Chapter 2

SCOPE DEVELOPMENT AND PLANNING

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Scoping and Planning Objectives

- Make a preliminary assessment of expected risk
- Determine appropriate planning activities
- Evaluate information to assign a level of risk for each risk category
- Indicate anticipated direction of risks
- Determine appropriate examination steps and procedures
- Assess examination resource needs

Overview

Effective allocation of resources in a risk-focused program requires that examiners clearly identify areas where a greater potential for loss exists. Examination scope describes the type and depth of review conducted within each risk area during a credit union examination.

Risk areas can vary between examinations. Therefore, examiners must document the examination scope to support the degree of review for specified areas. The Scope Workbook is the tool used to document the scope and risk assessment. This workbook serves as the examiner's documentation for the following:

- Preliminary risk assessments and supporting factors;
- Areas reviewed, depth of review, and reasons for review;
- Adherence of examination to regulatory compliance;
- Final risk assessments and supporting factors;
- Anticipated direction of risk over the next examination cycle;
- Estimates for resource needs over the next examination cycle; and
- Recommendations for future areas of review and supervision plans.

Scope Development

The scope development process enables examiners to evaluate unique characteristics of each credit union and determine what steps the examination will require. Planning activities will allow the examiner to draw more informed conclusions regarding the existence of risk. The Scope Workbook records focal points of the examination.

The risk-focused examination approach requires determination of the scope through a process involving:

- Recommendations from the prior examination and supervision contacts;
- Preliminary risk assessment;
- Consideration of internal and external factors;
- Discussions with credit union management; and
- Evaluations of the credit union's control environment and risk management systems.

Prior Examination and Supervision Recommendations

Reviewing the prior examination report and recent Scope Workbook (or history of Scope Workbooks, if significant developing trends exist) assists the examiner in preparing for the current examination. The examiner should pay close attention to the risk assessment and recommendations for areas of review.

Preliminary Risk Assessment

After evaluating the recent Scope Workbooks, examiners will make a preliminary assessment of the risk they expect to find while performing the examination. This assessment includes the following:

- Analyzing recent call report data;
- Comparing prior recommendations with recent financial trends; and
- Evaluating the credit union's risk profile.

The examiner will assign a preliminary risk assessment for each of the seven risk categories: Credit, Interest Rate, Liquidity, Transaction, Compliance, Reputation, and Strategic. (The Risk-Focused Program chapter provides more information for identifying the seven risks.) Quantitative data and any information the examiner has prior to conducting planning and scoping activities serve as determinants for this assessment. Information obtained through discussions with management and findings identified during the field work may change these preliminary assessments.

Reasons for documenting these preliminary assessments include:

- Demonstrating the examiner's thought process from beginning to end;
- Supporting requests for additional resources; and
- Supporting use of significant resources or transaction testing even though the final assessment may indicate low risk.

The 5300 Risk Parameters (found within the Scope Workbook) is a tool for examiners to use during their initial risk assessment. This tool provides information on the direction of risk and acts as an indication of potential risk. It does not predict future problems and does not supercede the examiner's judgment in assessing risk. It simply serves as one of the tools available to assist the examiner in this process. Other analysis tools available outside of the Scope Workbook include the Consolidated Balance Sheet program, the Cycle to Cycle Comparison program, regional and national risk reports.

Internal and External Factors

If applicable, examiners should consider the following factors, using the information obtained to mitigate or amplify the initial risk assessment:

- The size and sophistication of the credit union's operation. Examiners should identify the significant activities and all major programs or services offered, including off-balance sheet activities and other proposed ventures; and

- Information necessary to focus the examination scope and maximize the efficiency of onsite examination work. As needed, examiners should review the following sources of information, if available:

