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AUDIT READINESS GUIDE

CECL & ACL Audit Readiness Guide

What community banks & credit unions need to know to strengthen governance, documentation, and exam readiness.

CONTENTS

In This Guide

1 SECTION 1

Introduction

The Current Expected Credit Loss (CECL) standard reshaped how financial institutions estimate and report credit losses. For community banks and credit unions, CECL is more than a model — it is a comprehensive framework requiring:

- Robust governance
- Strong data foundations
- Documented methodology decisions
- Transparent modeling assumptions
- Independent validation
- Consistent internal controls

This guide provides practical, exam-focused information to help institutions strengthen their Allowance for Credit Losses (ACL), reduce audit findings, and maintain ongoing regulatory readiness.

Well-prepared institutions experience fewer exam findings, cleaner audits, and more confidence in their CECL process.

2 SECTION 2

CECL Overview for Community Banks

CECL requires institutions to estimate lifetime expected credit losses, replacing the incurred loss model.

This introduces:

- Greater emphasis on historical data
- Forward-looking assumptions
- More rigorous documentation
- Increased modeling transparency
- Higher expectations for validation and controls

For many community banks, CECL is manageable — when supported by clear processes, documentation, and internal oversight.

3 SECTION 3

Governance & Oversight Expectations

Regulators look for strong CECL governance that demonstrates accountability and control.

Key Governance Elements

- Formal assignment of CECL ownership
- Evidence of board/ALCO involvement
- Documented review & approval workflows
- Ongoing monitoring of assumptions and Q-factors
- Accountability across credit, finance, and risk teams

Strong governance shows that CECL is treated as a living process, not a one-time implementation.

4 SECTION 4

Data Requirements & Data Quality

CECL relies heavily on complete, accurate, and consistent historical data.

What Regulators Expect

- Full historical loss data
- Accurate loan attributes (origination date, maturity date, risk rating)
- Consistent segmentation across systems
- Documented data sources and transformations

Common Data Issues

- Missing origination dates
- Inconsistent risk ratings
- Gaps in charge-off and recovery history
- Segmentation changes without documentation
- Lack of a data dictionary

Best Practices

- Maintain a data dictionary
- Conduct regular data quality reviews
- Document all cleaning and adjustments
- Reconcile segmentation regularly

5 SECTION 5

CECL Methodology Selection

Multiple CECL methods are acceptable. The best choice depends on portfolio risk, data quality, and institutional capability.

Common CECL Methodologies

- Loss Rate Method
- WARM (Weighted Average Remaining Maturity)
- Vintage Analysis
- Discounted Cash Flow (DCF)
- PD/LGD

Factors to Consider

- Portfolio complexity
- Historical data availability
- Staffing & internal expertise
- Explainability to auditors & regulators
- Ability to maintain/validate the model

The best methodology is one where the institution can defend, document, and maintain consistently.

6

SECTION 6

Documentation Requirements

Documentation is one of the most common audit weaknesses.

Required Documentation

- Methodology selection rationale
- Detailed model logic and assumptions
- Data source descriptions
- Segmentation criteria
- Q-factor framework and support
- Model limitations
- Change logs and version control
- Annual validation reports

7 SECTION 7

Model Validation Essentials

Independent validation is a CECL expectation. A strong validation includes:

1. Conceptual Soundness

- Methodology appropriateness
- Reasonable assumptions
- Alignment with risk and portfolio characteristics

2. Process Verification

- Formula testing
- System logic review
- Data flow review
- Control evaluation

3. Outcomes Analysis

- Back-testing
- Sensitivity analysis
- Benchmarking

Annual validation (or sooner if changes occur) strengthens audit readiness.

8 SECTION 8

Q-Factor Best Practices

Qualitative factors remain the most frequently challenged part of CECL.

Strong Q-Factors Are

- Supported by measurable data
- Updated regularly
- Tied to documented risk trends
- Transparent and defensible
- Not used as "plug numbers"

Weak Q-Factors Are

- Unchanged quarter after quarter
- Broad or subjective with no metrics
- Unsupported adjustments
- Used to offset model outputs

Strong support connects qualitative adjustments to clear evidence.

9 SECTION 9

Reporting, Controls & Audit Trail

Regulators want consistent, repeatable, well-controlled CECL reporting.

Key Requirements

- Reconciliation to general ledger (GL)
- Documented review & approval
- Defined reporting workflows
- Controlled system access
- Change management logs
- Evidence of periodic control testing

A strong audit trail ensures model transparency and repeatability.

10 SECTION 10

Common Audit Findings

Recurring issues seen across community bank exams:

- Insufficient documentation
- Unsupported Q-factors
- Incomplete data history
- Weak governance
- No evidence of independent validation
- Errors from manual spreadsheets
- Inconsistent segmentation
- Poorly documented assumptions

Addressing these areas reduces regulatory feedback and improves CECL reliability.

11 SECTION 11

CECL Readiness Self-Assessment

Use this checklist to evaluate your institution's readiness:

Governance

- CECL responsibility assigned
- Regular board/ALCO oversight
- CECL included in audit plans

Documentation

- Comprehensive documentation packet
- Supported Q-factors
- Updated change logs

Data

- Complete historical data
- Validated segmentation
- Data dictionary maintained

Validation

- Independent validation completed
- Back-testing performed
- Sensitivity analysis documented

Methodology

- Method choice documented
- Assumptions reviewed periodically
- Aligned with institutional risk

Reporting & Controls

- ACL reconciles to GL
- Review/approval demonstrated
- Control testing documented

> Prefer a guided version of this checklist? Take PBC's free interactive CECL & ACL Readiness Assessment at **www.premierbankingconsultants.com/cecl-acl-assessment** for instant, scored results.

12 SECTION 12

Preparing for a CECL Audit or Exam

Pre-Exam Checklist

- Collect all CECL documentation
- Review last validation and remediation steps
- Reconcile ACL to GL
- Prepare Q-factor support packet
- Document assumption changes
- Retain evidence of sign-offs
- Conduct a mock review

Preparing early demonstrates strong governance and reduces exam friction.

13 SECTION 13

When Institutions Should Seek External Support

External help is recommended when:

- Documentation is incomplete
- Q-factors lack measurable support
- No recent validation exists
- Staff turnover reduced expertise
- New methodology or portfolio changes occurred
- Regulatory criticism was received
- Management wants pre-exam confidence

External review provides expert assurance and exam-focused clarity.

14 SECTION 14

About Premier Banking Consultants

Premier Banking Consultants (PBC) provides independent CECL and ACL services tailored to community banks and credit unions.

Our Expertise Includes

- CECL model validation
- ACL audit readiness reviews
- Documentation development
- Data quality assessments
- Methodology consultation
- Q-factor framework refinement
- Parallel testing support
- Exam preparation

With over 25 years of experience and support for more than 20 institutions, PBC brings practical, exam-ready expertise without selling software.

READY WHEN YOU ARE

Let's assess your institution's CECL readiness.

If you'd like to review your institution's CECL process or prepare for an upcoming audit cycle, Premier Banking Consultants can help.

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OR TAKE THE FREE INTERACTIVE ASSESSMENT

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