STATE OF CONNECTICUT

AUDITORS' REPORT
DEPARTMENT OF BANKING
FOR THE FISCAL YEARS ENDED JUNE 30, 2003 AND 2004

AUDITORS OF PUBLIC ACCOUNTS

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June 8, 2005

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We have made an examination of the financial records of the Department of Banking for the fiscal years ended June 30, 2003 and 2004. This report consists of the Comments, Condition of Records, Recommendations and Certification that follow.

Financial statement presentation and auditing have been done on a Statewide Single Audit basis to include all State agencies. This audit has been limited to assessing the Department of Banking's compliance with certain provisions of financial related laws, regulations and contracts, and evaluating the Department of Banking's internal control structure policies and procedures established to ensure such compliance.

COMMENTS

FOREWORD:

The Department of Banking operates under the provisions of Title 36a, Chapters 664 through 669 and Title 36b, Chapters 672 to 672c of the Connecticut General Statutes. The Department functions as a regulatory agency responsible for the supervision, licensing and regulation of financial institutions and organizations within the State. Included among such institutions are State chartered banks and credit unions, small loan and second mortgage companies, sales finance companies, collection agencies, security brokers, salesmen and investment counselors. Among the Department's other responsibilities are the administration and enforcement of Connecticut's Truth-in-Lending Law, other consumer credit laws and the Connecticut Uniform Securities Act.

John P. Burke served as Banking Commissioner during the audited period.

Recent State Legislation:

Notable legislative changes that took effect during the audited period are presented below:

> Section 46 of Public Act 03-1 of the June 2003 Special Session required the transfer of $5,000,000 from the resources of the Banking Fund to the resources of the General Fund.
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> Section 196 of Public Act 03-6 of the June 2003 Special Session required that at the request of the Office of Policy and Management, the Comptroller transfer up to $3,600,000 from the resources of the Banking Fund, to Other Expenses, for relocation expenses and furniture costs for the Department of Banking during the fiscal years ending June 30, 2003 and June 30, 2004.
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> Section 16 of Public Act 04-2 of the May 2004 Special Session required that no later than thirty days after the close of the first quarter of the fiscal year ending June 30, 2005, and not later than thirty days after the close of such quarter thereafter, the Banking Commissioner shall submit a report to the joint standing committee of the General Assembly containing the specific amount of each fee, charge, assessment, fine, civil penalty, settlement payment and other revenue collected by the Department of Banking.

RÉSUMÉ OF OPERATIONS:

Banking Fund:

The Banking Fund operates under Section 36a-65 of the Connecticut General Statutes. All assessments and other fees received from entities subject to the supervision of the Banking Commissioner are deposited in this special revenue fund. The expenditures of the Department of Banking are to be made pursuant to appropriation by the General Assembly and are charged to the Banking Fund.

Banking Fund receipts are summarized below, with amounts for the 2001-2002 fiscal year presented for comparative purposes.

	2001-2002	**2002-2003**	**2003-2004**
Receipt Type:			
Bank and credit union assessments	$	$1,249,975	$1,292,585
Registration of securities	4,233,304	4,094,000	4,144,754
Broker/dealer & investment advisor registration	8,371,850	8,072,500	8,289,300
Other application, license and examination fees	2,118,253	5,228,587	2,373,761
Penalties for failure to register	343,100	852,400	455,100
All other revenue	83,258	180,509	24,973
Total Banking Fund Receipts	**$15,149,765**	**$19,677,971**	**$16,580,473**

Subsection (a) of Section 36a-65 of the General Statutes gives the Commissioner discretion in the amount to assess banks and credit unions. These assessments are based on the funding needs of the Department and were imposed during the 2002-2003 and 2003-2004 fiscal years but were not imposed during the 2001-2002 fiscal year. Banking Fund revenues increased during the 2002-2003 fiscal year by 30 percent over the previous fiscal year. In addition to assessments imposed in the 2002-2003 fiscal year not imposed in the 2001-2002 fiscal year, "Other application, license and examination fees" increased by over three million dollars due to a change for certain licenses to a two-year license renewal period, and the establishment of two new licenses in that fiscal year. In addition, fees received increased by 16 percent during the 2002-2003 fiscal year. Banking Fund revenues decreased 16 percent in the 2003-2004 fiscal year primarily as the result of "Other application, license and examination fees" revenue decreasing by over $3.1 million as license revenue reflected new filings only.

