University of Mississippi

eGrove

Issues Papers

American Institute of Certified Public Accountants (AICPA) Historical Collection

1986

Accounting for estimated credit losses on loan portfolios; Issues paper (1986 February 14)

American Institute of Certified Public Accountants. Task Force on Accounting for Loan Origination Fees and Initial Direct Costs

Follow this and additional works at: https://egrove.olemiss.edu/aicpa_iss

Part of the Accounting Commons, and the Taxation Commons

Recommended Citation

American Institute of Certified Public Accountants. Task Force on Accounting for Loan Origination Fees and Initial Direct Costs, "Accounting for estimated credit losses on loan portfolios; Issues paper (1986 February 14)" (1986). *Issues Papers*. 56.
https://egrove.olemiss.edu/aicpa_iss/56

This Book is brought to you for free and open access by the American Institute of Certified Public Accountants (AICPA) Historical Collection at eGrove. It has been accepted for inclusion in Issues Papers by an authorized administrator of eGrove. For more information, please contact egrove@olemiss.edu.

File 3450
February 14, 1986

ISSUES PAPER 86 -1

Accounting for Estimated Credit Losses on Loan Portfolios

Prepared by
Task Force on Accounting for Loan
Origination Fees and Initial Direct Costs
Accounting Standards Division
American Institute of Certified Public Accountants

830484

1 2 3 4 5 6 7 8 9 0 AccS 8 9 8 7 6

NOTE

Issues papers of the AICPA's accounting standards division are developed primarily to identify financial accounting and reporting issues the division believes need to be addressed or clarified by the Financial Accounting Standards Board. Issues papers present neutral discussions of the issues identified, including reviews of pertinent existing literature, current practice, and relevant research, as well as arguments on alternative solutions. Issues papers normally include advisory conclusions that represent the views of at least a majority of the Institute's Accounting Standards Executive Committee (AcSEC).

Issues papers do not establish standards of financial accounting enforceable under Rule 203 of the Institute's Code of Professional Ethics. They are sent to the FASB for their consideration.

The accounting standards division (212-575-6369) can provide information to interested parties concerning actions the FASB has taken on this paper.

Introduction

1. The AICPA accounting standards division issues paper, "Accounting for Nonrefundable Fees of Originating or Acquiring Loans and Acquisition Costs of Loan and Insurance Activities," sent to the FASB on September 21, 1983, was drafted by the Task Force on Accounting for Loan Origination Fees and Initial Direct Costs. The task force members were selected from AICPA industry committees and task forces that deal with particular types of financial institutions, namely, banks, savings and loan associations (S&Ls), credit unions, finance companies, mortgage bankers, and insurance companies. The task force approach was based on the view that accounting for similar transactions of those institutions should be comparable based on the substance of those transactions rather than the type of financial institution.

2. That issues paper discusses issues related to accounting for loan origination fees, commitment fees, and loan acquisition costs. In preparing the paper, the task force did not address how accounting for credit losses relates to the issues dealt with in the paper. When the FASB staff raised the question of whether credit losses should be deemed acquisition costs, the task force decided to consider the accounting for estimated credit losses in a separate issues paper.

Scope

3. This issues paper addresses issues relating to accounting for estimated credit losses of certain loan portfolios held by business enterprises including banks, S&Ls, credit unions, finance companies, mortgage bankers, REITs, and insurance companies. Specifically, the scope of this paper is limited to issues concerning loan portfolios of such business enterprises for which the total amount of credit losses can be reasonably estimated when loans are made. For example, if a bank could estimate total credit losses on its consumer loans portfolios but not on its commercial loan portfolios, the paper would apply to the bank's consumer loans portfolios. The question of which types of portfolios are susceptible to such estimation is a factual issue not dealt with in this paper.

4. The issues paper applies to all such loan portfolios held by an enterprise except for those resulting from the sale of goods or services by any entity within the reporting group. For purposes of the paper, the reporting group does not include affiliates owned 50 percent or less, accounted for under the equity method. That scope would

- exclude such loan portfolios resulting from the sale of goods or services by members of the reporting group,
- include all such loan portfolios in the separate financial statements of a finance subsidiary, and
- include such loan portfolios held by members of the reporting group not resulting from sales of goods or services by a member of the reporting group.

5. The paper does not address issues on methods of computing estimated credit losses once principles for their recognition have been established, though diverse methods are discussed in the background sections of the paper. Further, this paper does not deal with credit losses of insurance policy issuances and pertains only to lending activities of insurance companies.

Relevant Literature and Current Practice

6. The FASB and AICPA literature on accounting for credit losses of financial institutions includes the following:

FASB Pronouncements

- FASB Statement No. 5, Accounting for Contingencies.
- FASB Statement No. 13, Accounting for Leases.
- FASB Statement No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings.
- FASB Statement No. 17, Accounting for Leases-Initial Direct Costs.
- FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises.
- FASB Statement No. 65, Accounting for Certain Mortgage Banking Activities.

AICPA SOPs, Guides, and Proposed Guides

- AICPA Statement of Position 75-2, Accounting Practices of Real Estate Investment Trusts.
- AICPA Audit and Accounting Guide, Audits of Savings and Loan Associations.
- AICPA Audit and Accounting Guide, Audits of Banks.
- AICPA Audit and Accounting Guide, Audits of Finance Companies.

- Proposed AICPA Audit and Accounting Guide for Credit Unions.

AICPA Issues Papers

- Accounting for Nonrefundable Fees of Originating or Acquiring Loans and Acquisition Costs of Loan and Insurance Activities (September 20, 1983).[1]
- Accounting for Installment Lending Activities of Finance Companies (June 25, 1981).
- Accounting for the Inability to Fully Recover the Carrying Amounts of Long Lived Assets (July 15, 1980).
- Accounting for Allowances for Losses on Certain Real Estate and Loans and Receivables Collateralized by Real Estate (June 21, 1979).

Notice to Practitioners

Accounting for Foreign Loan Swaps (May 27, 1985).

---

[1]The FASB issued an Invitation to Comment based on this issues paper, added a project on nonrefundable loan fees and costs to its agenda, and issued an exposure draft, "Accounting for Nonrefundable Fees and Costs Associated with Originating and Acquiring Loans."

