

This document and any attachments are superseded by Comptroller's Handbook - Internal and External Audits.

Introduction to Audits

This section provides guidelines to evaluate a trust department's audit program and to evaluate the work performed by internal and external auditors. Many of the considerations used to evaluate a trust department's audit program are the same as those used to evaluate the savings association's overall audit, although a separate trust department audit should be conducted. Due to the fact that the trust department may be audited at the same time as the savings association itself, in some regions examiners (other than trust and asset management examiners) may evaluate such matters as the auditor's independence and competence for the institution as a whole. In these cases, the examiner evaluation should separately consider the independence and competence of the auditors with regards to the trust department.

The primary objective of the audit function in the trust department is to detect errors and irregularities and ascertain the effectiveness of the policies and procedures used for the administration of accounts, safeguarding of assets and the accurate recording of transactions.

12 CFR §550.440 requires that a savings association must conduct a suitable audit of its significant fiduciary activities. The regulation permits the savings association to conduct these audits on either an *annual* basis or on a *continuous* basis. If the institution chooses to use an annual audit system it must "arrange for a suitable audit of all significant fiduciary activities at least once during each calendar year" (§440(a)). On the other hand, if the savings association adopts a continuous audit system, it must "arrange for a discrete audit of each significant fiduciary activity at an interval commensurate with the nature and risk of that activity" (§440(b)). Therefore, under this type of audit system, some fiduciary activities may receive audits at intervals greater or less than one year, as deemed appropriate for the risks associated with that activity. For institutions on a continuous audit system, examiners should ensure that a risk assessment has been made for all significant fiduciary activities and that those activities reviewed less often than annually have been determined to be low risk.

Independent audits enhance the probability that conditions that could adversely affect the savings association, OTS or the public will be detected. The audit process also subjects the policies, procedures, records and the internal controls of each institution to periodic review.

Examiners should evaluate a savings association's audit program for its trust department based on a review and evaluation of the competence and independence of the audit staff and the adequacy and effectiveness of the audit program. Areas that would normally be subject to criticism include the absence of an audit function; an inadequate audit program; instances where audit staff is restricted from full access to records or otherwise lacks independence; lack of competence; instances in which the audit function does not report directly to the board of directors (or an appropriately designated committee); and instances where the board or its designated committee is not properly established or initiating necessary corrective action based on audit findings.

Materials that pertain to overall audit policies and standards are noted in more detail in sections 350 and 355 of the Thrift Activities Handbook. Only a brief summary of those materials is presented in this handbook chapter.

Audit Committee

12 CFR §550.470 provides savings associations with guidance as to the composition of the board of director's fiduciary audit committee. Under the regulation, a fiduciary audit committee directs the conduct of the audit. The composition of the committee may consist of a committee of the savings association directors, an audit committee of an affiliate or the entire institution's board of directors. However, the regulation places the following two restrictions on membership on the committee:

- savings association officers or officers of an affiliate who participate significantly in administering fiduciary activities may not serve on the committee, and
- a majority of the members of the audit committee may not serve on any board committee responsible for the savings association's administration of its fiduciary activities.

Results of fiduciary audits (including significant actions taken as a result of the audit) must be reported in the minutes of the board of directors.

Trust Department Audit Objectives

The objectives of a trust department audit should be:

- to appraise the soundness and adequacy of accounting, operating and administrative controls and procedures designed to insure prompt, efficient and accurate recording of transactions and safekeeping of assets.
- to determine the degree of compliance with applicable law as well as the institution's policies, practices and procedures.
- to keep the board of directors and management informed of the institution's condition and make recommendations for improvement.
- to evaluate the institution's exposure to liability if the institution fails to fulfill its duties and responsibilities to trust and asset management accounts.
- to detect and prevent irregularities such as errors and fraud.
- to determine the quality of account administration.
- to verify that fee income from trust and asset management activities is recognized properly on the savings association's financial statements.

Examiners should ensure the trust audit function is effective in evaluating the department's internal controls and is of sufficient scope and coverage to protect the interests of trust and asset management accounts and the institution. Examiners should also ensure that the auditors review for compliance with applicable law. The review and evaluation of the audit function should be a key element in determining the scope of the trust and asset management examination. The examiner should generally not duplicate satisfactorily performed audit procedures, particularly those involving verification activities.

Audit reports should provide the examiner with information pertinent to the trust and asset management examination, such as areas where weaknesses were noted and areas where the examiner should determine whether management appropriately corrected cited deficiencies. If the examiner determines that audits have not been performed or that audit work is considered to be of limited value, the examiner should expand the

scope of the trust and asset management examination. In those instances, the audit or audit program and lack of board oversight should be criticized.

