

FINDINGS REPORT

Introduction:

The allowance for loan and lease losses (ALLL) is an estimate of uncollectible amounts that is used to reduce the book value of loans and leases to the amount that is expected to be collected. The ALLL is a valuation reserve established and maintained by charges against the Bank's operating income.

To establish and maintain an adequate allowance, the Bank must:

- Understand the purpose of the allowance.
- Be able to recognize its problem loans in a timely manner.
- Have a sound analytical process for estimating the amount of inherent loss in its loan portfolio.

Risks associated include the following:

- Credit Risk
- Compliance Risk
- Reputation Risk

Objectives:

- To assess the adequacy of the ALLL policy.
- To determine if the allowance process is methodically appropriate, logical, reasonable, timely and consistent.
- To determine if there is an effective loan charge-off process.

Procedures:

- Document the Bank's internal control structure using the OCC's Internal Control Questionnaire.
- Assess the adequacy of the ALLL Policy. The Policy should provide for the following:
 - A comprehensive and well documented process for maintaining an adequate allowance.
 - An effective loan review system that will identify, monitor, and address asset quality problems in an accurate and timely manner.
 - Procedures for the timely charge off of loans that are determined to be uncollectible.
 - A defined collection effort to be continued after a loan is charged off.
- Obtain a description of the process used by Management to determine an appropriate level for the allowance, along with the supporting documentation for the most recent evaluation. Determine if the process is sound, based on reliable information, and well documented.
- Obtain and review reports used by Management to accurately prepare the ALLL. Examples include: General and subsidiary ledger(s), monthly reconciliation of ALLL.
- Obtain and review the documentation supporting Management's quarterly review of the portfolio adequacy analysis for the ALLL report.
- Select a sample of charged-off loans and:
 - Review supporting documentation.
 - Trace approval by the directors, as evidenced in the minutes of Board meetings.
- Determine if processes relating to loan charge-offs ensure the accuracy of subsidiary records, security of notes, appropriate review and approval, and effective collection efforts.
 - Review Board meeting minutes to determine if all charged-off loans are reviewed and approved by the Board.
 - Review internal control procedures relating to loan files for charged-off loans.

ALLOWANCE FOR LOAN AND LEASE LOSSES

- Review the collection process for charged-off loans.
- Review periodic progress reports provided to Management for all charged-off loans for which collection efforts are continuing.
- Compare the total charged-off loans since the last audit date as recorded in the charged-off ledger to the total debit entries in the allowance for loan and lease losses for the same period.
- Obtain a listing of internal/external audit deficiencies noted in the latest review. Review for appropriate corrections.
- Assess Management's ability to properly analyze the adequacy of the allowance for loan and lease losses.
 - Evaluate Management's understanding of the principles and methods used.

Findings:

Recommendations:

Conclusion:

Manager Response: