127052

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Examination Of The Federal Deposit Insurance Corporation's Financial Statements For The Years Ended December 31, 1984 And 1983

GAO examined the financial statements of the Federal Deposit Insurance Corporation for the years ended December 31, 1984 and 1983. The examinations were made in accordance with generally accepted government auditing standards.

The Corporation has acquired $2.1 billion of poor quality loans and related assets, as part of financial assistance provided to Continental Illinois National Bank and Trust Company of Chicago, and may acquire an additional $1.4 billion of such troubled loans. The Corporation has not yet estimated the collectibility of these loans and the financial statements disclose no provision for loss. The Corporation acknowledges that collection of the acquired loans is subject to significant uncertainties because of financially troubled borrowers and the effects of general economic conditions on their industries. GAO believes that a significant amount of the loans already acquired will not be collectible. Continental Bank has estimated the Corporation will lose from $551 to $774 million on the acquired loans.

In GAO's opinion, except for the lack of a reserve for losses on the troubled loans acquired from Continental Bank, the financial statements present fairly the financial position of the Corporation as of December 31, 1984 and 1983, the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles.

127052

GAO/AFMD-85-58
MAY 29, 1985

032160

Request for copies of GAO reports should be sent to:

U.S. General Accounting Office
Document Handling and Information
Services Facility
P.O. Box 6015
Gaithersburg, Md. 20877

Telephone (202) 275-6241

The first five copies of individual reports are free of charge. Additional copies of bound audit reports are $3.25 each. Additional copies of unbound report (i.e., letter reports) and most other publications are $1.00 each. There will be a 25% discount on all orders for 100 or more copies mailed to a single address. Sales orders must be prepaid on a cash, check, or money order basis. Check should be made out to the "Superintendent of Documents".

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-114831

To the President of the Senate and the
Speaker of the House of Representatives

This report transmits our opinion on the Federal Deposit Insurance Corporation's financial statements for the years ended December 31, 1984 and 1983. We believe that a significant amount of the $2.1 billion of poor quality loans acquired from Continental Illinois National Bank and Trust Company of Chicago will not be collectible. The 1984 statements should, but do not provide for this loss. Appendix I is our report on the Corporation's system of internal accounting controls, and appendix II is our report on the Corporation's compliance with laws and regulations. The Comptroller General is required to audit the financial transactions of government corporations under 31 U.S.C. 9105, and we conducted our examinations in accordance with generally accepted government auditing standards.

The Federal Deposit Insurance Corporation is an independent agency created by the Banking Act of 1933 to protect deposits in the nation's banks, to help maintain confidence in the banking system, and to promote safe and sound banking practices. The Corporation also is a mixed ownership government corporation under 31 U.S.C. 9102(2)(c).

We are sending copies of this report to the Director of the Office of Management and Budget, the Secretary of the Treasury, and the Board of Directors of the Federal Deposit Insurance Corporation.

Milton J. Socolar

Acting Comptroller General
of the United States

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-114831

May 3, 1985

To the Board of Directors
Federal Deposit Insurance
Corporation

We have examined the statements of financial position of the Federal Deposit Insurance Corporation as of December 31, 1984 and 1983, and the related statements of income and the deposit insurance fund, and of the changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As described further in note 4 to the accompanying financial statements, during 1984 the Corporation acquired $2.1 billion of nonperforming, classified, or otherwise poor quality loans and related assets and it may acquire an additional $1.4 billion more of such troubled loans as part of an assistance program to Continental Illinois National Bank and Trust Company of Chicago. The Corporation has not yet estimated the ultimate collectibility of these loans, and the financial statements have no provision for loss. The Corporation acknowledges that collection of the acquired loan portfolio is subject to significant uncertainties because of financially troubled borrowers and the effects of general economic conditions on their industries. We agree and further believe that a significant amount of the loans already acquired will not be collectible. Continental Bank, as administrator for the Corporation, has estimated the losses on the loans acquired to date by the Corporation will range from $551 to $774 million. Further, the Corporation is committed to provide additional capital or other assistance should it become necessary. The success of the current assistance program with Continental Bank has not been determined, and the financial statements have no provision for any further assistance that may become necessary.