Internal and External Audits

In order to satisfy the requirements of §550.460, internal or external auditors, or a combination of both may perform a trust department audit, and should be responsible only to the savings association's board of directors. The form of audit developed and the personnel employed to conduct it will be primarily dependent upon the size and complexity of the trust and asset management activities. The scope and objectives of an external audit may differ somewhat from those of an internal audit. An external audit is generally aimed at enabling the accountant to express an opinion on the fair presentation of financial statements in conformity with generally accepted accounting principles. To that end, the audit requirements subject the accounting policies, procedures, records, and the internal controls of each institution to periodic, independent critical review and evaluation and typically cover only a specified historical period.

On the other hand, the internal audit function has a number of objectives, including the detection of errors; determination of compliance with an institution's policies, procedures and applicable law; and evaluation of the soundness and adequacy of an savings association's system of internal controls. Internal auditors may also play a role in the formation and revision of policies and procedures.

Actual practice may blur the distinctions between an internal and external audit. For example, internal and external auditors may work together on the same audit and set the audit scope and assign each auditor an area of responsibility or they may work side by side. Any distinction between internal and external audits is therefore relevant only to the extent that it impacts the quality or effectiveness of a savings association's overall audit program.

If the trust department is audited internally, the examiner should take the opportunity to review the auditor's programs, workpapers and reports as part of the overall examination process. However, if the department is audited externally the opportunity to review programs and workpapers may not always be feasible. In order to adequately assess the work performed by the external auditor, and to address the matters discussed in the preceding paragraph, the external audit report should provide adequate details concerning the areas audited (testing for receipt of income from investments, allocations of income and principal cash, etc.). A statement to the effect that "all applicable audit procedures were performed in compliance with PA-7a," without further elaboration, would not be acceptable. Examiners should encourage management to contact the external auditor and enable examiner access to audit programs and workpapers.

Competence and Independence

(The Thrift Activities Handbook contains detailed information on the competence and independence of auditors; only a brief summary is presented here.)

Two of the major considerations in evaluating the work of auditors are their competence and independence. This evaluation is the same as it would be for evaluating any audit or auditor; the fact that it is a trust department audit makes no difference. Thus, when a trust and asset management examination is being conducted as part of an examination of the entire savings association, an examiner (other than a trust and asset management examiner) may perform the audit evaluation of the trust department.

The very nature of an internal audit requires that it be independent. Only by being independent can the audit function fulfill its purpose of serving as a managerial control within an organization, i.e. to measure and

evaluate the effectiveness of operations and controls. To be independent means that the audit function should report only to the board of directors or its designated committee. The auditor should have full and free access to all books and records. Auditors should not audit any activity for which they are responsible on a daily basis; for example, auditors should not evaluate vault procedures if they are the vault custodians.

The size and complexity of a savings association's trust and asset management activities as well as the emphasis placed on the audit function by the board of directors will account for variations in the responsibilities and qualifications of internal auditors. In considering the qualifications of the audit staff, it is necessary to review the educational and experience qualifications required by the savings association for a position in the audit department and any available training. The trust department auditor must possess sufficient education and training to fully understand trust and asset management administration, investment practices and trust department operations. If a savings association has a small trust department, it may not always be feasible for its auditor to have trust department auditing experience. However, in those cases the auditor should participate in courses or programs sponsored by industry groups dealing with trust department audits and should review current literature on trust department auditing.

Conclusions in regard to the auditor's competence should be derived from a review of the audit program, training and the quality of reports. Indicators of the competence of the internal auditor include the quality of the work performed and the ability to communicate the results to the board.

The independence of the external audit function is similar to that of the satisfactory performance of audit activities: external auditors must be independent of those for whom they work. The AICPA and OTS have promulgated standards of independence. OTS provides that a public accountant will not be considered independent if, among other things, the accountant or his or her firm has any direct or material financial interest in the savings association. A financial interest is defined as the CPA being connected with the savings association, subsidiary or affiliate as an officer or director; being the beneficial owner of any shares of stock of the savings association; or having any conflict of interest or relationship of business or personal relationships with management or other individuals. Absent unusual circumstances, it should not be necessary to review the independence of the external auditor.

Qualified public accountants are required to perform their work according to generally accepted auditing standards. Absent unusual circumstances, it should not be necessary to review the qualifications of the external auditor. Where a review is considered necessary, the above standards relating to specialized work experience would be appropriate.

