

RESCINDED

Adequacy of Valuation Allowances Program

This document and any attachments are superseded by the Comptroller's Handbook - Allowance for Loan and Lease Losses

EXAMINATION

To determine if the institution's policies, procedures, and methodologies regarding the establishment of valuation allowances are adequate and consistent with OTS policies including the Interagency Policy Statement on the Allowance for Loan and Lease Losses (ALLL).

To determine if management is operating in conformance with the institution's own policies and procedures and applicable laws and regulations.

To determine if the institution's internal controls are adequate to ensure compliance with the institution's own policies and procedures and applicable laws and regulations.

To determine if the ALLL is accurately reported on the Thrift Financial Report (TFR) and internal reports prepared for management and the board of directors.

To determine if the existing ALLL is adequate to cover losses inherent in the portfolio.

EXAMINATION PROCEDURES

LEVEL I

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1. Review the preceding report of examination and ALLL-related exceptions noted and determine whether management has taken appropriate corrective action.

2. Review the Matters Requiring Board Attention and Corrective Actions from the three or four previous ROEs to ensure that the board and management have taken appropriate corrective action where necessary and persistent problems have not recurred.

3. Obtain and review the association's written policies and procedures for the establishment and maintenance of adequate valuation allowances. If no written policies and procedures exist, determine from management the methods and procedures used to determine the adequacy of valuation allowances.

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4. Complete the Valuation Allowance Questionnaire. Determine whether the institution's allowance policies conform to the guidelines in the Interagency Policy Statement on the Allowance for Loan and Lease Losses.

5. Evaluate the institution's actual (versus stated) practices and the adequacy of internal controls that relate to ALLL.

6. Obtain copies of reports prepared by the institution for management and the board of directors. Determine the adequacy and accuracy of the institution's reports. Determine whether (and how) the reports are used to make strategic and operating decisions.

7. Review the institution's documentation related to ALLL. Determine if these documents adequately reflect an analysis of all significant factors, and whether they indicate compliance with the institution's written ALLL guidelines.

8. Consider reviewing internal and external audit reports and work papers to determine compliance with written ALLL guidelines. Determine whether management corrected instances of noncompliance.

9. Based on a review of the institution's records and documentation pertaining to the allowance, and through discussion with the EIC and examiners assigned to the loan portfolio evaluation function of the examination, determine if management has:
 - maintained effective systems and controls for identifying, monitoring and addressing asset quality problems in a timely manner;

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- analyzed all significant factors that affect the collectibility of the portfolio in a reasonable manner; and
 - established an acceptable ALLL evaluation process.
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10. Using TFR net charge-off data from Schedule VA, determine the institution's historical net loss experience. (Any SVAs established on such assets will have to be added as they are not included in Schedule VA.) Make a preliminary evaluation as to the adequacy of the institution's ALLL. This evaluation should be made in light of the guidelines in the Interagency Policy Statement on the Allowance for Loan and Lease Losses. If, based on this preliminary analysis, the institution's ALLL appears inadequate, perform a more detailed review of management's analysis to determine whether it is reasonable and supportable by the weight of reliable evidence and that all relevant factors have been appropriately considered.

11. Test the association's compliance with its own stated policies and procedures. Determine if any previously cited deficiencies have been corrected.

12. If management has made any large or unusual provisions to the ALLL that occurred during the review period, determine the events giving rise to such provision(s) and whether the provision(s) should have been recognized in prior periods.

13. Review Level II procedures and perform those necessary to test, support, and present conclusions derived from performance of Level I procedures.

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LEVEL II

14. Review the following reports submitted to the board of directors:

- delinquent and classified assets,
- charge-offs, and
- valuation allowance adequacy.
- Comment on a lack of or inaccurate reporting.

15. Identify and evaluate factors causing any changes in loss trends, such as an increase in delinquencies and classified or other problem assets that may have been brought about by a worsening of economic conditions or changes in underwriting. Assess whether such factors and trends are likely to continue to affect delinquencies and losses.

16. Obtain a list of all additional classified assets arising from the examination that were not classified by the institution. Consider these assets in the analysis of the adequacy of the current ALLL.

17. Determine if any assets (or portions thereof) classified Loss during the examination exceed the SVAs (or charge-offs) established for such assets by management. Determine the effect that either additions required to specific allowances or charge-offs will have on the ALLL.

18. Considering all pertinent factors, determine the adequacy of the institution's ALLL.

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19. After consulting with the EIC and appropriate regional staff, discuss findings with management, including inadequate valuation allowances and any weaknesses in, or nonconformance to, policies, practices, and procedures. If necessary, request that management make any appropriate adjustments during the examination to increase SVAs or the ALLL to levels considered adequate. Determine management's agreement or opposition to such request.
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20. Discuss with the examiners reviewing Earnings and Capital Adequacy the amount of any additional SVAs or ALLL that the institution will have to record based on examination findings.
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21. Ensure that the Objectives of this Handbook Section have been met. State your findings and conclusions, as well as appropriate recommendations for any necessary corrective measures, on the appropriate work papers and report pages. The ROE comments should indicate if management's concurrence with any requested adjustments has not been obtained in order to facilitate follow-up supervisory action.
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EXAMINER'S SUMMARY, RECOMMENDATIONS, AND COMMENTS

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