

in the aggregate, they meet the tests of a significant subsidiary set forth in Rule 1-02(w).

Question 1: Must a registrant which includes separate financial statements or condensed financial statements for unconsolidated subsidiaries or investees in its annual report to shareholders also include in such report the summarized financial information for these entities pursuant to Rule 4-08(g)?

Interpretive Response: No. The purpose of the summarized information is to provide minimum standards of disclosure when the impact of such entities on the consolidated financial statements is significant. If the registrant furnishes more information in the annual report than is required by these minimum disclosure standards, such as condensed financial information or separate audited financial statements, the summarized data can be excluded. The Commission's rules are not intended to conflict with the provisions of APB Opinion 18, par 20(c) and (d), which provide that either separate financial statements of investees be presented with the financial statements of the reporting entity or that summarized information be included in the reporting entity's financial statement footnotes.

Question 2: Can summarized information be omitted for individual entities as long as the aggregate information for the omitted entity(s) does not exceed 10% under any of the significance tests of Rule 1-02(w)?

Interpretive Response: The 10% measurement level of the significant subsidiary rule was not intended to establish a materiality criteria for omission, and the arbitrary exclusion of summarized information for selected entities up to a 10% level is not appropriate. Rule 4-08(g) requires that the summarized information be included for all unconsolidated subsidiaries and investees. However, the staff recognizes that exclusion of the summarized information for certain entities is appropriate in some circumstances where it is impracticable to accumulate such information and the summarized information to be excluded is *de minimis*.

L. Financial Reporting Release 28—Accounting For Loan Losses By Registrants Engaged in Lending Activities

1. Accounting for Loan Losses

General: GAAP for recognition of loan losses is provided by Statements 5 and 114.¹ An estimated loss from a loss

contingency, such as the collectibility of receivables, should be accrued when, based on information available prior to the issuance of the financial statements, it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated.² Statement 114 provides more specific guidance on measurement of loan impairment and related disclosures but does not change the fundamental recognition criteria for loan losses provided by Statement 5. Additional guidance on the recognition, measurement, and disclosure of loan losses is provided by EITF Topic D-80, Interpretation 14, and the AICPA Audit and Accounting Guide, Banks and Savings Institutions.

Further guidance for SEC registrants is provided by FRR 28, which added subsection (b), Procedural Discipline in Determining the Allowance and Provision for Loan Losses to be Reported, of Section 401.09, Accounting for Loan Losses by Registrants Engaged in Lending Activities, to the Codification of Financial Reporting Policies (hereafter referred to as FRR 28). Additionally, public companies are required to comply with the books and records provisions of the Securities Exchange Act of 1934 (Exchange Act). Under Sections 13(b)(2)–(7) of the Exchange Act, registrants must make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets of the registrant. Registrants also must maintain internal accounting controls that are sufficient to provide reasonable assurances that, among other things, transactions are recorded as necessary to permit the preparation of financial statements in conformity with GAAP.

This staff interpretation applies to all registrants that are creditors in loan transactions that, individually or in the aggregate, have a material effect on the registrant's financial statements.³

² Paragraph 8 of Statement 5.

³ For purposes of this interpretation, a loan is defined (consistent with paragraph 4 of Statement 114) as a contractual right to receive money on demand or on fixed or determinable dates that is recognized as an asset in the creditor's statement of financial position. For purposes of this interpretation, loans do not include trade accounts receivable or notes receivable with terms less than one year or debt securities subject to the provisions of Statement 115

2. Developing and Documenting a Systematic Methodology

a. Developing a Systematic Methodology

Facts: Registrant A, or one of its consolidated subsidiaries, engages in lending activities and is developing or performing a review of its loan loss allowance methodology.

Question: What are some of the factors or elements that the staff normally would expect Registrant A to consider when developing (or subsequently performing an assessment of) its methodology for determining its loan loss allowance under GAAP?

Interpretive Response: The staff normally would expect a registrant that engages in lending activities to develop and document a systematic methodology¹ to determine its provision for loan losses and allowance for loan losses as of each financial reporting date. It is critical that loan loss allowance methodologies incorporate management's current judgments about the credit quality of the loan portfolio through a disciplined and consistently applied process. A registrant's loan loss allowance methodology is influenced by entity-specific factors, such as an entity's size, organizational structure, business environment and strategy, management style, loan portfolio characteristics, loan administration procedures, and management information systems.

However, as indicated in the AICPA Audit and Accounting Guide, Banks and Savings Institutions (Audit Guide), "[w]hile different institutions may use different methods, there are certain common elements that should be included in any [loan loss allowance] methodology for it to be effective."² A registrant's loan loss allowance methodology generally should:³

- Include a detailed analysis of the loan portfolio, performed on a regular basis;
- Consider all loans (whether on an individual or group basis);
- Identify loans to be evaluated for impairment on an individual basis under Statement 114 and segment the remainder of the portfolio into groups of loans with similar risk characteristics

¹ FRR 28 states that "the Commission's staff normally would expect to find that the books and records of registrants engaged in lending activities include documentation of [the]: (a) systematic methodology to be employed each period in determining the amount of the loan losses to be reported, and (b) rationale supporting each period's determination that the amounts reported were adequate."

² See paragraph 7.05 of the Audit Guide.

³ *Ibid.*

¹ As amended by Statement 118.