Audit Program

A savings association should develop a written audit program approved by its board or audit committee. The program should be tailored to the institution's trust and asset management activities; the risks associated with those activities; the experience level of the audit staff; and define an acceptable scope and frequency schedule for the audit. The scope and frequency of the audit testing should be dependent on the degree of risk that the trust and asset management activities pose to the savings association. Riskier activities should be audited more frequently, while those activities posing a minimal risk to the savings association may be tested on a more infrequent basis.

In the case of an external audit, a written program usually consists of having the external auditor submit an engagement letter to the directors prior to beginning their work. Engagement letters typically include the scope of the audit, the time period for the audit, and the reports expected to be rendered. The auditor may also provide a summary of procedures to be used, for example, in the verification of account assets. In the

case of an internal audit, a written program usually consists of a board resolution or an adopted procedure similar to an engagement letter.

The scope of the audit program must be broad enough to include all significant operations and functions of the trust department; however, its focus should be on the activities or operations of the trust department that have been associated with a high level of risk.

To illustrate, the scope of the audit program should consider the:

- past performance or results of past audits.
- organizational structure of the trust department.
- size and complexity of trust and asset management activities (dollar value of assets, level of discretionary accounts, complexity of assets, etc.).
- nature and extent of comments in OTC trust and asset management examination reports.
- individual factors, such as: effectiveness of internal controls, strength and integrity of trust department accounting, recordkeeping and other systems.
- nature and extent of insurance coverage.

Regulatory requirements for the scope of external and internal audits include, among other things, that:

- the audit be made in accordance with generally accepted auditing standards.
- the auditor be generally familiar with applicable law such as appropriate federal and state statutes and OTS regulations (e.g., 12 CFR §550).
- the audit incorporate all procedures necessary to satisfy the auditor that fiduciary activities are being administered in accordance with applicable law, fiduciary assets are being properly safeguarded and transactions are being recorded in appropriate accounts in a timely manner.

Audit Controls

The audit of a trust department can be divided into three main areas: compliance, physical control and activity control. Compliance consists of the prompt and complete fulfillment of all duties required by applicable law and management policies. Physical control includes the physical security of assets for which the trust department is responsible. Activity control includes the complete, accurate and timely recording of all individual account and departmental transactions.

The auditor's primary responsibility in auditing internal controls is to determine that such controls are in place, that the controls address all of the trust department's duties regarding trust and asset management accounts and that the department is in compliance with the internal controls. In terms of physical controls, the audit procedures employed will be determined at least, in part, by the extent to which the department's systems are automated or are otherwise controlled internally. For example, the auditor may perform more actual verification procedures in an automated department so as to determine whether the reconciliation of balances and statements are being properly performed by the internal accounting system, whereas in a nonautomated department the auditor may perform more actual reconciliation of account balances and controls.

An audit should include a review of the organizations that provide services to the department. Such a review will most likely be conducted by reviewing the service provider's own audit report. Such reports are rendered by the servicer pursuant to Statement on Accounting Standards (SAS) 70, which should discuss the control structure in place for trust department service providers, such as data processing servicers and securities custodians. The institution's auditors most likely will be preparing similar SAS 70 reports for use by other auditors, such as a plan sponsor's auditor and also for the trust department's common and collective investment funds.

Audits of Common Procedures and Administrative Audits

An effective trust department audit should include tests of systems and procedures that are common to the management of all or most accounts being administered, as well as tests of activity in individual accounts. Functions that are normally tested are the opening and closing of accounts; processing of assets into and out of the vault; fee charges and payments; and processing of asset purchases and sales.

Testing of individual account activity is referred to as an "administrative audit." In performing administrative audits, the auditor should perform sufficiently detailed tests to obtain reasonable assurance that activities and transactions within the various types of accounts are being conducted properly. A representative sample of accounts should therefore be selected for testing of individual transactions. The approach taken in a particular audit program will determine which functions are tested as part of common procedures and which functions are tested individually as part of an administrative audit. For example, a test of uninvested cash could be performed as a common procedure by obtaining a listing of all such cash or it could be performed as an individual account procedure.

In reviewing the savings association's internal audit program, the examiner should expect to find the following minimum functions being performed:

- Review of trust department committee minutes
- Balance and proof of subsidiary ledgers to general ledger
- Review of broker confirmations
- Spot-check and tracing of transactions for accuracy and validity
- Verification of commission and fee calculations
- Assessment of compliance with applicable law
- Evaluation of internal controls
- An administrative review of selected accounts comprising:
 - The trust agreement, other governing documents and court orders
 - Administrative actions (in compliance with above)
 - Income postings
 - Discretionary distributions
 - Principal invasions (including approvals therefore)
 - Investments in accordance with account objectives and department policy
 - Account documentation

- Consultation with, and approvals by, cofiduciaries

Audit Records and Reports

In order to have a sound basis upon which to evaluate the adequacy of the internal audit program, the audit workpapers must document the work performed by the auditor. Workpapers should contain audit work programs and analysis that clearly indicate the procedures performed, the extent of testing and the basis for the conclusions reached. In addition, the content of the workpapers is one indicator of an auditor's competence and adherence to professional standards. An analysis of the reporting process followed by the auditor and of the findings and recommendations in the audit reports is important in determining the auditor's duties and the independence of the audit function.