FASB Statement No. 5

7. FASB Statement No. 5, Accounting for Contingencies, comprises the present authoritative literature underlying current practice in accounting for credit losses in all industries. The Statement does not require identification of specific receivables that have become uncollectible for recognizing losses. Appendix A of that Statement (paragraph 22) states that

> Losses from uncollectible receivables shall be accrued when both conditions in paragraph 8 are met. Those conditions may be considered in relation to individual receivables or in relation to groups of similar types of receivables. If the conditions are met, accrual shall be made even though the particular receivables that are uncollectible may not be identifiable.

Paragraph 8 of that Statement requires that

> An estimated loss from a loss contingency (as defined in paragraph 1) shall be accrued by a charge to income if both of the following conditions are met:
>
> a) Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.
>
> b) The amount of loss can be reasonably estimated.

Paragraph 23 of the Statement explains how to determine whether the conditions in paragraph 8 have been met:

> If, based on available information, it is probable that the enterprise will be unable to collect all amounts due and, therefore, that at the date of its financial statements the net realizable value of the receivables through collection in the ordinary course of business is less than the total amount receivable, the condition in paragraph 8(a) is met because it is probable that an asset has been impaired. Whether the amount of loss can be reasonably estimated (the condition in paragraph 8(b)) will normally depend on, among other things, the experience of the enterprise, information about the ability of individual debtors to pay, and appraisal of the receivables in light of the current economic environment.

8. Diverse financial institutions use various methods and approaches to apply the requirements of FASB Statement No. 5 to credit losses resulting from their lending activities. Generally, the methods and approaches based on financial institution literature and practice tend to emphasize the adequacy of the allowance for losses as of the balance sheet date rather than the amount and timing of credit losses that should be charged to income. The task force is unaware of any studies that have explored whether those methods and approaches strictly conform to the requirements of FASB Statement No. 5.

Finance Companies

9. The finance companies guide discusses two types of credit losses: (1) expected losses based on factors such as type of receivable and loan experience and (2) losses that occur because of unexpected factors or adjustments to original predictions of expected credit losses.

10. In practice, a finance company develops a percentage based on its loss experience to apply to the amount of consumer loans when the loans are made. The resulting amount of credit loss is recognized as an expense immediately as loans are made, offset by an allowance for losses to reduce the carrying amount of the receivables. However, finance companies tend to use diverse methods for recognizing credit losses on commercial loans. Some finance companies use methods based on loss experience similar to those used with consumer loans. Other finance companies consider methods based on loss experience to be too difficult and unreliable for use in recognizing credit losses when commercial loans are made. Those companies recognize credit losses on commercial loans based on management judgment and reviews of individual loans as the potential for specific losses arises. Still other finance companies recognize credit losses on

commercial loans based on a combination of loss experience and individual loan reviews.

11. The finance companies guide describes three acceptable methods of accounting for finance revenue: the effective yield method, the combination method, and the pro rata with transfer method. The calculation of estimated credit losses affects recognition of finance revenue under two of those three methods.

12. <u>Effective Yield Method</u>. The effective yield method of finance revenue recognition is the most prevalent method used by finance companies. It relates the amount of revenue earned to the unpaid loan balance. Under that method, no portion of revenue is recognized to offset acquisition costs, and an allowance for credit losses is established by a charge to operations when the loan is made. Therefore, the calculation of estimated credit losses has no effect on recognition of finance revenue under this method. The result is to depress reported net income in periods of growth and accelerate reported income in periods of contraction when compared to the two alternative methods described below.

13. <u>Combination Method</u>. The combination method of finance revenue recognition relates revenues from loans to three factors.

A portion of the finance revenue is recognized when loans are made equal to the estimated direct and indirect acquisition costs per loan, including anticipated credit losses computed as a percentage of the face amounts of loans. Calculation of estimated credit losses therefore affects the amount of finance revenue recognized under the combination method when loans are made. The remaining finance revenue is recognized on a pro rata or straight line method to the degree it relates to servicing, collection, and other operating costs and on the effective yield method to the degree it relates to the cost of borrowed funds and profit before income taxes.

14. Pro Rata with Transfer Method. Under the pro rata with transfer method, a portion of finance revenue is recognized when loans are made equal to direct out of pocket acquisition costs and anticipated credit losses. Therefore, as under the combination method, calculation of expected credit losses affects the amount of finance revenue recognized under the pro rata with transfer method when loans are made. The remaining amounts of finance revenue are recognized as revenue in relation to collections rather than loan balances. Few finance companies follow the pro rata with transfer method.

15. Accounting for Installment Lending Activities of Finance Companies. The finance companies issues paper, "Accounting for Installment Lending Activities of Finance Companies," was prepared as part of a project to revise and update the finance companies guide. The introduction to the issues paper states that the accounting issues need to be addressed, in part, because the finance companies guide permits alternative methods of recognizing income.

16. The issues paper addresses accounting for credit losses as well as accounting for loan acquisition costs, because both affect finance revenue recognition under the combination and pro rata with transfer methods. The paper observes that the finance companies guide permits companies that use either of those two methods to recognize a portion of unearned interest income when the credit loss provision is made, because otherwise costs would be mismatched with related interest income.

17. The advisory conclusions to the issues paper reflect the belief that the criteria of FASB Statement No. 5 should control recognition of credit losses and that the criteria generally are met when loans are made. The advisory conclusions also state, however, that applying an enterprise's credit loss experience

percentage to loans as they are made is only a useful computational technique and, further, that such computations in concept should be the same regardless of whether a loan loss allowance is established in that way or by a periodic evaluation of the outstanding loans.

18. Notwithstanding the advisory conclusions to the issues paper, diverse results are obtained from applying those two approaches to recognition of credit losses. To illustrate, a finance company made 1,000 loans of $100 each to credit worthy borrowers on December 31, 1984, and made no other loans during the year. Past loss experience indicates that 1% of such loans made will not be collected. Under the advisory conclusions to the issues paper, the December 31 balance sheet would present net loans receivable of $99,000 ($100,000 of loans less an allowance for losses of $1,000). The income statement for 1984 would present an expense for credit losses of $1,000. However, if the allowance for losses is established by evaluating outstanding loans, the balance sheet would present the loan portfolio at $100,000 and the income statement would include no expense for credit losses, because no events have transpired since the decision to make the loans that would indicate that a particular loan will not be collected.

19. In approving the issues paper, a minority of both AcSEC and the Finance Companies Guide Committee believed that though the provision for credit losses should be estimated when loans are made, the provision should be capitalized and amortized as an expense over the terms of loans in relation to recognition of interest income.

