
Operations and Internal Controls Examination Program

Examination Objectives

To determine the adequacy and/or effectiveness of the trust department's operations and internal controls. Consider whether:

- all transactions are executed in accordance with applicable law and fiduciary principles;
- there is adequate documentation and timely execution of all transactions;
- the trust department has adopted and implemented an effective system of policies, procedures and practices;
- all accounting, custody, control and security processing systems and records are checked for reliability;
- segregation, custody and control are in accordance with applicable law, policies and procedures; and
- deficiencies are identified and corrective action is initiated as necessary.

Examination Procedures

Wkp. Ref.

Level I

Level I procedures first focus on a review of the examination scoping materials. The next step consists of interviews with trust department personnel to confirm their qualifications and levels of expertise; to determine if the trust department's practices conform to written guidelines; to establish whether any significant changes in personnel, operations or business practices have occurred; or whether new products and/or services have been introduced. If items of concern are uncovered during Level I procedures or if problems are identified during the preexamination monitoring and scoping, the examiner may need to perform particular Level II procedures.

1. Review examination scoping materials related to the trust department's operations and internal controls. Scoping material should include:
 - Risk profile
 - Relevant PERK documents
 - Previous trust and asset management examination report

Exam Date: _____

Prepared By: _____

Reviewed By: _____

Docket #: _____

Page 1 of 16

Operations and Internal Controls Examination Program

Wkp. Ref.

- Workpapers from the previous examination
- Safety and soundness examination report
- Examination reports of subordinate, functionally regulated entities
- Board of director and/or appropriate committee minutes
- Web site information

2. Evaluate the operations and internal control policies and procedures regarding:

- compliance with applicable law and fiduciary principles;
- the reliability of the systems and records for accounting, safekeeping, custody and securities processing; and
- exception transactions.

3. Evaluate whether management has the expertise necessary to carry out the operations and internal control policies and procedures.

4. Determine any significant changes in policies, procedures or outsourcing arrangements.

5. Determine whether management monitors outsourcing arrangements, e.g. through a review of SAS 70 reports and committee minutes.

6. Review and evaluate any significant personnel and/or organizational changes.

Exam Date: _____

Prepared By: _____

Reviewed By: _____

Docket #: _____

Page 2 of 16

Operations and Internal Controls Examination Program

Wkp. Ref.

7. Determine whether any new trust or asset management products or service have been instituted.

8. Evaluate management's procedures for monitoring the savings association's web site. If transactional, was the proper OTS notification and approval obtained?

9. Consider whether the following risk contributors (if applicable) have been addressed:

- Does management fully understand all aspects of operational risk?
 - Does management anticipate and respond well to market and technological changes?
 - Is the volume and complexity of transactions supported by the current system(s) and system development initiatives?
 - Is the internal control environment strong so the trust department is not exposed to transaction failures? Are there adequate controls over outsourcing arrangements?
 - Do management information reports satisfactorily monitor transaction processing?
 - Does management quickly identify weaknesses and take appropriate action?
 - Are there any unresolved operational issues noted in the audit, compliance or examination report(s)?
 - Does management adequately budget for system maintenance and for software and hardware needs?

 - Are there adequate disaster recovery plans?
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Exam Date: _____

Prepared By: _____

Reviewed By: _____

Docket #: _____

Page 3 of 16

Operations and Internal Controls Examination Program

Wkp. Ref.

The completion of the Level I procedures may provide sufficient information to make a determination that no further examination procedures are necessary. If no determination can be made, proceed to Level II.

Level II

Level II procedures focus on an analysis of trust department documents such as reports and outsourcing contracts. The examiner should complete the appropriate Level II procedures when the completion of Level I procedures does not reveal adequate information on which to base a conclusion that the trust department meets the examination objectives. Neither the Level I nor the Level II procedures include any significant verification procedures.

1. Determine whether internal controls are adequately monitored. Consider such items as:

- safekeeping of unissued trust checks;
- controlling computer access to accounting records;
- separating duties for the authorization, signing and mailing of trust department checks;
- handling and distributing trust account statements;
- separating duties for input, processing and reconciliation of trust account information;
- verifying and safeguarding trust and estate personal property;
- confirming after posting that the aggregate of debits and credits posted to the system agree with posting totals generated by the system;
- determining whether the savings association controls and monitors the use of facsimile signature devices;
- the proper receiving, holding or withdrawing of securities, other assets or unissued checks in and out of the vault; and
- determining whether the savings association follows proper cash management

Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

Page 4 of 16

Operations and Internal Controls Examination Program

Wkp. Ref.

practices.

