SOUTH DAKOTA
Division of Banking

1714 Lincoln Avenue, Suite 2
Pierre, SD 57501
Phone (605) 773-3421
Fax (866) 326-7504

Trust Company Audit Guidance

South Dakota Codified Laws (SDCL) 51A-6A-15 requires the governing board or an auditor selected by them to make a thorough examination of the books, records, funds, and securities held by the trust company at each of the mandatory quarterly meetings. In lieu of the required four quarterly examinations, the governing board may accept one annual audit by a certified public accountant or an independent auditor approved by the Director of Banking. Although a documented quarterly review of trust company financial statements combined with a quarterly review of trust assets technically complies with SDCL 51A-6A-15 internal audit requirements, it does not comply with the audit principles of the Statement of Principles of Trust Management (Statement) that each trust company is required to adopt at its first organizational meeting. Please note, the South Dakota Division of Banking (Division) drafted a customized Statement specific to the custodial business model, which generally do not exercise fiduciary powers.

The Statement requires management to provide for an adequate audit (by internal or external auditors or a combination thereof) of "all fiduciary activities" or "all trust company activities," annually. An external audit generally consists of either a financial statement audit and/or an agreed upon procedures audit performed by an independent accounting firm. While an annual financial statement audit or agreed upon procedures audit may technically satisfy audit requirements as defined by the above-referenced statute, these types of audits may not provide for an "audit of all fiduciary activities" or "all trust company activities" as required by Statement audit principles. Therefore, best business practices dictate the development and implementation of both an external and internal audit program to ensure compliance with Statement audit principles.

If a trust company adopts an internal audit program to complement an external audit program, or in lieu of an external audit program, management should develop, at minimum, a quarterly reporting system to ensure compliance with statutory audit requirements and Statement audit principles. Best business practices in developing an internal audit program include the following criteria:

- A control risk assessment (or risk assessment methodology) to aid and document the internal auditor's understanding of the institution's fiduciary and administrative activities and their associated risks. The assessments typically analyze the risks inherent in a given fiduciary or administrative activity, the mitigating control processes, and the resulting residual risk exposure of the institution. The assessments should be updated regularly to reflect changes to the system of internal control or work processes, and to incorporate new lines of business.
- An internal audit schedule that is based on the control risk assessment, which includes a summary of the timing and frequency of planned internal audit work and resource budget. Internal audits may be performed on an activity-by-activity basis at intervals commensurate with the level of risk associated with that activity. Audit intervals must be supported and reassessed regularly to ensure appropriateness given the current risk and volume of the activity.
- Written policies and procedures established to guide the audit staff. The form and content of these policies and procedures should be consistent with the size and complexity of the institution. Written policies and

procedures should provide institution-specific internal audit guidance, including review frequency, responsible personnel, reporting channels, tracking systems, and any other pertinent details.

- Retention and documentation of audit workpapers that identify the work performed and support the audit reports.
- Retention and documentation of audit reports, which state the purpose, scope, findings, recommendations, and management's response to audit findings and recommendations.

The internal audit function should be designed to independently and objectively evaluate and report on the effectiveness of an institution's risk management, control, and governance processes as it relates to fiduciary and administrative activities. In order to maintain its independence, the internal audit function should not assume a business-line management role over control activities, such as approving or implementing operating policies or procedures. The internal audit function should be competently supervised and staffed by people with sufficient expertise and resources to identify the risks inherent in the institution's activities and assess whether internal controls are effective.

At least annually, the Board should perform and document a thorough review of the institution's audit program, including written policies and procedures, to ensure it provides for an annual audit of "all fiduciary activities" or "all trust company activities."

The Board and management may determine that the institution's current structure cannot sustain an audit program that sufficiently incorporates all of the guidance contained herein. In such a case, the institution must document a thorough and effective analysis justifying this determination. The Board and management must annually reassess the audit program to determine whether circumstances have sufficiently changed to the extent that the institution's structure will allow for a more comprehensive audit program. In addition, examiners will continue to assess the institution's audit program at each examination and retain the right to continue to recommend enhancements to the audit program should the examiners' review deem it warranted.

