

EARNINGS

Core Analysis Decision Factors

Examiners should evaluate the Core Analysis in this section to determine whether an Expanded Analysis is necessary. Click on the hyperlinks found within each of the Core Analysis Decision Factors to reference the applicable Core Analysis Procedures.

Do Core Analysis and Decision Factors indicate that risks are appropriately identified, measured, monitored, and controlled?

C.1. Are profit planning and budgeting practices adequate? Refer to Core Analysis [Procedures #8-13](#).

C.2. Are internal controls adequate? Refer to Core Analysis [Procedures #14-18](#).

C.3. Are the audit or independent review functions adequate? Refer to Core Analysis [Procedure #19](#).

C.4. Are information and communication systems adequate and accurate? Refer to Core Analysis [Procedures #20-22](#).

C.5. Are earnings sufficient to support operations, provide for funding of the allowance for loan and lease losses (ALLL) (or allowance for credit losses (ACL)¹, when applicable) and augment capital? Refer to Core Analysis [Procedures #23-33](#).

C.6. Are earnings sustainable? Refer to Core Analysis [Procedures #34](#).

C.7. Do the board and senior management effectively supervise this area? Refer to Core Analysis [Procedures #35-36](#).

¹ ACL replaces the term ALLL for those banks that adopted ASU 2016-13.

EARNINGS
Core Analysis Procedures

Examiners are to consider the following procedures but are not expected to perform every procedure at every bank. Examiners should complete only the procedures relevant for the bank’s activities, business model, risk profile, and complexity. If needed, based on other identified risks, examiners can complete additional procedures. References to laws, regulations, supervisory guidance, and other resources are not all-inclusive.

Preliminary Review
<p>1. Review previous reports of examination, prior examination work papers, and file correspondence for an overview of any previously identified earnings concerns, strengths, or other considerations.</p>
<p>2. Review recent audits and independent reviews to identify deficiencies concerning the reliability of management information systems (MIS) that may affect the quality and reliability of reported earnings.</p>
<p>3. Review management’s remedial actions to correct examination and audit deficiencies.</p>
<p>4. Discuss with management any recent or planned changes in strategic objectives and their implications for profit plans.</p>
<p>5. Review board and committee minutes along with management reports to determine the adequacy/quality of MIS systems and reports.</p>
<p>6. Review recent Uniform Bank Performance Reports (UBPR) to develop an initial assessment of overall earnings performance. Consider the impact of Subchapter S tax filing status when selecting performance ratios to review.</p>
<p>7. Compare financial statements, UBPRs, and Consolidated Reports of Condition and Income (Call Reports) to determine whether there have been any significant changes that could materially affect earnings performance.</p>

Profit Planning and Budgeting Practices
<p>8. Review the strategic plan to determine the board’s goals and objectives over the near- and moderate-term, including consideration of local and national economic conditions, new products or services, and growth.</p>
<p>9. Assess the potential impact of new strategic initiatives on future earnings performance. Consider the following:</p> <ul style="list-style-type: none"> • Branching activities; • Acquisition/merger activity; • New products and services; and • Anticipated outlays (e.g., technological upgrades).
<p>10. Determine whether profit plans and budgeting practices are realistic, consistent with the strategic plan, and address the following areas with detail appropriate for the business model, size, complexity, and risk profile:</p> <ul style="list-style-type: none"> • Local and national economic conditions, • Competitive environment, • Strategic plans, • New or changing products and business lines, • Growth objectives, • Capital requirements, • Managerial resources, • Asset and liability mix and pricing, • Funding strategies, • Anticipated level and volatility of interest rates, • Interest rate and maturity mismatches, and • Anticipated funding of the ALLL (or ACL, when applicable).
<p>11. Determine whether profit plans realistically assess the costs associated with the risk management processes needed for new initiatives, changes in risk appetite, and potential deterioration in asset quality or market conditions.</p>
<p>12. Assess the timeliness of preparing and approving the profit plans and budgets.</p>
<p>13. Compare earnings performance to budget forecasts. Determine whether management compares</p>

budgeted performance to actual performance on a periodic basis, modifies projections when interim circumstances change significantly, and evaluates budget forecasts under multiple stress scenarios.

Internal Controls

14. Review management's procedures to prevent, detect, and correct errors with respect to MIS.

15. Determine whether the income and expense posting, reconciliation, and review functions are independent.

16. Consider testing selected income, expense, and balance sheet items to observe the flow of transactions and to identify internal control weaknesses. Areas commonly selected for review are:

- **High levels of other income in miscellaneous-income, service-fee, or unusual accounts;**
- **Proper amortization of loan origination fees;**
- **Insider expense accounts;**
- **Management fees or other payments to affiliates or insiders;**
- **Significant legal or consulting fees;**
- **Prepaid accounts;**
- **Stale items; and**
- **Expenses accrued and unpaid.**

17. Determine whether significant or non-recurring income, expenses, and capital charges are reviewed and authorized by senior management and the board.

