

CHAPTER 18
MAINTENANCE OF ALLOWANCE FOR LOAN LOSSES ACCOUNT

189—18.1(533) Definitions. The following words and terms, when used in these rules, shall have the meaning shown below:

“Allowance for loan losses” means a valuation account of the general ledger that is established for the purpose of disclosing and recognizing probable loan losses and is reported as a reduction to the loan asset whenever the credit union’s financial statement is generated.

“Contingency” means an existing condition, situation or set of circumstances involving uncertainty as to the possible gain or loss to an asset of the credit union that will ultimately be resolved when one or more future events occur or fail to occur.

“Financial statement” means the product by which the credit union presents accurately and fully the financial condition of the credit union as of a particular date and the results of operations for a specified period.

“General ledger” means the record of final entry which shows a summary of the current balances of the credit union’s accounts and the results of operations for the period, and acts as a control over numerous postings to the individual or subsidiary ledgers.

“Legal reserve” means the statutory reserve account of the credit union set aside from gross earnings as a regular reserve against losses on loans and other contingencies, in accordance with Iowa Code chapter 533.

“Loan classified as doubtful” means a loan with a probability classification for loss contingency of reasonably possible—when the chance of the future event or events is considered more than remote but less than likely to occur.

“Loan classified as loss” means a loan with a probability classification for loss contingency of probable—when the chance of the future event or events is considered likely to occur.

“Loan classified as substandard” means a loan with a probability classification for loss contingency of remote—when the chance of the future event or events occurring is considered slight.

“Provision for loan losses” means an expense account of the general ledger to which debit or credit adjustments to the allowance for loan losses account are charged.

“Special reserve” means an additional regular reserve account of the credit union, established and required by the superintendent, to be set aside against losses from loans or other contingencies, in accordance with Iowa Code chapter 533.

189—18.2(533) Legal reserve required.

18.2(1) Each credit union shall establish and maintain a legal reserve for contingencies as provided by Iowa Code chapter 533. The totals of the legal reserve and the allowance for loan losses account shall be combined for determining the applicable percentage of gross income to be transferred to the legal reserve.

18.2(2) Nothing in this rule shall preclude the requirements of Iowa Code chapter 533 relating to the maintenance of the legal reserve or to the authority of the superintendent to approve a plan for distribution of the reserve or to the requiring of additional amounts to be set aside as a special reserve.

189—18.3(533) Generally accepted accounting principles.

18.3(1) Credit union financial statements shall be prepared in accordance with generally accepted accounting principles (GAAP), except for authorized intentional regulatory accounting practices (RAP) which may differ, and shall provide for the complete and accurate disclosure of all assets, liabilities, and equity, including any valuation allowance accounts as may be necessary to correctly present the financial position; and all income and expenses necessary to correctly present the results of operations for the period concerned. The financial statement shall be prepared and made available within 15 days after the end of each month showing the condition of the credit union as of the close of business on the last business day of the month.

18.3(2) Complete and accurate disclosure shall be required of a credit union so as to provide for a level of disclosure to any person or entity in order to clearly and objectively inform them of the financial condition and the results of operations of the credit union.

18.3(3) Valuation allowance accounts shall be required of a credit union to provide for the net presentation of loan amounts without actually writing off estimated losses or expenses.

189—18.4(533) Allowance for loan losses.

18.4(1) Loans outstanding should be recorded to reflect the outstanding balance due the credit union and adjusted by the establishment of an allowance for loan losses account through periodic charges to operating expenses. This credit balance account reflects the amount set aside by the credit union to provide a cushion to absorb losses on outstanding loans. The amount carried in this account shall represent possible losses which may be incurred in the normal payoff of outstanding loans, and shall be considered as a deduction from total loans shown on the financial statement in order that the asset reflects fair market value.

18.4(2) A credit union may, at its option, establish separate allowance accounts for each of its various categories of loans, i.e., allowance for loan losses—consumer loans, allowance for loan losses—lines of credit, etc.

18.4(3) Periodic adjustment of the allowance for loan losses account shall be required to provide for the disclosure of the credit union's best estimate of potential losses which will be sustained in the liquidation of current outstanding loans. As a minimum, the account shall be adjusted at least quarterly or prior to the end of each dividend period, or more often as required. The amount of the periodic adjustments shall be determined by the credit union after all charge-offs and recoveries applicable to the period have been recorded. Periodic adjustments to the allowance for loan losses account will be charged to the provision for loan losses account.

18.4(4) The maintenance of an allowance for loan losses account shall not eliminate the requirement for transferring the percentage of gross income before the payment of a dividend to the credit union's regular reserves as required by Iowa Code chapter 533.