In our opinion, except for the effects on the 1984 financial statements of not establishing an allowance for loss related to the poor quality loans acquired from Continental Bank, as discussed in the preceding paragraph, the financial statements referred to above present fairly the financial position of the Federal Deposit Insurance Corporation as of

December 31, 1984 and 1983, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Milton J. Socolar

Acting Comptroller General
of the United States

Appendixes

REPORT ON INTERNAL ACCOUNTING CONTROLS

We have examined the Federal Deposit Insurance Corporation's financial statements for the years ended December 31, 1984 and 1983, and have issued our opinion thereon. As part of our examinations, we made a study and evaluation of the system of internal accounting controls to the extent we considered necessary to evaluate the system as required by generally accepted government auditing standards. This report pertains only to our study and evaluation of internal accounting controls for the year ended December 31, 1984. (Our report on the system of internal accounting control for the year ended December 31, 1983 is presented in GAO/AFMD-84-41, 6/14/84.) For the purpose of this report, we have classified the significant internal accounting controls in the following categories:

--assessments cycle,
--assistance to problem banks cycle,
--expenditures cycle,
--financial reporting cycle,
--investments cycle, and
--payroll cycle.

Our study included all of the control categories listed above. However, we did not evaluate the accounting controls over assistance to problem banks, financial reporting, and investments because it was more efficient to expand our substantive audit tests. The purpose of our study and evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the Corporation's financial statements. Our study and evaluation was more limited than would be necessary to express an opinion on the system of internal accounting controls taken as a whole or on any of the categories of controls identified above.

The Corporation's management is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that (1) assets are safeguarded against loss from unauthorized use or disposition and (2) transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of the inherent limitations in any system of internal accounting control, errors or irregularities may nevertheless occur and not be detected. Also, projections of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation was made for the limited purpose described in the first paragraph and would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of internal accounting control of the Corporation taken as a whole or on any of the categories of controls identified in the first paragraph. However, our study and evaluation disclosed no condition that we believed to be a material weakness.

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

We have examined the financial statements of the Federal Deposit Insurance Corporation for the years ended December 31, 1984 and 1983, and have issued our opinion thereon. Our examinations were made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures, including tests of compliance with laws and regulations, as we considered necessary in the circumstances. This report pertains only to our review of compliance with laws and regulations for the year ended December 31, 1984. (Our report on compliance with laws and regulations for the year ended December 31, 1983 is presented in GAO/AFMD-84-41, 6/14/84.)

In our opinion, the Corporation complied with the terms and provisions of laws and regulations for the transactions tested that could have materially affected the financial statements.

Nothing came to our attention in connection with our examination that caused us to believe that the Corporation was not in compliance with the terms and provisions of applicable laws and regulations for those transactions not tested.

FEDERAL DEPOSIT INSURANCE CORPORATION
STATEMENTS OF FINANCIAL POSITION
(In thousands)

	December 31 1984	December 31 1983
ASSETS:		
CASH	$ 4,158	$ 88,785
INVESTMENT IN U.S. TREASURY OBLIGATIONS (Note 2)	14,436,286	13,992,059
OTHER ASSETS, principally accrued interest receivable on investments	393,944	393,080
CERTIFICATES AND NOTES RECEIVABLE FROM INSURED BANKS (Note 3)	560,883	423,641
ASSETS ACQUIRED IN ASSISTANCE TO AN INSURED BANK (Note 4)	4,457,429	-0-
ASSETS ACQUIRED FROM FAILURES OF INSURED BANKS (Note 5)	2,143,540	1,992,029
PROPERTY AND BUILDINGS (Note 6)	41,701	36,969
TOTAL ASSETS	$22,037,941	$16,926,563

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements.