2. Determine whether individual account ledgers are balanced against the trust department's general ledger on a regular basis. Consider whether internal accounts are reconciled regularly and exceptions are timely cleared.

3. Determine if the trust accounting system generates sufficient and reliable information regarding each trust department account. Consider whether the following reports are regularly generated and reviewed by appropriate personnel:

- overdrafts;
- excess cash;
- issued and outstanding checks;
- investment transactions;
- asset classification; and
- principal and income posting.

4. Determine if there are adequate dual control procedures for trust account assets held for safekeeping in the trust department vault.

5. Determine whether proper monitoring and controls exist regarding the movement of securities and the processing of daily and periodic transactions and withdrawals. Consider whether there are system-generated management and/or exception reports available. Also consider whether such a manual or automated system includes:

Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

Page 5 of 16

Operations and Internal Controls Examination Program

Wkp. Ref.

- a written acknowledgement by joint custodians;
- dated vault transactions;
- description of securities;
- identity of the affected account; and
- information regarding the transaction, including, for example, the source of the securities being deposited and the purpose for which securities are being withdrawn.

6. Determine if adequate controls exist regarding purchase or sale orders for trust department accounts. Consider whether there is adequate documentation regarding directions provided by outside investment managers.

7. Determine if there is adequate documentation regarding the execution of the purchase or sale order.

8. Determine if policies and procedures are adequate to determine if broker confirmations are reconciled against the savings association's securities transaction register.

9. Determine if the trust department monitors the receipt of soft dollars and brokerage commissions being charged.

10. Determine whether there is correct usage and adequate monitoring by management of suspense and overdraft accounts.

Exam Date: _____

Prepared By: _____

Reviewed By: _____

Docket #: _____

Page 6 of 16

Operations and Internal Controls Examination Program

Wkp. Ref.

11. Determine whether the securities processing unit has adequate controls regarding:
- obtaining and disbursing accurate information regarding corporate reorganizations, puts, calls and tender offers;
 - posting and collecting all dividend and interest payments;
 - obtaining prior approval to settle particular security trades; and
 - validity and accuracy of wire transfers.
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11. Determine if trust funds on deposit with the savings association or its affiliate are secured in accordance with OTS regulations at §550.290-320.
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12. Determine when investment discretion has been delegated to an outside or affiliated investment adviser(s). Ensure that recommendations and/or decisions are appropriate for the affected trust department accounts in accordance with applicable state law requirements.
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13. Determine if the trust department's controls and safeguards for its securities lending activities are adequate.
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14. Determine if the trust department has proper controls in place to prevent "free riding".
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15. Determine if the trust department has adequate policies and procedures to govern its obligations in connection with the Shareholder Communications Act and proxy processing regulations.
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Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

Page 7 of 16

Operations and Internal Controls Examination Program

Wkp. Ref.

16. Determine if the trust department has adequate policies and procedures to comply with state escheat laws.

17. Review compliance monitoring procedures for any transactional web site.

If the examiner cannot rely on the trust and asset management Level I or Level II procedures, or data contained in department records or internal or external audit reports; proceed to Level III.

Level III

Level III procedures include verification procedures that auditors usually perform. Although certain situations may require that Level III procedures be completed, it is not the standard practice of the Office of Thrift Supervision (OTS) examination staff to duplicate or substitute the testing performed by auditors.

1. Reconcile individual account ledger totals to the trust department's general ledger.

2. Test the accuracy of purchase and sale transactions by comparing selected broker confirmation statements to the securities transaction register.

3. Test for timely posting of items to selected trust accounts. Ensure that postings to income and principal are correct.

4. Reconcile trust department demand account balances to outstanding trust department checks.

Exam Date: _____

Prepared By: _____

Reviewed By: _____

Docket #: _____

Page 8 of 16

Operations and Internal Controls Examination Program

Wkp. Ref.

5. Test selected trust department customer account statements for accuracy.

6. Reconcile suspense accounts.

7. Review all exception reports and verify resolution.

Examiner's UITRS Rating, Summary, Conclusions and Recommendations:

References - 310

Laws

HOLA	Section 5(n)(2)
ERISA	Section 404(b)
	Section 406(b)
Share Holders Communication Act	
Bank Secrecy Act	
Internal Revenue Code	Section 408(a)

Code of Federal Regulations

12 CFR 550.230	Custody or Control of Assets in a Fiduciary Account
12 CFR 550.240	Custody of Fiduciary Investments on Off-site Premises
12 CFR 550.250	Segregation of Fiduciary Assets
12 CFR 550.290	Funds Awaiting Investment or Distribution
12 CFR 550.300	Deposit of Temporary Investments
12 CFR 550.310	Pledging for Deposits
12 CFR 550.320	Acceptable Collateral
12 CFR 550.430	Fiduciary Records Separate and Distinct
12 CFR 550.490	Deposit of Securities with State Authorities

Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

Page 9 of 16

Operations and Internal Controls Examination Program

Wkp. Ref.