S&Ls

20. S&Ls traditionally have primarily made real estate and construction loans. The S&L guide permits but does not require the allowance for losses on a large portfolio of certain loans, such as those secured by single family residences, to be determined using statistical means. However, it requires loan by loan evaluations for other types of loans, such as large loans for commercial property, land, and properties under development.

21. In practice, for all types of real estate and construction loans, S&Ls do not rely greatly on statistical or experience based calculations in estimating the allowance for losses and expense for credit losses. Therefore, S&Ls generally do not establish allowances for losses based on experience as loans are made; instead S&Ls evaluate each loan when it appears to have a

collectibility problem. However, the allowance for losses sometimes is credited for an additional amount that does not relate to a particular individual loan but to unidentifiable loans included in the overall portfolio.

22. The S&L guide requires the allowance for losses on doubtful or troubled loans to be based on estimated net realizable value. Estimated net realizable value is defined as the estimated sales price expected to be received on sale of the underlying collateral less disposal costs, costs of completion or improvement, and direct holding costs. But if it is probable, as that word is defined in FASB Statement No. 5, that a mortgage will be foreclosed, the S&L guide requires the allowance for losses to be based on fair value as defined in FASB Statement No. 15.

23. The allowance for losses on residential loans often is small at any time because the net realizable value of the underlying collateral tends to minimize credit losses. Generally, mortgage loans are made in amounts limited to a percentage of the appraised value of the underlying collateral. Those limitations may be imposed by the S&L itself or by regulatory authorities to reduce credit risk exposure, and thus

minimizes or eliminates losses on sales of foreclosed properties. In addition, VA guarantees and FHA and private mortgage insurance also tend to minimize credit losses on certain loans.

24. S&Ls recently have begun to make consumer loans, though such loans still constitute a minor activity for most S&Ls. The S&L guide does not address consumer loans because S&Ls were not permitted to make such loans when the guide was written. Because such lending activities are relatively new for S&Ls, diverse practices have developed for recognizing credit losses on consumer loans. Some S&Ls develop a loss experience percentage to apply immediately when loans are made. Others establish an allowance for losses only when conditions indicate such a need based primarily on management judgment and individual loan reviews.

Banks

25. Banks engage in consumer, real estate, and commercial lending activities. The bank guide does not address accounting for credit losses separately for each activity but states generally that the allowance for loan losses should be adequate to cover estimated losses inherent in the loan portfolio as of the balance sheet date.

26. Banks generally review and determine the adequacy of their allowances for loan losses at the end of accounting periods for all types of loans. Thus, unlike other financial institutions, banks generally do not apply loss experience percentages or otherwise estimate credit losses continuously as loans are made. However, for credit losses estimated based on historical loss experience, the result generally is the same at the end of a reporting period regardless of whether the estimate is prepared as loans are made or at the end of reporting periods.

27. Regardless of the type of loans, the establishment and review of the adequacy of the allowances for losses are based on a combination of two broad approaches. First, banks review numerous loans individually, selected based on factors such as delinquencies, risks resulting from concentrations in particular industries or geographic areas, loans in excess of certain amounts, loans classified by regulatory authorities, and changes in collateral values. Second, a bank commonly credits the allowance for losses for an additional amount that does not relate to particular loans but to unidentifiable loans included in the overall portfolio.

28. The relative importance of individual loan reviews compared with historical loss experience considerations varies with the types of loans being evaluated for collectibility. Individual loan reviews usually are necessary for large or unusual loans, such as commercial loans. Historical loss experience considerations are most significant for consumer loans as well as for certain standardized mortgage loans such as mortgage loans made against personal residences or small multiple housing buildings.

Credit Unions

29. Credit unions primarily make consumer loans and mortgage loans. Like the bank audit guide, the proposed credit union audit guide generally states that the allowance for loan losses should be adequate to cover estimated losses inherent in the loan portfolio as of the reporting date. Credit unions rely mostly on historical loss experience considerations to estimate credit losses and may apply percentages against loans as the loans are made. However, in circumstances involving unusual loans or problems, individual loans also may be reviewed for collectibility.

Mortgage Bankers

30. Mortgage bankers acquire loans to sell to investors. As a result, mortgage bankers do not assume material credit risks because before they acquire loans they generally obtain commitments for resale of the loans to investors. However, mortgage bankers still may assume some credit risk in the circumstances described below.

31. Sales of GNMA and Other Mortgage Backed Securities. Mortgage bankers originate and pool FHA and VA mortgages, after which the mortgage bankers seek GNMA approval to issue GNMA mortgage backed securities collateralized by the pooled mortgage loans. GNMA guarantees timely payment of principal and interest on those loans. If foreclosure becomes necessary on one of the loans in a pool, mortgage bankers are required to absorb losses resulting from foreclosure. Credit risk exposures are limited for loans supporting GNMA mortgage backed securities, because of FHA insurance and VA guarantees. In certain instances, some credit risk remains if the VA guarantee is insufficient to cover foreclosure losses. Also, neither FHA insurance nor VA guarantees cover all foreclosure costs. Mortgage bankers also originate other mortgage loans and issue mortgage backed

securities that have no federal guarantees. Private mortgage insurance coverage helps minimize credit risk on loans that are pooled for other mortgage backed securities.

32. Generally, mortgage bankers do not anticipate future credit losses expected to occur but recognize such a credit loss when a loss becomes probable. However, if they anticipate a significant amount of credit losses, mortgage bankers recognize such credit losses based on estimates.

33. Construction Loans. Some mortgage bankers make short term construction loans. Before making such a loan, a mortgage banker usually requires another lender to supply a take out commitment, which usually contains a provision that requires certain conditions to be met for the commitment to be effective. If those conditions are not met, the mortgage banker probably would be unable to sell the construction loan readily and, therefore, may incur a loss due to nonpayment. Mortgage bankers provide an allowance for losses on construction loans by reviewing each loan.

Insurance Companies

34. Terms of many life insurance policies permit policyholders to borrow against the cash surrender values of their

insurance policies. Such loans are in effect fully collateralized and therefore never result in loan losses.

35. Insurance companies are involved in lending activities, such as mortgage lending, which are an integral part of their investment operations. Insurance companies generally review loans individually and provide allowances for losses or permanent impairments when considered necessary in each circumstance rather than creating allowances based on historical loss experience.

REITs

36. REITs engage in a variety of real estate lending activities. SOP 75-2 discusses whether REITs should determine provisions for loan losses based on systematic provisions (usually based on fixed percentages of loans or net income), individual evaluations of loans, or some combinations of those two methods. The SOP concludes that the allowance for losses should be calculated based only on individual evaluations of loans.