Banking Fund expenditures are summarized below, with amounts for the 2001-2002 fiscal year presented for comparative purposes.

	2001-2002	**2002-2003**	**2003-2004**
Expenditure Type:			
Personal services and fringe benefits	$11,296,444	$10,782,151	$11,045,659
Contractual services	1,734,081	1,953,703	2,084,131
Commodities	39,920	47,856	52,591
Revenue refunds	64,044	0	0
Sundry charges, excluding fringe benefits	407,599	304,646	282,514
Equipment	1,278	48,785	242,243
Total Banking Fund Expenditures	**$13,543,366**	**$13,137,141**	**$13,707,138**

Personal services and fringe benefits decreased in the 2002-2003 fiscal year and increased slightly in the 2003-2004 fiscal year. This reflects the decrease in filled positions from 125 as of June 30, 2002, to 110 as of June 30, 2003, due to layoffs and early retirements. Filled positions increased to 118 as of June 30, 2004, due to the refilling of critical positions and the hiring of temporary personnel. The fringe benefit cost recovery rate decreased from 42.29 percent in the 2001-2002 fiscal year to 40.21 percent in the 2002-2003 fiscal year, and increased to 45.82 percent in the 2003-2004 fiscal year. The State Comptroller establishes the fringe benefit cost recovery rate annually.

As a result of increases in Banking Fund revenues, and accompanied by expenditures that remained relatively constant during the audited period, the fund balance of the Banking Fund increased in the 2002-2003 fiscal year as presented below:

Year Ended	Fund Balance
June 30, 2002	$24,046,572
June 30, 2003	$30,209,214
June 30, 2004	$28,332,542

As noted earlier, Section 46 of Public Act 03-1 required a $5,000,000 cash transfer to be made from the Banking Fund to the General Fund during the 2003-2004 fiscal year.

General Fund:

The Department deposited $29,799 to the General Fund in the 2002-2003 fiscal year. The Department deposited $3,804,835 to the General Fund in the 2003-2004 fiscal year, as a result of a nationwide settlement reached with the Securities and Exchange Commission investigating the research practices of nine broker-dealers.

The Department expended $26,158 from the General Fund for investor education during the 2002-2003 fiscal year.

Other Funds:

The Department deposited $14,360 and from the "Federal and Other Restricted" Fund and expended $31,641 from this Fund for investor education during the 2003-2004 fiscal year.

CONDITION OF RECORDS

Our audit of the Department of Banking found areas where improvement is needed, as described in the following findings:

Equipment Inventory and Reporting:

Criteria: The State of Connecticut Property Control Manual requires all State agencies to submit a Fixed Assets/Property Inventory Report (CO-59) on or before October 1st, reflecting the sum total of the physical inventory as of June 30th. Good internal control procedures require changes in the physical inventory to be properly recorded in the property control records.

Condition: Our review found that the Department's property control records did not accurately reflect the physical inventory reported to the State Comptroller as of June 30, 2003 and 2004. Eight items, with a value of $179,262, could not be found. Four of these items, totaling $130,567, had been properly transferred to another State agency and two others totaling $13,724, had been declared surplus but have not been removed from the property control records. Two additional items, totaling $34,971, should not have been in the inventory records because they were not accounted for in accordance with Property Control Manual requirements.

We found that 62 items, with an estimated value of $79,879, have not been recorded in the property control records. These items have been tagged and most are in service.

We also found the Department incorrectly included non-capital items, totaling $94,500, on the Fixed Assets/Property Inventory Reports to the State Comptroller.

Effect: The inventory reported on the Department's Fixed Assets/Property Inventory Reports was overstated by $292,000, and $284,000, for fiscal years ended June 30, 2003 and June 30, 2004, respectively.

Cause: The Department did not properly record all additions and deletions to the property control records.

Recommendation: The Department of Banking should update and maintain its property control records to ensure that Fixed Assets/Property Inventory Reports to the State Comptroller reflect the actual capital inventory as of June 30th. Internal controls should be improved over changes to the property control records. (See Recommendation 1).