12 CFR 550.510	Records
12 CFR 550.580	Exempt Activities
12 CFR 563.117	Bank Secrecy Act Procedures
12 CFR 568	Minimum Security Devices and Procedures
17 CFR 403.5	Custody of Securities Held by Financial Institutions that are Government Securities Brokers or Dealers
17 CFR 450.4	Custodial Holdings of Government Securities
29 CFR 2550.404(b)(1)	Maintenance of Plan Assets Outside of Jurisdiction of US Courts
31 CFR 103	Bank Secrecy Act Regulations

Office of Thrift Supervision Publications

OTS Compliance Activities Handbook	Section 405
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Other

PTE 81-6	Securities Lending from Qualified Plans
PTE 82-63	Payment to Fiduciaries for Providing Securities Lending Services
DOL Advisory Opinion 88-02A	Sweep Fees
SEC Rule 14a	Shareholders Communication Act

Workpaper Attachments - 310

Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

Operations and Internal Controls Examination Program

Optional Topic Questions

The following list of questions is offered merely as a tool and reference for the examiner and is not a required part of the examination process.

Policies, Procedures and Records

<ul style="list-style-type: none"> • Has the savings association adopted a formal disaster recovery and contingency plan?
<ul style="list-style-type: none"> • Are account records posted daily?
<ul style="list-style-type: none"> • Are entry source documents initiated by an individual not responsible for posting the entry to the accounting system?
<ul style="list-style-type: none"> • Are individual account cash and asset ledgers sufficiently clear to identify transactions, current holdings and balances?
<ul style="list-style-type: none"> • Are there trust departmental control accounts that provide accounting control over all assets?
<ul style="list-style-type: none"> • Are trial balances generated periodically?
<ul style="list-style-type: none"> • Are there regular reconcilements of trust department demand account balances and outstanding trust checks?
<ul style="list-style-type: none"> • Are separate ledger controls for each account maintained for principal and income?
<ul style="list-style-type: none"> • Is there use of departmental (general ledger) accounts to ensure that accounting control is provided over all assets?
<ul style="list-style-type: none"> • Are there accurate and complete asset and transaction descriptions?
<ul style="list-style-type: none"> • Are postings to the system once a source document is received, done timely?
<ul style="list-style-type: none"> • Is confirmation after posting done to ensure that the aggregate of debits and credits posted to the system agree with posted totals generated by the automated system?
<ul style="list-style-type: none"> • Does the savings association's system have the ability to generate information (or reports) for the following key controls? <ul style="list-style-type: none"> • Aged breaks (identify breaks between trust accounting and other systems) • Asset classification (separate assets by type) • Automatic investment of dividends • Overdraft report • Excess cash report • Transaction report of previous day's activity • Income receivable reconciliation • Issued and outstanding checks • Daily checks

Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

Operations and Internal Controls Examination Program

Account Statement Processing

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| <ul style="list-style-type: none">• Is there a verification or quality control for statements regarding cash balance reconciliation, asset pricing, verification of pending trade settlement dates, transaction detail, loan detail or fee charges? |
| <ul style="list-style-type: none">• Does the savings association have a controlled environment for the processing (including changes) and review of statements prior to mailing? |

Suspense Accounts

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| <ul style="list-style-type: none">• Are all suspense or “house” accounts identified? |
| <ul style="list-style-type: none">• Is there a periodic reconciliation of all suspense accounts? |
| <ul style="list-style-type: none">• Does the frequency of reconciliation depend on the number and/or dollar amount of transactions? |
| <ul style="list-style-type: none">• Are suspense accounts used only for the purpose intended? |
| <ul style="list-style-type: none">• Does an individual who is not authorized to generate or post entries to the account, reconcile suspense accounts? |
| <ul style="list-style-type: none">• Are exceptions documented and followed up on a timely basis until they are cleared? |
| <ul style="list-style-type: none">• Is the time period an exception is outstanding noted? Are exceptions outstanding for 30-60 days reported to senior management? Are exceptions outstanding for a certain time (usually 90 days) being charged off to the savings association if no recovery within a reasonable time is foreseen? |
| <ul style="list-style-type: none">• Are exception reports reviewed and initialed by a supervisor? |

