

# Module: Management

## Section: Policies and Procedures

### EM-520

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#### Introduction

Clear and concise policies and procedures are an essential ingredient in any management system. FCA Regulations require Farm Credit System (System) institutions to adopt policies in many areas. Beyond what is required by law or regulation, policies should be established for other key areas of an institution's operations. The need for policies and procedures depends on materiality and the organization of the institution. For example, documented policies and procedures that cover every significant area of operations may be more critical for a large institution with several offices than for a small institution. Examiners should use judgment and consider cost/benefits when determining the necessity of having documented policies and procedures for areas of operations not required by FCA Regulations.

Policies are guides for achieving the established objectives and strategies of the institution. Procedures are the steps taken to accomplish policies. Both policies and procedures are necessary to ensure sound business practices. Because it is the source of authority and responsibility in a System institution, the board of directors is responsible for formulating sound policies. Executive officers are responsible for implementing the board's policies through the development of procedures. Although it usually delegates the day-to-day conduct of the institution's business, the board is fully and ultimately accountable for the consequences of unsound or imprudent policies and the lack of policy guidance.

Policy and procedure weaknesses have the potential to cause credit, financial, and other operational problems. FCA examiners should attempt to identify and require corrections of weaknesses in an institution's policies and procedures before they develop into an unsafe or unsound condition.

This section concentrates on policies and procedures in general. Examiners should refer to the related section of the FCA Examination Manual for guidance in evaluating policies and procedures for a specific examination area.

#### Examination Objective

Determine the adequacy of the institution's policy-making process.

Determine the adequacy of the institution's policies and procedures.

#### Criteria and Guidance

The purpose of policy-making is to provide direction and guidance to executive officers and employees for making decisions and taking actions. Policies indicate a course of action that is expected to achieve a particular goal. The anticipated effects of these goals on the organizational structure, financial matters, existing products and services, and marketing should be considered in policy development.

Policies and procedures can be developed in a number of ways. In some instances, the board of directors might draft the actual policy and delegate the development of procedures to executive management. In other instances, the board of directors might delegate the entire drafting of the policy and procedures to executive management after providing general guidance and direction. Regardless of the method used to develop policies, they are ultimately adopted by the board of directors and the board remains responsible for them. The board of directors must ensure that policies and procedures are appropriate for the institution and consistent with strategic goals and objectives.

A good policy usually provides for forward planning, taking into account the unique characteristics of the institution and the board of directors' goals and objectives. The policy should establish responsibility for management decisions and provide a mechanism for the necessary coordination between different departments within the institution. The board must provide a clear framework of policies within which the chief executive officer must operate and administer the institution's affairs. Policies should be stated in terms broad enough to allow for varying situations. At the same time, they should communicate known and agreed-upon goals. Such policies should cover the key areas of an institution's operations and should be reevaluated and modified when necessary. Examples of areas that should be covered include investments, loans, asset/liability management, business planning, capital planning, and personnel policies.

- Policies generally should incorporate the following six principal elements:
- Purpose and Objective--The purpose of the policy should be clearly defined. The policy should also define the objectives that are to be accomplished.
- Operating Parameters--The policy should specify the parameters within which management and staff are expected to operate. The parameters should be consistent with FCA Regulations, Federal and State law, and generally accepted accounting principles. The parameters should also ensure the safety and soundness of the institution, adequately control risk, and be compatible with the institution's risk-bearing ability.
- Authorities Delegated to Management--The authorities delegated to management should be clearly defined, consistent with the risk-bearing ability of the institution, and within the operating parameters, regulations, and laws.
- Authorities Retained for Board Approval or Action--The authorities not delegated to executive management and retained by the board of directors should be clearly defined in the policy.
- Process for Addressing Exceptions--The policy should provide a clearly defined process to address exceptions to the operating parameters.
- Reporting Requirements--The policy should describe what is to be reported to the board of directors, the frequency and content of the reports, and the individual responsible for preparing the reports.

