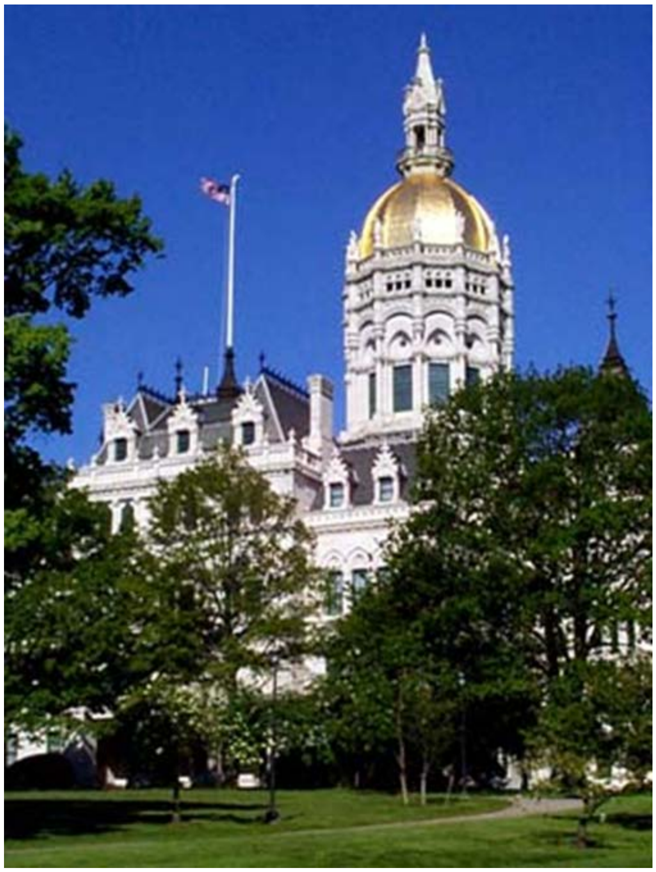
STATE OF CONNECTICUT



AUDITORS' REPORT
DEPARTMENT OF BANKING
FOR THE FISCAL YEARS ENDED JUNE 30, 2016 and 2017

AUDITORS OF PUBLIC ACCOUNTS
JOHN C. GERAGOSIAN ❖ ROBERT J. KANE

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April 23, 2019

EXECUTIVE SUMMARY

In accordance with the provisions of Section 2-90 of the Connecticut General Statutes we have audited certain operations of the Department of Banking. The objectives of this review were to evaluate the department's internal controls, compliance with policies and procedures, as well as certain legal provisions, and management practices and operations for the fiscal years ended June 30, 2016 and 2017.

The key finding is presented below:

Finding 1 **Page 6**	The Department of Banking should improve internal controls over accounts receivable. The department could not provide a comprehensive listing of all outstanding accounts receivable in the form required by the State Accounting Manual. The Department of Banking submitted inaccurate receivables reports to the Office of the State Comptroller for the fiscal years ended June 30, 2016 and 2017.

STATE OF CONNECTICUT

AUDITORS OF PUBLIC ACCOUNTS

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April 23, 2019

INTRODUCTION
AUDITORS' REPORT
DEPARTMENT OF BANKING
FOR THE FISCAL YEARS ENDED JUNE 30, 2016 and 2017

We have audited certain operations of the State of Connecticut – Department of Banking in fulfillment of our duties under Section 2-90 of the Connecticut General Statutes. The scope of our audit included, but was not necessarily limited to, the fiscal years ended June 30, 2016, and 2017. The objectives of our audit were to:

1. Evaluate the department's internal controls over significant management and financial functions;

2. Evaluate the department's compliance with policies and procedures internal to the department or promulgated by other state agencies, as well as certain legal provisions; and

3. Evaluate the economy and efficiency of certain management practices and operations, including certain financial transactions.

Our methodology included reviewing written policies and procedures, financial records, minutes of meetings, and other pertinent documents; interviewing various personnel of the department; and testing selected transactions. We obtained an understanding of internal controls that we deemed significant within the context of the audit objectives and assessed whether such controls have been properly designed and placed in operation. We tested certain of those controls to obtain evidence regarding the effectiveness of their design and operation. We also obtained an understanding of legal provisions that are significant within the context of the audit objectives, and we assessed the risk that illegal acts, including fraud, and violations of contracts, grant agreements, or other legal provisions could occur. Based on that risk assessment, we designed and performed procedures to provide reasonable assurance of detecting instances of noncompliance significant to those provisions.

We conducted our audit in accordance with the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides such a basis.

The accompanying Résumé of Operations is presented for informational purposes. This information was obtained from the department's management and was not subjected to the procedures applied in our audit of the department. For the areas audited, we identified:

1. Deficiencies in internal controls;

2. Apparent noncompliance with legal provisions;

3. No need for improvement in management practices and procedures that we deemed to be reportable.

The State Auditors' Findings and Recommendations in the accompanying report presents any findings arising from our audit of the Department of Banking.