FEDERAL DEPOSIT INSURANCE CORPORATION
STATEMENTS OF FINANCIAL POSITION
(In thousands)

	December 31 1984	1983
LIABILITIES AND THE DEPOSIT INSURANCE FUND:		
ACCOUNTS PAYABLE, ACCRUED LIABILITIES AND ESCROW FUNDS	$ 100,478	$ 79,581
NET ASSESSMENT INCOME CREDITS DUE TO INSURED BANKS (Note 7):		
Available July 1, 1985	67,548	-0-
Available July 1, 1984	-0-	164,039
LIABILITIES INCURRED IN ASSISTANCE TO INSURED BANKS (Note 8)	3,848,342	-0-
LIABILITIES INCURRED FROM FAILURES OF INSURED BANKS (Note 9)	859,641	1,253,763
TOTAL LIABILITIES	4,876,009	1,497,383
DEPOSIT INSURANCE FUND	17,161,932	15,429,180
TOTAL LIABILITIES AND THE DEPOSIT INSURANCE FUND	$22,037,941	$16,926,563

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements.

APPENDIX III

FEDERAL DEPOSIT INSURANCE CORPORATION
STATEMENTS OF INCOME AND THE DEPOSIT INSURANCE FUND
(In thousands)

	For the year ended December 31 1984	1983
INCOME:		
Gross assessments earned	$ 1,322,587	$ 1,215,817
Provision for assessment credits	68,548	164,903
Net assessments earned	1,254,039	1,050,914
Interest on U.S. Treasury obligations	1,495,378	1,404,325
Interest on notes receivable	111,730	65,065
Interest on assets in liquidation	168,580	90,462
Other income	2,243	17,161
TOTAL INCOME	3,031,970	2,627,927
EXPENSES AND LOSSES:		
Administrative operating expenses	151,201	135,660
Merger assistance losses and expenses	197,559	127,486
Provision for insurance losses (Notes 3, 5, and 10)	933,374	675,119
Nonrecoverable insurance expenses (Note 11)	17,084	31,426
TOTAL EXPENSES AND LOSSES	1,299,218	969,691
NET INCOME	1,732,752	1,658,236
DEPOSIT INSURANCE FUND - January 1	15,429,180	13,770,944
DEPOSIT INSURANCE FUND - December 31	$17,161,932	$15,429,180

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements.

APPENDIX III

FEDERAL DEPOSIT INSURANCE CORPORATION
STATEMENTS OF CHANGES IN FINANCIAL POSITION
(In thousands)

	For the year ended December 31 1984	1983
FINANCIAL RESOURCES WERE PROVIDED FROM:		
Operations:		
Net income	$ 1,732,752	$1,658,236
Add (deduct) items not involving cash in the period:		
Amortization of U.S. Treasury obligations	18,104	(59,961)
Loss on sale of U.S. Treasury obligations	982	-0-
Depreciation on buildings	977	897
Income maintenance agreement adjustments	80,753	1,418
Amortization of merger assistance agreements	40,131	51,315
Provision for insurance losses	933,374	675,119
Resources provided from operations	2,807,073	2,327,024
Other resources provided from:		
Maturity and sale of U.S. Treasury obligations	3,755,184	4,346,245
Collections on notes receivable	2,528,119	375,619
Collections on assets acquired from failures of insured banks	1,701,734	611,849
Liabilities incurred in assistance to insured banks	3,848,342	-0-
Liabilities incurred from failures of insured banks	-0-	698,565
Decrease (increase) in cash	84,627	(87,450)
Other decreases (increases)	20,033	(61,013)
TOTAL FINANCIAL RESOURCES PROVIDED	$14,745,112	$8,210,839
FINANCIAL RESOURCES WERE APPLIED TO:		
Purchase of U.S. Treasury obligations	$ 4,218,497	$5,025,978
Acquisition of notes receivable	2,848,342	218,998
Assets acquired in assistance to an insured bank	4,457,429	-0-
Assets acquired from failures of insured banks	2,603,638	2,442,851
Additions to property and buildings	5,709	3,713
Decrease (increase) in net assessment income credits due to insured banks	96,491	(67,858)
Payments on liabilities incurred in failures of insured banks	515,006	587,157
TOTAL FINANCIAL RESOURCES APPLIED	$14,745,112	$8,210,839

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements.

FEDERAL DEPOSIT INSURANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 1984 AND 1983

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

General. These statements do not include accountability for assets and liabilities of closed insured banks for which the Corporation acts as receiver or liquidating agent. Periodic and final accountability reports of its activities as receiver or liquidating agent are furnished by the Corporation to courts, supervisory authorities, and others as required.

