STATE OF CONNECTICUT

AUDITORS' REPORT
DEPARTMENT OF BANKING
FOR THE FISCAL YEARS ENDED JUNE 30, 2010 and 2011

AUDITORS OF PUBLIC ACCOUNTS

JOHN C. GERAGOSIAN ❖ ROBERT M. WARD

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JOHN C. GERAGOSIAN

State Capitol
210 Capitol Avenue
Hartford, Connecticut 06106-1559

ROBERT M. WARD

November 27, 2012

AUDITORS' REPORT
DEPARTMENT OF BANKING
FOR THE FISCAL YEARS ENDED JUNE 30, 2010 and 2011

We have made an examination of the financial records of the Department of Banking for the fiscal years ended June 30, 2010 and 2011. This report consists of the Comments, Condition of Records, Recommendation and Certification that follow.

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 internal control policies and procedures established to ensure such compliance. Financial statement presentation and auditing have been done on a Statewide Single Audit basis to include all state agencies, including the Department of Banking.

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 state chartered credit unions, suppliers of consumer credit such as mortgage lenders, brokers, consumer collection agencies, small loan companies, check cashers, and landlord/tenant conflicts. The department receives the majority of its revenues through the registration, supervision, and examination of the securities business within the state, including brokerage firms, investment banking houses, retail stockbrokers and investment advisors. The department administers and enforces Connecticut's Truth-in-Lending Law and Uniform Securities Act, among other consumer-credit laws.

Howard F. Pitkin was appointed Banking Commissioner on October 1, 2006, and served throughout the audited period.

New Legislation:

Public Act 10-3, Section 6, effective April 14, 2010, required the transfer of $15,000,000 from the Banking Fund to the General Fund for fiscal year ended June 30, 2010 and the transfer of $11,600,000 from the Banking Fund to the General Fund for the fiscal year ended June 30, 2011.

Public Act 10-179, Section 13, effective July 1, 2010, required $9,000,000 to be transferred from the Banking Fund to the General Fund for the fiscal year ended June 30, 2011.

Public Act 11-6, Section 134, effective July 1, 2011, states that any fines, civil penalties or restitution imposed by the Banking Commissioner or ordered by a court in accordance with section 36a-50, 36a-53 or 36a-57 of the general statutes shall be deposited into the General Fund. These fines, penalties and other revenues were previously deposited into the Banking Fund. During fiscal years ended June 30, 2010 and 2011, $2,658,290 and $10,272,927 were deposited into the Banking Fund for these types of receipts, respectively.

Public Act 11-48, Section 10, effective July 1, 2011, requires banks and credit unions to pay the commissioner the assessment amount allocated to them no later than the date specified by the commissioner for payment. Banks or credit unions shall pay an additional two hundred dollars if such payment is not paid by the time specified.

RÉSUMÉ OF OPERATIONS:

Receipts:

Receipts of the Department of Banking are summarized below by fund for the fiscal years ended June 30, 2009, 2010 and 2011:

	2008-2009	**2009-2010**	**2010-2011**
Banking Fund	$20,493,591	$32,833,589	$40,916,068
Grant/Restricted Fund	-0-	10,000	6,000
Total Receipts by Fund	**$20,493,591**	**$32,843,589**	**$40,922,068**

Receipts of the Department of Banking are summarized below by revenue category for the fiscal years ended June 30, 2009, 2010 and 2011:

	2008-2009	**2009-2010**	**2010-2011**
Fees	$17,732,950	$25,849,595	$27,810,159
Licenses	2,370,960	4,195,995	2,638,445
Fines	319,333	2,658,290	10,272,927
Miscellaneous	70,348	139,709	200,537
Total Receipts by Category	**$20,493,591**	**$32,843,589**	**$40,922,068**

Total receipts increased by 60 percent and by 25 percent during the fiscal years ended June 30, 2010 and 2011, respectively. Fees increased significantly in the first year of the audit period, primarily due to an increase in the fee structure as a result of Public Act 09-3. Revenues for fines also increased because large fines were assessed and collected during the fiscal year ended June 30, 2011. Fines in previous years were not as large.