Audit reports should be submitted as soon as practicable after completion of the audit. Reports should be sent to those officials who have both the responsibility and the authority to implement the suggested changes. Management's prompt and effective response to the auditor's recommendations is essential to the effectiveness of the audit program. The examiner should determine not only what was contained in the auditor's reports but also the timeliness and content of management's response. The examiner should expect to see either corrective action taken in response to the audit findings or reasons for nonimplementation.

Risk Based Audits

Risk based audit programs are a relatively recent development in the trust and asset management activities arena and are being more widely adopted by trust departments. The primary objectives for implementing a risk-based audit program are to improve the effectiveness of internal audit activity and enhance company profitability through efficient resource utilization. Risk-based auditing programs are designed to place audit resources in the areas of highest risk and enable an efficient and proactive risk assessment and control environment. This process necessitates and fosters cooperation and improved relationships between auditors and management.

Numerous large financial institutions have implemented trust department risk-based auditing programs as part of a corporate-wide, risk-based auditing system. Institution or holding company audit personnel that report to a trust department audit committee of the board typically administer these audit programs. This committee may report to another board audit committee or directly to the board.

Risk-based auditing programs are designed to be dynamic processes that focus on the identification and measurement of risk and the implementation of appropriate risk management systems. It requires, at a minimum, periodic risk assessments of all significant trust and asset management activities. These assessments are documented, reviewed and updated before a new audit of a specific activity has begun. While these audit programs and risk assessment models are primarily internally designed, there are a few vendors who are providing prototype shells, which the financial institution purchases and modifies to meet its particular needs.

The basic design standards of the risk-based auditing programs are similar. There are, however, significant variances in the risk assessment models and monitoring formats. The sophistication of each program will vary with the size, complexity, geographic diversity and technological capital of each financial institution. In designing the program and its components the auditors may work closely with trust department management in order to identify the various trust and asset management products and services and the risks associated with them.

The following is a brief summary of some steps that can be used to begin building an effective risk-based audit program.

- Develop an auditable universe and define auditable entities.

The first step in the risk assessment process is to develop an auditable universe. Auditors should determine the significant trust and asset management activities of the organization and construct these activities into identifiable auditable entities. Auditable entities are most often established by business line but can also be defined by service or function.

- Develop an auditable entity business profile.

A profile of each trust and asset management auditable entity is then developed that documents the entity's business goals and objectives, strategies, organizational structure and operating systems. The purpose of the profile is to identify key risks inherent in the entity and document the structure of risk management and internal control systems. Workflow analysis is sometimes performed at this stage, but is more frequently documented during the planning of actual audit work programs.

- Prepare the auditable entity risk assessment.

The trust and asset management risk assessment is typically structured to evaluate and measure business, inherent risk and control system risk. Within each of these categories, specific trust and asset management risk factors are listed for analysis and provided with a rating (usually numerical). The factors are supported by written standards with definitions and application guidelines. Risk factors vary in focus and number but examples of common factors include the following:

- financial indicators such as account size and type, transaction volumes, growth trends and earnings;
- control environment that includes the corporate risk culture, management style and organizational structure;
- risk management and internal control systems;
- management information systems and technology;
- strategic factors such as product development and marketing focus; and
- compliance, litigation and regulatory environment.

Some trust and asset management risk based audit programs have structured their risk assessment models to specifically address the nine risk categories that have been identified and promulgated by OTS.

Trust and asset management risk based systems may attempt to quantify the various risks through the application of a qualitative model rating system. The risk factors are often rated or scored based on a formalized scale such as High, Medium, or Low, or 1 through 5. Some systems may even apply a weighting factor to the process, which may be based upon the auditor's knowledge of the savings association's history versus industry averages or standards.

Programs may include the use of risk matrixes and charts that compare the risk and control aspects and then attempt to identify control or efficiency gaps. This type of analysis illustrates where business risk is equal to or different from the appropriate risk control level. This "gap" analysis concept is informally applied in the auditor's evaluation of risk and control systems. The matrixes and charts rarely stand on their own. Usually there is a narrative commentary accompanying the matrixes, which analyze and support the auditor's conclusions.