U.S. Treasury Obligations. Securities are shown at amortized cost which is the purchase price of securities less the amortized premimum or plus the accreted discount. Such amortizations and accretions are computed on a daily basis from the date of acquisition to the date of maturity. For the year ended December 31, 1984, the Corporation changed from the straight-line method to the constant-yield method. This change did not have a material effect on net income.

Deposit Insurance Assessments. The Corporation assesses insured banks at the rate of 1/12 of one percent per year on the bank's average deposit liability less certain exclusions and deductions. Assessments are due in advance for each six-month period and credited to income each month. The Depository Institutions Deregulation and Monetary Control Act of 1980 authorized a percentage of net assessment income to be transferred to insured banks each July 1 of the following calendar year to 60 percent. Additionally, the Act authorized the FDIC Board of Directors to make adjustments to this percentage within certain limits in order to maintain the Deposit Insurance Fund between 1.25 and 1.40 percent of estimated insured deposits. If this ratio falls below 1.10 percent, the FDIC is mandated to reduce the percentage of net assessment income distributed to a limit of 50 percent. If this ratio exceeds 1.40 percent, the FDIC is mandated to increase the percentage of net assessment income distributed by such an amount as it determines will result in maintaining that ratio at not more than 1.40 percent.

Allowance for Losses. The Corporation establishes an estimated allowance for loss at the time a bank fails. These allowances are reviewed every six months and adjusted as required, based on financial developments which occur during each six-month period. The Corporation does not state its estimated contingent liability for unknown future bank closings because such estimates are impossible to make. The Corporation's contingent liability for eventual net losses depends upon factors which cannot be assessed until or after a bank has actually failed. The Corporation's entire Deposit Insurance Fund and borrowing authority are available, however, for such contingencies.

Depreciation. The Washington Office Buildings are depreciated on a straight-line basis over a 50-year estimated life. The San Francisco Condominium Offices are depreciated on a straight-line basis over a 35-year estimated life. The cost of furniture, fixtures, and equipment is expensed at time of acquisition.

Income Maintenance Agreements. The Corporation records its liability under an income maintenance agreement at the present value of each estimated cash outlay at the time the agreement is accepted. Estimated cash outlays are anticipated future payments the Corporation will provide to offset the difference between the annualized cost of funds and the annualized return on the declining volume of earning assets acquired in a merger transaction, plus an amount to cover overhead costs. The charge is recorded to insurance loss. The present value of the liability is then accreted daily and recorded monthly over the term of the agreement. Any differences between the estimated and actual cash outlays are recorded as payment adjustments. The present value of remaining estimated cash outlays is also reviewed and adjusted each year when interest rate changes occurring in the marketplace appear material or permanent in nature. The originally recorded loss, plus or minus any payment and present value adjustments, will then be prorated between insured banks and the Deposit Insurance Fund as provided in Section 7(d) of the Federal Deposit Insurance Act.

Reclassifications. Reclassifications have been made in the 1983 Financial Statements to conform to the presentation used in 1984.

2. U.S. TREASURY OBLIGATIONS:

All cash received by the Corporation which is not used to defray operating expenses or for outlays related to assistance to banks and liquidation activities is invested in U.S. Treasury securities. The Corporation's investment portfolio consist of the following (in thousands):

		December 31, 1984		December 31, 1983	
Maturity	Description	Book Value	Market Value	Book Value	Market Value
One Day	Special Treasury Certificates	$ 759,127	$ 759,127	$ 484,331	$ 484,331
Less Than 1 Year	U.S.T. Bills, Notes and Bonds	2,209,252	2,226,362	1,886,210	1,884,915
1-3 Years	U.S.T. Notes and Bonds	6,186,261	6,239,531	4,985,240	4,975,485
3-5 Years	U.S.T. Notes and Bonds	5,281,646	5,216,021	5,781,924	5,621,113
5-10 Years	U.S.T. Notes and Bonds	-0-	-0-	854,354	779,366
		$14,436,286	$14,441,041	$13,992,059	$13,745,210