18. Determine whether insider or affiliate-related income and expense items are routinely reviewed for authorization, appropriateness, and compliance with laws and regulations.

Audit or Independent Review

19. Determine whether the audit or independent review program provides sufficient coverage of earnings activities relative to the bank's business model, size, complexity, and risk profile. Determine whether these programs:

- **Assess compliance with profit planning objectives, accounting standards, and Call Report Instructions;**
- **Include sufficient transaction testing to assure income and expenses are accurately recorded;**

- Assess separation of duties and internal controls;
- Assess the adequacy, accuracy, and timeliness of reports to senior management and the board;
- Recommend corrective action when warranted; and
- Verify implementation and effectiveness of corrective action.

Information and Communication Systems

20. Determine whether managerial reports provide sufficient information relative to the business model, size, complexity, and risk profile of the bank.

21. Evaluate the accuracy and timeliness of reports produced for the board and executive management. Reports may include:

- Periodic earnings results,
- Budget variance analyses,
- Income and expense projections,
- Nonrecurring or cyclical items,
- Exposure to interest rate/market risk,
- Large item reviews,
- Insider related transaction disclosures, and
- Tax planning analyses.

22. Validate the accuracy of Call Reports as appropriate. Review bank work papers, the general ledger, and downloaded exception reports; and interview bank personnel to verify the accuracy of Call Report schedules RI, RI-A, RI-B, RI-C, RI-D, RI-E, and RC-K.

Ratio and Trend Analysis

23. Assess the level and trend of the return on average assets (ROAA) relative to historical performance, peer comparisons, the organization's business model, risk profile, balance sheet structure/composition, and local and national economic conditions. Consider the amount and volatility of income from high-risk assets, asset concentrations, non-recurring items, and accounting practices subject to management discretion (which could manipulate earnings). Identify and assess areas needing further investigation.

24. Evaluate the level, trend, and stability of the net interest margin (NIM). Discuss with credit, market, and liquidity risk examiners the impact to present and future earnings performance from potential changes in asset quality, market fluctuations, and interest rates.

25. Evaluate the level and trend of overhead in relation to operational activities. Consider the effect of strategic initiatives (such as, new products/services, branch openings/closings, and staffing increases/decreases).
26. Evaluate the level, trend, and sources of non-interest income. Discuss with management any projections for changes in fee structures. Consider the impact of changes in interest rates and market conditions on mortgage banking income, securities gains, or other non-interest revenue sources.
27. Review the level and trend of provisions to the ALLL (or ACL, when applicable) and the relationship to actual loan losses to determine the impact of asset quality on earnings. Discuss with the examiner(s) responsible for loan review the potential need for additional provision expenses resulting from examination findings.
28. Review the level, trend, and expected frequency of non-operating gains and losses and their impact on earnings.
29. Consider the impact to earnings from purchased-impaired accounting practices, and if applicable, discuss with an accounting specialist.
30. Determine whether there have been or are expected to be any non-recurring events and consider their impact to earnings performance. If necessary for comparison purposes, evaluate this impact on a tax-equivalent basis.
31. Evaluate the level and trend of income tax payments recognizing the bank's basis for filing taxes. (e.g., Subchapter S, tax allocation agreement)
32. Determine whether transactions between affiliated organizations and subsidiaries have an impact on the bank's earnings.

33. Assess the ability of earnings to support capital growth under current, projected, and stressed conditions. Review the earnings retention rate in comparison to past and forecasted growth rates.

Sustainability

34. Determine whether the current level of earnings is sustainable. Consider the following:

- **Level and trend of the ROAA, NIM, overhead, fee income, and ALLL (or ACL, when applicable) provisions;**
- **Asset quality trends;**
- **Management’s ability to forecast or control funding and operating expenses;**
- **Strategic plans, including new initiatives;**
- **Competitive and economic conditions; and**
- **Vulnerability to adverse events.**

Board and Senior Management Supervision

35. Review relevant documentation to determine whether the board assesses bank earnings and responds to significant budget deviations.

36. Assess compliance with bank policies, applicable regulations, and governing accounting standards. If applicable, determine compliance with outstanding formal or informal enforcement actions.

End of Core Analysis. If needed, Continue to the Expanded and Impact Analyses.