ASSIGNMENT OVERVIEW

A well-performed analytical review of earnings provides an understanding of the bank’s operations, and highlights matters of interest and potential problems which, if detected early, might avert more serious situations. Earnings should be sufficient to cover the bank’s recurring expenses and provide adequate reserves, leaving a net profit to contribute toward capital accretion and pay dividends. In evaluating earnings, comparisons are made between current and historic performance, and to the performance of other banks of similar size and characteristics. Management’s profit plans and budgets should be reviewed since planning and prospects are important to the long-term viability of the financial institution. Examiners may also want to review a sample of income and expense accounts and call reports to verify data and ensure proper accounting techniques. Refer to Section 5.1, Earnings, in the FDIC Examination Manual for a complete discussion of earnings. Refer to the DOB’s Reference Material documents for a list of reference materials applicable to this procedure.

INSTRUCTIONS


All examiners performing these procedures must be listed above in the “Prepared By” section. All of the CORE ANALYSIS PHASE should be completed. Comments and findings for each step should be made in the comment box below each question. Reference to work paper documentation should also be included here. Documentation is to be sufficient to allow an audit trail of the examiner’s thought process and all significant findings.

Based on any weaknesses or risks noted in the CORE ANALYSIS PHASE or as directed by the EIC, the applicable SUPPLEMENTAL ASSESSMENT PHASE (SAP) should also be performed. Responses should be entered in the SAP and conclusions summarized in the CORE section. Examiners should indicate when SAP is performed.

Information on the Summary of Findings page must tie back to the findings noted within the procedure. The SEIC/EIC will determine which information in the Summary of Findings will be included in the Report of Examination.

The EIC/AEIC should review this procedure when complete. Acknowledgement that this procedure has been reviewed by the EIC/AEIC will be noted on the SCOPE FORM.

Examiners are responsible for exercising sound judgment and utilizing reasonable investigative and analytical skills to arrive at an accurate assessment of the risk profile of this segment of the institution’s operations. Performing alternate procedures not listed with these guidelines may be necessary to complete this risk analysis.
#9 Earnings

## 1. Prior Criticisms

**1a.** Determine whether deficiencies were noted in the last examination and most recent internal/external audit. If so, determine if deficiencies have been addressed and/or corrected by management. Detail how deficiencies were corrected. *Include copy of exam and/or audit exceptions and management response in work papers, or summarize exceptions/criticisms below or indicate the page number in the last examination report where deficiencies are noted, if applicable.*

**Comment:**

## 2. Reconciliation

**2a.** Coordinate with other examiners to verify proper categorization of GL accounts against Call Report schedules RI, RI-E, RC-K for the most recent year-end. If numerous or amendable errors are noted or there have been errors in the past, then verify current period and complete the **SAP**. *Include detailed audit trail and copy of all general accounts in 9-C of work papers.*

SAP Completed:  YES ☐  NO ☐

If Yes, Comment:

## 3. Budget/Budgeting Process

**3a.** Review the budget and evaluate the budgeting process considering: significant deficiencies/weaknesses in the process, large variances, material adjustments, and other important factors such as significant new products or services, high overhead, complex or unusual sources of income, below average ROA or declining trend contrary to industry. Comment on any deficiencies.

If numerous weaknesses are observed address the following:

1. Identify the key personnel involved and the factors/variables used.

2. Verify that the current year budget and last year budget (if applicable) were approved by the Board.

3. Determine that reports go to the Board informing them of earnings performance and any differences in the budget. *Include copy of regular Board report on earnings vs. budget in the work papers.*

4. Explain reasons for major revisions and verify Board approval.

5. Explain if variances are the result of planning deficiencies or from external factors beyond management’s control.
#9 Earnings

6. Document actual net income to budgeted for the current period and prior year end
   \((NI \text{ Variance: } $\underline{\text{_______}}/ \underline{\text{_______}} \%)\). Include in work papers.

7. Calculate projected current year-end ROA to determine reasonableness. Note projected ROA
   in comments.

   Include year-end and current budget comparisons in 9-B of work papers.

Comment:

4. Earnings Review

4a. Determine if the bank’s system of earnings review meets the requirements of the Interagency
    208 Regulation H, Subpart D for member banks).

