



FEDERAL RESERVE BANK OF DALLAS

2200 N. PEARL ST.
DALLAS, TX 75201-2272

March 19, 2004

Notice 04-14

TO: The Chief Executive Officer of each member bank, bank holding company, foreign banking organization, and others concerned in the Eleventh Federal Reserve District

SUBJECT

Interagency Update on Accounting for Loan and Lease Losses

DETAILS

The Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Office of Thrift Supervision, and National Credit Union Administration have issued an interagency statement titled *Update on Accounting for Loan and Lease Losses*.

This statement

- describes recent developments in accounting for the allowance for loan and lease losses (ALLL), and
- identifies current sources of generally accepted accounting principles (GAAP) and supervisory guidance, which should be used by financial organizations in determining the ALLL and associated provisions for loan losses.

ATTACHMENTS

A copy of the Board's SR letter 04-05 dated March 1, 2004, and a copy of the interagency statement are **attached**.

MORE INFORMATION

For more information, please contact Dorsey Davis, Banking Supervision Department, at (214) 922-6051. For additional copies of this Bank's notice, contact the Public Affairs Department at (214) 922-5254 or access District Notices on our web site at www.dallasfed.org/banking/notices/index.html.



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 04-5
March 1, 2004

**TO THE OFFICER IN CHARGE OF SUPERVISION AND APPROPRIATE SUPERVISORY
AND EXAMINATION STAFF AT EACH FEDERAL RESERVE BANK AND TO
DOMESTIC AND FOREIGN BANKING ORGANIZATIONS SUPERVISED BY THE
FEDERAL RESERVE**

SUBJECT: Interagency Update on Accounting for Loan and Lease Losses

The Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Office of Thrift Supervision, and National Credit Union Administration (the agencies) have issued the attached interagency [Update on Accounting for Loan and Lease Losses](#) (statement). This statement describes recent developments in accounting for the allowance for loan and lease losses (ALLL). In addition, the statement identifies current sources of generally accepted accounting principles (GAAP) and supervisory guidance, which should be used by financial organizations in determining the ALLL and associated provisions for loan losses.¹

Last month, the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA) decided to limit the scope of its project to provide ALLL guidance. Going forward, the project will focus on improving ALLL disclosures. Consistent with these actions by AcSEC, banking organizations, as well as examiners and other supervisory staff, are reminded that financial institutions should continue to follow existing GAAP and supervisory guidance when determining the ALLL.

Reserve Banks are asked to distribute this SR letter and the attached statement to senior management of state member banks, bank holding companies, and foreign banking organizations supervised by the Federal Reserve, as well as to supervisory and examination staff. Questions pertaining to this letter should be directed to Charles Holm, Deputy Associate Director, at (202) 452-3502 or Linda Ditchkus, Project Manager, at (202) 452-3506, in the Accounting Policy & Disclosure section.

Richard Spillenkothen
Director

[Attachment](#)

Cross reference: SR letters [SR 01-17](#), [SR 99-22](#), [SR 99-13](#), and [SR 93-70](#)

Notes:

1. For additional guidance on the ALLL and the associated provisions, refer to [SR letter 01-17](#) Final Interagency Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation, [SR letter 99-22](#) Joint Interagency Letter on the Loan Loss Allowance, [SR letter 99-13](#) Recent Developments Regarding Loan Loss Allowances, and [SR letter 93-70](#) Interagency Policy Statement on the Allowance for Loan and Lease Losses.

UPDATE ON ACCOUNTING FOR LOAN AND LEASE LOSSES¹

Purpose and Background

This guidance addresses recent developments in accounting for loan and lease losses and provides an update on the status of the proposed Statement of Position, “Accounting for Credit Losses” (SOP), issued by the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA). Because an assessment of the appropriateness of the allowance for loan and lease losses (ALLL) is critical to the safety and soundness of a financial institution, this issuance also provides a listing of the existing allowance guidance that financial institutions should continue to apply.