Procedures detailing how policies are to be implemented should be developed and include steps for obtaining appropriate board approval for exceptions. Procedures should be reevaluated and modified when necessary. Procedures should be consistent with adopted policies and generally establish the following:

- Purpose and objective;
- Tasks to be performed;
- Responsibilities of positions involved;
- Appropriate departmental/unit interactions;
- A clear sequence of actions or steps to be taken to accomplish the objectives of the procedures and provide adequate controls; and
- Sufficient detail to provide adequate direction to intended users.

The board of directors should ensure that policies and procedures are thoroughly understood at all levels of the institution. Without adequate communication, policies and procedures may not be properly implemented.

## **Examination Procedures**

The extent of the examiner's review will depend on the degree of problems disclosed in other examination areas and previous examination and monitoring activities. New policies and procedures adopted by the board should be considered when determining the scope of the review. In addition, the comfort level established with the policy-making process should be considered.

Policies and procedures should be reviewed by examiners as work is performed in the areas assigned. For example, the examiner responsible for capital should examine all capital-related policies and procedures. Examiners assigned to the other areas should look for credit, financial, and management findings that may suggest deficiencies in policies and procedures. Unusual delays in loan processing, for example, could indicate serious procedural weaknesses. Once conclusions are reached regarding the adequacy of policies and procedures for specific examination areas, results should be summarized. Examiners should require correction of weaknesses in an institution's policies and procedures that have a realistic potential to cause problems before adverse credit and financial conditions occur. Critical comments must be supported by reasonableness, regulation requirements, and/or the potential for adverse effects.

The following list of examination procedures is provided to assist examiners in determining the adequacy of policies and procedures. Some of the procedures may be performed by other examiners as they review their assigned areas. Consistent with risk-based examination principles, examiners should add, delete, or modify procedures as needed based on the particular circumstances of the institution.

1. Interview management to determine how policies are developed. Consider how the following information is used:
  - a. Strategic, operational, and capital plans;
  - b. The institution's condition and performance;
  - c. Differences between planned goals and current conditions;
  - d. Regulatory requirements; and
  - e. Risks (credit, interest rate, off-balance-sheet, etc.).
2. Determine the extent of the board of directors' participation and involvement in the development of policies.
3. Determine whether the institution has an effective system or process to periodically review and revise, when necessary, policies and procedures.
4. Determine if the board of directors periodically analyzes the adequacy of existing policies and modifies them as necessary.
5. By coordinating with examiners responsible for major examination activities, determine that policies and procedures have been established for all key areas of the institution's operations and as required by FCA Regulations.
6. Determine that all proposed policies are adopted by the board of directors before distribution and implementation.
7. Determine that there is a procedure for disseminating written policies and procedures to institution staff in a timely manner.
8. Ensure that policies and procedures are:
  - a. Consistent with the institution's goals and objectives;
  - b. Consistent with each other;
  - c. Uniformly applied throughout the organization; and
  - d. Up to date.
9. Ensure that policies clearly define:

- a. Purpose and objective;
  - b. Operating parameters;
  - c. Authorities;
  - d. A process for addressing exceptions; and
  - e. Reporting requirements.
10. Determine that procedures establish:
- a. The purpose and objective;
  - b. Tasks to be performed;
  - c. Responsibilities of positions involved;
  - d. Appropriate departmental/unit interactions;
  - e. Actions or steps to accomplish the objectives of the procedures;
  - f. Adequate direction to intended end users; and
  - g. Adequate internal controls.
11. Evaluate the process management relies on to ensure that adopted policies are followed or that exceptions are documented.
12. Determine, through discussions with examiners responsible for major examination activities, that policies are being adhered to throughout the institution.
13. Weigh the results of the policies and procedures examination and draw tentative conclusions giving consideration to cause, effect, materiality, and results of other related examination work.
14. Discuss tentative conclusions and examination findings with examiners responsible for major examination activities, such as asset quality, financial condition, management, and compliance.
15. Discuss items of concern, scope of work performed, and conclusions with the examiner-in-charge and with the appropriate institution manager. Obtain a response regarding the cause(s) of deficiencies or weaknesses and anticipated corrective actions.
16. Prepare a leadsheet or other summary document to provide workpaper support for work performed and the conclusions reached.