18.4(5) Credit unions shall be required to use an acceptable method of adjusting the allowance for loan losses account, such as, but not limited to, the "adjustment method" or "experience method." There is no one method that is preferable. The method used by a credit union shall be consistent, comprehensive, logical, and relevant to the credit union's circumstances, and the calculation shall be comprehensive, taking into account the risks inherent in the various types of lending.

189—18.5(533) Allowance for loan losses computation.

18.5(1) The credit union shall perform a review of all loans to determine potential losses which will be sustained in collection and to establish an adequate allowance for loan losses account. The estimate shall be based on the best judgment of the credit union officials and take all pertinent factors into consideration including, but not limited to: loan delinquency status of two months or more; collection experience of the credit union; unusual economic conditions that may affect collectibility; availability of pledged shares, collateral, security, or endorsers; insured FHA or educational loan coverage; and the general credit reputation of the borrowers.

18.5(2) Loans considered or classified as a loss shall be included in the allowance for loan losses account at 100 percent of the outstanding loan balance as reported on the credit union's records. Loss loans shall include, but not be limited to: contractual delinquency 12 months or more past due; borrower adjudged a bankrupt or a skip unless there are extenuating circumstances; deficiency balance after the sale of repossessed collateral; a loan turned over to an attorney or outside agency for final collection; or, loans deemed to be uncollectible or where continued collection effort is nonproductive regardless of the number of months delinquent. These loans would represent a high degree of risk of default or probability of loss.

18.5(3) Loans considered or classified as doubtful shall be included in the allowance for loan losses account at 50 percent of the outstanding loan balance as reported on the credit union's records. Doubtful loans shall include, but not be limited to: contractual delinquency 6 to 12 months past due; or, loans with material deficiency in perfection of loan documentation which could result in collection-in-

full being highly improbable. These loans represent a material degree of default risk, and based on the facts and payment performance of the loan, collection-in-full is doubtful.

18.5(4) Loans considered or classified as substandard shall be included in the allowance for loan losses account at 10 percent of the outstanding loan balance as reported on the credit union's records. Substandard loans may include, but are not limited to: contractual delinquency two to six months past due; or remaining delinquent loans with extenuating circumstances such as recent employment lay-offs, discharges, or terminations, and loans with repetitive broken payment history. These loans represent a slight degree of risk of default but, with continued collection efforts, should result in probable collection-in-full.

18.5(5) The allowance for loan losses account should include estimated amounts to cover loan losses which may result from specifically identified troubled or classified loans, pools of classified loans, pools of loan types or credit instruments, and a general portion of all other loans and credit instruments for inherent losses. Credit unions are responsible for determining an adequate allowance for loan losses account, and adopting a reasonable methodology for doing so. If a credit union fails to determine an adequate and reasonable allowance for loan losses account which will result in the fair presentation of its financial statement, the superintendent may require additional amounts to be set aside as provided by Iowa Code chapter 533.

189—18.6(533) Accounting treatment.

18.6(1) The allowance for loan losses account shall be charged with the amount of the uncollectible loans which have been authorized for write-off by the board of directors or as directed by the superintendent. Likewise, recoveries on loans charged off shall be credited to this account.

18.6(2) Routine periodic adjustments to the allowance for loan losses account, accomplished during an accounting or dividend period within the current fiscal year, shall be made by a charge to the provision for loan losses account.

18.6(3) Prior period adjustments to the allowance for loan losses account, within the current fiscal year, may be permitted only in relation to the correction of an error in a prior period financial statement. These corrections shall be accounted for and reported in the same manner as routine periodic adjustments, and shall be charged to the current period expenses through the provision for loan losses account.

18.6(4) Prior period adjustments to the allowance for loan losses account, outside of the current fiscal year, may be permitted only in relation to the correction of an error in the previous fiscal year financial statement. These corrections shall be accounted for and reported as a charge to the undivided earnings account. If the result of this correction would create a deficit balance in the undivided earnings account, the deficiency so created may be transferred to other segregations of undivided earnings or to the legal reserve account, subject to the prior approval of the superintendent.

18.6(5) If a deficit is created in the legal reserve account, through the establishment or maintenance of the allowance for loan losses account, the deficit shall be transferred first to undivided earnings and, if this shall cause a deficit in undivided earnings, then to other segregations of undivided earnings that may exist, exclusive of the special reserve account should it be required by the superintendent.

18.6(6) The superintendent may waive, in whole or in part, the requirement for the maintenance of the allowance for loan losses account which is in excess of the statutory reserve requirements of Iowa Code chapter 533 but is required under this chapter. Such waiver shall be as a result of written application from the directors of a credit union and shall set forth their justification for the requested waiver.

These rules are intended to implement Iowa Code chapter 533.

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