Loan Loss Accounting Basics

Starting on 12/31/2009, the bank has 5,000 in loans on the balance sheet and 100 in the loan loss reserve account (contra-asset). So, net loans are 4,900:

\[
\text{Loans} 5,000 - \text{Loan Loss Reserve} 100 = \text{Net Loans} \ 4,900
\]

On 5/25/2010, a loan in the amount if 5 becomes totally uncollectible and is written off:

Debit: Loan Loss Reserve 5  
Credit: Loans 5

Now, net loans are still 4,900 (4,995-95)

On 8/10/2010, a loan in the amount if 20 becomes totally uncollectible and is written off:

Debit: Loan Loss Reserve 20  
Credit: Loans 20

Now, net loans are still 4,900 (4,975-75)

As of 12/31/2010, bank management estimates that the loan loss reserve should be 120, so the loan loss reserve account must be increased by 45 (from 75 to 120):

Debit: Loan Loss Provision* 45  
Credit: Loan Loss Reserve 45

Now, net loans are 4,855 (4,975-120). The decrease in net loans over the year of 45 results from write-offs of 25 and a net increase in the reserve of 20.

*Loan Loss Provision is an expense on the income statement for 2010.