    - Previous examination reports, supervision contacts, and results of any special targeted examinations occurring since the last contact;
    - Auditors' reports (both internal and external) and management letters;
    - Management's response to audit and examination reports;
    - Prior examination work papers (paying attention to the depth and breadth of review in each area). Consider the credit union's

level of service (e.g., member business loans, real estate loans, indirect lending);
- Correspondence files;
- Financial Performance Reports (FPRs);
- Call reports and recent financial statements;
- Risk management reports;
- Income and expense budgets and projections;
- Balance sheet (financial) management policy and philosophy;
- Internal management reports;
- Board of director's packages;
- Business, strategic, and marketing plans;
- Asset-liability management (ALM) models, policies, and interest rate risk reports;
- Evidence of management due diligence for existing and anticipated products, services, and systems;
- Internal control structure and process;
- Credit union service organization (CUSO) activities;
- Data processing system and the availability of the automated integrated regulatory examination system (AIRES) download;
- Delivery channels (web-sites, home banking, bill payment services, automated clearing house (ACH)), etc.);
- Sponsor newsletters or news articles;
- Economic environment (locally, regionally, and nationally); and
- Recent regulatory changes.

Discussions with Credit Union Management

After establishing a preliminary risk assessment and evaluating internal and external factors, the examiner conducts discussions with credit union management, preferably onsite. Practical considerations (distance to the credit union, schedules of the examiner and manager, etc.) may mandate a telephone or email contact, which can accomplish the intended purpose. However, examiners may find an onsite contact especially important for more sophisticated credit unions with complex services and products. If examiners-in-charge do not schedule an early onsite visit, they should obtain as much information as possible through questionnaires, telephone, email or other contacts. These discussions enable examiners to develop their own assessments of current examination risk by refining the initial risk assessments.

Discussions with management should focus on changes to management, policies, strategic direction, management information systems, management due diligence, staff turnover, and other significant activities occurring since the last examination or supervision contact. This contact allows the examiner to obtain management's perspective about economic conditions, internal and external audit programs, and the risk management process. The examiner controls the timing of the contact and should schedule it close enough to the examination to ensure the information discussed remains relevant and usable for the examination.

The examiner should make every effort to obtain the following information regardless of whether an onsite or offsite contact occurs:

- Economic conditions that have a direct or indirect impact on the credit union's overall financial condition. Discussions with senior management may include the following issues:

  - Field of membership, including the principal types of businesses within the field of membership and plans for future expansion;
  - Sponsor relationships or special relationships with operating subsidies that may affect interpretation of comparative data;
  - Trends of the credit union's local economy and stability of major select groups within the field of membership; and
  - Dependence upon a particular industry or economic sector (e.g., oil and gas, agriculture.)

- Operational and functional changes. The credit union may experience, or management may anticipate, changes in the following areas:

  - Overall objectives or management philosophy;
  - Senior management, the board of directors, official committees, or key operating staff;
  - Types of loans offered and material changes in loan types and volume;
  - Types of shares offered and material changes in share types and volume;
  - Investment strategies or brokers;

  - Liquidity position;
  - Operations, including information systems;
  - Policies and procedures;
  - Formal committee structures; and
  - Risk areas posing the highest risk to the operation currently and in the future.

- Internal control risks identified by the internal or external audits, the previous examination, verification of members' accounts or through other reports should prompt examiners to do the following:

  - Consider the following when reviewing the findings of the internal auditor or personnel responsible for evaluating internal controls:

    i. Independence and experience of personnel conducting internal control reviews, adequacy of staff size, appropriateness of audit schedule, and sufficiency of scope;
    ii. Reliability and effectiveness of internal control reviews;
    iii. Quality of audit reports, and management's responsiveness to auditors' findings;
    iv. Quality of internal audit work papers; and
    v. Procedures for internal audit reporting;

  - Consider reviewing the external auditors' workpapers if the following risk-related circumstances exist:

    i. Internal control weaknesses;
    ii. Substantial exposure to high-risk activities; and
    iii. Past problems with the quality of the audit or audit firm; and

  - Consider the internal controls surrounding the verification of members' accounts and the quality of the verification.

- Assessment of the quality of management. Examiners may wish to consider the following:

- Findings from prior examinations and CAMEL coding of Management;
- Changes since the last examination in key management officials;
- Activities of the board and other committees including their degree of activity and participation;
- Education and experience of senior management and key officials;
- Performance evaluation system or process;
- Organizational chart;
- Quality of written policies and procedures;
- Quality of the budgeting and planning processes;
- Member service and membership recruitment;
- Quality of management due diligence, including cost-benefit studies, for existing or planned products, services, and systems; and
- Adherence to policies and procedures by staff.

