#3 – OPERATIONS, INTERNAL CONTROLS, & AUDITS
(Risk Focused)

ASSIGNMENT OVERVIEW

The operations area of a trust institution often is considered the most difficult area to evaluate. Activities performed by fiduciary operations must encompass the numerous fiduciary services provided as well as the specialized accounting requirements of the different types of accounts under administration. The institution’s accounting system must be capable of providing detailed accounting information to management, customers, regulatory agencies and other appropriate parties. Although organizational structure and record keeping systems may vary widely in accordance with the size and relative complexity of fiduciary activities, certain basic principles and controls should be present in fiduciary operations.

INSTRUCTIONS

All examiners performing these procedures must be listed above in the “Prepared By” section. Completion of this procedure must be done electronically. 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 significant/critical findings in the CORE ANALYSIS PHASE or as directed by the EIC, the applicable SUPPLEMENTAL ASSESSMENT PHASE (SAP) should also be performed. All findings in the SAP should be summarized in the corresponding CORE ANALYSIS comment section. Indicate if the SAP is performed, in the comment section.

The Summary of Findings page contains Report Worthy comments which should be included in the report and Discretionary Report Worthy comments which may/may not appear in the report. The SEIC/EIC should determine if the Discretionary Report Worthy comments will be included.

The EIC/AEIC should review this procedure when complete. Acknowledgement that this procedure has been reviewed by the EIC/AEIC will be indicated 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.
## 3 OPERATIONS, INTERNAL CONTROLS, & AUDITS

### 1. Prior Criticisms

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

Comment:

### 2. Audit Function

2a. Determine if the institution has a written audit program which has been approved by the Board or audit committee. Based on a review of the external and internal audits, is the program adequate for the size and complexity of fiduciary accounts? Refer to Appendix for additional guidance.

Comment:

### 3. Accounting and Internal Controls

3a. Determine if there are material weaknesses noted in the accounting system and/or data processing system that require further review. The data processing system should provide for fundamental reports (including investment analysis reviews, large cash balance/overdraft reports, anticipated dividend/interest/maturity reports, security location reports, and an automated tickler system), the separate accounting of principal and income, and satisfactory customer or court accountings. Refer to Appendix for additional guidance.

Comment:

3b. Determine if proper dual controls are practiced. Proper dual controls should provide for proper protection of fiduciary assets, fiduciary assets kept separate from corporate assets as provided in the Statement of Principles of Trust Management, and adequate separation of duties and responsibilities among personnel. Refer to Appendix – for additional guidance.

Comment:

3c. Evaluate the vacation policy and/or procedures to ensure that employees in key sensitive positions are absent from their duties for a minimum of two consecutive weeks annually. This would also include denying access to individuals who have electronic access to systems and records from remote locations. Prepare a comment for the report of examination and give to the EIC if the two-week absence from duties is not met or there are significant deficiencies in the bank’s procedures to ensure an employees’ absence from duties.

For guidance, refer to SR 96-37 Supervisory Guidance on Required Absences from Sensitive Positions and Section 4.2 FDIC Examination Manual - Internal Routines and Controls.
### #3 Operations, Internal Controls, & Audits

**Comment:**

3d. Review a copy of the overdraft and large balance report. Through discussions with management determine why larger and long-standing items exist, and how they will be eliminated. Are there any items not adequately explained by management? Refer to Appendix for additional guidance.

**Comment:**

3e. Review the reconcilements of cash, assets, and any suspense accounts to verify that reconcilements are adequate, and reconciled by someone other than the person who maintain/posts these records on a regular basis. All reconcilements should be performed timely, regularly, and should not include any stale items (any outstanding items older than 30 days). Comment on any deficiencies noted. Refer to Appendix for additional guidance.

**Comment:**

3f. Are all original trust agreements maintained in fireproof cabinets or in the vault?

**Comment:**

3g. Does the institution have a satisfactory written disaster recovery and business continuity plan in place? Evaluate the adequacy of internal controls over information systems used by the trust department, including the adequacy of contingency plans for possible failures of critical systems and the frequency with which contingency plans are tested.

**Comment:**

3h. If the institution holds any trust assets in safekeeping, determine if proper controls are in place. Refer to Appendix for additional guidance.

**Comment:**

3i. Are there procedures in place for the escheating of returned checks, unclaimed checks, or other funds as provided in §74.101 (Property Report) of the Texas Property Code? Are all items noted in outstanding checks, returned checks, suspense accounts, or reconcilements less than three years? Refer to Appendix for additional guidance.