Expenditures:

The expenses of the Department of Banking are made pursuant to appropriations by the General Assembly. Expenditures for the fiscal years ended June 30, 2009, 2010 and 2011, totaled $18,209,701, $17,742,214 and $18,635,514, respectively. Most expenses were charged to the Banking Fund. Those expenditures charged to the Grant/Restricted Fund were for investor education programs. A summary of expenditures by fund is presented below:

	2008-2009	2009-2010	2010-2011
Banking Fund	$18,184,494	$17,740,127	$18,619,261
Grant/Restricted Fund	25,207	2,087	16,253
Total Expenditures	**$18,209,701**	**$17,742,214**	**$18,635,514**

A summary of expenditures for the Department of Banking by account is presented below:

	2008-2009	2009-2010	2010-2011
Personal Services & Employee Benefits	$15,591,808	$15,131,445	$16,064,665
Employee Expenses, Allowances & Fees	431,883	378,536	294,881
Purchases & Contracted Services	405,932	408,309	237,527
Motor Vehicle Costs	10,909	10,895	11,677
Premises & Property Expenses	722,093	720,519	738,421
Information Technology	279,647	197,910	216,852
Purchased Commodities	35,459	15,268	15,353
Other Charges	731,970	879,332	1,039,567
Capital Outlays – Equipment	-0-	-0-	16,571
Total Expenditures	**$18,209,701**	**$17,742,214**	**$18,635,514**

Expenditures decreased 3 percent and increased 5 percent during the fiscal years ended June 30, 2010 and 2011, respectively. Personal services and employee benefits decreased 3 percent and increased 6 percent during the fiscal years ended June 30, 2010 and 2011, respectively. The increases were due to medical insurance costs and changes in the fringe benefit contributions to the State Employees Retirement System, as established by the State Comptroller. Personal services and fringe benefits comprised over 86 percent of the department's total expenditures. Filled positions totaled 112 as of June 30, 2011.

Fund Balance:

The budgetary fund balance plus reserve amounts for the fiscal years ended June 30, 2009, 2010 and 2011 was $21,293,993, $20,798,936 and $18,997,660, respectively.

CONDITION OF RECORDS

Our audit of the Department of Banking found an area where improvement is needed, as described in the following finding:

Foreign Bank Examinations and Assessments:

Criteria: Section 36a-428l, subsection (e), of the Connecticut General Statutes states that a foreign bank, licensed to maintain a branch in the state, shall pay the actual cost of any examination as determined by the Banking Commissioner. Section 36a-428b, subsection (e), states that the commissioner shall annually assess each foreign bank that has established a branch in this state.

Condition: The Department of Banking overcharged one foreign bank for the actual costs of examination in the amount of $400 for the fiscal year ended June 30, 2009 and overcharged $1,466 for fiscal year ended June 30, 2010. Also, the department overcharged the assessment fee for the fiscal year ended June 30, 2009 in the amount of $34,716 and undercharged the assessment amount for the fiscal year ended June 30, 2010 in the amount of $5,985. Incorrect charges identified in prior audits relating to foreign bank exams and assessments were recovered or credited correctly.

Effect: Fees received from foreign banks were not always accurate.

Cause: Errors were made in the calculations of foreign bank examination costs and assessment fees.

Recommendation: The Department of Banking's Financial Institutions Division should comply with Section 36a-428l, subsection (e), improve its internal controls over the calculation of foreign bank examinations, and recover or credit amounts as needed. (See Recommendation 1.)

Agency Response: "The Financial Institutions Division will input correcting entries for the identified assessment and direct examination cost charging errors. These entries will be reflected in the 2011-2012 fiscal year assessment.

New assessment documentation procedures were implemented at calendar year end 2010 and these will be amended to include a quality control review for spreadsheet formula input which should correct the errors noted in the audit. Further, in order to enhance control of the FBO billing process for both the assessment and direct examination billing components, the DOB Business Office will review the methodology, calculations, and direct cost inputs to ensure data accuracy and compliance with the documented billing methodology."

RECOMMENDATIONS

Status of Prior Audit Recommendations:

- The Department of Banking's Financial Institutions Division should adequately follow through on its concerns and document the information necessary to support the sick and compensatory time it grants to employees. Our testing did not disclose any situations similar to the issues that resulted in this recommendation. As a result, this recommendation will not be repeated.

