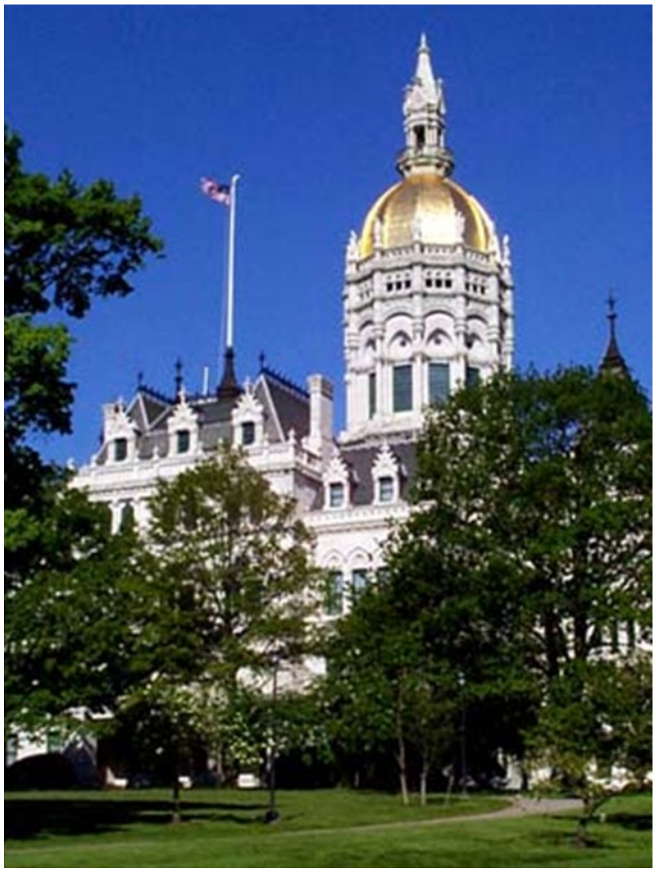
STATE OF CONNECTICUT



AUDITORS' REPORT
DEPARTMENT OF BANKING
FISCAL YEARS ENDED JUNE 30, 2020 AND 2021

AUDITORS OF PUBLIC ACCOUNTS
JOHN C. GERAGOSIAN ❖ CLARK J. CHAPIN

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August 31, 2022

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 for the fiscal years ended June 30, 2020 and 2021. Our audit identified one internal control deficiency.

Page 7	Our review of the Department of Banking's reporting of receivables to the State Comptroller for the fiscal years ended June 30, 2020 and 2021, disclosed that the amounts reported were incomplete. We noted that the department did not record $900,000 for seven imposed fines. The business office was not notified at the time the department imposed the fines. The Department of Banking should design and follow procedures to ensure that receivable balances reported to the State Comptroller are complete and accurate. (Recommendation 1)

STATE OF CONNECTICUT

AUDITORS OF PUBLIC ACCOUNTS

JOHN C. GERAGOSIAN

State Capitol
210 Capitol Avenue
Hartford, Connecticut 06106-1559

CLARK J. CHAPIN

August 31, 2022

AUDITORS' REPORT
DEPARTMENT OF BANKING
FISCAL YEARS ENDED JUNE 30, 2020 AND 2021

We have audited certain operations of the 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, 2020 and 2021. The objectives of our audit were to evaluate the:

1. Department's internal controls over significant management and financial functions;

2. 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. Effectiveness, 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. Our testing was not designed to project to a population unless specifically stated. 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 this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the 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 a reasonable basis for our findings and conclusions based on our audit objectives.

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

1. Identified deficiencies in internal controls;
2. Identified apparent non-compliance with laws, regulations, contracts and grant agreements, policies, and procedures; and
3. Did not identify a need for improvement in management practices and procedures that we deemed to be reportable.

The State Auditors' Findings and Recommendations section of this report presents 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 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 stockbrokers, and investment advisors. The department administers and enforces Connecticut's Truth-in-Lending Law and Uniform Securities Act, among other consumer-credit laws.

The Department of Administrative Services Small Agency Resource Team (SmART) has administered the payroll and human resources functions for DOB since October 2018.

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

Programs and Services

The department is comprised of four operational divisions responsible for specific regulatory functions.

- The **Financial Institutions Division** is responsible for the supervision of insured state-chartered bank and trust companies, savings banks, savings and loan associations and credit unions, in addition to uninsured banks and trust banks. The division also licenses foreign banking organizations that establish and maintain representative offices, agency offices and branch offices in Connecticut, and supervises bank holding companies. It has responsibility for analyzing applications for new bank or credit union charters, acquisitions, mergers, conversions, branches, changes in corporate structure, and credit union field of membership expansions. In addition, the division licenses business and industrial development corporations, international trade and investment corporations, and certain non-banking corporations that exercise fiduciary powers.