Examiners' past experience and knowledge of the credit union will affect the amount of time devoted to the scoping and planning phase. Generally, examiners will spend more time and effort on planning for larger than for smaller credit unions. However, asset size alone does not determine the extent of the scope. Examiners must consider the nature of the credit union's services, compliance history with those services, changes in the regulatory environment, and safety and soundness implications.

For larger and more sophisticated credit unions, early review will allow examiners-in-charge greater flexibility in determining necessary resources, including the number, experience, and qualifications of team members.

Team Examinations

The supervisory examiner and district examiner schedule team examinations according to regional policies. In addition to reviewing team participants' workpapers, analyzing the credit union's performance, and meeting with the officials, the examiner-in-charge coordinates, monitors, and facilitates the smooth completion of the examination.

If needed, the examiner-in-charge and selected team members should begin the examination before the full team arrives, unless travel and time considerations preclude an advance team contact. Examiners can lose substantial time during the initial phases of the examination waiting for credit union staff to provide data downloads or loan files.

When examiners-in-charge schedule a subject matter examiner or regional specialist to participate on the examination, they should schedule these examiners first to ensure their availability when needed during the examination. The examiner-in-charge should also consider the amount of time these individuals might need to provide training to other team members during their onsite work.

The examiner-in-charge (or advance team) should complete the following steps before the full team's arrival:

- Contact key officials to inform them of the examination and its probable duration. Examiners-in-charge that plan to hold a joint conference should determine a mutually agreeable date and time (see the Joint Conference/Exit Meeting chapter of this Guide);

- Arrange working space for the team;

- Obtain the supervisory committee work and schedule a meeting with the auditor, if necessary;

- Obtain all relative board policies scheduled for review;

- Select loans for review, as appropriate. Since examiners-in-charge usually request that credit union employees pull the loan files, they should give staff as much time as possible before the arrival of the full team;

- Scan board, executive, ALCO minutes, etc., as appropriate;

- Allocate work assignments to team members. The AIRES Team Examination option gives the examiner-in-charge the ability to import and export loan lists, reports, general ledger worksheets (except balance sheet and income statements) and questionnaires to and from various team members;

- Provide significant portions of the prior examination to the appropriate team members, if possible. The examiner-in-charge often assembles appropriate workpapers, policies, questionnaires and instructions for team members responsible for specific areas of the examination; and

- Notify team members of their assignments before beginning the onsite examination to allow the team time to review their assigned areas and to assemble needed reference material. The examiner-in-charge will then have the freedom to more effectively coordinate and direct the overall examination.

A primary goal for the examiner-in-charge's planning work, after outlining the scope, is to communicate information gathered from the process to the applicable team members. The risk-focused examination process avoids repeating the work already completed by competent, professional individuals and documented in reports and audits.

The examiner-in-charge often holds pre- and post-examination conferences with either the full team or selected team members. During pre-examination conferences, the examiner-in-charge can discuss the credit union's risk profile, relate problems noted during prior examinations and supervision contacts, answer team members' questions pertaining to their delegated areas of responsibility, provide instructions on communicating with personnel at the credit union and, in general, plan the work. The examiner-in-charge should provide an open door of communication throughout the examination, inviting team members to discuss risk assessment adjustments based on their field work.

Post-examination conferences have value in the more complex examinations in which the examiner-in-charge may not have had the opportunity to become acquainted with all phases of the credit union's operations. Team members can brief the examiner-in-charge on requested areas, provide reports on their areas of responsibility, and discuss risk assessment adjustments as necessary. The examiner-in-charge decides whether to hold pre- or post-examination conferences.

The examiner-in-charge should ensure that adequate documentation exists and all appropriate meetings with credit union personnel have occurred before team members depart at the end of the examination.

Scope Determination

Completing the Scope Workbook will assist the examiner in determining and documenting the scope of the current examination. This workpaper uses prior risk assessments and quantitative data from the most recent call report to highlight areas of concern.

Process or Transactional Review

When developing the examination scope, the examiner needs an understanding of the difference between "process" and "transaction" examination steps. **Process** involves the planning, direction, and control aspects, including management's reporting of information for a given area. **Transaction** involves the actual individual transactions or records of a credit union.