Determine if the bank or senior management:

- Compares recent earnings trends relative to equity, assets, or other commonly used benchmarks
to historical results and provide adequate reports for review.
- Evaluates adequacy of earnings given the size, complexity, and risk profile of assets and
  operations.
- Assesses the source, volatility, and sustainability of earnings, including the effect of
  nonrecurring or extraordinary income or expense.
- Takes steps to ensure that earnings are sufficient to maintain adequate capital and reserves after
  consideration of the institution’s asset quality and growth rate.

Comment on weaknesses.

Complies with Interagency Guidelines (12 CFR 364 or 12 CFR208): YES ☐  NO ☐

A response of “No” requires a comment.

Comment:

4b. Utilizing ETS calculated ratios and the UBPR, evaluate the quality and the adequacy of earnings by
analyzing peer, level, and trend of: ROA, asset yields, cost of funds, earning assets/total assets, NIM,
noninterest income, overhead expense, and provisions to the ALLL.

Comment on the following:

1. Significant increasing/decreasing trends
2. Instances where ratios are well above/below peer and reasons why.
3. ROA
4. NIM
#9 Earnings

5. Overhead

6. If applicable: Impact on interest income if bank is reducing concentration levels of higher risk categories. Implications for future earnings. (Consider fee income, interest only loans, renewals)

Refer to Appendix for ratio calculations.

Comment:

4c. Comment on nonrecurring items and the impact to the ROA for current and prior periods. Recalculate the adjusted ROA excluding these items. Refer to Appendix for guidance.

Comment:

4d. Investigate any other unusual income or expense accounts as necessary or as directed by the EIC. If justified, review invoices and/or other supporting documentation. Comment on findings.

Comment:

5. Final Analysis

5. Prepare an Earnings comment and assign a rating for the bank. Refer to Supervisory Memorandum 1001 for definitions of ratings. Complete the Summary of Findings.
### SUMMARY OF FINDINGS

#### #9 - EARNINGS

<table>
<thead>
<tr>
<th>Describe all strengths evident from the evaluation.</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Describe all weaknesses evident from evaluation, including violations of law/regulation/rules; noncompliance with Departmental policies/guidelines; internal policy deficiencies/noncompliance; internal control weaknesses; MIS problems; and deficiencies in management supervision.</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Determine why weaknesses exist and comment on management’s response and plan of action. Identify bank personnel making the response.</th>
</tr>
</thead>
</table>

#### SUMMARY RISK RATING ASSIGNED: Choose a Rating

**Ratings:** 1-Strong; 2-Satisfactory; 3-Less than satisfactory; 4-Deficient; 5-Critically deficient; NR-Not Rated

Provide copy of this page to EIC/AEIC. Receipt and review of this form by the EIC/AEIC will be evidenced by his/her initials in the appropriate column for this procedure on the SCOPE FORM.

[Return to Core Analysis](#)
**Supplemental Assessment Phase (SAP)**

**Document findings within the SAP. Summarize conclusions in the CORE ANALYSIS section.**

**Reconcilements (Q2a)**

**CALL REPORT ERRORS**

1. Determine if the errors are considered significant. The FDIC’s Call Report Analysis Unit (800-688-3342 or 202-898-6607) may be useful in determining the necessity of amendments.

   Information is material if omitting it or misstating it could influence decisions that users make on the basis of the financial information of a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude or both of the items to which the information relates in the context of an individual entity’s financial report.

   A general guideline for materiality is 1% or more of total assets or 1% or more of total revenues.

   Exceptions are allowed for amounts in excess of these general levels if both the EIC and RD agree that the error does not materially change the financial condition or risk profile of the institution. EIC and RD support should be adequately documented and explained.

2. Compile a list indicating: A) Significant, Amendable Errors and B) Irregularities (inmaterial errors). Provide a copy of this list to the AEIC. *Include copy of list in work papers.*

3. For all significant amendments, request the bank to file amended reports within 20 days from the date of request and include a comment in the open section of the report.

   - If 5 or more errors are found that do not require an amendment to the Call Report, a general comment on the errors should be made in the open section.

4. If it is determined those Call Report errors are deliberate or the result of gross negligence, consult with your Regional Director to determine if a Suspicious Activity Report (SAR) should be filed.

