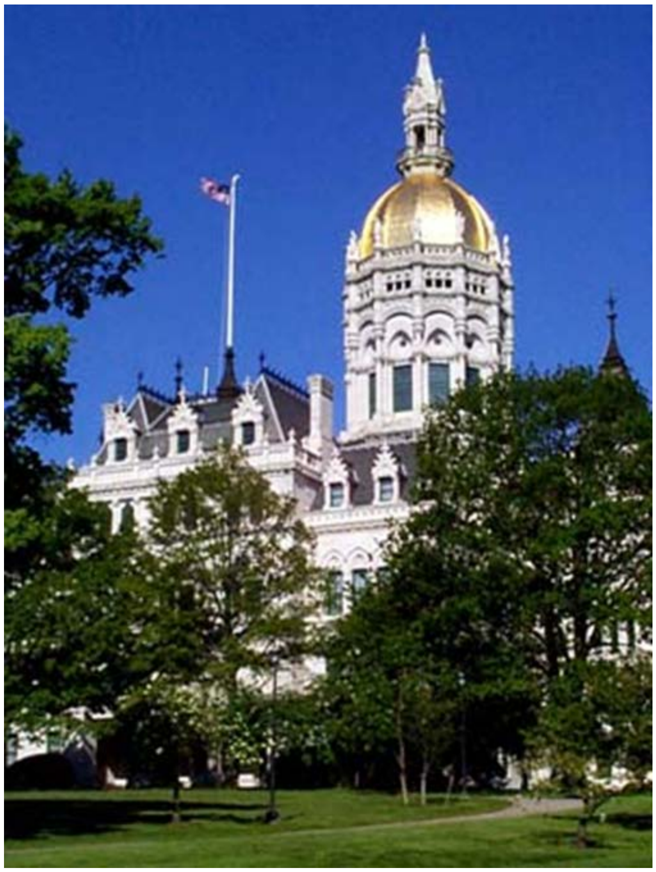
STATE OF CONNECTICUT



AUDITORS' REPORT
DEPARTMENT OF BANKING
FOR THE FISCAL YEARS ENDED JUNE 30, 2014 and 2015

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

Table Of Contents

STATE OF CONNECTICUT

AUDITORS OF PUBLIC ACCOUNTS

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August 10, 2017

INTRODUCTION
AUDITORS' REPORT
DEPARTMENT OF BANKING
FOR THE FISCAL YEARS ENDED JUNE 30, 2014 and 2015

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 years ended June 30, 2014, and 2015. 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. 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) operates primarily 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.

Howard F. Pitkin was appointed Banking Commissioner on October 1, 2006 and served as commissioner during the audited period. Commissioner Pitkin retired from state service on January 15, 2015. Jorge L. Perez was appointed Banking Commissioner effective March 13, 2015 and continues to serve in that capacity.

New Legislation

Public Act 13-253, Section 3, effective October 1, 2013, broadened the definition of those engaged in monetary transmissions and the requirements to obtain a license issued by the commissioner. Section 13 allowed the commissioner to request proof of compliance with the Currency and Foreign Transaction Reporting Act. Section 13 also enabled the commissioner to determine that violations of federal laws or regulations may be deemed a violation under PA 13-253, and the commissioner may take enforcement actions pursuant to Section 36a-608 of the Connecticut General Statutes. Section 23(a) of the act gave the commissioner the authority to issue a license for consumer collection agencies for each main office and branch office. Section 23 (c) defined the findings the commissioner must make before issuing a consumer collection agency license.

Public Act 14-89, Section 1 to 20, effective October 1, 2014, broadened the commissioner's licensing powers to include mortgage servicer licensure. Section 33 authorized the commissioner to require persons engaged in the financial service industry subject to the commissioner's jurisdiction to be licensed or registered through the system, as defined in Section 36a-2 of the of the General Statutes. Section 38 extended the State of Connecticut's mortgage foreclosure meditation program from June 30, 2014 to June 30, 2016.