- Develop the trust and asset management risk-based auditing plan.

Once the risk assessment process is completed, the auditor is now ready to develop his audit plan. The assessment process is used as the primary tool in developing the plan. The audit plan is a comprehensive document that is approved each year by the trust department audit committee or board. It establishes audit schedules, work program scope and resource allocations for each auditable entity.

- Audit execution, exception reporting and follow-up processes.

Implementation of the trust department audit plan involves three key processes, planning, execution and reporting. During the planning stage, the auditable entity's risk profile is analyzed and a risk-based audit work program is developed which will be used to execute the audit of the specific activities. The auditing process will identify any exceptions found. In the reporting process, the auditor must determine what exception items are reportable in a formalized report and which are communicated to department management in an informal manner.

Similar to the Uniform Trust Interagency Rating System used by OTS and the other banking regulators, each audit report may contain a rating categorizing the auditor's overall findings regarding the auditable activity. An activity's overall rating will usually depend upon the amount and severity of exceptions found. The distribution of formalized audit reports may be impacted by the audit report rating with more critical reports receiving broader or higher level distribution.

Once the report is distributed, the auditor must develop a system to monitor any actions taken by department management to resolve the auditor's concerns. The exception rating system may also impact the timing of the auditor's follow-up of audit exceptions. The follow-up program should require some form of monitoring for all exceptions regardless of their significance.

- Implement systems to monitor and update risk assessments.

Prior to the next audit, the risk assessments will need to be reviewed and updated to reflect any changes from the last audit.

Formally or informally, trust department auditors are provided periodic monitoring information reports for risk assessment purposes. The auditors use the information to adjust auditing priorities but an update of the risk assessment profile or matrix of the trust department may or may not be completed until the required annual assessment date or until an audit is conducted.

- Audits of One or More Affiliates

With the continual growth in multi-bank and unitary thrift holding companies, many financial organizations now have one or more of its subsidiaries performing trust and asset management activities. Many of these holding companies will use their holding company internal auditors to perform audits of their subsidiaries' trust and asset management activities. In order to create efficiencies, many of these auditors will perform an audit of a specific function or functions for each of the trust and asset management subsidiaries at the same time rather than auditing a subsidiary institution's entire trust and asset management activities at one time. Upon the conclusion of their audit, the auditors will present the results of their audit (usually in one report) to the subsidiaries' audit committee(s).

OTS does not object to this auditing method as long as the sample includes the functions performed by the savings association entity. However, the trust department audit committee should receive a presentation of findings in accordance with the requirements set forth in §550.480 and ensure monitoring practices are established to correct noted deficiencies.

Audit Examination Program

Examination Objectives

To determine the level and quality of the audit process. Consider whether:

- qualified personnel perform the audit function;
- the scope of the audit is consistent with the savings association's size, complexity of operations, level of growth and previous examination findings;
- the fiduciary audit committee or other appropriate committee directs the conduct of the audit;
- the results of the audit are reported to the board and management;
- appropriate actions are taken by management as a result of the audit;
- the audit program strengthens internal controls; and
- internal controls are effective in monitoring management and staff's adherence to policies, procedures and applicable law.

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 certain Level II procedures.

1. Review examination scoping materials related to the audit program. Scoping material should include:
 - Risk profile
 - Relevant PERK documents

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- Previous trust and asset management examination report
 - Previous safety and soundness examination report
 - Workpapers from the previous examination
 - Board of director and audit committee minutes
 - Examination reports of subordinate, functionally regulated entities
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2. Assess whether an audit committee has been formed and made responsible for directing the conduct of the saving association's trust and asset management activities.
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3. Determine if the audit committee members include officers of the savings association or an affiliate or are members of other committees involved with fiduciary activities.
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4. Review the board of director and the audit committee minutes. Evaluate the level of control of the trust department audit as well as the audit approval process.
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5. Determine if the trust department has been audited according to the approved type of audit program, continuous or annual.
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6. Evaluate whether the auditors have sufficient education and experience to audit trust and asset management activities. Assess whether the savings association has recently changed auditing personnel or firms and discuss with management the reasons for the change. Evaluate evidence of any disagreements between the auditor and the savings association regarding matters of fiduciary principles or practices, internal controls or auditing procedures.