Direct Finance Leases

37. FASB Statement No. 13 requires lessors to account for leases that transfer substantially all of the benefits and risks incident to the ownership of property and do not result in a manufacturer's or dealer's profit or loss as financing arrange-

ments. The Statement provides criteria for determining whether a lease makes such transfers. The Statement, however, does not address directly the issue of calculating credit losses on leases that are accounted for as financing arrangements. Nevertheless, Appendix D to the Statement includes an illustration of a note disclosure for a lessor in which an allowance for losses is deducted in deriving the net investment in direct financing leases. Thus, the FASB clearly intended direct finance leases to be treated the same as other financing arrangements in respect to credit loss calculations.

38. FASB Statement No. 13 requires lessors to charge initial direct costs of direct finance leases to expense when incurred. A portion of unearned income equal to the initial direct costs is recognized as revenue in the same period. The Statement defines initial direct costs as "those incremental direct costs incurred by the lessor in negotiating and consummating leasing transactions." In FASB Statement No. 17, issued because of requests to clarify the meaning of "incremental direct costs," the FASB redefined such costs to include costs "directly associated with negotiating and consummating completed leasing transactions," which include certain allocable costs.

39. FASB Statement No. 17, paragraph 6, states that "[t]he Board does not intend that initial direct costs, as defined, include a provision for bad debts. Accounting for bad debts that are expected to result from leases and other financing activities is a pervasive issue that the Board did not address in FASB Statement No. 13." However, the Statement also says that "[t]he Board ... did not intend that Statement No. 13 would change existing practices in accounting for bad debts." Therefore, it is conceivable that a company may recognize a portion of unearned income equal to credit losses recognized when leases are negotiated, because FASB Statement No. 17 appears to indicate that FASB Statement No. 13 does not proscribe such accounting.

40. Leveraged leases are a special type of direct finance leases. However, the scope of this paper does not include leveraged leases, because FASB Statement No. 13 describes them primarily as investments rather than financing arrangements.

Summary of Current Practice

41. The discussions of how various financial institutions account for credit losses generally reflect two different kinds of treatments in accounting for estimated credit losses. Credit losses that are estimated based on historical loss experience,

such as losses on consumer loans that are statistically estimated, are recognized as expense without regard to whether individual loans are identified as uncollectible. Credit losses that are estimated based on individual loan reviews, however, are not recognized as expense until specific collectibility problems have been identified. Thus, estimation based on historical loss experience causes earlier recognition of credit losses than estimation based on individual loan reviews.

Issues on Accounting for Credit Losses

42. This paper addresses issues on accounting for estimated credit losses if the total amount of credit losses for a portfolio can be reasonably estimated when loans are made. For example, such an estimate may be possible for portfolios of consumer loans. However, this paper does not address questions regarding the types of portfolios for which such estimates are possible because that raises factual rather than conceptual issues. If such an estimate is not possible when loans are made, no accounting issues need to be addressed. In those situations, FASB Statement No. 5 requires recognition when it is probable that the credit losses have been incurred and the amount of such losses can be reasonably estimated.

43. The first issue in this paper deals with how estimated credit losses should be accounted for if the total amount of credit losses for a portfolio can be reasonably estimated when loans are made. The remaining issues are relevant only if estimated credit losses are to be recognized systematically over the expected lives of loans in a portfolio. Those issues address

- how to account for changes in estimates of credit losses,

- whether an additional loss should be recognized to reduce the carrying value of loans receivable to their net realizable value if identified probable losses to date exceed the amount of estimated credit losses recognized to date, and
- whether loans receivable should be presented in the balance sheet as a single amount or separated into two components.

ISSUE 1: When should the amount of estimated credit losses be recognized in income? Three possibilities exist:

(a) Recognize estimated credit losses when loans are made.

(b) Recognize estimated credit losses only when it is probable that existing loans have become uncollectible in whole or in part.

(c) Recognize estimated credit losses systematically over the expected lives of the loans in a portfolio.

44. Recognize estimated credit losses when loans are made. Some believe that estimated credit losses should be recognized as expense at the time loans are made. They believe that those credit losses reflect an impairment in value of the related loans that should result in an immediate reduction in assets and income. Those who hold that view believe that paragraphs 22 and 23 of FASB Statement No. 5 clearly indicate that the value of the receivables is impaired in the amount of such losses, assuming the amount can be reasonably estimated, when the loans are made.

45. They further believe that recognizing estimated credit losses as expense when loans are made with a corresponding decrease in the net loan balances is consistent with reporting loans at net realizable value. Paragraph 67 of FASB Statement of Financial Accounting Concepts No. 5 describes net realizable value as an amount "of cash, or its equivalent, into which an asset is expected to be converted in due course of business less direct costs, if any, necessary to make that conversion." They recognize that lenders frequently are willing to sell new loans to each other at face value when the loans are made; however, they observe that net realizable value is based on future rather than current exchanges. They consider the willingness of lenders

to sell new loans to each other to be evidence of current selling price rather than net realizable value as long as the lender expects to hold the loan and collect interest on it.

46. Some of those proponents believe that credit losses on trade accounts receivable should be recognized when sales are made and consider distinguishing between trade accounts receivable and loans receivable to be arbitrary and conceptually unsupportable. Regardless of whether the receivable results from a sale of goods or services or a lending activity, they observe that the enterprise gives up something of value in exchange for a promise of receiving cash in the future, and fulfillment of that promise depends primarily on the credit worthiness of the debtor.

47. Recognize estimated credit losses only when it is probable that existing loans have become uncollectible in whole or in part. Some believe credit losses should be recognized as expense only when it is probable that existing loans have become uncollectible in whole or in part, notwithstanding the ability to reasonably estimate credit losses when loans are made. They acknowledge that estimates of credit losses generally are a factor in determining interest rates. Nonetheless, they believe that estimated credit losses reflect a future and not a present

impairment in the value of loans. Therefore, they believe such amounts should not be recognized as credit losses when loans are made.

48. They observe that the criteria of paragraph 8 of FASB Statement No. 5 require an asset to have been impaired or a liability to have been incurred at the date of the financial statements. Paragraph 67 further supports that concept, citing paragraph 25 of APB Statement 4, which states that "[f]inancial accounting and financial statements are primarily historical in that information about events that have taken place provides the basic data of financial accounting and financial statements." In their view, recognizing an impairment in the carrying amounts of loans as loans are made is inconsistent with that concept, because no event has occurred at that time to render the loans uncollectible. They consider the willingness of lenders to sell new loans to each other at face value to be evidence that the values of such loans have not been impaired at the dates the loans are made. Therefore, they believe a credit loss should not be recognized until it is probable that a specific loan has become uncollectible in whole or in part.