COMMENTS

FOREWORD

The Department of Banking (DOB) primarily operates under the provisions of Title 36a, Chapters 664 through 669, Title 36b, Chapters 672 through 672c, and Section 47a-21 subsection (b), (d), (h), (i), and (j) of the Connecticut General Statutes. DOB functions as a regulatory agency responsible for the supervision, licensing, and regulation of financial institutions and organizations within the state. 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, and check cashers. Also, DOB has jurisdiction over landlord/tenant security deposit 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 stock brokers, and investment advisors. The department administers and enforces Connecticut's Truth-in-Lending Law and Uniform Securities Act, among other consumer-credit laws.

Jorge L. Perez was appointed Banking Commissioner effective March 13, 2015 and served in that capacity during the audited period.

New Legislation

Public Act 16-65 (Section 45), effective May 26, 2016, allowed the banking commissioner to assess licensed money transmitters and student loan servicers. DOB assesses Connecticut banks and credit unions, pro rata based on asset size, to cover the department's expenses. This act added licensed money transmitters and student loan servicers to those entities subject to assessment. The assessments are annual, but the commissioner may impose them more frequently.

Public Act 17-38 (Sections 1 to 17), effective October 1, 2017, created a license, administered by the Department of Banking, for a category of mortgage professionals who sell information identifying new customers for residential mortgage loans (lead generators). This act prohibits any person from acting as a lead generator without this new license. It also gives the Department of Banking investigatory and enforcement authority over licensees, including authority to discipline those who fail to comply, and prohibits certain conduct.

Public Act 17-120 (Section 2), effective July 5, 2017, required the Department of Banking to post on its website links to educational materials on financial planning and other designations, including prerequisites and requirements for investment advisers under the Connecticut Uniform Securities Act. The department must also include information concerning a consumer's right to ask for disclosures from financial planners about fees and compensation as required by state and federal law.

RÉSUMÉ OF OPERATIONS:

Receipts

Department of Banking receipts categorized by fund are summarized below for the fiscal years ended June 30, 2015, 2016, and 2017:

	2014-2015	2015-2016	2016-2017
General Fund	$ 6,196,097	$ 6,568,742	$126,091,841
Banking Fund	28,151,021	30,082,640	30,544,614
Restricted Fund	-0-	1,800	286,000
Total Receipts by Fund	**$34,347,118**	**$36,653,182**	**$156,922,455**

Department of Banking receipts by revenue category are summarized below for the fiscal years ended June 30, 2015, 2016, and 2017:

	2014-2015	2015-2016	2016-2017
Fees	$30,133,551	$30,688,323	$ 30,803,084
Fines	763,387	1,068,702	120,597,541
Licenses	3,419,975	4,824,503	5,144,427
Miscellaneous	30,205	71,654	377,403

Total Receipts by Category	**$34,347,118**	**$36,653,182**	**$156,922,455**

Total receipts increased by 7% in fiscal year 2016 and by 328% in fiscal year 2017. The increase for fiscal year 2017 was due to a negotiated settlement with a financial institution for $120,000,000. This settlement was the result of an investigation into the underwriting of residential mortgage-backed securities related to the 2008 financial crisis.

Expenditures

Expenditures of the Department of Banking for the fiscal years ended June 30, 2015, 2016, and 2017, totaled $19,645,814, $20,455,380 and $20,127,659, respectively. The majority of these 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:

	2014-2015	**2015-2016**	**2016-2017**
Banking Fund	$19,487,263	$20,417,533	$20,119,239
Restricted Fund	158,551	37,847	8,420
Total Expenditures by Fund	**$19,645,814**	**$20,455,380**	**$20,127,659**

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

	2014-2015	**2015-2016**	**2016-2017**
Total Personal Services	$17,969,257	$18,724,306	$18,567,643
Employee Allowances & Travel	137,819	152,791	136,577
Contractual Services	357,730	223,027	212,003
Motor Vehicle Costs	160,195	144,847	172,304
Premises and Property	752,885	783,403	778,618
Information Technology	73,882	156,025	103,153
Purchased Commodities	26,073	57,062	70,499
Other Charges	129,307	167,151	86,862
Capital Outlays – Equipment	38,666	46,768	-0-
Total Expenditures	**$19,645,814**	**$20,455,380**	**$20,127,659**

Expenditures increased by 4% in fiscal year 2015-2016 and then decreased 2% during fiscal year 2016-2017. Increases during the 2015-2016 fiscal year were primarily attributed to an increase in charges to the State Employee Retirement System (SERS). The majority of the decrease in expenditures for the 2016-2017 fiscal year was attributed to a decrease in salaries & wages for full time employees. Personal Services accounted for 92% of the department's total expenditures in the audited years.

Fund Balance

The Banking Fund budgetary fund balances plus reserves for the fiscal years ended June 30, 2015, 2016 and 2017, were $13,499,398, $9,983,299, and $3,443,710, respectively.

Staffing Levels

The department employed an average of 114, 116, and 117 staff members for the fiscal years ended June 30, 2015, 2016, and 2017, respectively.

