

EARNINGS

Expanded Analysis Decision Factors

This section evaluates the significance of deficiencies or other specific concerns identified in the Core and Expanded Analyses. Click on the hyperlinks found within each of the Expanded Analysis Decision Factors to reference the applicable Expanded Analysis Procedures. If needed, proceed to the accompanying [Impact Analysis](#).

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

E.1. Are management and control of earnings functions satisfactory? Refer to Expanded Analysis [Procedures #1-28](#).

E.2. Are earnings deficiencies or fluctuations immaterial? Refer to Expanded Analysis [Procedures #1-28](#).

EARNINGS
Expanded Analysis Procedures

Generally, procedures used in the Expanded Analysis should target concerns identified in the Core Analysis and Decision Factors. The flexible guidelines specified for the Core Analysis also apply to the Expanded Analysis.

Profit Planning and Budgeting Practices
<ol style="list-style-type: none"> 1. Assess the significance and determine causes of budgeting deficiencies. Address areas that do not appear realistic in the examination report.
<ol style="list-style-type: none"> 2. When appropriate, consider requesting that management revise budget projections using modified assumptions. Revisions to the budget should be presented to the board for approval.
Internal Controls
<ol style="list-style-type: none"> 3. Determine the causes of inadequate accounting or reporting practices and evaluate the implications to earnings performance and as appropriate, stock price, and pending or needed capital raises.
<ol style="list-style-type: none"> 4. Verify source documents against general ledger entries to determine whether errors on Consolidated Reports of Condition and Income (Call Reports) influence performance ratio levels and trends.
<ol style="list-style-type: none"> 5. Consider transaction testing to verify the authorization, propriety, and accuracy of reviewed activity if internal controls are deemed insufficient.
Audit or Independent Review
<ol style="list-style-type: none"> 6. Review audit or independent review workpapers and consider expanding examination activities in the areas of concern.
<ol style="list-style-type: none"> 7. Research deficiencies cited in audit or independent review reports to determine the underlying causes and assess management's corrective efforts.

Information and Communication Systems
8. Assess the significance of internal management reporting deficiencies and determine underlying causes.
9. Determine needed changes in report distribution throughout the organization.
10. Consider performing a detailed review of the Call Report where significant errors are indicated. Request that filings be amended where identified errors are material, and revise Report of Examination data where necessary.
Ratio and Trend Analysis
11. Determine the underlying reasons for a low or erratic return on average assets and discuss management’s plans to improve or stabilize earnings performance.
12. Determine the extent a low or inconsistent net interest margin results from composition and yields of the loan and investment portfolios versus composition and costs of funding sources.
13. Where earnings concerns derive from interest income levels, identify the underlying cause(s). Potential reasons for low interest income levels may be:
<ul style="list-style-type: none"> • The level and trend of nonaccrual loans and other nonearning assets, • Ineffective asset pricing strategies, • Investment decisions, • Asset repricing structure and excessive interest rate risk exposure, • Asset distribution, • Changes in asset mix, and • Competition.
14. If interest income levels are fluctuating significantly, review IRRSA (FDIC), FOCUS (FRB), or other interest rate reports for possible interest rate risk exposure. Coordinate with examiners reviewing sensitivity to market risk.

15. Where earnings concerns derive from interest expense levels, determine the underlying causes, such as:

- Use of high-cost borrowings;
- Concentration of high-cost deposits;
- Liability repricing structure and excessive interest rate risk exposure;
- Migration of core deposits to higher rate products;
- Ineffective funding strategies;
- Competition; and
- Low levels of core deposits.

16. When earnings concerns derive from non-interest expenses, determine the underlying causes. Examples include:

- Excessive personnel expenses, including unreasonable incentive compensation plans relative to the bank's business model, risk profile, complexity, and earnings performance;
- Unusually high personnel benefits;
- Inaccurate reporting of employee benefits;
- Inadequate authorization by the board of directors of all material employee benefits;
- Inefficient staffing levels relative to the organization's business lines and risk profile;
- Over-reduction of personnel (downsizing) and occupancy expense that negatively affect management's ability to prudently conduct and supervise banking activities;
- Unusually high expenses for premises and fixed assets (depreciation/amortization, property insurance, real estate taxes, etc.); and
- Abnormal impact of write-downs of intangible assets.

17. Assess fixed asset investments and lease payments, paying particular attention to any insider or intercompany transactions (e.g., purchase of bank vehicles from a director's auto dealership, leasing office space to or from the parent company).

18. Review service fees paid to affiliated parties and others to ensure compliance with applicable laws or regulations. Review and assess service agreements or intercompany transaction agreements and compliance therewith.

19. Review legal expenses and identify underlying causes of increased legal charges. Discuss with the responsible examiner the bank's inherent level of litigation risk, adequacy of litigation risk management practices, and composite risk level and trend. Consider the following situations, which can elevate legal expenses:

- Administration and disposal of problem assets;

<ul style="list-style-type: none">• Involvement in significant litigation; and• Significant changes in the bank's strategic objectives (purchases or mergers).
20. Review the sources or activities generating significant volumes of non-interest income and determine whether the current volume is sustainable (e.g., insurance activities or mortgage banking programs).
21. Determine management's rationale or motivation for increased reliance on non-interest income. Consider the strategic decisions that support an increased level of non-interest income (such as new service or business ventures) and whether management prudently researched the risks and rewards of such initiative(s).
22. If there are asset quality concerns, analyze (or discuss with examiners reviewing asset quality) the potential impact to operating profitability from: <ul style="list-style-type: none">• Increasing levels of nonperforming assets;• Escalating administrative, legal, and collection expenses; and• Increasing provisions for loan losses or inadequate reserves.
23. Determine whether gains from asset sales result from strategic asset restructurings or a short-term response to improve earnings. If the latter, assess the sustainability of this income source and evaluate the potential, long-term affects to core earnings.
24. Review erratic or unusually large tax levels to determine the underlying reason. High or fluctuating tax liabilities may be indicative of: <ul style="list-style-type: none">• Inaccurate financial reporting;• Inaccurate accounting for applicable taxes;• Poor tax planning; and/or• A change in tax basis.
25. Verify internal tax calculations, assess the timing of required interim payments, and review compliance with intercompany tax-sharing agreements and applicable laws or regulations.

Board and Senior Management Supervision
26. Where applicable, determine why previously identified deficiencies remain uncorrected.
27. Determine the reasons for poor compliance with internal policy guidelines, governing accounting standards, applicable regulations, or formal/informal enforcement actions.
28. Identify needed corrective actions and assess the adequacy and viability of management's commitments.
End of Expanded Analysis. If needed, Continue to Impact Analysis.

EARNINGS
Impact Analysis Procedures

Impact Analysis reviews the impact that deficiencies identified in the Core and Expanded Analysis and Decision Factors have on the bank's overall condition, and directs the examiner to consider possible supervisory options.

Impact Analysis Procedures
1. Analyze the impact of earnings deficiencies on the bank's overall condition. Estimate future earnings levels and calculate the impact on capital levels and access to liquidity sources if these performance issues continue.
2. Determine the need for administrative or enforcement actions, formulate specific recommendations, and advise the appropriate supervisory officials on the nature of the concerns.
3. Discuss the possibility of administrative or enforcement actions with senior management and the board of directors.
End of Impact Analysis.