**Comments:**

*Return to Core Analysis*
Guidance on Evaluating the Significance of Nonrecurring Items:

1. Identify all extraordinary (nonrecurring / nonoperating) income and expense items and amounts for the current period and each prior year-end since the last examination.

The following are examples of extraordinary items, but it is not all-inclusive:

These are always considered non-operating:

- Securities gains/losses,
- gains/losses on the sale of OREO and other assets,
- law-suit settlements,
- and insurance settlements

It is also possible for some ALLL provisions to be considered extraordinary (consult with the examiner performing the ALLL review).

Large attorney’s fees may be considered nonrecurring if a lawsuit or other legal issue caused a temporary need for legal assistance.

2. Determine to what extent extraordinary items have impacted net income by eliminating these items from the calculation for ROA. Do not ignore the tax effects.

- Current period ROA adjusted for nonrecurring items:
- Prior year-end(s) ROA adjusted for nonrecurring items:

In the Core Analysis, comment on the extent that the bank is operationally profitable, i.e., able to meet its needs outside of extraordinary or nonrecurring items, noting the extent to which these items contribute to or detract from net income.

Return to Core Analysis
APPENDIX

Ratio Calculations

Utilize the following schedule when necessary to manually calculate ratios for Analysis of Bank Earnings. Averages, which are used in the denominator of most earnings ratios, are defined first. Earnings ratios from prior periods may need to be recalculated if amendments have been made or are deemed necessary.

ANNUALIZATION OF RATIOS USING INTERIM - PERIOD REPORT-OF-INCOME-DATA

For interim-period calculations (for example, March, June, and September), the income and expense data used in producing ratios are annualized for comparison with prior periods. The UBPR annualization factors are:

<table>
<thead>
<tr>
<th>Month</th>
<th>Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>March</td>
<td>4.0</td>
</tr>
<tr>
<td>June</td>
<td>2.0</td>
</tr>
<tr>
<td>September</td>
<td>1.3333</td>
</tr>
</tbody>
</table>

TAX EQUIVALENCY

If the bank has tax-exempt loan or securities income, income on a tax equivalent basis should be used in calculating ratios below with a “TE” indicated. Refer to Appendix B of the FFIEC User's Guide for the Uniform Bank Performance Report for the tax-equivalency worksheet.

CORPORATE TAX RATE

Consider impact of Corporate Tax Rate Change from the Tax Cuts and Jobs Act of 2017.

On January 18, 2018, the banking agencies issued an Interagency Statement on Accounting and Reporting Implications of the New Tax Law. The tax law was enacted on December 22, 2017 and is commonly known as the Tax Cuts and Jobs Act (the Act). U.S. GAAP requires the effect of changes in tax laws or rates to be recognized in the period in which the legislation is enacted. Thus, in accordance with Accounting Standards Codification (ASC) Topic 740, Income Taxes, the effects of the Act were to be recorded in an institution’s Call Report for December 31, 2017, because the Act was enacted before year-end 2017. Changes in deferred tax assets (DTAs) and deferred tax liabilities (DTLs) resulting from the Act’s lower corporate income tax rate and other applicable provisions of the Act were to be reflected in an institution’s income tax expense in the period of enactment, i.e., the year-end 2017 Call Report.
### AVERAGE CALCULATION WORKSHEET

<table>
<thead>
<tr>
<th>AVERAGE CALCULATIONS</th>
<th>12-__</th>
<th>3-__</th>
<th>6-__</th>
<th>9-__</th>
<th>12-__</th>
<th>Total / # of periods</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Average Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>= N/A</td>
</tr>
<tr>
<td>= sum the quarterly avg. for total assets (from RC-K) for each reporting period of the current year/the number of reporting periods</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>=</td>
</tr>
<tr>
<td><strong>Average Earning Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>= N/A</td>
</tr>
<tr>
<td>= sum the quarterly average for interest-bearing balances + all investment securities + federal funds sold + total loans + asset held in trading accounts + lease financing receivables (from RC-K) for each reporting period of the current year/the number of reporting periods</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>=</td>
</tr>
<tr>
<td><strong>Average Total Loans and Leases</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>= N/A</td>
</tr>
<tr>
<td>= sum the quarterly average for total loans and leases (from RC-K) for each reporting period of the current year/the number of reporting periods</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>=</td>
</tr>
<tr>
<td><strong>Average Total Securities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>= N/A</td>
</tr>
<tr>
<td>= sum the quarterly average for total securities (from RC-K) for each reporting period of the current year/the number of reporting periods</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>=</td>
</tr>
<tr>
<td><strong>Average Total Equity</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>= N/A</td>
</tr>
<tr>
<td>= total equity capital at the preceding year-end + total equity at each qtr. of the current year (from RC)/the number of reporting periods</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>=</td>
</tr>
</tbody>
</table>
### COMPONENT RATIOS AND TRENDS