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7. Review the operation of the audit department to determine its functional responsibilities and independence. Determine whether:
- the auditor approaches the audit process in an ethical and professional manner.
 - management imposes any restrictions on the audit program or places any budgetary or scheduling restraints on the auditors.
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8. If the audit function is outsourced to a third party, determine that the board or audit committee has reviewed the qualifications of the auditor or approved an audit plan or program. Review the engagement letter to determine if the procedures to be performed are clearly stated.
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9. Review the audit program and schedule and determine its completeness and compliance with §550.440 – 550.480. Consider:
- Whether the internal audit program is modified in a timely manner to keep pace with changes in trust and asset management activities, economic environment, technology and applicable law.
 - Whether the audit program is designated a continuous or annual audit.
 - Whether the internal auditor has experience in auditing all types of trust and asset management activities.
 - Whether the auditor has established the scope based on an assessment of risk. Evaluate the reasonableness of the assessment. Check for evidence that the auditor has investigated areas with the greatest risk of loss and has allocated sufficient coverage time.
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10. Review audit reports and recommendations by the auditors. Determine whether management, the board and/or the audit committee has approved the recommended changes or provided other satisfactory responses. Also, determine that all noted deficiencies and concerns have been addressed.

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

- Significant risks are consistently and effectively identified, measured, monitored and controlled
 - The expertise and independence of the audit team is considered adequate
 - The quality of the written audit programs, policies and procedures is sufficient
 - Corrective action is immediately implemented and monitored
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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 the auditors are free from the influence of management, including performance evaluation and control of salaries.

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| 2. | Review the distribution of internal audit reports. | |
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| 3. | Determine if the auditors have reviewed the savings association's policies and procedures to determine if they adequately cover all areas of trust and asset management activities and comply with applicable law. | |
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| 4. | Review and evaluate the educational background and training of auditors. | |
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| 5. | Determine if the external auditors have any relationships with the savings association, its directors, officers, employees or other material involvements that would compromise their independence. | |
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| 6. | Determine if the external auditors have any stock holdings or borrowings with the savings association. | |
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| 7. | Review the external auditor's engagement letter and note any restrictions and/or critical comments. | |
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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 to form a conclusion; proceed to Level III.

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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 Office of Thrift Supervision (OTS) examination staff to duplicate or substitute for the testing performed by auditors.

1. Evaluate the scope of the auditor's work and review the written audit reports and working papers for adequacy. Determine if the audit reports are adequate, prepared in accordance with the audit program, comply with prescribed procedures and are properly documented. Ensure that the auditor has tested and verified the reliability of information produced in the report.

2. Discuss with management the level of problems and identified risk exposure. Focus on the cause of the problems and subsequent risk that has been created.

3. Encourage management to enhance their audit program or remove the current auditors.

4. Discuss with management the ability of the savings association to commit to specific actions regarding deficiencies.

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

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References - 410P

Laws

Code of Federal Regulations

12 CFR 550 Trust Powers of Federal Associations (General)

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12 CFR 550.440	Audit of Fiduciary Activities
12 CFR 550.450	Standards that Govern Audit
12 CFR 550.460	Who May Conduct the Audit
12 CFR 550.470	Fiduciary Audit Committee and Restrictions
12 CFR 550.480	Reporting Audit Results
12 CFR 563c.3	Qualifications of Public Accountant

Office of Thrift Supervision Publications

Thrift Activities Handbook Sections 350, 355

Other

Workpaper Attachments - 410P

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Audit 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.

Audit Committee

<ul style="list-style-type: none">▪ Does the entire board of directors or a distinct audit committee have responsibility for directing the conduct of the savings association's trust and asset management activities?
<ul style="list-style-type: none">▪ If there is a distinct audit committee,<ul style="list-style-type: none">• Is the composition of the committee in compliance with 12 CFR §550.470?• Do any active officers of the savings association or an affiliate serve as a member of the committee?• Are a majority of the committee members not members of another board committee delegated power to manage the organization's fiduciary activities?
<ul style="list-style-type: none">▪ Does the auditor report directly to the board or the audit committee?
<ul style="list-style-type: none">▪ Has the audit committee reported in writing to the board the results of the audit, including significant actions taken as a result of the audit?
<ul style="list-style-type: none">▪ Has the audit committee reviewed comments about trust and asset management activities in the most recent OTS report of examination and taken appropriate corrective actions?
<ul style="list-style-type: none">▪ Does the board of directors or audit committee require timely and sufficiently detailed audit reports? Do the audit reports address the auditor's scope for each audit, procedure performed, areas not covered, the justification for the auditor's sample sizes and the basis for each conclusion?