RÉSUMÉ OF OPERATIONS:

Receipts:

Department of Banking receipts categorized by fund are summarized below for the fiscal years ended June 30, 2013, 2014, and 2015:

	2012-2013	**2013-2014**	**2014-2015**
General Fund	$ 6,593,741	$11,363,992	$ 6,196,097
Banking Fund	26,157,810	29,871,866	28,151,021
Restricted Fund	490,000	50,000	-0-
Total Receipts by Fund	**$33,241,551**	**$41,285,858**	**$34,347,118**

Department of Banking receipts by revenue category are summarized below for the fiscal years ended June 30, 2013, 2014, and 2015:

	2012-2013	**2013-2014**	**2014-2015**
Fees	$28,059,692	$30,879,362	$30,133,551
Fines	1,583,528	5,995,972	763,387
Licenses	3,107,450	4,342,150	3,419,975
Miscellaneous	490,881	68,374	30,205
Total Receipts by Category	**$33,241,551**	**$41,285,858**	**$34,347,118**

Total receipts increased by 24% in fiscal year 2014 and decreased by 17% in fiscal year 2015. General Fund revenue increased by 72% during the 2013-2014 fiscal year due to a $5,000,000 fine received from broker-dealer Morgan Stanley Smith Barney LLC. The majority of increases in the Banking Fund for the fiscal year ended June 30, 2014 were due to mortgage recording fees and consumer collection agency license fees. The mortgage recording fees and consumer collection agency license fees declined significantly during the 2014-2015 fiscal year, but were offset by increases in broker fees and mortgage license fees.

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, 2013, 2014, and 2015, totaled $18,172,814, $19,179,867 and $19,645,814, 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:

	2012-2013	2013-2014	2014-2015
Banking Fund	$17,880,903	$18,799,949	$19,487,263
Restricted Fund	291.911	379,918	158,551
Total Expenditures by Fund	**$18,172,814**	**$19,179,867**	**$19,645,814**

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

	2012-2013	2013-2014	2014-2015
Total Personal Services	$16,190,197	$17,378,183	$17,969,257
Employee Allowances & Travel	243,078	109,588	137,819
Contractual Services	502,594	459,938	357,730
Motor Vehicle Costs	74,684	153,535	160,195
Premises and Property	745,579	742,803	752,885
Information Technology	103,783	124,368	73,882
Purchased Commodities	23,507	24,958	26,073
Other Charges	215,207	120,739	129,307
Capital Outlays – Equipment	74,185	65,755	38,666
Total Expenditures	**$18,172,814**	**$19,179,867**	**$19,645,814**

Expenditures increased by 6% in fiscal year 2014 and 2% during fiscal year 2015. Increases during the 2013-2014 fiscal year were primarily attributed to an increase in charges to the State Employee Retirement System (SERS). The decrease in Employee Allowances & Travel for the 2014-2015 fiscal year was due to a decrease in mileage reimbursements but was offset by an increase in motor vehicle costs. The majority of the increases in expenditures for the 2014-2015 fiscal year were attributed to increases in salaries & wages for full time employees. Personal

Services accounted for 91% of the department's total expenditures in the respective audited years.

Fund Balance

The Banking Fund budgetary fund balances plus reserve amounts for the fiscal years ended June 30, 2013, 2014 and 2015 were $27,350,239, $20,288,228, and $13,499,398, respectively.

Staffing Levels

The department employed 114, 115, and 112 staff members as of June 30, 2013, 2014, and 2015, respectively.

STATE AUDITORS' FINDINGS AND RECOMMENDATIONS

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

Audit Trails in Information Technology Systems

Criteria: National Institute of Standards and Technology (NIST) Special Publication (SP) 800-14 called *Generally Accepted Principles and Practices for Securing Information Technology Systems* has established professional standards in information security. A key area identified in NIST SP 800-14 is audit trails. Audit trails link actions in the information system to user accounts for accountability, reconstruction of events, intrusion detection, and problem identification.

Conditions: The Department of Banking uses access databases to track examinations, investigations, and complaints. The systems, as designed, do not have audit trails to link user actions in the systems to user accounts. Once a user has write permissions to the systems, they can modify any data entered into the system. Users cannot be held accountable for modifications or changes made in the system as they are not tracked to individual user accounts.

The Business Integrated Public Service System (BIPSS) is used for registrants and licensing in the Securities & Business Investment and Financial Institution Divisions. The system does not have audit trails to link user actions in the systems to user accounts. Once a user account is established for a BIPSS module, the user can update or make changes to data in an entry field.

Effect: The lack of audit trails limits user accountability for changes, decreases accuracy of the data, and limits problem identification in information technology systems.

Cause: The systems in use are not sophisticated in design and rely upon manual records to support data.

Recommendation: The Department of Banking should determine whether audit trails can be established in current systems to comply with professional standards. (See Recommendation 1)

Agency Response: "We agree with this finding. The existing technology has limited tools to support audit trails and we are in the beginning stages of implementing the E-Licensing system. The Department of Banking plans to focus its efforts and resources on the implementation of E-Licensing. We anticipate the project to take 18 months to complete."