<table>
<thead>
<tr>
<th>Ratio Description</th>
<th>Date 1</th>
<th>Date 2</th>
<th>Date 3</th>
<th>Date 4</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Income to Average Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>= net income (annualized)/average assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net Operating Income to Avg. Assets (ROA)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>= NOI after tax (including securities gains/losses, not including extraordinary items) (annualized)/avg. assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net Interest Income to Avg. Earning Assets (TE)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>= total interest income on a tax-equivalent basis - total interest expense (annualized)/avg. earning assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Overhead expense to Avg. Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>= all overhead accounts associated with personnel, occupancy, and other noninterest expenses (net of rental income) (annualized)/avg. assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net Income to Avg. Total Equity</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>= year-to-date net income after taxes (annualized)/avg. total equity</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net Losses to Avg. Total Loans and Leases</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>= gross loan and lease charge-offs - gross recoveries (annualized)/avg. total loans and leases</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><em>(If gross recoveries exceed gross losses, NA is shown at this caption.)</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Earnings coverage of Net Losses</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>= net operating income before taxes, before securities gains/losses, before extraordinary items + provision for loan losses (not annualized)/net loan and lease losses <em>(DON’T MULTIPLY BY 100. If gross recoveries exceed gross losses, NA is shown at this caption.)</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Loss Reserve to Total Loans and Leases</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>= ending balance of the ALLL (not annualized)/total loans and leases</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Noncurrent Loans and Leases to ALLL</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>= (Total loans and leases 90+ days past due + nonaccrual loans and leases)/ALLL</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### EARNINGS WORKSHEET
#### RATIO CALCULATIONS

<table>
<thead>
<tr>
<th>COMPONENT RATIOS AND TRENDS</th>
<th>Date</th>
<th>Date</th>
<th>Date</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recoveries to Prior Period Losses</td>
<td>= gross loan and lease recoveries in the current year {annualized}/gross loan and lease losses of the preceding year</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yield on Total Loans and Leases (TE)</td>
<td>= interest and fees on loans and leases + estimated tax benefit on tax-exempt loan income {annualized}/avg. total loans and leases</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yield on Total Investment Securities (TE)</td>
<td>= income on securities not held in trading accounts + estimated tax benefit on tax-exempt municipal securities income {annualized}/avg. total securities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest income (TE) to Avg. Earning Assets</td>
<td>= total interest income on a tax-equivalent basis {annualized}/avg. earning assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Expense to Avg. Earnings Assets</td>
<td>= total interest expenses {annualized}/avg. earning assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted Net Operating Income to Avg. Assets</td>
<td>= net operating income after taxes and securities gain/losses + provision for loan losses - net loan and lease losses {annualized}/avg. assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><em>Net Income adjusted Sub S to Avg. Assets</em></td>
<td>= net income plus applicable income taxes (RI-9) less estimated income taxes¹ {annualized}/avg. assets</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

¹*Estimated income taxes (for Sub S):*  
Net income before extraordinary items and taxes (RI-8):  
PLUS: Non-deductible interest expense to carry tax exempt securities (RI-M.1): +  
LESS: Tax-exempt securities income (RI-M.4): -  
LESS: Tax-exempt loan and lease income (RI-M.3): -  
SUBTOTAL: =  
X Tax rate (34% unless NI < $100M): X 34%  
EQUALS: Estimated income taxes (for Sub S):  

*Report this ratio only if the bank is classified as a Subchapter S corporation for tax purposes.*  

[Return to Core Analysis]