**Comment:**

### 4. External Agents

4a. Does the bank or trust company employ any external agents to conduct fiduciary business or provide support services? Refer to Appendix for additional guidance.
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<th>Comment:</th>
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<td><strong>5. Securities</strong></td>
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<td><strong>5a.</strong> Are account assets held by outside depositories pledged to secure loans? Refer to Appendix for additional guidance.</td>
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<td><strong>5b.</strong> Does the institution maintain custody of trust securities on premises? Refer to Appendix for additional guidance.</td>
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<td><strong>6. Securities Trade Processing</strong></td>
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<td><strong>6a.</strong> Did the trust department (not applicable to trust companies) conduct more than 500 securities transactions during the past or current calendar year? Refer to Appendix for additional guidance.</td>
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<td><strong>7. Final Analysis</strong></td>
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<td><strong>7.</strong> Complete the Summary of Findings.</td>
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### #3 - OPERATIONS, INTERNAL CONTROLS, & AUDITS

#### Describe all strengths evident from the evaluation.

#### Describe all weaknesses evident from the 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.

**Report Worthy:**

**Discretionary Report Worthy:**

Determine why weaknesses exist and comment on management’s response and plan of action. Identify bank personnel making the response.

#### SUMMARY RISK RATING ASSIGNED: enter rating here

Risk Rating Definitions:

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.

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APPENDIX

Audit Program

Consider the following to determine whether the written audit program is adequate for the size and complexity of fiduciary accounts administered.

1. Is the program consistent with the size and complexity of the institution and the experience level of those required to implement it?
2. Are written policies and procedures satisfactory?
3. Are the schedules approved by the Board being followed?
4. Are all portions of the audit and outlined procedures being performed?
5. Does the audit cover:
   • Trust Committee minutes?
   • Balance and proof of subsidiary ledgers to general controls?
   • Asset confirmations?
   • Spot-checks and tracing of transactions for accuracy and validity?
   • Review of commissions and fee calculations?
   • Review for compliance with applicable regulations?
   • Review of internal routines and controls?
   • Administrative review of a varied sample of selected accounts?
6. Is there a pattern of exceptions by a particular administrator or group of administrators? If so, has it been identified and investigated by management?
7. Are management’s actions and responses to noted exceptions adequate to resolve potential problems?
8. Does the institution have a monitoring system so that problems are properly reported to a responsible supervisor who has the authority to resolve the noted problems? Are unresolved or outstanding exceptions reported to the Board or Trust Committee on a periodic basis?

Accounting and Internal Controls

Consider the following when reviewing Accounting Systems / Data Processing Systems:

1. How does the institution control and monitor the use of facsimile signature devices?
2. Are overages, shortages, losses, recoveries, and suspense items promptly reflected in accounts specifically set up for their control?
3. If the institution is on a manual system of record-keeping, do all subsidiary records reconcile to their control accounts?

4. When performing a securities count using a printout of all assets held in the vault, were any exceptions noted? Did all assets held outside the institution balance to the institution’s reconciliation?

5. Did principal and income cash reconcile to their combined total figures shown on the institution’s general ledger? Are there any stale dated checks? If dual signatures are required, were any exceptions noted?

6. Are asset descriptions accurate and complete?

7. Are all assets recorded when received and paid for?

8. Does the institution disburse by prenumbered check only?

9. Are canceled trust checks filed numerically?

10. Are voided checks maintained as a permanent record?

11. Does the institution maintain a retention schedule of important documents?

12. Are assets protected properly by physical safeguards and insurance coverage?

13. Are overages, shortages, losses, recoveries, and suspense items promptly reflected in accounts specifically set up for their control?

14. Are there procedures for following up on over or under payment of dividends or interest?
   - Do personnel investigate under payments and file written claims against the appropriate party?
   - Does the institution have detailed records or dividend and interest claim activity?
   - Does the institution have a list of aged dividends and interest receivables?

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Dual Controls

Consider the following:

1. Is there division of duties for the authorization, signing, and mailing of fiduciary checks?

2. Is there adequate control over checks returned undelivered?

3. Are entries (source documents) to fiduciary accounts approved by an officer who is not responsible for posting the entry?

4. Where practical, are duties rotated between employees?

5. Is the reserve supply of unissued trust checks or Unicode checks kept under dual control and are they recorded when withdrawn from the vault?

6. Are register copies of outstanding checks maintained by an employee who does not have duties connected with preparing or approving the entries to accounting records?
7. Is there a periodic verification of assets by someone not involved in the maintenance of the records or the assets? Is the verification sample of a sufficient size to draw valid conclusions?