3. CERTIFICATES AND NOTES RECEIVABLE FROM INSURED BANKS:

The Corporation's outstanding principal balances on certificates and notes receivable from insured banks are as follows (in thousands):

	December 31 1984	1983
Certificates:		
Net worth certificates	$348,342	$ -0-
Allowance for losses	(182,981)	-0-
	$165,361	-0-
Notes receivable to:		
Assist operating banks	27,000	27,000
Facilitate deposit assumptions	93,374	120,993
Facilitate merger agreements	275,148	275,648
	$560,883	$423,641

The net worth certificate program was established at the FDIC by authorization of the Garn-St Germain Depository Institutions Act of 1982. Under this program, the Corporation would purchase a qualified institution's net worth certificate and, in a non-cash exchange, the Corporation would issue its non-negotiable promissory note of equal value. The total assistance outstanding to qualified institutions as of December 31, 1984 and 1983 is $578,791,000 and $376,866,000 respectively. As of December 31, 1984, the Corporation has recorded $348,342,000 of net worth certificates for which an allowance for losses of $182,981,000 is estimated. The financial statements exclude $230,449,000 of net worth certificates for which no losses are expected because of the non-cash exchange nature of the transactions.

4. ASSETS ACQUIRED IN ASSISTANCE TO AN INSURED BANK:

On July 26, 1984, the FDIC, the Federal Reserve Board, the Comptroller of the Currency and a group of major U.S. banks agreed to provide a "permanent assistance program" to the Continental Illinois National Bank and Trust Company of Chicago ("CINB") and its parent, Continental Illinois Corporation. This program, which became effective on September 26, 1984 after Continental Illinois Corporation shareholder approval, replaced a temporary, emergency assistance package among the same parties that had been in effect since May 1984. Major elements of the new package included a financial assistance plan to remove problem loans from CINB and infuse new capital resources into CINB, the continuation of on-going lines of credit from the Federal Reserve Board and a group of major U.S. banks to alleviate liquidity pressures and the installation of a new management team. Additionally, the FDIC agreed to commit more capital or other forms of assistance if the permanent assistance program proves to be insufficient for any reason.

4. ASSETS ACQUIRED IN ASSISTANCE TO AN INSURED BANK: (Continued)

The key aspects of the permanent assistance program applicable to the FDIC are embodied in an Implementation Agreement and an Assistance Agreement between the FDIC and CINB, Continental Illinois Corporation, and Continental Illinois Holding Corporation, a new holding company formed to own all Continental Illinois Corporation stock as of the effective date for the purpose of implementing the FDIC Option (described below). Discussed below are the major aspects of the FDIC's participation in the permanent assistance program and their effect on the FDIC financial statements.

The assets acquired by the FDIC in assistance to CINB on the commencement date and as of year end are as follows (in thousands):

	(Commencement Date) September 26, 1984	December 31, 1984
Loans and related assets purchased	$2,000,000	$2,010,313
Promissory note	1,500,000	1,447,116
Preferred stock investment	1,000,000	1,000,000
	$4,500,000	$4,457,429

Loans acquired were selected by CINB with the restrictions that such loans were nonperforming, classified or otherwise of poor quality (i.e., "troubled loans"). Certain foreign loans were excluded from selection. On September 26, 1984, after consumation of the permanent assistance program, CINB transferred $2.0 billion of troubled loans to the FDIC. The unpaid legal principal value of these loans was approximately $3.7 billion.

Also, on September 26, 1984, the FDIC received a promissory note from CINB for $1.5 billion. At CINB's option, the promissory note can be paid anytime within three years by transfer of additional troubled loans (subject to the above restrictions) at CINB's book value as of the date of transfer. Until such time as the promissory note is paid, interest will be charged. As of December 31, 1984, CINB transferred $52,844,000 of additional troubled loans to the FDIC as partial repayment on the original promissory note. As a result, the remaining unpaid principal balance on the note is $1,447,116,000.