Examples of various internal audit review criteria include:

- Assess the organizational structure ensuring the establishment of clear lines of authority and responsibility.
- Verify that accounts are being administered and invested in conformance with governing instruments, laws, rules, and sound fiduciary principles.
- Assess the level of account and trust company oversight as documented in board and/or committee meeting minutes.
- Review synoptic records, verifying that information was correctly entered on the trust accounting system, and that the records are reliable, comprehensive, and periodically updated.
- Review operating system user profile reports to ensure users are properly classified.
- Assess management response to and compliance with Division examination findings and recommendations.
- Assess management response to and compliance with internal/external audit findings and recommendations.
- Verify the accuracy of accounts and assets as reported on the Form RC-T and/or the Fiduciary and Related Services Report.

- Assess written policies and procedures to ensure adequate direction is given for account administration and trust company operational duties and functions.
- Assess adequacy of strategic planning.
- Assess adequacy of succession planning.
- Review and assess the adequacy of tickler systems, identifying any dated items or negative trends.
- Assess compliance with Bank Secrecy Act and Regulation R reporting requirements.
- Assess controls over unissued check stocks.
- Ensure callback procedures are in place for any nonverbal distribution requests.
- Ensure the timely reconciliation of any suspense accounts. Review the appropriateness of all outstanding items in the reconcilements and determine whether outstanding items are properly cleared in a timely manner.
- Review trust company bylaws/operating agreements to ensure compliance with written objectives.
- Assess the adequacy and timeliness of service provider due diligence reviews.
- Confirm adequate insurance coverage as required by SDCL 51A-6A-19. Asses the adequacy of policy limits in relation to the trust company's overall risk profile.
- Review litigation/complaint log(s) to identify any negative trends and to ensure timely resolution.
- Conduct a vault/safekeeping audit.
- Assess accuracy and timely completion of account-level distributions.
- Conduct testing to ensure accurate mapping of account-level income and expenses.
- Assess internal controls ensuring proper segregation of duties (e.g. one individual should not be capable of approving, executing, and subsequently reconciling transactions for appropriateness).
- Assess a sample of account liabilities to ensure that the trustee has power to incur the liability and that the proceeds were used for the intended purpose.
- Ensure proper underwriting documentation is executed for loans to and from trust accounts.
- Review non-ordinary transactions for appropriateness.
- Confirm passwords are changed on a regular basis.
- Assess the overdraft and large cash balance oversight programs ensuring both are well monitored and observations are addressed timely.
- Assess adequacy of cybersecurity protocol.
- Assess accuracy and effectiveness of the budget process.
- Assess the adequacy of the pledge for trust powers in relation to the trust company's overall risk profile and Division mandate.
- Assess adequacy of capital in relation to the trust company's overall risk profile and Division mandate.
- Review a sample of accounts to ensure the original or certified copies of governing instruments/amendments are on file, synoptic records of each account are accurate and up-to-date, and tax returns are prepared and filed timely.
- For directed accounts, review documentation to ensure adequate direction is given regarding investing/holding of account assets.

- Assess the adequacy of the account-level administrative and investment review process ensuring timely documentation and proper reporting channels.
- Assess the adequacy of account-level insurance coverage for real estate, antiques, paintings, and any other unique assets.
- Assess the adequacy of the valuation program for illiquid assets. For discretionary real property holdings, ensure that inspections and appraisals are completed timely with appropriate documentation.
- Sample testing of discretionary accounts to ensure account assets are invested within authorized parameters.
- Review any trading errors to ensure timely correction and appropriate reallocation.
- Sample testing to ensure the timely execution of trades and ultimate reconciliations.
- Review the reconcilement of the sweep account statement to determine the reconcilement was timely, accurate, complete, and reviewed by supervisory personnel.
- Verify that transactions between fiduciary accounts and trust company directors, officers, employees, or affiliated entities are in compliance with self-dealing restrictions.
- Assess escheatment policies and procedures. Review account listings to determine whether any escheatable assets exceed the time limits established by local escheatment laws.