Audit Program

<ul style="list-style-type: none">▪ Has the audit been conducted, either directly or through others, of the savings association's significant trust and asset management activities at least once each calendar year (if annual audit) or at an interval commensurate with the activity's nature and risk (if continuous audit)?
<ul style="list-style-type: none">▪ Has the board devised a satisfactory written audit program?
<ul style="list-style-type: none">▪ Does the board of directors or the audit committee approve the frequency schedule and scope?
<ul style="list-style-type: none">▪ Is the audit function involved in the design or review of major changes in operational procedures?
<ul style="list-style-type: none">▪ Is the audit scope based on a risk assessment of trust and asset management activities?

Program Section - Accounting and Physical Security Controls

<ul style="list-style-type: none">▪ Does the audit program verify account assets annually, including a confirmation from outside custodians?
<ul style="list-style-type: none">▪ Does the program determine whether assets are safeguarded adequately (including unissued stocks, bonds and trust department checks) through the use of dual control? Are trust department assets kept separate from the savings association's assets?

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<ul style="list-style-type: none"> ▪ Does the audit program verify that a written record of vault asset movements is maintained under joint custody?
<ul style="list-style-type: none"> ▪ Does the audit program determine whether securities pledged under 12 CFR §550.310 & 320 and 12 CFR §550.490 – 550.510 are adequate, properly safeguarded, held separate and earmarked appropriately on book entry systems?
<ul style="list-style-type: none"> ▪ Does the audit program use appropriate sampling techniques and verify prompt ledger control of assets?
<ul style="list-style-type: none"> ▪ Does the audit program verify that cash in trust department accounts is reconciled regularly with demand deposit statement(s)?
<ul style="list-style-type: none"> ▪ Does the audit program verify that internal balancing control procedures are performed appropriately each time ledgers are posted?
<ul style="list-style-type: none"> ▪ Does the audit program verify that all suspense or operating accounts are reconciled at least monthly, contain only appropriate items and are cleared in a timely manner?
<ul style="list-style-type: none"> ▪ Does the audit program verify the proper reconciliation of each of the following to the trust department's general ledger controls at least quarterly: <ul style="list-style-type: none"> • Income cash • Principal cash • Invested income • Invested principal • Each type of investment, such as stocks, bonds, real estate loans and real estate • Investments by issuer
<ul style="list-style-type: none"> ▪ Is the bookkeeping system adequate for the volume and nature of business transacted?
<ul style="list-style-type: none"> ▪ Does the audit program require reconciling or verifying the reconciliation by others of bonds printed to the printer's certificate for each bond trusteeship at least once in each calendar year?
<ul style="list-style-type: none"> ▪ Does the audit program use appropriate sampling techniques to verify the accurate payment of dividends from dividend disbursing agency accounts by reconciling or verifying the savings association's reconciliation?
<ul style="list-style-type: none"> ▪ Does the audit program use appropriate sampling techniques to verify the savings association's reconciliation of bond closing statements of new corporate bond trusteeships to trustee records? Reconcilements should include trustee records of bonds authenticated and issued, proceeds from bond sales and initial funding of related accounts.
<ul style="list-style-type: none"> ▪ Does the audit program use appropriate sampling techniques to verify the accuracy of payments from paying agency accounts by reconciling or verifying the savings association's reconciliation?

Program Section – Activity Control

<ul style="list-style-type: none"> ▪ Do the auditors verify commissions and fees paid to the savings association and check that they are collected systematically and on a timely basis? Do they ensure that they are properly authorized and correctly calculated?

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<ul style="list-style-type: none"> ▪ Do the auditors compare proceeds from the sale(s) of assets to brokers' invoices, purchasers' receipts or other evidence of sales price?
<ul style="list-style-type: none"> ▪ Do the auditors compare payment for purchases of assets to brokers' invoices, seller's receipts or other evidence of purchase price?
<ul style="list-style-type: none"> ▪ Are disbursements verified to ensure that income and principal distributions are reviewed for accuracy, conformity with the governing instrument and received by beneficiaries or other persons in the proper amount and within the specified time period?
<ul style="list-style-type: none"> ▪ Do the auditors compare the income receipts from investments with the amounts received for accuracy?
<ul style="list-style-type: none"> ▪ Do the auditors verify payments for services, such as brokerage fees, real estate management, maintenance charges and similar disbursements with the appropriate bills or invoices?
<ul style="list-style-type: none"> ▪ Do the auditors verify that combined securities transactions result in equitable distributions in the price and commission among accounts?
<ul style="list-style-type: none"> ▪ Do the auditors verify that an independent party with the trader's memo and broker's confirmation reconciles securities transactions by price and commission for each security transaction?
<ul style="list-style-type: none"> ▪ Do the auditors verify that securities transactions are completed within acceptable time limits?
<ul style="list-style-type: none"> ▪ Do the auditors verify that there is no evidence of excessive trading in managed accounts?
<ul style="list-style-type: none"> ▪ Do the auditors verify that investment objectives are appropriate for accounts?
<ul style="list-style-type: none"> ▪ Do the auditors verify that account documentation is appropriately maintained?
<ul style="list-style-type: none"> ▪ Do the auditors verify that account statements are generated and submitted to an individual independent of the trust department at least annually?