Agency Response: "At the time of the Auditor's arrival, the Department was in the process of updating its property control records. With the assistance of the auditors, we have identified all such records and have now been able to proceed with our work in updating all required property records. The updating process is presently on-going and the Department expects to have all control records properly updated by May 31, 2005. Upon completion, sum total of all property records will support the ending balance of equipment inventory surveyed as of 6/30/2005."

Accounting and Reporting of Unpaid Fines:

Background: Section 36a-50 of the Connecticut General Statutes provides for the Commissioner of Banking to fine persons who have violated any provision of the General Statutes or any regulation, rule or order adopted or issued thereunder within the Commissioner's jurisdiction, in an amount not exceeding seven thousand five hundred dollars per violation, except in the case of violations of Section 36a-746b to 36a-746g, inclusive, the Commissioner may order a civil penalty not exceeding fifteen thousand dollars per violation.

Criteria: The State Accounting Manual requires that accounts receivable records be accurate, complete, and maintained in a manner to indicate the length of time the debt has been outstanding, and establishes policies and procedures for all State agencies in the management and collection of receivables. The State Comptroller requires agencies to report outstanding receivables on GAAP Form 2.

Section 3-7 of the General Statutes provides for cancellation of uncollectible claims.

Condition: Our review of Department of Banking documents revealed that at least $1.2 million in unpaid fines have not been recorded in accounts receivable records, or reported on GAAP Reporting Package Form 2 to the State Comptroller.

Effect: State Accounting Manual requirements for accounting and reporting of receivables have not been complied with.

Without adequate accounts receivable records the Department cannot properly pursue collection of these amounts, or cancel these claims under Section 3-7 of the General Statutes.

Cause: The cause was not determined.

Recommendation: The Department of Banking should establish accounts receivable records for all unpaid fines, report the total of unpaid fines in accordance with GAAP Reporting Package Form 2, and cancel uncollectible fines in accordance with Section 3-7 of the General Statutes. (See Recommendation 2).

Agency Response: "A separate agency ledger will be created to record Accounts Receivable activity pertaining to unpaid fines. In addition, the Department will comply with instructions contained in the State Accounting Manual to report annually all such outstanding receivables on Form 2 of the GAAP Reporting Package."

Late Deposits:

Criteria: Section 4-32 of the General Statutes requires each State agency to deposit and account for revenue within 24 hours of receipt.

Condition: Our review of receipts found that the Department did not deposit seven receipts, totaling $6,653, within 24 hours of receipt during the 2002-2003 and 2003-2004 fiscal years.

Specifically, for the 2002-2003 fiscal year, one receipt of $1,200 was deposited three days late, one receipt of $500 was deposited two days late, and two receipts totaling $2,053 were deposited one day late. For the 2003-2004 fiscal year one receipt of $800 was deposited 89 days late, one receipt of $100 was deposited four days late and one receipt of $2,000 was deposited one day late.

Effect: All receipts were not deposited in a timely manner as required by Section 4-32 of the General Statutes. Delays in depositing compromise physical controls over undeposited checks.

Cause: The cause was not determined.

Recommendation: The Department of Banking should deposit all receipts in accordance with Section 4-32 of the General Statutes. (See Recommendation 3).

Agency Response: "The Department will continue to comply with Section 4-32 of the General Statutes which requires that State agencies deposit and account for revenues within 24 hours of receipt. Exceptions, when they occur, will be duly noted in writing so as to provide an explanation for reviewing why the exception occurred."

RECOMMENDATIONS

Status of Prior Audit Recommendations:

- We recommended that the Department adhere to the Office of State Comptroller's Property Control Manual and make every effort to locate missing property, and if not successful, notify the proper law enforcement authorities and the Office of the State Comptroller and Auditors of Public Accounts. The Department has complied with this recommendation.

- We recommended that the Department adhere to its procedure of date stamping all employee vouchers upon receipt to ensure that it is conforming to the timely submission of these vouchers, as required by the State Accounting Manual. The Department has implemented this recommendation.

Current Audit Recommendations:

1. **The Department of Banking should update and maintain its property control records to ensure that Fixed Assets/Property Inventory Reports to the State Comptroller reflect the actual capital inventory as of June 30th. Internal controls should be improved over changes to the property control records.**

   Comment:

   The inventory reported on the Department's Fixed Assets/Property Inventory Reports was overstated by $292,000, and $284,000, for fiscal years ended June 30, 2003 and June 30, 2004, respectively.