Business Integrated Public Service System

Background: The Department of Banking currently uses the Business Integrated Public Service System (BIPSS) to record, track, and monitor licensing and registration of securities in the Securities & Business Investment and Financial Institution Divisions. The system has 4 modules: securities registrants, securities licensing, financial institution licensing, and business revenue module.

Criteria: Legacy systems have been identified in the information technology sector as high risk and high cost. The State of Connecticut Information and Telecommunications Strategic Plan for fiscal year 2016, states that legacy systems prevent integration with other systems and is a substantial impediment that prevents agencies from realizing greater efficiencies. The Bureau of Enterprise Systems and Technology has identified legacy systems as a burden on technology resources.

Conditions: During the audit, we noted that very limited information on the architecture and programming of BIPSS was available. Records detailing important information technology controls were destroyed, including change control logs, data dictionary information, system development, and source code records. We could not attest to the proper development and changes of the legacy system, as the records were not maintained and no electronic copies exist.

During the audit, it became apparent that knowledge of BIPSS is concentrated to one employee in the management information system division. This employee is responsible for ensuring access rights are granted, reports are run, and BIPSS is operating as intended. The divisions relying on BIPSS do not have the knowledge to run their own reports and rely on this one employee to provide information for operational needs. If this employee leaves the department, operations will be severely affected. This has created a single point of failure for the system.

In July 2014, the business office stopped using BIPSS for revenue tracking. The business office went to a manual log system, maintained in Excel, to improve efficiencies and remove redundant processes resulting from BIPSS. This reduced BIPSS operational usage by 25%.

BIPSS, as designed, lacks audit trails or workflow for approval of transactions, and does not allow for electronic documentation management. This requires significant manual processes and documentation outside of the system to substantiate information in BIPSS.

During the review of BIPSS, it came to our attention that BIPSS has standard query language (SQL) command issues. Reports cannot be run from production data in BIPSS. Data from production has to be transferred into testing to run reports. The department intends to obtain a new software writer for the system to update the SQL commands. Updating the SQL commands in BIPSS will require significant time from management information system personnel. As BIPSS continues to age, integration with new systems will be a continuing problem, resulting in additional resources to maintain the system.

Effect: DOB must allocate additional resources for continued functionality of BIPSS. The benefits of the information technology system are not realized in operational effectiveness and performance. The concentration of knowledge on the legacy system creates a high risk for the system as it relies on a single point of failure.

Cause: BIPSS was designed and implemented over 17 years ago, when information technology was vastly different. As technology has advanced to include documentation and business process management systems, BIPSS has become outdated.

Recommendation: The Department of Banking should evaluate a replacement for its Business Integrated Public Service System with a business process management system that integrates documentation management to increase internal control capabilities and realize efficiencies in operational performance. (See Recommendation 2)

Agency Response: "We agree with the findings. BIPSS is currently supported by a single individual and some of the relevant systems documentation has been lost or destroyed over the past 17 years. The Department of Banking realizes that BIPSS is an outdated system and is currently in the process of seeking an agency-wide system that also replaces BIPSS."

Information Technology Environment

Criteria: In 2015, the Department of Banking hired a consultant to perform a review on processes and applications at the department. This effectively created enterprise architecture (EA). An EA can be viewed as a blueprint for organizational transformation and information technology modernization. The report includes business process and information technology applications as currently in place, and details opportunities for improvement.

Criteria: The U.S. Government Accountability Office defines successful organizations as, "Having operations and technology environments that maximize institutional mission performance and outcomes. Among other things, this includes realizing cost savings through consolidation and reuse of shared services and elimination of antiquated and redundant mission operations, enhancing information sharing through data standardization and system integration, and optimizing service delivery through streamlining and normalization of business processes and mission operations."

Conditions: The consultant determined that, "DOB staff has become accustomed to working in an environment with multiple systems and workarounds. They have developed solutions to get their jobs done, but the result is a web of manual processes and data silos." The report also identified 4 key opportunities for improvement of weaknesses at the department. These weaknesses included no centralized source of information about the individuals and businesses DOB regulates, excessive time spent on manual business process, the department underutilizing some information technology products, and maintaining large volumes of paper records. The report stated that the functional effectiveness of the department is impacted by its current information technology environment. We reviewed the report and concurred with the recommendations made by the consultant.