The purchase of these assets was, in part, funded by the assumption of $3.5 billion of indebtedness to the Federal Reserve Bank of Chicago (FRB) on behalf of CINB. These borrowings will bear interest at specified rates established by the FRB and the U.S. Treasury. The FDIC will repay these borrowings by making quarterly remittances of its collections, less expenses, on the troubled loans. If there is a shortfall at September 26, 1989, the FDIC will make up such deficiency with its own funds.

4. <u>ASSETS ACQUIRED IN ASSISTANCE TO AN INSURED BANK:</u> (Continued)

The Implementation Agreement provides for the FDIC to be reimbursed each quarter for its expenses related to administering the transferred loan portfolio and for interest paid on the indebtedness to the FRB which it assumed. Thus, such costs are recorded as assets. The FDIC and CINB have entered into a service agreement whereby CINB will administer the transferred loan portfolio on behalf of the FDIC. The FDIC is also permitted to establish a special reserve account from troubled loan collections. The balance in this account, if any, reverts to the FDIC in those quarters when loan collections have been insufficient to cover interest owing on the indebtedness which it assumed. For financial accounting purposes, cash collections received on the transferred loan portfolio (plus certain other amounts) are applied quarterly in accordance with the Implementation Agreement terms, as follows: 1) to the administrative expenses paid by the FDIC; 2) to the interest owing on the assumed indebtedness; 3) to fund the special reserve account such that this account plus accrued interest thereon is at least $75 million; and 4) to principal owing under the FRB Agreement. The FDIC is entitled to receive interest on the cumulative deficiencies between cash collections and the costs incurred in administering the troubled loans and the interest on the assumed debt. Further, CINB has assigned to the FDIC all its existing and future claims against any party which may be related to any loss incurred in connection with any transferred loan.

Total cash flow consists of the above collections of principal and interest on the transferred loan portfolio, interest payments on the CINB promissory note and interest earned on daily collections. As of December 31, 1984, the FDIC received cash flow totaling $147,044,000. Cash flow was applied to administrative costs and interest expense of $3,224,000 and $94,564,000 respectively, and to establish a special reserve account balance of $49,256,000. Accordingly, total FDIC obligations for purposes of exercising the FDIC option (discussed below) are $3.457 billion. The collection results during this period should not necessarily be considered indicative of the ultimate loan portfolio collectibility.

Ultimate collection results on the transferred loan portfolio are subject to significant uncertainties because of the financially troubled nature of the borrowers and the effects of general economic conditions on their industries. Due to the number and complexity of the loans within the transferred loan portfolio, an estimate of the ultimate collectiblity has not been completed by the FDIC. Accordingly, no determination has been made as to whether or not any allowance for loss related to the CINB permanent assistance program is necessary. Consequently, none has been recorded in the financial statements for the year ended December 31, 1984. The Corporation expects to complete its initial determination of the estimated net realization on the transferred loan portfolio during 1985.

4. ASSETS ACQUIRED IN ASSISTANCE TO AN INSURED BANK: (Continued)

The FDIC holds an option to acquire up to 40.3 million shares of Continental Illinois Corporation common stock. The shares subject to the option are owned by Continental Illinois Holding Corporation, which is owned by the former stockholders of Continental Illinois Corporation. The option cannot be exercised prior to the fifth anniversary of the commencement date, September 26, 1989. Further, the option is excercisable only if the FDIC suffers a loss (disregarding any profit or loss from the FDIC's interest in Continental Illinois Corporation preferred or common stock) on the transferred loan portfolio, including unrecovered administrative costs and interest expense. If the FDIC suffers a loss, the FDIC will be entitled to retain any remaining transferred loans and to exercise the FDIC Option for one share of Continental Illinois Corporation common stock for every $20 of loss, at the exercise price of $0.00001 per share of common stock. No value has been assigned to the FDIC's right to exercise this option as of December 31, 1984. If the FDIC does not suffer any loss under the permanent assistance program, all remaining loans and other assets acquired will be returned to CINB and the option would not be exercisable.