The risk-focused examination enables examiners to perform a process review in the credit union's well-managed areas, without extensive transaction testing. This type of examination permits examiners to evaluate the credit union's process for managing risk, including how effectively the credit union uses its information systems.

Level of Risk

The scope determination process culminates in identifying specific procedures the examiners will perform during the examination. If examiners' preliminary risk assessment indicates an area has high or moderate risk, they will then determine which procedures will most effectively evaluate the depth of the risk and result in recommendations for improvement. If examiners judge an area to contain low risk, they may choose to perform no procedures or a very limited process review.

Adjusting the Scope

The final scope determination relies on examiner judgment. Examiners should adjust the scope of the examination as appropriate. This will require the examiners to use sound professional judgment and analysis, and to maintain open lines of communication with management. A successful examination requires discussing relevant concerns as they arise. The Scope Workbook provides a forum for the examiner to summarize the scope of the examination and document the areas reviewed.

Minimum Procedures

Examiners will evaluate the credit union's overall risk profile to determine most of the procedures they plan to perform during an examination. However, the examiners must complete the following three procedures during each examination, regardless of risk:

- Verify the accuracy of the call report. The steps required to perform this verification will vary based on the risk characteristics present in each credit union. Credit unions with multiple internal control checks in the accounting and reporting areas may require little verification. In those credit unions lacking an effective system of internal controls, examiners may need to perform more extensive testing to satisy themselves as to the accuracy of the report.

- Review the supervisory committee audit and verification. Again, this review will vary significantly based on the qualifications of the auditors, the audit findings, the extent of the audit scope, and the level of oversight provided by the supervisory committee or internal auditors.

- Verify compliance with the Bank Secrecy Act (BSA). The Federal Credit Union Act requires NCUA to determine compliance with this law during each examination. Part 748 of NCUA's Rules and Regulations specifies some of the requirements of this law. The Compliance chapter of this Guide provides further information on the BSA.

Documenting the Scope

Examiner's discretion determines the extent of documentation. Although no specific requirements exist, the documentation should demonstrate:

- The extent of procedures and testing performed;
- Review of regulatory compliance in applicable areas (e.g., if a credit union grants member business loans, the examiner should

evaluate and document compliance with Part 723 of the Rules and Regulations);
- Reasons and factors considered in determining areas and extent of review;
- Analysis and assessment of risk areas;
- Conclusions reached and recommendations made; and
- Adequate support for conclusions and recommendations.

In cases that result in losses or administrative action, the examination workpapers will lay the groundwork for building an administrative record.

Final Risk Assessment

The examiner will evaluate all information gathered to assign a final assessment of risk for each of the seven risk categories. Information obtained during the examination may result in changes to the preliminary risk assessment.

Each category of risk will receive a risk assignment of high, moderate, or low, depending on the factors present in the credit union. At the conclusion of the examination, the examiner will also indicate the anticipated direction (increasing, decreasing, or unchanged) of the risk over the next examination cycle. Some factors contributing to this anticipated direction include the examiner's expectations regarding:

- Management's ability to monitor and control identified risks;
- Management's willingness to monitor and control identified risks; and
- Anticipated changes in management, services, economic environment, field of membership, etc.

Attachment 2.1 contains a list of risk indicators for each risk category. Examiners should use this attachment only as guidance in the assignment of risk level.

Budget and Plans

After conducting the examination, the examiner begins the planning cycle again by suggesting future review areas and estimating resource needs for the next examination and interim supervision. The Budget and Plans section of the Scope Workbook documents these recommendations. Examiners should consider the following items when completing this sheet:

- Level of complexity in any given area;
- Need for subject matter examiners or regional specialists;
- Recommendations for transactional reviews;
- Recommendation for risk-based examination scheduling category;
- Anticipated changes in field of membership, charter, services, management, etc.;
- Known or expected changes in senior management, board of directors, official committees, or key operating staff;
- Known or expected regulatory changes affecting the credit union;
- Known or expected events affecting budgeted hours (merger, conversion, voluntary liquidation, involuntary liquidation, etc.); and
- Known or expected trends in local and national economy.

When the examiner uploads the scope workbook, the Budget and Plans section records the hours anticipated for the next examination and interim supervision. The supervisory examiner will have the opportunity to review this document as part of the completed workbook.

