

SEQUENTIAL SAMPLING OF ASSETS REVIEWED UNDER IAR PROGRAMS

Summary

The examiner will undertake “sequential sampling,” under which a small sample of assets is initially reviewed to determine if the IAR program is reliable for the purpose of including the results of the IAR program in meeting minimum examination sampling coverage standards. If, after analyzing the sample, the examiner determines that the IAR program’s results are acceptable, all internally reviewed assets can be included in meeting the minimum examination sampling coverage standards. The sample size is increased if “exceptions” (as defined in Appendix A of this Section) are found in the initial sample. Examiners may conclude that the institution has an acceptable IAR program if an acceptable number of exceptions are found. Once 4 or more exceptions are found however, the IAR program does not meet the reliability standards established in this Handbook Section and the examiner can only include the assets he or she independently reviews in meeting the minimum examination sampling coverage standard.

The chart below summarizes the sample discussed more fully below under “Process” and the maximum number of exceptions allowable:

<u>Sample Size</u>	<u>Number of Exceptions Allowed</u>
29	0
46	1
61	2
76	3

If 4 or more exceptions are found, the IAR program does not meet the reliability standards established in this Handbook Section, and the examiner can only include the assets he or she independently reviews in meeting the minimum examination sampling coverage standard.

If fewer than 4 exceptions are found, an examiner can conclude, with a 95% confidence level (reliability), that the IAR program meets the reliability standards established in this Section. Specifically, there is only a 5% risk that the population deviation rate (e.g., the number of internally reviewed assets that are inappropriately classified) exceeds 10%.

To ensure that OTS does not inappropriately decide that an institution’s IAR program does not meet the reliability standards established in this Section, exceptions should be reviewed by the EIC or another examiner. This review, like the initial review, should focus on whether reviewer’s classifications of the assets are the same as the institution’s classification of the assets. The results of this review should be used for purposes of determining if the IAR program is reliable for the purpose of including the results of the IAR program in meeting minimum examination sampling coverage standards.

Process

Note: All of the assets reviewed by the institution under its IAR program should be considered one population of assets.

Step 1: The examiner should systematically select 29 assets for review from the population of assets reviewed under the IAR program, unless the sample size can be reduced in accordance with Appendix C.

- One method to systematically select the assets for review is to assign each asset in the pool a number, starting from 1. The examiner should then divide the total number of assets in the pool by 29 to get the “numeric interval” to be used to select the loans to review.

For example, if there are a total of 900 assets, the examiner should divide 900 by 29, which equals 31 ($900/29 = 31$). 31 is the “numeric interval” — the examiner will review every 31st asset. The examiner should start selecting assets from a random starting place between the 1st and 31st asset. If asset number 3 is the first asset selected for review, the examiner should next select assets number 34 ($3 + 31$), then asset number 65 ($34 + 31$), and so on, until all 29 assets have been selected for the sample.

Step 2: The examiner should then review the 29 assets.

- The review should focus on whether the examiner’s classifications of the assets are the same as the institution’s classifications of the assets. An exception should be noted as discussed in Appendix A of this Section.

Examiners should refer to Examination Handbook Section 260, Classification of Assets, for guidance on classification.

- If there are no exceptions in the classification of the 29 assets, then the examiner can conclude that the institution has a satisfactory IAR program for the purpose of including the results of the IAR program in meeting minimum examination sampling coverage standards and all internally reviewed assets can be included in meeting the minimum examination sampling coverage standards. The examiner should proceed to Step 3.
- If exceptions are noted, the sample size should be expanded in accordance with the chart above, until either the number of exceptions is within the acceptable tolerance or the number of exceptions total 4 or more.

Step 3: The examiner should document his/her conclusions about the reliability of the institution’s IAR program for the purpose of including the results of the IAR program in meeting minimum examination sampling coverage standards, and should state any recommendations for necessary corrective measures in the appropriate work papers and, if necessary, in the Report of Examination.