- The **Consumer Credit Division** is responsible for examination, enforcement, and licensing of mortgage lenders, brokers, servicers, lead generators of residential mortgage loans and loan originators; small loan companies; sales finance companies; debt adjusters; debt negotiators; consumer collection agencies, including debt buyers; money transmitters; issuers of money orders and travelers checks; check cashing services; and student loan servicers. In addition, Consumer Credit also administers Truth-in-Lending laws and retail installment sales financing laws.

- The **Securities and Business Investments Division** is responsible for registering securities and business opportunity offerings sold in or from Connecticut, registering (licensing) broker-dealers, agents, investment advisers and investment adviser agents who transact business in Connecticut, and registering branch offices of broker-dealer and investment advisory firms. The division also conducts examinations of broker-dealers, investment advisers and branch office registrants, and enforces the Connecticut Uniform Securities Act, the Connecticut Business Opportunity Investment Act, and the Connecticut Tender Offer Act.

- The **Government Relations and Consumer Affairs Division** assists consumers with issues involving financial services and products regulated by the department and oversees the administration and enforcement of the rental security deposit laws. The division also directs the agency's legislative program, manages the department’s communications and media relations, coordinates financial and investor-education outreach efforts, and provides assistance to homeowners in foreclosure or in danger of foreclosure through the Foreclosure Assistance Hotline.

Significant Legislation

The following notable legislative changes affecting the department took effect during the audited period:

- **Public Act 21-130 (Section 3),** effective July 1, 2021, required federal student loan servicers to annually register with the Department of Banking, rather than obtain licensure. The registration and renewal fees are $900.

- **Public Act 21-138,** effective October 1, 2021, implemented several recommended minor administrative changes to the state banking statutes concerning financial institutions and consumer credit licenses.

RÉSUMÉ OF OPERATIONS

Banking Fund

DOB does not receive General Fund appropriations. Instead, the department funds its operations by collecting annual assessment fees on supervised financial institutions. The State Treasurer is responsible for depositing these fees into the legally separate State Banking Fund as outlined in Section 36a-65a of the General Statutes. DOB may only expend amounts in the fund pursuant to approval by the General Assembly.

The Banking Fund budgetary fund balances plus reserves for the fiscal years ended June 30, 2020 and 2021 were $8,343,703, and $14,934,636, respectively.

General Fund

The State Treasurer deposits any fines or civil penalties imposed by the Banking Commissioner and any late fees received by the commissioner into the General Fund. Fees collected from institutions filing with the Securities and Exchange Commission activity also are deposited in the General Fund.

Revenues

Revenues for the Department of Banking, by fund and account, for the fiscal years under review and the preceding fiscal year are presented below:

Revenues by Fund

	Fiscal Year Ended June 30,		
Fund	**2019**	**2020**	**2021**
Banking Fund	$ 35,923,775	$ 35,723,649	$ 38,522,769
General Fund	6,427,848	5,754,417	6,107,547
Federal & Other Restricted Accounts Fund	47,200	57,600	418,400
Total Revenues by Fund	**$ 42,398,823**	**$ 41,535,666**	**$ 45,048,716**

Increases in the banking fund revenues were due to a higher assessment rate to fund additional payroll costs and growth in collected license revenue. The increase in Federal & Other Restricted Accounts was due to money from a settlement with a large brokerage firm.

Revenues by Account

Account	Fiscal Year Ended June 30, 2019	2020	2021
Fees	$ 36,260,014	$ 35,660,950	$ 37,026,633
Fines	1,023,582	450,689	659,862
Licenses	4,894,350	5,201,825	6,822,400
Miscellaneous	220,877	222,202	539,821
Total Revenues by Account	**$ 42,398,823**	**$ 41,535,666**	**$ 45,048,716**

Total receipts from fees remained relatively consistent throughout the audited period. Fluctuations in revenue from fines are expected, as most of the revenue is generated from only a few large fines. Total license revenue increased from $4,894,350 in the 2018-2019 fiscal year to $6,822,400 in the 2020-2021 fiscal year due to the increase in mortgage license revenue. The COVID-19 pandemic resulted in a substantial increase in real estate activity and a need for more licensed loan originators.

Expenditures

Expenditures for the Department of Banking, by fund and account, for the fiscal years under review and the preceding fiscal year follows:

Expenditures by Fund

Fund	Fiscal Year Ended June 30, 2019	2020	2021
Banking Fund	$ 22,409,988	$ 21,419,719	$ 23,007,493
Federal & Other Restricted Accounts Fund	111,152	5,215	-
Total Expenditures by Fund	**$ 22,521,140**	**$ 21,424,934**	**$ 23,007,493**

Expenditures by Account

Account	Fiscal Year Ended June 30, 2019	2020	2021
Personal Services & Employee Benefits	$ 19,587,684	$ 19,714,754	$ 21,454,746
Employee Allowances & Travel	123,030	99,076	28,397
Contractual Services	309,446	238,921	277,200
Motor Vehicle Costs	152,806	107,593	24,947
Premises and Property	791,979	758,506	833,172
Communications	53,634	52,111	40,890
Information Technology	981,676	155,210	110,425
Purchased Commodities	79,270	85,961	75,227
Other Expenditures	441,615	212,801	162,489
Total Expenditures by Account	**$ 22,521,140**	**$ 21,424,933**	**$ 23,007,493**

The increase in personal service costs was due to managers being admitted into the union through the collective bargaining negotiations and receiving retroactive 5.5% raises in the fiscal year ended June 30, 2021. The decreases in employee allowances & travel and motor vehicle costs were due to remote working as a result of the COVID-19 pandemic. Information technology expenditures decreased due to a new e-License software system upgrade during the 2018-2019 fiscal year.