Credit Risk Indicators

Factor	Low	Moderate	High
Board and Operational Management Understanding	Fully understands all aspects of credit risk and has a fully effective process in place to control that risk.	Reasonably understands key aspects of credit risk and has an adequate process in place to control that risk	Does not understand risks, has chosen to ignore, or does not have a satisfactory process in place for key aspects of credit risk.
Risk Management	Management anticipates and identifies issues before they become problems, including those resulting from changes in market conditions.	Management has an adequate system in place to identify problems and adequately respond to those signals, including those resulting from changes in market conditions.	Management does not anticipate problems or is ineffective in responding to problems once they occur.
Policies	Current, effective and followed.	Satisfactory.	Ineffective.
Diversification	Credit risk diversification is actively managed.	Adequate attention to credit risk diversification.	Unsatisfactory credit risk diversification.
Loans Granted, Loans or Investments Purchased	Conservative in structure, terms, growth, or settlement practices. Effective due diligence.	Prudent in structure, terms, growth, or settlement practices. Due diligence is adequate.	Aggressive in structure, terms, growth, or settlement practices. Due diligence is lacking, ineffective, or inadequate.
Underwriting Standards	Sound and few or no exceptions exist.	Sound with a limited volume of exceptions.	Not adequate or are not prudent and a large volume of exceptions exist.
Concentrations	Appropriate diversification	Adequate diversification.	Significant concentrations exist.
Collateral Values	Collateral values satisfactorily support credit exposure.	Values protect credit exposure.	Collateral is illiquid or values provide inadequate support.
Problem Assets	Low volume, resolution times are within normal course of business and process is controlled.	Moderate volume, reasonable resolution times, and adequate reporting.	High volume, extended resolution times, and inadequate reporting.
Reserves	Reserves adequately cover inherent losses. Exposure to loss of earnings or capital from credit risk is minimal.	Inherent losses should not seriously deplete current reserves or require more than normal provisions. Exposure to loss of earnings or capital is manageable.	Losses may seriously deplete current reserves or require abnormal provisions. Exposure to loss of earnings or capital is substantial.
Internal Audit and Review	Timely, comprehensive, and independent. Promotes early identification of emerging risks. Management responds to findings quickly.	Acceptable. Promotes reasonable identification of problems. Management responds to findings.	Serious weaknesses exist such as lack of independence, timeliness, or scope of review. Does not promote early identification of problems and risk. Management ignores findings.
ALLL Methodology	Evaluation method is sound, well documented, and appropriate coverage of risks exists.	Method is generally acceptable and provides an acceptable coverage of risks.	Method is flawed and provides insufficient coverage of risks.

Interest Rate Risk Indicators

Factor	Low	Moderate	High
Board and Operational Management Understanding	Fully understands all aspects of IRR.	Reasonably understands key aspects of IRR.	Does not understand or ignores key aspects of IRR.
Responsiveness to Market Conditions	Anticipates and responds well to changes.	Adequately responds to changes.	Does not anticipate or take timely and appropriate actions in response to changes.
Monitoring & Measuring	Process is independent from those executing risk-taking decisions. Effective reporting of IRR exists.	Process is independent from those executing risk-taking decisions. Adequate reporting of IRR exists.	Process is not independent from those executing risk-taking decisions. Lack of monitoring and reporting of IRR.
Risk Exposure	Little repricing risk and minimal exposure to basis and yield curve risk.	Repricing risk, basis risk, yield curve risk, and options risk exposures are collectively maintained at manageable levels.	Significant levels of repricing risk, basis risk, yield curve risk, or significant levels of options risk exist.
Mismatches	Mismatched positions are short- term.	Mismatched positions may be longer but are managed effectively.	Mismatched positions are longer term and inadequately managed.,
Risk to Capital and Earnings	Mismatches are unlikely to cause earnings or capital volatility due to the movement of interest rates.	Substantial volatility in earnings or capital due to the movement of interest rates is not anticipated.	High probability of substantial volatility in earnings or capital due to the movement of interest rates.
IRR Process	Effective, documented, and proactive.	Adequate.	Deficient.
Measurement Tools and Methods	Enhance decision making by providing meaningful and timely information under a variety of defined and reasonable rate scenarios.	Minor weaknesses, but are appropriate given size and complexity of the credit union's on-and off-balance-sheet exposures.	Overly simplistic in light of the relative size and complexity of the credit union's on- and off-balance-sheet exposures.
MIS Reporting	Timely, accurate, complete, and reliable.	For the most part, timely, accurate, complete and reliable.	Significant weaknesses.
Risk Limits	Clear parameters, that are regularly reviewed, are set for risk to earnings and the economic value of equity under defined stressed interest rate scenarios.	Adequate to control the risk to earnings and the economic value of equity under defined stressed interest rate scenarios.	Not reasonable or do not reflect an understanding of the risks to earnings and the economic value of equity.