2. **The Department of Banking should establish accounts receivable records for all unpaid fines, report the total of unpaid fines in accordance with GAAP Reporting Package Form 2, and cancel uncollectible fines in accordance with Section 3-7 of the General Statutes.**

   Comment:

   Over $1.2 million in unpaid fines have not been reported as receivables as of June 30, 2003 and June 30, 2004.

3. The Department of Banking should deposit all receipts in accordance with Section 4-32 of the General Statutes.

Comment:

Our review of receipts found that seven receipts, totaling $6,653, were not deposited within 24 hours of receipt during the 2002-2003 and 2003-2004 fiscal years.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 of the General Statutes we have audited the books and accounts of the Department of Banking for the fiscal years ended June 30, 2003 and 2004. This audit was primarily limited to performing tests of the Agency's compliance with certain provisions of laws, regulations and contracts, and to understanding and evaluating the effectiveness of the Agency's internal control policies and procedures for ensuring that (1) the provisions of certain laws, regulations and contracts applicable to the Agency are complied with, (2) the financial transactions of the Agency are properly recorded, processed, summarized and reported on consistent with management's authorization, and (3) the assets of the Agency are safeguarded against loss or unauthorized use. The financial statement audits of the Department of Banking for the fiscal years ended June 30, 2003 and 2004, are included as part of our Statewide Single Audits of the State of Connecticut for those fiscal years.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial-related audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Department of Banking complied in all material or significant respects with the provisions of certain laws, regulations and contracts and to obtain a sufficient understanding of the internal control to plan the audit and determine the nature, timing and extent of tests to be performed during the conduct of the audit.

Compliance:

Compliance with the requirements of laws, regulations and contracts applicable to the Department of Banking is the responsibility of the Agency's management.

As part of obtaining reasonable assurance about whether the Agency complied with laws, regulations and contracts, noncompliance with which could result in significant unauthorized, illegal, irregular or unsafe transactions or could have a direct and material effect on the results of the Agency's financial operations for the fiscal years ended June 30, 2003 and 2004, we performed tests of its compliance with certain provisions of laws, regulations and contracts. However, providing an opinion on compliance with these provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial or less than significant instances of noncompliance, which are described in the accompanying "Condition of Records" and "Recommendations" sections of this report.

Internal Control over Financial Operations, Safeguarding of Assets and Compliance:

The management of the Department of Banking is responsible for establishing and maintaining effective internal control over its financial operations, safeguarding of assets, and compliance with the requirements of laws, regulations and contracts applicable to the Agency. In planning and performing our audit, we considered the Agency's internal control over its financial operations, safeguarding of assets, and compliance with requirements that could have a material or significant effect on the Agency's financial operations in order to determine our auditing procedures for the purpose of evaluating the Department's financial operations, safeguarding of assets, and compliance with certain provisions of laws, regulations, contracts and grants, and not to provide assurance on the internal control over those control objectives.

However, we noted certain matters involving the internal control over the Agency's financial operations, safeguarding of assets, and/or compliance that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control over the Agency's financial operations, safeguarding of assets, and/or compliance that, in our judgment, could adversely affect the Agency's ability to properly record, process, summarize and report financial data consistent with management's authorization, safeguard assets, and/or comply with certain provisions of laws, regulations, contracts and grants. We believe the following finding represents a reportable condition: internal control weaknesses over fixed assets/inventory.

A material or significant weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with certain provisions of laws, regulations, contracts, and grants or the requirements to safeguard assets that would be material in relation to the Agency's financial operations or noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions to the Agency being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over the Agency's financial operations over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material or significant weaknesses. However, we believe that the reportable condition described above is not a material or significant weakness.

This report is intended for the information of the Governor, the State Comptroller, the Appropriations Committee of the General Assembly and the Legislative Committee on Program Review and Investigations. However, this report is a matter of public record and its distribution is not limited.

CONCLUSION

In conclusion, we wish to express our appreciation for the courtesies and cooperation extended to our representatives by the personnel of the Department of Banking during the course of our examination.

Gary P. Kriscenski
Principal Auditor

Approved:

Robert G. Jaekle
Auditor of Public Accounts

Kevin P. Johnston
Auditor of Public Accounts