8. Are fiduciary assets maintained under proper dual controls?

9. Do operations personnel assign responsibility for and provide proper safeguards for items being processed (such as coupons, bonds in process, unissued bonds, and canceled bonds)?

10. Are receipts secured and properly filed for bonds certified and delivered and bonds canceled and returned to obligors?

11. Are there procedures for safeguarding assets in the residence of a decedent until they can be transferred to the institution or distributed?

12. Review the data processing user’s profile. Are access levels appropriate?

13. Are appropriate dual controls and procedures in place for password access controls over terminals which interface to the depository?

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**Cash Balances and Overdrafts**

Consider the following:

1. Follow-up management discussions by obtaining transaction histories to determine when the balance cleared. If not cleared (or invested) the following business day, determine if the account should be made whole to compensate for lost interest.

2. Determine if the overdraft or large cash balance results from a procedural weakness or problems with the sweep set-up.

3. Are administrators appropriately anticipating recurring expenses and distributions?

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**Reconcilements**

Consider the following:

1. How frequently are deposit accounts reconciled?

2. How often are suspense, operating, other “house” accounts or related depository accounts (i.e. dividend and interest suspense) reconciled?

3. Do reconcilements provide for an independent proof of input processing?

4. Do accounting records include a general ledger or other suitable control records?

5. Is the general ledger posted daily and a statement of condition prepared?

6. Are account records posted and updated daily?
7. Are departmental records reconciled by someone other than the person who maintains/posts these records on a regular basis?
8. Determine the purpose and use of all house and suspense accounts. Investigate all large and stale items. Verify that they are reconciled at least monthly.
9. Reconcile subsidiary ledgers of trust accounting system to institution’s control ledgers. (i.e. mutual fund statements)
10. Are overages, shortages, losses, recoveries, and suspense items promptly reflected in accounts set up for their control?

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Safekeeping Items

Consider the following:
1. Are fiduciary items held in safekeeping segregated from bank-owned assets and maintained under dual control?
2. Are duplicate safekeeping receipts issued, with a full description of the items accepted?
3. Are the receipts prenumbered?
4. When the items are released, are receipts obtained from the customer?

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Escheat

Consider the following:
1. After what period of time are accounts classified as inactive or dormant?
2. What classifies an account as inactive or dormant? (i.e. no deposit or withdrawal, no communication from customer, no response or attempt to locate, or other)?
3. Does the institution have a board approved policy regarding escheatable property?
4. Are all inactive accounts segregated and placed under special dual control procedures?
5. After three years of inactivity, are accounts reported as required by law?
6. Are unpresented or stale-dated official trust checks periodically transferred to a separate income general ledger account or a trust data processing suspense account? If so, to what account? After what length of time?
7. Does the institution consider the payee or remitting trust account to be the owner of an uncashed check?

8. When did the institution last remit unclaimed funds to the State Comptroller? What amount in dollars was reported?

9. Did any unclaimed property which has not been previously reported appear to be subject to remittance to the State Treasurer? If so, identify the types of such property and estimated value. Include any evidence of noncompliance and institution’s reason for not reporting this property.

For additional information, refer to:
Texas Comptroller’s Unclaimed Property Reporting Instructions:
Texas Comptroller’s Unclaimed Property Texas Statutes Title 6 Property Code Chapters 72-76
Texas Property Code

External Agents

Consider the following:

1. Has management evaluated the safety, reliability, and confidentiality of the services?
2. Does the institution reconcile accounting records, safekeeping lists, etc.?
3. Does the institution retain control over investment decisions and other discretionary responsibilities?
4. Is the institution advised of all transactions and recommendations pertaining to discretionary matters in a timely fashion?
5. Are the agent’s transaction ledgers submitted to the fiduciary at least monthly for review and reconcilement?
6. Does management obtain and review a SAS 70 or other audit report concerning the agent’s operation?
7. Does management periodically review the financial condition of the agent to ensure fiscal responsibility?

Securities – Accounts Held by Outside Depositories

Consider the following:

1. Are acknowledgements of receipt obtained evidencing such assets and the institution’s fiduciary ownership?
2. Are appropriate records maintained indicating the location of the assets?
3. Are daily reconciliations of changes in the depository position performed, as well as a full reconciliation at least monthly?
4. Are appropriate dual control procedures in place for the release of assets that allow release only upon the written direction of the designated custodian?
5. Does institution obtain written confirmation of release instructions received via telephone or another terminal system?