49. Recognize estimated credit losses systematically over the expected lives of the loans in a portfolio. Some believe that estimated credit losses should be recognized systematically over the expected lives of the loans in the portfolio to correctly reflect the effective yields in a portfolio of loans. They agree that an asset has not been impaired when loans are made because no event has occurred at that time to render the loans uncollectible, and lenders are willing to sell new loans to each other at face value. They also observe that the loans would not have been granted had evidence existed at the date the loans were made that the loans were impaired or uncollectible.

50. Those proponents, however, disagree with those who conclude a credit loss should not be recognized until it is probable that a specific loan has become uncollectible in whole or in part. In their opinion, that approach incorrectly treats each loan transaction as an isolated and distinct event and ignores the tendency of financial institutions to view estimable credit losses within a portfolio as one factor, related to risk, in determining the interest rates to be charged on individual loans. They note that, barring unexpected occurrences, the interest rates thus charged are intended to provide sufficient

interest income on the entire portfolio to recoup credit losses incurred in the portfolio and provide a satisfactory return on funds lent.

51. In their view, the effect of finance income on the entity's operating results should reflect the effective yield on a portfolio of loans. Thus, they would recognize estimated credit losses systematically over the expected lives of the loans. They believe that reflects the concept that recognizing estimated credit losses systematically results from issues involving revenue recognition and not asset impairment.

52. They consider FASB Statement No. 66, Accounting for Sales of Real Estate, to provide further support for their position. Under the full accrual method of accounting for retail land sales, as described in paragraph 70 of that statement, expected cancellations in future periods reduce reported revenue from those land sales. Therefore, they believe cancellations on retail land sales are another example of an adjustment resulting from issues involving revenue recognition rather than asset impairment.

53. Others agree that estimates of total amounts of credit losses that are made at the inception of loans should be

recognized systematically over the lives of loans in a portfolio. However, they reach that conclusion through an application of FASB Statement No. 5 in determining whether losses have been realized on loans receivable.

54. They note that estimated credit losses rarely occur on specific dates; rather, loans generally become totally or partially uncollectible over time because of gradual deterioration in the borrowers' abilities and willingness to repay the loans. Therefore, they believe such losses should be recognized systematically over time to best reflect those economic events. Further, in their view, recognition of estimated credit losses systematically over the expected lives of the loans provides an accounting estimate of the results that would be obtained under FASB Statement No. 5 if, at the reporting date, each loan in a portfolio could be analyzed individually to determine which loans probably had become uncollectible in whole or in part.

55. Those proponents point to the willingness of lenders to sell new loans to each other at face value as evidence that nothing has happened to affect individual loans at dates the loans were made. Though paragraphs 22 and 23 of FASB Statement No. 5 appear to indicate that the value of receivables is

impaired in the amount of estimated credit losses when loans are made, they believe that reflects an inconsistency within FASB Statement No. 5, because the statement requires loss recognition only if events have already occurred to impair the value of assets, not if events are expected to occur in the future. In their view, the asset impairment occurs gradually over the lives of the loans in the portfolio rather than when the loans are made.

56. Still others also believe that estimated credit losses should be recognized systematically over the lives of loans in a portfolio but reach their conclusion in a different manner. They observe that, when making loans, a lender gives cash to the borrowers and, in return, receives promises from the borrowers of repayment with interest. No other events that cause changes in assets, liabilities, or both occur at those times in connection with the loans. Though accounting for the payments of cash to the borrowers requires cash to be credited, they believe accounting for the receipts of promises to repay is not so clear cut.

57. Those proponents believe that the probability when loans are made that some loans in the portfolio will not be collected

is an aspect of receiving promises of repayment that should affect accounting for the receipts of those promises. They believe recognition of similar aspects of events exists in other areas of accounting. For example, health care providers accrue estimated losses for unreported incidents that have occurred that could result in malpractice claims in the future, that is, incurred but not reported (IBNR) claims. That view is expressed in the advisory conclusion to the AICPA issues paper, "Accounting for Medical Malpractice Loss Contingencies (Asserted and Unasserted Claims) and Related Issues of Health Care Providers." Those proponents believe accounting for product warranties provides another example. Liabilities are accrued for product warranties based on sales of goods, though the particular parties that will make claims under the warranties can not be identified at the times of the sales.

58. However, those proponents believe that recognizing losses when loans are made is not the proper way of recognizing the aspect of the event that some loans will become uncollectible. They note that FASB Statement No. 5, paragraph 80, in considering application of the matching concept to uncollectible receivables, states that losses from uncollectible receivables of credit sales

generally can be associated with revenue from those sales based on cause and effect. The paragraph does not address expected uncollectible loans receivable arising from lending activities, but applying the cause and effect rationale leads to the conclusion that expected credit losses on a portfolio of loans should be recognized over the same periods in which the related revenues are recognized. In their view, an alternative conclusion could produce an anomalous result of recognizing an immediate loss each time a lender enters into a transaction, because most of the transactions are profitable and result in no actual losses.

59. Some of those proponents acknowledge that some amendment of FASB Statement No. 5 may be necessary to accommodate their view. Nevertheless, they believe the results reflect better the relationship between estimated credit losses and interest revenue and therefore support whatever amendments may be necessary. In their view, accounting for credit losses on loan receivables should differ from accounting for credit losses on trade accounts receivables resulting from sales transactions. They note that in commercial sales, for which a product has been delivered or a service has been performed, the earnings process is complete at

the time of sale when the trade account receivable is obtained; recognizing bad debt expense at the time of the sale therefore gives a proper matching. However, they note that in a loan transaction, the earning process extends over the life of the loan receivable and has not even begun when the loan is made; they therefore believe that recognizing estimated credit losses systematically over future periods best reflects their relationship to revenues earned on loans.

60. Regardless of the rationale for their belief, those who conclude estimated credit losses should be recognized systematically over the expected lives of the loans in a portfolio acknowledge the necessity of identifying credit losses by type of loan and by periods in which loans were originated. In that way, the adequacy of original estimates of credit losses in a portfolio can be periodically evaluated against actual credit losses to date.