Liquidity Risk Indicators

Factor	Low	Moderate	High
Board and Operational Management Understanding	Fully understands all aspects of liquidity risk.	Reasonably understands key aspects of liquidity risk.	Does not understand, or chooses to ignore key aspects of liquidity risk.
Management Responsiveness	Anticipates and responds well to changes in market conditions.	Adequately responds to market condition changes.	Does not anticipate or take timely or appropriate actions in response to changes.
Liquidity Position and Risk Exposure	Favorable position with negligible exposure to earnings and capital.	Not excessively vulnerable to funding difficulties should an adverse change in market perception occur. Earnings or capital exposure is manageable.	Access to funds is impacted by poor market perception or market resistance, resulting in substantial exposure to loss of earnings or capital.
Funding Sources	Ample funding sources exist. Funding sources provide the credit union with a competitive cost advantage.	Sufficient funding sources exist to provide cost-effective liquidity.	Funding sources and portfolio structures suggest current or potential difficulty in sustaining long-term and cost-effective liquidity.
Borrowing Sources	Widely diversified, with little or no reliance on wholesale or other credit-sensitive funds providers.	Diversified with few providers or groups sharing common investment objectives and economic influences.	Concentrated in a few providers, or providers with common investment objectives or economic influences.
Future Liquidity Position	Market alternatives exceed demand for liquidity with no adverse changes expected.	Liquidity position is not expected to deteriorate in the near term.	Liquidity needs may be increasing with declining medium- and long-term funding alternatives.
Risk Management Process	Processes reflect a sound culture that has proven effective over time.	Processes are adequate.	Processes are deficient.
MIS Reporting	Timely, complete, reliable, and reviewed by management.	For the most part, timely, complete, reliable, and reviewed by management.	Do not provide useful information for managing liquidity risk.
Balance Sheet Management	Appropriate attention is given to balance sheet management and the cost effectiveness of liquidity alternatives.	Attention to balance sheet management is appropriate. Access to funding markets is properly assessed and diversified based upon size and complexity.	Attention to balance sheet management is inappropriate. Management has not realistically assessed the credit union's access to funds and has not paid sufficient attention to diversification.
Contingency Plans	Well-developed and effective.	Effective and the cost of liquidity alternatives is adequately considered.	Nonexistent or incomplete. Cost of alternatives has not been adequately considered. High probability exists that contingency funding sources are needed. Improvement is not expected in the near future.
Cash Flow Analysis	Effective, reliable and timely analyses are conducted.	Adequate analysis conducted based upon size and complexity.	Analysis not done or is inadequate.