The FDIC also purchased $1 billion of two non-voting, Continental Illinois Corporation, preferred stock issues. The proceeds of these issues were transferred to CINB in the form of a capital contribution. The Junior Perpetual Convertible Preference Stock, in the amount of $720 million, is convertible into 160 million shares of Continental Illinois Corporation common stock upon sale or transfer by the FDIC. Dividends are to be received on this preferred stock only to the extent that dividends are paid on the Continental Illinois Corporation common stock and are equivalent to that which would be paid on 160 million shares of common stock. The Adjustable Rate Preferred Stock, Class A, in the amount of $280 million, is a cumulative issue that is callable at the option of Continental Illinois Corporation. The issuer also has the option to pay dividends on this issue in the form of additional shares of this issue or cash until the third anniversary of their original issue date.

5. ASSETS ACQUIRED FROM FAILURES OF INSURED BANKS:

Assets acquired from failures of insured banks are as follows (in thousands):

	December 31 1984	December 31 1983
Depositors' claims paid	$ 731,288	$ 413,748
Depositors' claims unpaid	6,815	7,048
Loans and assets purchased in a fiduciary capacity	3,088,354	2,494,059
Assets purchased in a corporate capacity	377,219	386,917
	4,203,676	3,301,772
Allowance for losses	(2,060,136)	(1,309,743)
	$2,143,540	$1,992,029

5. ASSETS ACQUIRED FROM FAILURES OF INSURED BANKS: (Continued)

An analysis of the changes in the allowance for losses by account groups is as follows (in thousands):

	Depositors' claims paid	Loans and assets purchased in a: Fiduciary capacity	Corporate capacity	Total
1984				
Balance, January 1	$175,832	$ 727,362	$406,549	$1,309,743
Provision for insurance losses	(17,775)	810,036	(41,868)	750,393
Write-off at termination	-0-	-0-	-0-	-0-
Balance, December 31	$158,057	$1,537,398	$364,681	$2,060,136
1983				
Balance, January 1	$ 58,352	$213,536	$362,744	$ 634,632
Provision for insurance losses	117,480	513,826	43,805	675,111
Write-off at termination	-0-	-0-	-0-	-0-
Balance, December 31	$175,832	$727,362	$406,549	$1,309,743

6. PROPERTY AND BUILDINGS:

Property and buildings consist of (in thousands):

	December 31 1984	1983
Land	$ 4,014	$ 4,014
Office buildings	43,025	37,316
Accumulated depreciation	(5,338)	(4,361)
	$41,701	$36,969

The Corporation's 1776 F street property is subject to notes payable totaling $10,926,000 and $11,224,000 at December 31, 1984 and 1983, respectively.

7. ASSESSMENT CREDITS DUE INSURED BANKS:

Contingent upon a legislatively specified ratio of the Corporation's Deposit Insurance Fund to estimated insured bank deposits, the Corporation credits a legislatively authorized percentage (currently 60 percent) of its net assessment income to insured banks. This credit is distributed, pro-rata, to each insured bank as a reduction of the following year's assessment. Net assessment income is determined by gross assessments less administrative operating expenses and expenses and losses related to insurance operations.

The Garn-St Germain Depository Institutions Act of 1982 amended Section 7(d)(1) of the Federal Deposit Insurance Act and authorized the Corporation to include certain lending costs in the computation of the net assessment income. The lending costs are the amounts by which the amount of interest earned on each loan made by the Corporation under Section 13 of the Federal Deposit Insurance Act after January 1, 1982, is less than the amount of interest the Corporation would have earned for the calendar year if interest had been paid on the loans at a rate equal to the average current value of funds to the U.S. Treasury for the calendar year.

The computation and distribution of net assessment income credits for calendar year 1984 and 1983 are as follows (in thousands):

1984 Net Assessment Income Credits Due Insured Banks - July 1, 1985

Computation:		
Gross assessment income - C.Y. 1984		$1,319,170
Less: Administrative operating expenses	$151,201	
Merger assistance losses and expenses less amortization and accretion	135,383	
Provision for insurance losses	933,374	
Nonrecoverable insurance expenses	17,084	
Lending costs	-0-	1,237,042
Net assessment income		$ 82,128
Distribution:		
40% to the Deposit Insurance Fund	$32,851	
60% to insured banks	49,277	$ 82,128
Assessment credit due insured banks:		
Assessment credit - C.Y. 1984		$ 49,277
Assessment credits - prior years		18,271
Total credits due, July 1, 1985		$ 67,548

