



NACD

Bank Director Workshop

AUDIT

Rebecca P. Sproul, Partner
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Agenda

Allowance for Loan Losses (ALL)

- Authoritative Literature
- Audit Issues
- Methodology
- Calculating and Documenting the ALL
- Developing Loss Measurements

Authoritative Literature

- ❑ **Financial Accounting Standards Board (FASB) Statement No. 5, “Accounting for Contingencies”**
- ❑ **FASB No. 114, “Accounting by Creditors for Impairment of a Loan an Amendment to FASB Statements No. 5 and 15”**
- ❑ **FASB No. 118, “Accounting by Creditors for Impairment of a Loan – Income Recognition and Disclosures an amendment of FASB Statement No. 114”**

Authoritative Literature

- ❑ Emerging Issues Task Force Topic D-80: Application of FASB Statements No. 5 and No. 114 to a Loan Portfolio
- ❑ SEC Staff Accounting Bulletin: No. 102 – Selected Loan Allowance Methodology and Documentation Issues

Regulatory Guidance

- ❑ Interagency Policy Statement on the Allowance for Loan and Lease Losses
- ❑ Questions and Answers on Accounting for Loan and Lease Losses

Audit Issues

- ❑ Failure to include evidence in the workpapers supporting evaluation of loan loss factors used to determine the allowance
- ❑ Failure to obtain sufficient evidence to support the unallocated allowance

Methodology

Common elements in a loan loss allowance methodology

(per the AICPA Audit & Accounting Guide for Depository and Lending Institutions):

- a. **Include a detailed and regular analysis of the loan portfolio;**
- b. **Include procedures for timely identification of problem credits;**
- c. **Be used consistently;**
- d. **Consider all known relevant internal and external factors that may affect collectibility;**
- e. **Consider all loans (whether on an individual or pool-of-loans basis);**

Methodology

- f. **Consider the particular risks inherent in the different kinds of lending;**
- g. **Consider current collateral fair values, where applicable;**
- h. **Be performed by competent and well-trained personnel;**
- i. **Be based on current and reliable data; and**
- j. **Be well documented, with clear explanations of the supporting analyses and rationale.**

Calculating and Documenting the ALL

- ❑ Loans within the scope of FASB Statement No. 114
- ❑ All other loans (FASB Statement No. 5)
 - Segmentation of the portfolio
 - Historical loss experience, adjusted for changes in trends, conditions and other relevant factors

Developing Loss Measurements

Factors to consider in developing loss measurements (per the AICPA Audit & Accounting Guide for Depository and Lending Institutions):

- ❑ **Levels of and trends in delinquencies and impaired loans**
- ❑ **Levels of and trends in recoveries of prior chargeoffs**
- ❑ **Trends in volume and terms of loans**
- ❑ **Effects of any changes in lending policies and procedures**
- ❑ **Experience, ability, and depth of lending management and other relevant staff**
- ❑ **National and local economic trends and conditions**
- ❑ **Credit concentrations**