Transaction Risk Indicators

Factor	Low	Moderate	High
Board and Operational Management Understanding	Fully understands all aspects of transaction risk.	Reasonably understands key aspects of transaction risk.	Does not understand, or chooses to ignore key aspects of transaction risk.
Responsiveness to Market and Technological Conditions	Anticipates and responds well to changes.	Adequately responds to changes.	Does not anticipate or take timely or appropriate actions in response to changes.
Risk Exposure	Only a slight probability of damage to reputation, capital, or earnings.	Possible loss to reputation, earnings or capital exists but is mitigated by adequate internal controls.	Weak internal controls expose the credit union to significant damage to reputation, or loss of earnings or capital.
Transaction Processing Controls	History of sound operations. Likelihood of transaction processing failures is minimal due to strong internal controls.	History of adequate operations. Likelihood of transaction processing failures is minimized by generally effective internal controls.	History of transaction processing failures. Likelihood of future failures is high due to absence of effective internal controls.
Systems and Controls	Strong control culture that results in systems, internal controls, audit, and contingency and business recovery plans that are sound.	Adequate operating and information processing systems, internal controls, audit coverage, and contingency and business recovery plans are evident.	Serious weaknesses exist in operating and information systems, internal controls, audit coverage, or contingency and business recovery plans.
MIS	Satisfactory	Minor deficiencies may exist that relate to transaction and information processing activities.	Significant weaknesses in transaction and information processing activities.
New Products or Services	Favorable performance in expansions and introductions of new products and services.	Planning and due diligence prior to introduction of new services are performed although minor weaknesses exist.	Inadequate. CU is exposed to risk from the introduction or expansion of new products and services.
Conversion Management	Conversion plans are clear, comprehensive, and followed.	Conversion plans are evident, although not always comprehensive.	CU may be exposed to processing risks due to poor conversion management, either from the integration of new acquisitions with existing systems, or from converting one system to another.
Problem Identification and Corrective Action	Management identifies weaknesses quickly and takes appropriate action.	Management recognizes weaknesses and generally takes appropriate action.	Management has not demonstrated a commitment to make the corrections required to improve transaction processing risk controls.

Strategic Risk Indicators

Factor	Low	Moderate	High
Risk Management Practices	Practices are an integral part of strategic planning.	Quality is consistent with the strategic issues confronting the credit union.	Practices are inconsistent with strategic initiatives. A lack of strategic direction is evident.
Strategic Planning	Strategic goals, objectives, culture, and behavior are effectively communicated and consistently applied throughout the institution. The depth of management talent enhances strategic direction and organizational corporate efficiency.	Demonstrated the ability to implement goals and objectives and successful implementation of strategic initiatives is likely.	Operating policies and programs inadequately support strategic initiatives. The structure and talent of the organization do not support long-term strategies.
Management/Staff Turnover	Changes in key management or staff are well managed and minimal. Succession plans are documented and effective.	Key management or staff changes recently occurred. Succession plans are adequate.	Key management or staff turnover is high and poorly managed. Succession plans are non-existent, inadequate, or ignored.
Track Record	Management has been successful in accomplishing past goals and is appropriately disciplined.	Management has a reasonable record in decision-making and controls.	Deficiencies in management decision-making and risk recognition do not allow the institution to effectively evaluate new products, services, or FOM expansions.
MIS	Management information systems effectively support strategic direction and initiatives.	Management information systems reasonably support the credit union's short-term direction and initiatives.	Management information systems supporting strategic initiatives are seriously flawed or do not exist.
Risk Exposure	Exposure reflects strategic goals that are not overly aggressive and are compatible with developed business strategies.	Exposure reflects strategic goals that are aggressive but compatible with business strategies.	Strategic goals emphasize significant growth or expansion that is likely to result in earnings volatility or capital pressures.
Impact and Risk of Initiatives	Initiatives will have a negligible impact on capital, systems, or management resources. The initiatives are well supported by capital for the foreseeable future and pose only nominal possible effects on earnings volatility.	Actual practices have only minor inconsistencies with planned initiatives. Initiatives are reasonable considering the capital, systems, and management. Decisions are not likely to have a significant adverse impact on earnings or capital and can be reversed without significant cost or difficulty.	The impact of strategic decisions is expected to significantly affect net worth. Strategic initiatives may be aggressive or incompatible with developed business strategies. Decisions are either difficult or costly to reverse.
Appropriateness of New Products & Services	New products/services are supported by sound due diligence and strong risk management. The decisions can be reversed with little difficulty and manageable costs.	New products/services will not materially alter business direction, can be implemented efficiently and cost effectively, and are within management's abilities.	Strategic goals are unclear or inconsistent, and have led to an imbalance between the credit union's tolerance for risk and willingness to supply supporting resources for new product/service offerings.

