed the staff's views on the proposed rule. In that letter, the FASB staff agreed with the proposed rule that would require thrift institutions to return to reporting in accordance with generally accepted accounting principles. To date, the proposed rule has not been adopted.

<u>Recent FASB actions regarding regulatory accounting</u>

In 1987, the FASB has responded to a number of Congressional initiatives designed to have financial institutions that are experiencing financial difficulty because of loan concentrations in certain troubled sectors of the economy modify their reporting to avoid timely recognition of losses that have been incurred.

- In response to proposed temporary regulations regarding the implementation of the provisions of the Farm Credit Act Amendments of 1986, Mr. James J. Leisenring of the FASB staff in a letter dated February 23, 1987 discussed the staff's views on the proposed regulations.

- In response to legislation proposed in H.R. 1063, the "Thrift Forbearance and Supervisory Reform Act," Mr. James J. Leisenring of the FASB staff in a letter dated March 11, 1987 to the Honorable Ronald L. Wyden and letters dated March 18, 1987 to the Honorable Fernand J. St Germain and to the

Honorable Steve Bartlett discussed the staff's views on this proposed legislation. On March 10, 1987, representatives of the FASB staff met with certain staff members and aides to members of the Committee on Banking, Finance and Urban Affairs to discuss with them the FASB's concerns regarding the proposed legislation.

- In response to legislation proposed in Amendment 51 to S. 790, the "Competitive Equality Banking Act of 1987," Mr. James J. Leisenring of the FASB staff in a letter dated March 31, 1987 to the Honorable William Proxmire discussed the staff's views on this proposed legislation.

- On April 2, 1987, Mr. James J. Leisenring of the FASB staff testified before the Subcommittee on International Finance and Monetary Policy of the Committee on Banking, Housing, and Urban Affairs of the United States Senate on certain aspects of accounting standards affecting Third World debt.

- In response to legislation proposed in S. 898, the "International Lending Institution Safety Act of 1987," Mr. James J. Leisenring of the FASB staff in letters dated April 14, 1987 to the Honorable William Proxmire and to the Honorable Phil Gramm discussed the staff's views on this proposed legislation.

The FASB is concerned about the growing propensity of the Congress to consider legislation that would permit or require financial institutions experiencing difficulty to modify their reporting so as to avoid timely recognition of losses. If the intent of Congress in such legislation is to permit the continued operation of financial institutions that do not meet previously defined requirements for capital adequacy, the FASB believes that objective is better achieved through amending those requirements or forbearing supervisory action to enforce the requirements rather than through modifications to financial statements.

The FASB is concerned about the need to maintain the credibility of financial reporting. The discipline of financial reporting and the resulting financial statements are used by numerous segments of society as a basis for economic decisions and actions. Investors and creditors use individual financial statements as a basis for decisions about individual entities. Government departments and regulatory agencies use both individual financial statements and aggregate statistics compiled from financial statements in making policy and regulatory decisions. Thus, the financial reporting system and the resulting financial statements play an important role in the efficient functioning of the nation's capital markets. Financial statements must have the primary characteristic of neutrality to be effective. If the financial reporting system were to lose its neutrality, or to be perceived as having lost it, the effectiveness of the system would be diminished because the resultant financial information would be suspect.

If you would like to discuss these matters further, please contact me. The members and staff of the FASB would be most willing to meet with you or your staff to discuss our concerns.

Very truly yours,

Dennis R. Beresford

Dennis R. Beresford
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