61. Each estimate would be recognized only in relation to the portfolio of loans from which the estimate was derived. Thus, the estimate for a portfolio would be recognized over the average expected loan repayment period for that portfolio. Such periods should be determined based on the enterprise's experience. If an

enterprise lacks such experience, for example, when it first begins operations, the enterprise may base its calculations of average expected loan repayment periods on the experience of other enterprises with similar loans in the same geographical area.

Issues on Changes in Estimates of Credit Losses

ISSUE 2: Assuming estimated credit losses are recognized systematically over expected lives of loans, should a change in the estimate of credit losses be accounted for using

(a) cumulative catch-up treatment or

(b) reallocation treatment?

62. Estimation entails judgment concerning uncertainty. Therefore, estimates of credit losses may change over time as those judgments are reevaluated in light of more experience and additional information. The periodic reevaluation of a portfolio of loans may indicate that the original estimate of credit losses was inaccurate and should be revised. If so, how to account for a change in the estimate needs to be addressed, because APB Opinion 20 has been applied in practice in diverse ways.

63. APB Opinion 20 contains general guidance on how changes in estimates should be accounted for. Paragraph 31 of APB Opinion 20 states:

> The Board concludes that the effect of a change in accounting estimate should be accounted for in (a) the period of change if the change affects that period only or (b) the period of change and future periods if the change affects both. A change in an estimate should not be accounted for by restating amounts reported in financial statements of prior periods or by reporting pro forma amounts for prior periods.

64. A change in the estimate of credit losses on a portfolio of loans affects both the period of change and future periods. The AICPA issues paper, "Accounting for Changes in Estimates," observes that the guidance in part (b) of paragraph 31 of APB Opinion 20 has been interpreted to permit two alternative treatments, which it refers to as the cumulative catch-up and reallocation treatments. Under the cumulative catch-up treatment, the balance sheet at the end of the period and the accounting in subsequent periods are presented as if the changed estimate had been the original estimate. Under the reallocation treatment, the change in estimate is allocated ratably over the period of the change and future periods.

65. Both the cumulative catch-up and reallocation treatments

affect the pattern of recognition of credit losses over the remaining lives of loans in a portfolio after the period of change. The cumulative catch-up treatment produces credit loss recognition on the portfolio after the period of change that reflects what it would have been during those periods had the revised estimate been used when the loans were made. Under reallocation, however, the credit loss recognition on the portfolio after the period of change reflects the amount of the change relating to prior periods as yet another systematic adjustment over the remaining lives of loans in a portfolio.

66. To contrast cumulative catch-up and reallocation treatment, the following facts are assumed.

Original estimate of credit losses	\$100
Recognition of estimate to date	\$ 70
Revised estimate of credit losses	\$125
If the revised estimate of credit losses had been used from the beginning, the amount recognized to date would have been	\$ 84

67. Cumulative catch-up would result in an additional expense recognition in the current period of \$84-\$70 = \$14. Future expense recognition would then be adjusted to recognize \$125-\$84 = \$41 over the remaining life of the portfolio.

68. Reallocation would result in no cumulative adjustment to expense in the current period other than the difference resulting from adjustment of the rate of recognition. The rate of recognition would be adjusted to recognize \$125-\$70 = \$55 over the remaining life of the portfolio.

69. Some believe that a change in the estimate of credit losses should be reallocated, because they consider such a change to be similar to a change in the estimate of periods of benefit or service and residual values of assets. They note that APB Opinion 20 has been applied using reallocation to recognize the effects of such changes and therefore believe different treatment is not justifiable for changes in estimates of expected credit losses. Proponents of using reallocation note that it is also required for changes in estimated

- motion picture gross revenues in paragraph 12 of FASB Statement No. 53,
- capitalized software costs in paragraph 8 of FASB Statement No. 86, and
- capitalized acquisition costs and proved oil and gas reserves in paragraph 30 of FASB Statement No. 19.

70. Others believe that a change in the estimate of credit losses should be cumulatively caught-up, because they believe reallocation misstates the effect on operations over the remaining lives of loans in a portfolio. They believe the amount of the change should be reflected in its entirety in income for the period of change to properly present financial position at future balance sheet dates.

71. Those proponents point to SOP 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts, for additional support. That SOP recommends accounting for changes in estimates using cumulative catch-up so that the balance sheet at the end of the period of change and the accounting in subsequent periods are as they would have been had the revised estimate been the original estimate. They consider changes in estimates relating to depreciation to be distinguishable from changes in estimates of credit losses, because depreciation is an allocation of cost and not an attempt to recognize changes in net realizable value. They observe that estimates affecting depreciation relate to productive facilities. However, estimates of credit losses relate to loans, and unlike

productive facilities, loans are subject to tests of net realizable value. They therefore believe the use of reallocation for productive facilities should not influence whether it should be used in accounting for changes in estimated credit losses.

72. In addition, proponents of using cumulative catch-up note that paragraph 46 of FASB Statement No. 13 requires lessors to use cumulative catch-up to account for changes in estimated total net income of leveraged leases. They point out that, like changes in estimates of credit losses, changes in estimated residual value of leased property concern writedowns to net realizable value rather than cost allocation.

73. If identified probable losses to date exceed the amount of estimated credit losses recognized to date, the following issue must be addressed:

<u>ISSUE 3</u>: <u>If identified probable losses to date exceed the amount of estimated credit losses recognized to date, should an additional loss be recognized in the current period to reduce the carrying value of the loans receivable to their net realizable value?</u>

74. Issue 3 may be considered in two ways. First, identified probable losses to date may exceed the amount of estimated credit

losses recognized to date. Nevertheless, the financial institution may decide that the estimate should not be revised, because it expects future identified losses to be less than the remaining unrecognized amount of the estimate. Alternatively, the financial institution may decide that the original estimate of credit losses should be revised. The following illustrates both applications of Issue 3.

75. No change in the original estimate. The following facts are assumed:

Original estimate of credit losses	\$100
Recognition of estimate to date	\$ 70
Identified probable credit losses to date	\$ 90

The financial institution decides that its original estimate is correct though the amount of losses identified exceeds the cumulative amount recognized to date. Therefore, whether the financial institution should recognize a loss of \$90-\$70 = \$20 currently and reduce the future rate of recognition accordingly or recognize no additional loss for the period and continue applying the original recognition rate without change needs to be addressed.