Outsourcing Arrangements

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| <ul style="list-style-type: none">• Did management perform an adequate due diligence review of the service provider? |
| <ul style="list-style-type: none">• Is there a contract with the service provider that clearly articulates the expectations and responsibilities of both sides? Does the agreement include a clause whereby the savings association may rescind the agreement if the service provider is not adequately performing? |
| <ul style="list-style-type: none">• Is there an effective structure in place to manage and monitor the outsourcing arrangement? |
| <ul style="list-style-type: none">• Has management ensured that the service provider has a viable contingency plan? |
| <ul style="list-style-type: none">• Does management obtain and review audit/examination reports (such as a SAS 70) of the service provider? |
| <ul style="list-style-type: none">• Does the savings association have complete and immediate access to critical information? |

Trust department vault

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| <ul style="list-style-type: none">• Is there a separate trust vault or lock box for trust assets in the savings association’s main vault? |
| <ul style="list-style-type: none">• Is the vault under dual control (at least 2 personnel authorized to enter the vault)? |
| <ul style="list-style-type: none">• Does the board of directors or their designee appoint vault custodians? |
| <ul style="list-style-type: none">• Is a written log denoting time of entry, who entered and what was taken or placed in the vault, maintained? |

Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

Operations and Internal Controls Examination Program

Nominee Registration

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| <ul style="list-style-type: none">• If trust securities are held at the Depository Trust Company (DTC) in the nominee name of CEDE & CO, is there a written agreement and are the authorized signers for the savings association added or deleted on a timely basis? |
| <ul style="list-style-type: none">• If another nominee name is utilized, is it registered with The American Society of Corporate Secretaries (to guard against duplication of the nominee name) or the appropriate state authority if so required? |

Control of Assets

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| <ul style="list-style-type: none">• Are trust assets properly secured at all times? |
| <ul style="list-style-type: none">• Are transactions processed on a timely basis? |
| <ul style="list-style-type: none">• Is there timely follow-up to update asset values for proper pricing as to both market and cost values? |
| <ul style="list-style-type: none">• Are securities being handled in a secured area with limited access? |
| <ul style="list-style-type: none">• Is there use of prenumbered receipt or withdrawal forms or fanfold tickets for the deposit or withdrawal of assets? Are these deposits or withdrawals verified and authenticated in writing by joint custodians? |
| <ul style="list-style-type: none">• Are trust department checks prepared and disbursed by someone other than the person who authorized them? |
| <ul style="list-style-type: none">• Are there proper physical controls of unissued trust department checks to prevent unauthorized issuance? This should include:<ul style="list-style-type: none">• Checks being prenumbered;• Checks being used in numerical order;• Periodic reviews should be performed to make sure no checks are missing; and• Working supply signed out (in a log) and stored in locked desk or cabinet when not in use. |
| <ul style="list-style-type: none">• Are changes to customer records initiated by appropriate parties and supported by adequate documentation? |
| <ul style="list-style-type: none">• Are unissued checks and unissued securities of corporate trusts and transfer agencies held in the vault along with records of those withdrawn? |

Custodial Holdings of Government Securities

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| <ul style="list-style-type: none">• If the savings association holds securities for the account of a customer (including securities subject to repurchase transactions) does it maintain possession and control by:<ul style="list-style-type: none">• Segregating such securities from the assets of the savings association?• Keeping them free of any lien, charge or claim of any third party granted or created by the savings association? |
| <ul style="list-style-type: none">• If customer securities are maintained at another financial institution (a "custodian" financial institution such as a correspondent bank but other than a Federal Reserve Bank), does the savings association:<ul style="list-style-type: none">• Notify the custodian institution that such securities are customer securities? |

Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

Operations and Internal Controls Examination Program

<ul style="list-style-type: none">• Instruct the custodian institution to maintain such securities free of any lien, charge, or claim of any kind in favor of the savings association or any persons claiming through it?• Receive adequate assurance from the custodial financial institution that securities are being maintained in an account designated for the savings association's customers and such account does not contain proprietary securities of the custodian financial institution or the savings association?
<ul style="list-style-type: none">• Where the savings association is holding securities for another financial institution as a custodian, does it:<ul style="list-style-type: none">• Receive notification from the depositing financial institution regarding which securities are customer securities?• Maintain such customer securities free of any lien, charge or claim of any third party granted or created by the financial institution?• Treat such securities as customer securities and maintain such securities separate from any other securities held for the account of the depositing financial institution, and from any other securities held by the savings association?
<ul style="list-style-type: none">• If the savings association is providing clearing services for a government securities broker or dealer by holding securities that have been identified as customer securities by such broker or dealer, does the savings association:<ul style="list-style-type: none">• Treat such securities as customer securities separate from other securities held for the account of the broker or dealer; and• Comply with the same requirements detailed above when the customer securities are maintained at another financial institution; or• If the securities are not segregated as of the close of business upon the broker-dealer's instruction, does the savings association have procedures for giving notification to the supervising agency of the broker or dealer that such securities are not being segregated because they continue to be required as collateral for an extension of clearing credit to such dealer and are such procedures being followed?
<ul style="list-style-type: none">• If customer securities are maintained for the savings association at a Federal Reserve Bank, does the savings association have procedures designed to prevent the unauthorized pledge of customer securities to the Federal Reserve Bank?
<ul style="list-style-type: none">• Review the savings association's procedures for complying with the regulation regarding the issuance of a confirmation or a safekeeping receipt for each security held.<ul style="list-style-type: none">• Does the confirmation or safekeeping receipt identify the issuer, the maturity and the par amount and coupon rate of the security?• Is the confirmation supplied to the customer in the manner specified in the regulations?
<ul style="list-style-type: none">• Review the savings association's compliance with the recordkeeping requirements of 17 CFR 450.4(c) and determine if the savings association's records:<ul style="list-style-type: none">• Provide a system for identifying each customer and each security?• Describe the customer's interest in the security?• Indicate all receipts and disbursements of securities?• Indicate all receipts and disbursements of cash by the savings association in connection with

Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

Operations and Internal Controls Examination Program

<p>government securities?</p> <ul style="list-style-type: none"> • Include a copy of the safekeeping receipt or a confirmation issued for each security held?
<ul style="list-style-type: none"> • Review the policies and procedures for securities held for customers (17 CFR 450.4(d)) and determine if: <ul style="list-style-type: none"> • Policies and procedures are adequately documented. • Actual counts are performed at least annually. • Securities are reconciled with customer account records. • Securities held by another institution, as custodian, are properly reconciled. • Securities that have not been in the savings association's possession for longer than 30 days are verified, including those in transfer, transit, pledged, loaned, borrowed, deposited, failed to receive or deliver, subject to repurchase or reverse repurchase agreements?
<ul style="list-style-type: none"> • Review the savings association's policies and procedures for complying with government securities that are subject to a repurchase transaction. 17 CFR 403.5(d): <ul style="list-style-type: none"> • Are written agreements between the customer and the savings association on file? • Does the repurchase agreement state that the funds held by the savings association are not a deposit and therefore not federally insured? • If the right to substitute securities is granted the savings association, does the repurchase agreement contain a provision allowing it to substitute securities? • Is the savings association in compliance with the substitution provision?

Securities Lending

<ul style="list-style-type: none"> • Has management developed and implemented adequate written policies, procedures and a system of controls that will enable the trust department to conform to applicable law as well as minimize the potential risks associated with securities lending?
<ul style="list-style-type: none"> • Is there authorization contained in the governing instrument?
<ul style="list-style-type: none"> • Is the activity subject to a written agreement between the security borrower and the savings association delineating duties of each (custodianship of collateral, collateral margin, types of securities to be used as collateral, default procedures, etc.)?
<ul style="list-style-type: none"> • Does the savings association have personnel who are knowledgeable and experienced in securities lending?
<ul style="list-style-type: none"> • Is a due diligence analysis and review of the borrower periodically updated?

Free Riding

<ul style="list-style-type: none"> • Are the policies and procedures adequately documented?
<ul style="list-style-type: none"> • Have standards been set for the acceptance of new custodial accounts, including customer background and credit information?
<ul style="list-style-type: none"> • Is identification required of broker-dealers sending securities to, and receiving funds from, customer

Exam Date: _____
 Prepared By: _____
 Reviewed By: _____
 Docket #: _____

Operations and Internal Controls Examination Program

accounts?
<ul style="list-style-type: none">• Has a system been established to track accounts involving numerous broker-dealers?
<ul style="list-style-type: none">• Is it policy to disaffirm customer trades where acceptance would result in a violation of Regulation U?
<ul style="list-style-type: none">• Are procedures in place to determine that if margin credit is extended, that collateral requirements are met?

Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____