STATE AUDITORS' FINDINGS AND RECOMMENDATIONS

Our examination of the records of the Department of Banking disclosed the following finding and recommendation, which has been repeated from the previous audit.

Accounts Receivable Reporting

Background:	The Department of Banking is authorized to impose fines and penalties on financial institutions doing business in the state that have not adhered to certain sections of Chapter 664 of the General Statutes. The department considers these fines and penalties to be receivables until they are paid or written off.
Criteria:	The Office of the State Comptroller requires all state agencies to report receivable balances as of every fiscal year ending June 30th. These reports should be complete and accurate. The State Accounting Manual requires three documented collection efforts and approval from the Secretary of the Office of Policy and Management (OPM) prior to writing off receivables over $1,000.
Condition:	Our review of the Department of Banking's reporting of receivables to the State Comptroller for the fiscal years ended June 30, 2020 and 2021, disclosed that the amounts reported were incomplete. We noted that the department did not record $900,000 for seven imposed fines. The business office was not notified at the time the department imposed the fines. After the conclusion of our field work, the department determined that the fines were uncollectible and submitted them to OPM for write off.
Context:	The Department of Banking imposed 46 fines, totaling $4,042,366, on financial institutions performing financial services under the department's purview during the audited period.
Effect:	The amount the department reported to the State Comptroller did not accurately reflect its accounts receivable balance. Also, the department's failure to report the receivables to the business office hindered its collection efforts.
Cause:	A lack of communication between the divisions overseeing the assessment of penalties and the business office responsible for recording the transactions contributed to the incomplete reporting of receivables.
Prior Audit Finding:	This finding has been previously reported in the last three audit reports covering the fiscal years ended 2014 to 2019.

Recommendation:	The Department of Banking should design and follow procedures to ensure that receivable balances reported to the State Comptroller are complete and accurate. (See Recommendation 1.)
Agency Response:	"The Department agrees with this audit finding. To ensure complete and accurate communication between the divisions overseeing the assessment of penalties and the business office responsible for recording the transactions, the Business Office Manager instituted sending a monthly e-mail to the divisions instructing them to provide any updated information on receivables. This includes any that may have been deemed uncollectible due to the person or entity declaring bankruptcy and providing evidence of inability to pay or going to prison. It is also a requirement that the division sign off on these updates. This enhancement to the process was instituted in late Fiscal Year 2021."

RECOMMENDATIONS

Status of Prior Audit Recommendations:

Our prior audit report on the Department of Banking contained six recommendations. Five have been implemented or otherwise resolved and one has been restated with modification during the current audit.

- The Department of Banking should strengthen internal controls over the accounting and reporting of its accounts receivable balances. **This recommendation is being repeated in a modified form. (See Recommendation 1.)**

- The Department of Banking should strengthen internal controls to ensure that amounts on its annual inventory report are accurate, complete, and reported in accordance with the State Property Control Manual. **This recommendation has been resolved.**

- The Department of Banking should strengthen controls over purchasing card transactions by ensuring compliance with established purchasing card procedures. **This recommendation has been resolved.**

- The Department of Banking should improve monitoring of medical leave to ensure employees provide medical certificates for any absence of more than five consecutive workdays as prescribed by the commissioner of Administrative Services. **This recommendation has been resolved.**

- The Department of Banking should establish internal controls to ensure that it promptly deactivates employee access to the Core-CT system upon termination. **This recommendation has been resolved.**

- The Department of Banking should comply with the Office of the State Comptroller's software policies and procedures. **This recommendation has been resolved.**

Current Audit Recommendations:

1. **The Department of Banking should design and follow procedures to ensure that receivable balances reported to the State Comptroller are complete and accurate.**

   Comment:

   Our review of the Department of Banking's reporting of receivables to the State Comptroller for the fiscal years ended June 30, 2020 and 2021, disclosed that the amounts reported were incomplete. We noted that the department did not record $900,000 for seven imposed fines. The business office was not notified at the time the department imposed the fines.

ACKNOWLEDGMENTS

The Auditors of Public Accounts 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.

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

Ramiz Mehmedovic
Matthew B. Wood

Matthew B. Wood
Principal Auditor

Approved:

John C. Geragosian
State Auditor

Clark J. Chapin
State Auditor