76. Original estimate is revised. The following facts are assumed:

Original estimate of credit losses	\$100
Recognition of estimate to date	\$ 70
Identified probable credit losses to date	\$ 90
Revised estimate of credit losses	\$125
If the revised estimate of credit losses had been used from the beginning, the amount recognized to date would have been	\$ 84

77. If the answer to Issue 2 supports cumulative catch-up treatment for the change in estimate, a question arises whether a loss should be recognized in the current period for \$90-\$70 = \$20 to reduce the carrying amount of the receivables to their net realizable value. That \$20 amount is \$6 more than the \$84-\$70 = \$14 that would otherwise be recognized in the current period using the cumulative catch-up method.

78. Alternatively, if the answer to Issue 2 supports reallocation treatment for the change in estimate, whether a \$20 loss should be recognized in the current period to reduce the carrying amount of the receivables to their net realizable value would still need to be addressed. If so, the rate of recognition for the remaining life of the portfolio would be adjusted to

recognize $125-90 = $35 over the remaining life of the portfolio instead of $125-$70 = $55.

79. Some believe that if identified probable losses exceed the cumulative amount of estimated credit losses that have been recognized to date, that is evidence that a loss has already occurred and should be recognized. In their view, the identifi-ation of credit losses in excess of the cumulative amount of the estimate recognized to date confirms that an asset had been impaired at the date of the financial statements. Therefore, they believe a loss should be recognized in the current period to reduce the carrying value of the loans receivable to their net realizable value.

80. Those proponents claim conservatism supports that approach. They note that conservatism is important for financial statements of financial institutions because of public and lender expectations. Further, they believe the need to require such a writedown is not likely. They observe that, for amortizing loans, recognition of estimated credit losses systematically over the expected lives of the loans in a portfolio causes the major portion of the estimate to be recognized towards the beginning of the portfolio's life. Also, under a portfolio approach to

accounting for estimated credit losses, the uncollectibility of many loans within the portfolio would have to become probable for that writedown to be required. In addition, they believe alternative accounting would not be consistent with accounting for credit losses on loans that are not covered in this issues paper, namely, portfolios of loans for which total credit losses cannot be reasonably estimated when loans are made.

81. Others believe no additional writedown should be made if identified probable losses exceed the cumulative amount of estimated credit losses that have been recognized to date. In their view, the important consideration is the accuracy of the estimate of total credit losses, either original or as revised. Assuming satisfaction with that estimate, they believe it should be recognized based on that estimate regardless of the fact that actual identified probable losses do not follow the amount recognized in any one accounting period.

82. Some of those proponents support that approach because they believe it best matches costs with revenues. Others support that treatment because they consider recognizing estimated credit losses systematically over the expected lives of loans in a portfolio to result from issues involving revenue recognition and not asset impairment.

Balance Sheet Presentation

83. If estimated credit losses are recognized systematically over the expected lives of loans in a portfolio, whether the amount of loans should be presented in the balance sheet as a single asset or as two separate assets needs to be addressed. The two separate assets would consist of an intangible asset representing estimated credit losses expected to be incurred but not yet recognized in income and loans receivable reduced by the amount of that intangible asset. Regardless of the balance sheet presentation, the effect on net income and total assets are the same under those approaches. Therefore, the following issue is presented.

ISSUE 4: How should loans receivable be presented in the balance sheet? Two possibilities are considered.

(a) Present loans receivable at an amount net of estimated credit losses expected to be incurred but not yet recognized in income with the difference presented separately.

(b) Present loans receivable as a single amount with

<u>no separate presentation of estimated credit losses expected to be incurred but not yet recognized in income</u>.

84. Some believe the carrying amount of a portfolio of loans should be reduced with separate presentation of another asset equal to the amount of estimated credit losses expected to be incurred but not yet recognized in income. They believe that presentation is preferable because loans receivable are thereby stated at the amount of loan principal expected to be collected over the lives of loans in the portfolio.

85. In their opinion, estimated credit losses represent costs that meet the definition of an asset under FASB Statement of Financial Accounting Concepts No. 3 in that such amounts are necessary to produce other benefits, namely, revenue to be generated from the loans. Paragraph 108 of Concepts Statement No. 3 states "[i]f research or development activities result in an enterprise's acquiring future economic benefit, that future economic benefit qualified as an asset...." Barring uncertainty as to whether those activities will produce future economic benefits, their costs conceivably would be recognized as assets. Some believe estimated credit losses are a cost incurred when

loans are made that also result in an enterprise's acquiring future economic benefits but without the uncertainties inherent in research and development activities. Therefore, they hold analogously that costs of estimated credit losses represent separate assets that should be recognized as expense over the future periods benefitted.

86. Some of those proponents also believe estimated credit losses are a form of acquisition cost as defined in the advisory conclusions to the issues paper, "Accounting for Nonrefundable Fees of Originating or Acquiring Loans and Acquisition Costs of Loan and Insurance Activities." Those advisory conclusions define acquisition cost of loans as incremental and allocable costs related to loans, which excludes general and administrative costs and comprises the same types of costs associated with accounting for manufacturing inventories. The conclusions also recommend recognizing loan acquisition costs as yield adjustments over the lives of related loans. Those who hold that view consider estimated credit losses to be analogous to the cost of normal spoilage for inventories, thus falling within the definition of loan acquisition costs to be amortized as yield adjustments.

87. Others believe that estimated credit losses expected to be incurred but not yet recognized in income should not be presented as a separate asset. They note that incurring credit losses is a necessary cost of establishing a portfolio of revenue earning loans and that the estimated cost should be included in the balance sheet as part of the loan receivable amount. They believe this type of presentation better reflects the lower effective interest rate produced by recognizing the estimate systematically over the expected lives of the loans in the portfolio. Those proponents consider such treatment to be consistent with that suggested for debt issuance costs in paragraph 161 of FASB Statement of Financial Accounting Concepts No. 3.

Advisory Conclusions

88. Paragraphs 88 to 91 present the advisory conclusions of AcSEC and the Task Force on Accounting for Loan Origination Fees and Initial Direct Costs.

89. AcSEC (9 yes, 1 no, 1 abstain, 4 absent) and the task force (7 yes) agree that estimated credit losses should be charged to expense systematically over expected lives of the loans in the portfolio in direct proportion to the related interest revenue.

90. Assuming estimated credit losses are charged to expense systematically over the expected lives of the loans in the portfolio in direct proportion to the related interest revenue, AcSEC (10 yes, 1 abstain, 4 absent) and the task force (7 yes) agree that a change in the estimate of credit losses should be accounted for using cumulative catch-up treatment.