Reputation Risk Indicators

Factor	Low	Moderate	High
Board and Operational Management Response to Change	Anticipates and responds well to changes of a market or regulatory nature that impact its reputation in the marketplace.	Adequately responds to changes of a market or regulatory nature that impact the institution's reputation in the marketplace.	Does not anticipate or take timely or appropriate actions in response to changes of a market or regulatory nature.
Organization and Overall Operations	Management fosters a sound culture that is well supported throughout the organization and has proven very effective over time.	Administrative procedures and processes are satisfactory. Management has a good record of correcting problems.	Weakness may be observed in one or more critical operational or administrative activities. Management information at various levels exhibits significant weaknesses.
Risk Management	The credit union effectively self-polices risks.	The credit union self-polices risks.	The credit union's performance in self-policing is suspect.
Internal Controls and Audits	Fully effective.	Generally effective.	Not effective in reducing exposure. Management has either not initiated, or has a poor record of, corrective actions to address problems.
Net Worth Exposure	Net worth is only minimally exposed by reputation risk. Minimal member complaints received, involving minor issues. Complaints are handled promptly, effectively, and efficiently.	The exposure of net worth from reputation risk is controlled. Adequate systems exist to process member complaints satisfactorily.	Net worth is substantially exposed by reputation risk shown in significant litigation, large dollar losses, or a high volume of member complaints. The potential exposure increases with the number of accounts, the volume of assets under management, or the number of affected transactions.
Legal Risk	Losses from fiduciary activities are low relative to the number of accounts, the volume of assets under management, and the number of affected transactions. The credit union does not regularly experience litigation or member complaints.	The credit union has avoided conflicts of interest and other legal or control breaches. The level of litigation, losses, and member complaints are manageable and commensurate with the volume of business conducted.	Poor administration, conflicts of interest, and other legal or control breaches may be evident.
Disaster Recovery Plans	Documented, tested, and effective plans are in place.	Adequate plans are in place.	Inadequate or non-existent plans.
Promotional and Educational Efforts	Effective promotional and educational efforts are made to reach existing and potential members.	Adequate promotional and educational efforts are undertaken.	Inadequate or non-existent promotional and educational efforts.

Compliance Risk Indicators

Factor	Low	Moderate	High
Board and Operational Management Understanding	Fully understands all aspects of compliance risk and exhibits a clear commitment to compliance. Commitment is communicated throughout the institution.	Reasonably understands the key aspects of compliance risk. Commitment to compliance is reasonable and satisfactorily communicated.	Does not understand, or has chosen to ignore, key aspects of compliance risk. The importance of compliance is not emphasized or communicated throughout the organization.
Authority and Accountability	Authority and accountability for compliance are clearly defined and enforced.	Authority and accountability are defined, although some refinements may be needed.	Management has not established or enforced accountability for compliance performance.
Response to Changes	Anticipates and responds well to market or regulatory changes.	Adequately responds to market or regulatory changes.	Does not anticipate or take timely or appropriate actions in response to market or regulatory changes.
Product and Systems Development	Compliance considerations are incorporated into product or systems development.	While compliance may not be formally considered when developing product or systems, issues are typically addressed before they are fully implemented.	Compliance considerations are not incorporated in product or systems development.
Violations & Risk Exposure	Violations, noncompliance, or litigation are insignificant, as measured by their number or seriousness.	The frequency or severity of violations, noncompliance, or litigation is reasonable.	Violations, noncompliance, or litigation expose the credit union to significant impairment of reputation, value, earnings, or business opportunity.
Error Detection and Corrective Action	When deficiencies are identified, management promptly implements meaningful corrective action.	Problems can be corrected in the normal course of business without a significant investment of money or management attention. Management is responsive when deficiencies are identified.	Errors are often not detected internally, corrective action is often ineffective, or management is unresponsive.
Risk Management	Good record of compliance. The CU has a strong control culture that has proven effective. Compliance management systems are sound and minimize the likelihood of excessive or serious future violations.	Compliance management systems are adequate to avoid significant or frequent violations or noncompliance.	Compliance management systems are deficient, reflecting an inadequate commitment to risk management.
Controls and Systems	Appropriate controls and systems are implemented to identify compliance problems and assess performance.	No shortcomings of significance are evident in controls or systems. The probability of serious future violations or noncompliance is within acceptable tolerance.	The likelihood of continued violations or noncompliance is high because a corrective action program does not exist, or extended time is needed to implement such a program.
Training and Resources	Training programs are effective and the necessary resources have been provided to ensure compliance.	Management provides adequate resources and training given the complexity of products and operations.	Management has not provided adequate resources or training.