- The Department of Banking should have procedures in place to monitor compliance with Sections 36a-11 and 36a-12 of the General Statutes. The Department implemented a procedure to monitor employee compliance with the statutes and we did not become aware of any instances of noncompliance during the course of our audit. This recommendation will not be repeated.

- The Department of Banking should more carefully assess its needs before making computer-related purchases and should determine how best to document the approval requirements for future software license purchases. Our review of inventory showed no signs of excess computer hardware and there were no additional payments made for software license purchases. This recommendation will not be repeated.

- The Department of Banking's Consumer Credit Division should seek to obtain and review the audit report on the processes of the outside service organization that it hired to perform revenue collection services. It appears the outside organization has contracted with an audit firm to produce a report on Service Organization Control for 2012, and it is anticipated that the report will be issued in the first quarter of 2013. We will review this report during our next audit and therefore will not repeat this recommendation at this time.

- The Department of Banking's Financial Institutions Division should comply with Section 36a-428l, subsection (e), improve its internal controls over the calculation of foreign bank examinations, and recover or credit amounts as needed. Errors were made in the calculation of foreign bank examinations and assessments. This recommendation is being repeated. (See Recommendation 1.)

Current Audit Recommendation:

1. **The Department of Banking's Financial Institutions Division should comply with Section 36a-428l, subsection (e), improve its internal controls over the calculation of foreign bank examinations, and recover or credit amounts as needed.**

   Comment:

   The department did not accurately determine the cost of the foreign bank examination and calculation errors were made in determining the assessment amount for foreign banks.

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, 2010 and 2011. This audit was primarily limited to performing tests of the department's compliance with certain provisions of laws, regulations, contracts and grant agreements, and to understanding and evaluating the effectiveness of the department's internal control policies and procedures for ensuring that (1) the provisions of certain laws, regulations, contracts and grant agreements applicable to the department are complied with, (2) the financial transactions of the department are properly initiated, authorized, recorded, processed, and reported on consistent with management's direction, and (3) the assets of the department are safeguarded against loss or unauthorized use. The financial statement audits of the Department of Banking for the fiscal years ended June 30, 2010 and 2011, 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 auditing standards generally accepted in the United States of America and the standards applicable to financial 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, contracts and grant agreements, 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.

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

Management of the Department of Banking is responsible for establishing and maintaining effective internal control over financial operations, safeguarding of assets, and compliance with the requirements of laws, regulations, contracts, and grants. In planning and performing our audit, we considered the Department of Banking's internal control over its financial operations, safeguarding of assets, and compliance with requirements as a basis for designing 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 grant agreements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over those control objectives. Accordingly, we do not express an opinion on the effectiveness of the Department of Banking's internal control over those control objectives.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions to prevent, or detect and correct on a timely basis, unauthorized, illegal or irregular transactions, or breakdowns in the safekeeping of any asset or resource. A *material weakness* is a deficiency, or combination of deficiencies in internal control, such that there is a reasonable possibility that non compliance which could result in significant unauthorized, illegal, irregular or unsafe transactions and/or material noncompliance with certain provisions of laws, regulations, contracts, and grant agreements that would be material in relation to the department's financial operations will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial operations, safeguarding of assets, and compliance with requirements was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial operations, safeguarding of assets, and compliance with requirements that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over the department's financial operations, safeguarding of assets, or compliance with requirements that we consider to be material weaknesses, as defined above. However, we consider the following deficiency, described in detail in the accompanying Condition of Records and Recommendations sections of this report, to be a significant deficiency, Recommendation 1 Foreign bank examination and assessments. A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters:

As part of obtaining reasonable assurance about whether the Department of Banking complied with laws, regulations, contracts and grant agreements, 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 department's financial operations, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements. However, providing an opinion on compliance with those 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 or other matters that are required to be reported under *Government Auditing Standards.*

The Department of Banking's response to the finding identified in our audit is described in the accompanying Condition of Records sections of this report. We did not audit the department's response and, accordingly, we express no opinion on it.

This report is intended for the information and use of department management, 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.

David Tarallo
Associate Auditor

Approved:

John C. Geragosian
Auditor of Public Accounts

Robert M. Ward
Auditor of Public Accounts