

Allowance for Loan Loss Testing

SOX Testing Procedures

Select a sample of significant loan relationships (including loans on the watch list and loans not on the watch list) and test for the following:

1. The loan has been recently graded by management. The grade is consistent with lending policy considering current financial condition of the borrower.
2. Specific reserves provided on individual problem loans are supported by detailed estimates of borrower cash flows and discounted collateral. Assumptions utilized in establishing specific reserves are considered reasonable.

Select a sample of significant loan relationships (including loans on the watch list and loans not on the watch list) and test for the following:

1. Independent loan review function has concluded specific reserve allocation and assigned loan grade is reasonable.

Determine the process for assembling the watch list and that there are proper segregation of duties. For a sample of loans listed as past due, impaired etc., confirm that the loans are showing on the watch list.

Determine that there is review of the allowance by a proper level of management. For a sample of monthly or quarterly calculations, determine that the allowance is being properly adjusted through the provision.

Select a sample of significant charge-offs and determine whether the charge-off was consistent with the amounts previously identified as specific reserves in recent AFLL analysis and that the timing of the charge off was consistent with confirmation of loss. Determine if the charge-off was approved by the required level of management.

Review the process of posting recoveries and confirm that it is being done in accordance with proper accounting guidance and net charge-offs are properly disclosed.

Review tickler system in order to determine the adequacy of information captured. Determine if information appears to be obtained in a timely manner.

Inquire, inspect and observe the process for the generation of the past due report and review by senior management to determine that adequate segregation of duties exists. For a sample of loans that over 90 days past due, confirm that the loans are placed on nonaccrual.

For a sample of loans that have been placed on nonaccrual, test to see that accrued interest has been reversed.

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For a sample of loans on nonaccrual that have received payments, test to see that the payments were posted to principal.

For a sample of loans that have been taken off of nonaccrual and placed back onto accrual, review for proper approval.

Obtain the AFLL analysis and determine the following:

1. The analysis was performed on a timely basis (at least quarterly) and is tied to the loan grading system / watch list system. Provision expense taken during the year are based upon the periodic analyses performed by management (unallocated reserves did not change significantly during the year).
2. The analysis provides for specific reserves consistent with SFAS No. 114.
3. The analysis provides for general reserves consistent with SFAS No. 5 (Reserves in excess of historical experience are supported by observable data and other factors).
4. The analysis is mathematically accurate and agrees to source documentation.

Confirm that management conducts a review of the details of the disclosure and financial statements.