Allowance for Loan and Lease Loss (ALLL) Policy

The ALLL Policy sets forth a framework of procedures and guidelines to be followed in the management of the ALLL.

The credit union should be in compliance with FAS 5: Accounting for Contingencies and FAS 114: Accounting by Creditors for Impairment of a Loan when evaluating loans for potential loss. The Board of Directors is responsible for ensuring that controls are in place to determine the appropriate level of the ALLL at your credit union. The ALLL process must be thorough, disciplined and consistently applied, and must incorporate management's current judgments about the credit quality of the loan portfolio.

More Information on FAS 5 and FAS 114

Under GAAP, Statement of Financial Accounting Standards No. 5*, Accounting for Contingencies* (FAS 5), provides the basic guidance for recognition of a loss contingency, such as the collectability of loans (receivables), when it is probable that a loss has been incurred and the amount can be reasonably estimated. Statement of Financial Accounting Standards No. 114*, Accounting by Creditors for Impairment of a Loan* (FAS 114) provides more specific guidance about the measurement and disclosure of impairment for certain types of loans. Specifically, FAS 114 applies to loans that are identified for evaluation on an individual basis. Loans are considered impaired when, based on current information and events, it is probable that the creditor will be unable to collect all interest and principal payments due according to the contractual terms of the loan agreement.

For individually impaired loans, FAS 114 provides guidance on the acceptable methods to measure impairment. Specifically, FAS 114 states that when a loan is impaired, a creditor should measure impairment based on the present value of expected future principal and interest cash flows discounted at the loan's effective interest rate, except that as a practical expedient, a creditor may measure impairment based on a loan's observable market price or the fair value of collateral, if the loan is collateral dependent. When developing the estimate of expected future cash flows for a loan, a credit union should consider all available information reflecting past events and current conditions, including the effect of existing environmental factors. FAS 114 deals with individual classification of large-balance, non-homogeneous loans, which for credit unions will predominantly consist of business and agricultural loans.

Large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment are *not* included in the scope of FAS 114. Such groups of loans may include, but are not limited to, credit card, residential mortgage, and consumer installment loans. FAS 5 addresses the accounting for impairment of these loans. Also, FAS 5 provides the accounting guidance for impairment of loans that are not identified for evaluation on an individual basis

Contact me at 518-420-2108 or by email at elis@edwardlis.com for additional assistance.

Further information regarding this topic is available online at Edwardlis.com ALLL

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