91. If identified probable losses to date exceed the amount of estimated credit losses recognized to date, AcSEC (7 yes, 1 no, 3 abstain, 4 absent) and the task force (7 yes) agree that an additional loss should be recognized in the current period to reduce the carrying value of the loans receivable to their net realizable value.

92. AcSEC (8 yes, 3 abstain, 4 absent) and the task force (5 yes, 2 no) agree that loans receivable should be presented in the balance sheet as a single amount with no separate presentation of estimated credit losses expected to be incurred but not yet recognized in income. A minority of the task force believes that the carrying amount of a portfolio of loans should be reduced when loans are made with separate presentation of another asset equal to the amount of estimated credit losses.

Appendix

93. The following illustrates the systematic allocation of estimated credit losses over the expected lives of loans in a portfolio. An enterprise entered into the following fixed rate 16% consumer loans on December 31, 1985:

- $350,000 three year loans
- $250,000 four year loans
- $400,000 five year loans

Based on its experience with consumer loans, the enterprise expects the estimated lives of those loans will be their contractual lives. Principal and interest payments are made only at the end of the quarter and interest is computed on the loan balance at the beginning of the quarter.

94. To allocate credit losses based on expected interest revenue, the enterprise must estimate the timing and amount of loans to be transferred to nonaccrual status. In this illustration, credit losses are estimated to be $30,000 for the three year loans, $25,000 for the four year loans, and $45,000 for the five year loans. The losses are expected to be incurred as illustrated in the schedule below. Based on its assumptions of the pattern of estimated credit losses, the enterprise prepared

the following schedule to determine the beginning loan balance at each quarterly financial statement date. The enterprise considered all its consumer loans as a single portfolio for purposes of allocating estimated credit losses as the loans all had the same interest rate and, based on experience, the enterprise expected similar risk of loss on its consumer loans regardless of their term. In this illustration, loans are transferred to nonaccrual status on the last day of the quarter and the credit loss is assumed to occur when the loan is transferred to nonaccrual status, because it is assumed that all such loans will be subsequently written off.

Allocation of Estimated Credit Losses on Loans Entered Into on December 31, 1985

	Quarter Ending 9/30/88	Quarter Ending 12/31/88	Quarter Ending 3/31/89	Quarter Ending 6/30/89	Quarter Ending 9/30/89	Quarter Ending 12/31/89	Quarter Ending 3/31/90	Quarter Ending 6/30/90	Quarter Ending 9/30/90	Quarter Ending 12/31/90	Total Interest Revenue	Total Estimated Credit Losses
3 Year Loans - Continued												
Beginning balance*	59,543	30,355										
Loans transferred to nonaccrual status												30,000
Principal paid	29,188	30,355										
Ending balance*	30,355	-0-										
4 Year Loans - Continued												
Beginning balance*	97,486	82,789	67,504	45,608	30,998	15,803						
Loans transferred to nonaccrual status			6,000									25,000
Principal paid	14,697	15,285	15,896	14,610	15,195	15,803						
Ending balance*	82,789	67,504	45,608	30,998	15,803	-0-						
5 Year Loans - Continued												
Beginning balance*	214,206	196,365	177,810	148,513	129,710	110,155	89,818	62,668	42,592	21,713		
Loans transferred to nonaccrual status			10,000				6,000			1,000		45,000
Principal paid	17,841	18,555	19,297	18,803	19,555	20,337	21,150	20,076	20,879	20,713		
Ending balance*	196,365	177,810	148,513	129,710	110,155	89,818	62,668	42,592	21,713	-0-		
Beginning balance - all loans*	371,235	309,509	245,314	194,121	160,708	125,958	89,818	62,668	42,592	21,713		
Interest revenue	14,849	12,380	9,813	7,765	6,428	5,038	3,593	2,507	1,704	869	365,016	
Percent of total interest revenue	4.07	3.39	2.69	2.13	1.76	1.38	.98	.69	.47	.24	100.00	
Allocation of Estimated Credit Losses**	4,070	3,390	2,690	2,130	1,760	1,380	980	690	470	240		100,000

* Represents loan balances on which interest continues to be accrued.

** Estimated credit losses are allocated at a constant rate of approximately 27.4% (100,000 ÷ 365,016) of the interest revenue each period.

Allocation of Estimated Credit Losses on Loans Entered Into on December 31, 1985

	Quarter Ending 3/31/86	Quarter Ending 6/30/86	Quarter Ending 9/30/86	Quarter Ending 12/31/86	Quarter Ending 3/31/87	Quarter Ending 6/30/87	Quarter Ending 9/30/87	Quarter Ending 12/31/87	Quarter Ending 3/31/88	Quarter Ending 6/30/88
3 Year Loans										
Beginning balance*	350,000	332,679	313,205	286,577	259,497	231,334	202,045	156,584	127,674	87,608
Loans transferred to nonaccrual status			5,000				15,000		10,000	
Principal paid	17,321	19,474	21,628	27,080	28,163	29,289	30,461	28,910	30,066	28,065
Ending balance*	332,679	313,205	286,577	259,497	231,334	202,045	156,584	127,674	87,608	59,543
4 Year Loans										
Beginning balance*	250,000	238,545	226,632	214,242	201,357	177,956	164,761	151,038	136,766	121,923
Loans transferred to nonaccrual status					10,000					9,000
Principal paid	11,455	11,913	12,390	12,885	13,401	13,195	13,723	14,272	14,843	15,437
Ending balance*	238,545	226,632	214,242	201,357	177,956	164,761	151,038	136,766	121,923	97,486
5 Year Loans										
Beginning balance*	400,000	386,567	372,597	358,068	342,958	327,244	295,901	279,724	262,900	245,403
Loans transferred to nonaccrual status						15,000				13,000
Principal paid	13,433	13,970	14,529	15,110	15,714	16,343	16,177	16,824	17,497	18,197
Ending balance*	386,567	372,597	358,068	342,958	327,244	295,901	279,724	262,900	245,403	214,206
Beginning balance - all loans*	1,000,000	957,791	912,434	858,887	803,812	736,534	662,707	587,346	527,340	454,934
Interest revenue	40,000	38,312	36,497	34,355	32,152	29,461	26,508	23,494	21,094	18,197
Percent of total interest revenue	10.96	10.50	9.99	9.41	8.81	8.06	7.26	6.44	5.78	4.99
Allocation of Estimated Credit Losses	10,960	10,500	9,990	9,410	8,810	8,060	7,260	6,440	5,780	4,990

* Represents loan balances on which interest continues to be accrued.