Program Section - Compliance

<ul style="list-style-type: none"> ▪ Do the auditors verify that transactions with affiliates are in compliance with written agreements and applicable law? See 12 CFR §563.42(b).
<ul style="list-style-type: none"> ▪ Have the auditors reviewed fiduciary account holdings for compliance with 12 CFR §550.330?
<ul style="list-style-type: none"> ▪ Do the auditors review the investment of discretionary fiduciary accounts in the stock or obligations of directors, officers and employees of the savings association, its holding company or its affiliates without authorization under applicable law?
<ul style="list-style-type: none"> ▪ Do the auditors review for compliance with 12 CFR §550.350 regarding loans of discretionary fiduciary account assets to directors, officers and employees of the savings association or its affiliates?
<ul style="list-style-type: none"> ▪ Do the auditors verify that discretionary accounts are reviewed in accordance with 12 CFR §550.220?
<ul style="list-style-type: none"> ▪ Do the auditors verify that cash receipts for discretionary fiduciary accounts are invested or distributed promptly in compliance with 12 CFR §550.290?
<ul style="list-style-type: none"> ▪ Have the auditors checked for compliance with 12 CFR §563.177 and 12 CFR §563.180 (Bank Secrecy Act and suspicious activity reports)?

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<ul style="list-style-type: none"> ▪ Have the auditors verified that products and services purchased with securities brokerage commissions are within the “safe harbor” provision of Section 28(e) of the Securities Exchange Act of 1934?
<ul style="list-style-type: none"> ▪ Have the auditors reviewed overdrafts to determine the amounts, cause, duration, anticipated date of elimination and adequacy of security, including testing of more than one date? (Note: Overdrafts in ERISA accounts exceeding 3 business days may be a prohibited transaction).
<ul style="list-style-type: none"> ▪ Have the auditors evaluated the allocation of income and principal for compliance with the governing instrument and state law?
<ul style="list-style-type: none"> ▪ Have the auditors tested documents necessary for closing accounts, such as discharges, releases, receipts and accountings?
<ul style="list-style-type: none"> ▪ Have the auditors tested for compliance with state escheat laws?
<ul style="list-style-type: none"> ▪ Have the auditors reviewed employee benefit accounts for compliance with Employee Retirement Income Security Act of 1974 (ERISA)?
<ul style="list-style-type: none"> ▪ Have the auditors determined whether real estate is properly insured, subject to periodic appraisals and inspections, and when appropriate, produces income? Have the auditors tested to ensure that account files are adequately documented?
<ul style="list-style-type: none"> ▪ Have the auditors determined that supporting papers for real estate loans and contracts are appropriate and accurate?

Program Section - Administrative Audits

<ul style="list-style-type: none"> ▪ Have the auditors determined whether the original or an authenticated copy of the governing instrument is on file?
<ul style="list-style-type: none"> ▪ Have the auditors determined if account synoptic and history records are reliable and comprehensive?
<ul style="list-style-type: none"> ▪ Have the auditors determined whether accounts are administered and invested in conformance with management policies, fiduciary principles, governing instruments and applicable law?
<ul style="list-style-type: none"> ▪ Have the auditors verified distributions of income and principal for accuracy and conformity with terms of the governing instrument? Distribution receipts should be in the file.
<ul style="list-style-type: none"> ▪ Have the auditors determined whether written approvals or directions of appropriate parties are obtained promptly?
<ul style="list-style-type: none"> ▪ Have the auditors determined if tax returns are prepared and filed on time with proper remittances?
<ul style="list-style-type: none"> ▪ Have the auditors tested the accuracy of account statements submitted to beneficiaries and others?
<ul style="list-style-type: none"> ▪ Have the auditors determined if board of director minutes, or designated persons and committees, document the review of important matters, such as the acceptance and closing of accounts, investment reviews and discretionary payments of principal or income?
<ul style="list-style-type: none"> ▪ Do the auditors determine if the board or a board-appointed designee reviews, updates and approves policies and procedures on a regular basis?

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- Have the auditors reviewed policies and procedures to determine if they adequately cover all areas of fiduciary activities in which the bank engages and whether they comply with applicable law?

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