STATE AUDITORS' FINDINGS AND RECOMMENDATIONS

The following recommendation resulted from our current review of the Department of Banking:

Management of Accounts Receivable

Criteria: The State Accounting Manual, Management of Receivables section 2.0, requires that accounts receivable records be maintained in an accurate and complete manner, and indicate the length of time a debt has been outstanding.

Section 4.3 of the State Accounting Manual, requires each agency to report its fiscal year-end receivables transactions and balances to the Office of the State Comptroller, Budget & Financial Analysis Division.

Condition: During the time of our review, we found the department could not provide a comprehensive listing of all outstanding accounts receivable in the form required by the State Accounting Manual.

The Department of Banking submitted inaccurate receivables reports to the Office of the State Comptroller for the fiscal years ended June 30, 2016 and 2017. For the fiscal year 2016-2017, the department reported receivables totaling $126,332,096. Of this amount, the department received $120,878,935 prior to June 30, 2017. In addition, the department wrote off $2,122,043 prior to June 30, 2017, which should not have been reported.

Effect: Poor controls over the management of receivables increases the risk that DOB revenues may not be collected. Also, the department may not be able to properly write-off amounts deemed uncollectible and may not accurately report outstanding receivable amounts to the State Comptroller.

Cause: The Department of Banking has inadequate internal controls over accounts receivable.

Recommendation: The Department of Banking should improve internal control over receivables and identify, record, and report receivables as required by the State Comptroller. (See Recommendation 1)

Agency Response: "The Department of Banking acknowledges that our current accounts receivable procedures need updating in order to improve internal controls, and improve the reporting of receivables. A working group, consisting of the operational division directors working with our business office division director, has been established and has developed and implemented new accounts receivable procedures effective July 1, 2018."

RECOMMENDATIONS

Status of Prior Audit Recommendation:

Our prior report audit examination resulted in 10 recommendations, of which 1 is being repeated in our current report. The following is a summary of those recommendations and the action taken by the Department of Banking.

- **The Department of Banking should determine whether audit trails can be established in current systems to comply with professional standards.** The Department of Banking is in the process of implementing a new eLicense system which will replace the outdated systems currently in use. This finding is not being repeated.

- **The Department of Banking should evaluate a replacement for its Business Integrated Public Service System (BIPSS) with a business process management system that integrates documentation management to increase internal control capabilities and realize efficiencies in operational performance.** The Department of Banking is in the process of replacing BIPSS with a new system. This finding is not being repeated.

- **The Department of Banking should develop an information technology strategic plan on the department level to address inefficiencies in the information technology environment.** The Department of Banking has implemented a plan that includes a new license system that replaces much of the information technology software being used by the department. This finding is not being repeated.

- **The Department of Banking should improve internal controls to ensure that assets are properly recorded in Core-CT, accurately reported to the State Comptroller as prescribed by the State Property Control Manual, and internal control activities are documented.** There were no exceptions identified during our review of asset management and, therefore, this finding is not being repeated.

- **The Department of Banking should strengthen internal control by requiring documentation of the review process and implement an entity-wide quality assurance program. The quality assurance program should standardize aspects of examinations that should not deviate from each division.** The Department of Banking has implemented new procedures over the review process for examinations. This finding is not being repeated.

- **The Department of Banking should strengthen internal controls by documenting policies and procedures and requiring adequate documentation to support internal control activities.** The department has documented procedures as part of an extensive process to address this finding. This finding is not being repeated.

- **The Department of Banking should institute the use of non-financial performance indicators to monitor examinations conducted on a long-term basis. Department of Banking should also conduct a business analysis to identify any other factors limiting the department from conducting examinations and create a strategic action plan to conform to best practice.** The department is making progress in addressing the concerns of this finding and, therefore, it is not being repeated.

- **The Department of Banking should document its internal controls and improve effectiveness of cost recovery by creating a detailed billing policy approved by the commissioner.** The department implemented new billing procedures for the fiscal year ended June 30, 2018, which were reviewed and determined to adequately address the concerns of the finding. This finding is not being repeated.

- **The Department of Banking should improve collection efforts by adhering to the minimum collection procedures established by the Office of the State Comptroller.** The Department of Banking established new procedures to better document its collection efforts. This finding is not being repeated.

- **The Department of Banking should strengthen internal control in its management of accounts receivables to prevent reporting errors. The department should perform reconciliations between the business office and operational divisions to enhance accuracy.** The department continued to have deficiencies in the accounting for and reporting of accounts receivable during the audited period. This finding is being repeated in a modified form. (See Recommendation 1)

Current Audit Recommendations:

The following recommendation resulted from our current review.

1. The Department of Banking should improve internal control over receivables and identify, record, and report receivables as required by the State Comptroller.

Comment:

We found that the Department of Banking's internal controls over receivables were inadequate. This resulted in inaccurate reporting of receivables to the State Comptroller.

ACKNOWLEDGEMENT

The Auditors of Public Accounts would like to recognize the auditors who contributed to this report:

Taulant Baci
David Tarallo

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 this examination.

David Tarallo
Principal Auditor

Approved:

John C. Geragosian
State Auditor

Robert J. Kane
State Auditor