Effective rate of assessment for C.Y. 1984: 1/12.5 of 1% of total assessable deposits
Percent of total credits due insured banks: 5.12048% of gross assessments

APPENDIX III

7. ASSESSMENT CREDITS DUE INSURED BANKS: (Continued)

1983 Net Assessment Income Credits Due Insured Banks - July 1, 1984

Computation:		
Gross assessment income - C.Y. 1983		$1,211,440
Less: Administrative operating expenses	$135,660	
Merger assistance losses and expenses less amortization and accretion	90,123	
Provision for insurance losses	675,119	
Nonrecoverable insurance expenses	31,426	
Lending costs	8,640	940,968
Net assessment income		$ 270,472
Distribution:		
40% to the Deposit Insurance Fund	$108,189	
60% to insured banks	162,283	$ 270,472
Assessment credit due insured banks:		
Assessment credit - C.Y. 1983		$ 162,283
Assessment credits - prior years		1,756
Total credits due, July 1, 1984		$ 164,039

Effective rate of assessment for C.Y. 1983: 1/14 of 1% of total assessable deposits
Percent of total credits due insured banks: 13.54086% of gross assessments

8. LIABILITIES INCURRED IN ASSISTANCE TO INSURED BANKS:

The Corporation's outstanding principal balances on liabilities incurred in assistance to insured banks are as follows (in thousands):

	December 31	
	1984	1983
Federal indebtedness	$3,500,000	$ -0-
Promissory (exchange) notes	348,342	-0-
	$3,848,342	-0-

9. LIABILITIES INCURRED FROM FAILURES OF INSURED BANKS:

The Corporation's outstanding principal balances on liabilities incurred from failures of insured banks are as follows (in thousands):

	December 31 1984	1983
Federal indebtedness	$442,667	$ 811,666
Notes payable	222,813	242,293
Income maintenance agreements	187,346	192,756
Depositor's claims unpaid	6,815	7,048
	$859,641	$1,253,763

10. PROVISION FOR INSURANCE LOSSES:

An analysis of the provision for insurance losses is as follows (in thousands):

	December 31 1984	1983
Provision for insurance losses:		
Net worth certificates		
Current year provision	$182,981	$ -0-
Assets acquired from failures of insured banks		
Current year provision	283,219	122,450
Prior year adjustments	467,174	552,661
Termination adjustments	-0-	8
	750,393	675,119
	$933,374	$675,119

11. NONRECOVERABLE INSURANCE EXPENSES:

The Corporation's nonrecoverable insurance expenses primarily represent costs associated with (1) preparing and executing the activity in payoff cases and (2) administering and liquidating the assets purchased in a corporate capacity. As of December 31, 1984 and 1983, nonrecoverable insurance expenses included $13,136,000 and $25,211,000, respectively, of interest expense incurred on the Federal Reserve Bank of New York indebtedness related to the administering and liquidating of assets purchased in a corporate capacity.

12. LEASE COMMITMENTS:

Rent for office premises charged to administrative operating and liquidation overhead expenses were $11,947,000 (1984) and $7,393,000 (1983). Minimum rentals for each of the next five years and for subsequent years thereafter are as follows (in thousands):

1985	1986	1987	1988	1989	1990/Thereafter
$15,870	$12,385	$11,189	$9,696	$6,763	$42,278

Most office premise lease agreements provide for increase in basic rentals resulting from increased property taxes and maintenance expense.

13. RETIREMENT PLAN:

All permanent, full-time and part-time employees of the FDIC are covered by the contributory Civil Service Retirement Plan. The Corporation makes bi-weekly contributions to the plan equal to the employee's bi-weekly contributions. The retirement plan expenses incurred for calendar years 1984 and 1983 were $7,634,000 and $7,073,000 respectively.

(916864)

31314.

AN EQUAL OPPORTUNITY EMPLOYER

UNITED STATES
GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

OFFICAL BUSINESS
PENALTY FOR PRIVATE USE $300

BULK RATE
POSTAGE & FEES PAID
GAO
PERMIT No. G100