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Securities – On-Premises Custody of Trust Securities

Consider the following:

1. Do at least two authorized persons have to be present when handling or having access to securities, and in all securities processing and control functions?
2. Is access to the trust vault and securities processing area restricted to authorized personnel, and are persons entering the vault required to sign vault logs or other control documents?
3. Are persons responsible for originating entries or trust vault instructions authorized to access the vault or securities cage?
4. Is the vault used for safekeeping trust assets equipped with minimum security devices such as appropriate lighting, alarm, and other physical controls?
5. Do security movement and control records detail all asset movements, deposits, and withdrawals?
6. Do the records include: the initials of joint custodians, the date of vault transactions, description and amount of assets, the identity of the affected account, and appropriate notations on the source of assets deposited and the purposes for which assets are withdrawn?
7. Are procedures for the temporary storage of securities adequate?

Return to Core Analysis – Q5b

Securities Transactions

If the trust department conducted more than 500 securities transactions during the past or current calendar year, consider the following:

1. Has the institution established appropriate written policies and procedures for recording and processing securities transactions?
2. Does the institution maintain adequate trade records including an itemized daily record of all purchases and sale?
3. Does the daily record include: the account name, description of securities, unit and total purchase or sale price, the trade date, and the broker/dealer with whom the trade was placed?

4. Do written records include receipt of written trade authorizations when appropriate, placement of trades with the appropriate broker for execution, receipt or delivery of securities vs payment, reconcilement of trade information to broker confirmations, and posting the trade to the affected account?

5. Are account assets, other than agency and custodian, registered in the name of the institution in its fiduciary capacity, or a nominee name?

6. If nominee name, is it subject to a partnership agreement that is amended as required?

7. Is the partnership agreement approved by the Board of Directors?

8. Is the nominee name registered with the American Society of Corporate Secretaries to guard against duplication?

9. Are trade orders and associated trade information documented on separate order tickets?

10. Is there a chronological file of all daily trade activity?

11. Does the trade confirmation provided by broker/dealer contain the full details of the trade?

12. Do personnel independent of the trade placement function reconciled the broker confirmation to the original trade memorandum?

13. Are the policies and procedures adequate regarding paying called bonds, coupons, etc.?

14. Does the institution employ trading personnel?

15. Are their duties described in writing?

16. Are there established policies and controls to preclude them from participating or dealing with accounts management, account ledgers, securities handling or control, and reconciliation of written broker confirmations to transactions records?

17. Are training personnel appropriately licensed or if not has the company established trader competency in knowledge of securities laws, securities markets and broker/dealers best suited for individual transactions to ensure the best execution for accounts, efficiency in handling block trades, and use of available communications facilities such as direct lines and automated facilities (e.g. Autex)?

18. Are the policies and procedures for processing securities transactions satisfactory?

19. Do instructions to buy or sell originate with account managers to preclude traders from taking a position in a security without prior orders?

20. Are instructions in writing?

21. Do instructions contain a verifiable signature of the authorizing party, regardless of whether they are original instructions, or confirmations of telephone instructions from the account manager?

22. Do instructions indicate the time and date forwarded to the trader?

23. Do instructions include information such as the affected account, market/limit orders, and any special instructions?

24. Do traders use pre numbered tickets, and are permanent records of transactions kept in chronological sequence?
25. Do orders and permanent records include the date and time of the receipt of the order and the execution of the order, the settlement date, the price at execution, and the commission or any other type of compensation paid?

26. Does the institution combine purchase or sale orders for the same security for more than one account?

27. Are the resulting benefits in price and broker/dealer charges applied on a prorate or average basis to the account involved?

28. Does the institution prorate to each account its share of the securities purchased or sold, if the entire order cannot be executed?

29. If the institution does not combine purchase or sale orders of the same security, are transactions made on a first-in, first-out basis?

30. Does the institution notify customers of securities transactions within 3 business days of the date of the transaction as required by CFR 12 Part 344, and provide a copy of the broker’s confirmation and a statement of the source and amount of any remuneration to be received by the company in connection with the transaction? If alternative notification methods have been adopted, are they acceptable?

31. Are parties independent of account managers and traders performing the reconciliations of confirmations from brokers/dealers to the instructions and traders memorandum, posting of account ledgers, maintaining a record of unexecuted orders, and following up on unexecuted orders within 48 hours after placement with a broker?

32. Are the institution’s procedures for processing redemptions of municipal securities in compliance with SEC standards?

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