Financial institutions are reminded of their responsibility for ensuring that controls are in place to consistently determine the ALLL in accordance with generally accepted accounting principles (GAAP), the institution’s stated policies and procedures, and relevant supervisory guidance. To fulfill this responsibility, financial institutions should develop, maintain, and document a comprehensive, systematic, and consistently applied process to determine the amounts of the ALLL and provisions for loan and lease losses. Consistent with longstanding supervisory guidance, financial institutions must maintain an ALLL at a level that is appropriate to absorb estimated credit losses inherent in the loan and lease portfolio. Arriving at such an allowance involves a high degree of management judgment and results in a range of estimated losses. Accordingly, prudent, conservative, but not excessive, loan loss allowances that represent management’s best estimate from within an acceptable range of estimated losses are appropriate.

Status of the Proposed SOP

In June 2003, AcSEC issued the proposed SOP for public comment. The issuance resulted from work over several years to clarify accounting guidance for loan and lease losses. The proposed SOP received a great deal of attention among bankers, auditors, regulators, and others who wrote nearly 300 comment letters to AcSEC. The Agencies expressed concerns over the proposed guidance, as did many other commenters. After carefully reviewing these comment letters, AcSEC decided, at its January 2004 meeting, to proceed only with guidance to improve disclosures. AcSEC’s Allowance Task Force will evaluate existing ALLL disclosure requirements and disclosure recommendations received through the recent comment process and will present a list of recommended disclosure enhancements at AcSEC’s April 2004 meeting.

¹ This guidance is being issued jointly by the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA) (the “Agencies”).

AcSEC also decided to submit to the Financial Accounting Standards Board (FASB) its recommendation that the accounting for loan losses (Statement of Financial Accounting Standards No. 5, “Accounting for Contingencies”) be reconsidered.²

As a result of these decisions, it appears that AcSEC will not issue additional loss recognition and measurement guidance for the ALLL. Consequently, financial institutions should continue to determine the appropriateness of their ALLL on the basis of the existing guidance set forth in GAAP and in the Agencies’ supervisory guidance. The Agencies also anticipate issuing supplemental guidance regarding the ALLL.

Current Guidance

The listing below presents the current sources of GAAP and supervisory guidance for accounting for the ALLL. Institutions and examiners should refer to the actual sources for complete guidance.

- Statement of Financial Accounting Standards No. 5, “Accounting for Contingencies” (March 1975)
- Securities and Exchange Commission (SEC) Accounting Series Release No. FR-28 (Article 9, Section 401.09), “Accounting for Loan Losses by Registrants Engaged in Lending Activities” (December 1986)
- Statement of Financial Accounting Standards No. 114, “Accounting by Creditors for Impairment of a Loan” (May 1993)
- Interagency Policy Statement on the ALLL³ (December 1993)
- Emerging Issues Task Force (EITF) Topic D-80, “Application of FASB Statements No. 5 and 114 to a Loan Portfolio” (May 1999)
- Joint Interagency Letter to Financial Institutions⁴ (July 1999)
- AICPA Audit and Accounting Guides⁵:
 - Banks and Savings Institutions, Chapter 7, “Credit Losses” (May 2000)
 - Credit Unions, Chapter 6, “Allowance for Loan Losses” (May 2000)
- FFIEC Policy Statement on ALLL Methodologies and Documentation for Banks and Savings Institutions (July 2001)
- SEC Staff Accounting Bulletin No. 102, “Selected Loan Loss Allowance Methodology and Documentation Issues” (July 2001)
- NCUA Interpretative Ruling and Policy Statement 02-3, “Allowance for Loan and Lease Losses Methodologies and Documentation for Federally Insured Credit Unions” (May 2002)

² This recommendation, if adopted by the FASB, is likely to be a longer-term project.

³ Jointly issued by the FDIC, FRB, OCC, and OTS.

⁴ Jointly issued by the SEC, FDIC, FRB, OCC, and OTS.

⁵ A new Audit and Accounting Guide for Depository and Lending Institutions that replaces the separate guides for banks and savings institutions, credit unions, and finance companies will be issued in 2004.