During the audit, we noted that each division has its own method of tracking and monitoring examinations, complaints, and investigations. The Division of Consumer Credit uses 2 separate databases to monitor progress and completion. The Governmental Relations Division uses a complaint access database. The Securities and Business Investment Division has a separate database for examinations and investigations. The Financial Institution Division uses manual records, Excel spreadsheets, and electronic calendars to monitor examinations and investigations. The information technology in use for business operations does not have workflows for processing or audit trails. As such, manual documentation outside of information systems is required to document operational process and support data in the system.

DOB uses a legacy system for licensing and registrants not handled by third-party vendors, National Mortgage Licensing Service (NMLS), and Financial Industry Regulatory Authority (FINRA). The legacy system does not maintain audit trails and requires significant manual documentation to support the data in the system.

The systems, as designed, do not accommodate any electronic documentation, and all records must be maintained manually. The systems, as designed, act as recordkeeping systems that cannot be relied upon to replace manual processes or documentation.

Effect: The department is not realizing the cost and performance efficiencies that routinely are obtained from information technology systems.

Cause: A review of the information technology environment was not previously conducted. The department relied upon workarounds to accomplish information technology objectives on a division level instead of a department level.

Recommendation: The Department of Banking should develop an information technology strategic plan on the department level to address inefficiencies in the information technology environment. (See Recommendation 3)

Agency Response: "We agree with this finding. We are working with Department of Administrative Services Bureau of Enterprise Systems and Technology and Office of Policy and Management to implement the recommendations from the consultant's report to address current inefficiencies in our information technology environment."

Asset Management

Criteria: Section 4-36 of the Connecticut General Statutes requires that, "Each state agency shall establish and keep an inventory account in the form prescribed by the Comptroller, and shall, annually, on or before October first, transmit to the Comptroller a detailed inventory, as of June thirtieth, of all of the following property owned by the state and in the custody of such agency: (1) Real property, and (2) personal property having a value of one thousand dollars or more." The methods prescribed by the Comptroller are published in the State Property Control Manual. Chapter 3 of this manual includes reporting requirements and categorical inclusions for the various valuations reported on the Asset Management/Inventory Report/GAAP Reporting Form (CO-59).

Chapter 9 of the manual also requires that "if the values recorded on the CO-59 do not reconcile with Core-CT, the agency must provide a written explanation of the discrepancy in an attachment".

The U.S. Government Accountability Office *Standards for Internal Control in the Federal Government* has designated a key component of internal control as control environment. A principle of control environment is the enforcement of accountability, which means management holds the entity personnel accountable for performing its assigned internal control responsibilities. The standards also state that documentation is required for effective design, implementation, and operating effectiveness of an entity's internal control system.

Conditions: For the audited period, analytical testing revealed differences between the balances recorded on the Department of Banking's CO-59 and those found on the applicable Core-CT reports. The department did not include a written explanation for the differences, per the Office of the State Comptroller instructions. The following variance was discovered, but no explanation was provided with the CO-59:

- The beginning balance on the CO-59 for the equipment category, as of June 30, 2013, was understated by $84,756 from Core-CT reported amounts. The understatement was carried forward to the ending balance as of June 30, 2014 and the beginning and ending balance for the June 30, 2015 CO-59. We could not trace the variance on the CO-59 to Core-CT transactions.

During the audit, we noted that DOB is not documenting the approval and review of physical inventory, and the disposal of assets. We noted the following during our audit:

- The physical inventory conducted for the June 30, 2014 and June 30, 2015 periods was not signed by the person conducting the inventory. No documentation exist demonstrating supervisory review and approval of the physical inventory.

- During the 2014-2015 fiscal year, assets totaling $29,453 were processed for deletion in the business office and Core-CT. However, management approval was not obtained. The fiscal administrative manager at DOB confirmed, upon request, that she approved the disposal and processed the transactions in Core-CT. We could not attest to approval at the time of disposal.

- We noted one instance of an asset that had been deleted during the 2014-2015 fiscal year totaling $2,212, in which no supporting documentation existed to demonstrate approval by the employee responsible for the asset disposal. Furthermore, there was no documentation to indicate that management had approved the disposal. The only documentation for the disposal was a Department of Administrative Services certificate of recycle acknowledging approval to dispose of the asset.

- We noted one instance during the 2014-2015 fiscal year in which a shredder, valued at $2,249, was disposed of according to Core-CT records. The asset is still in use at the department and was included on the inventory count as of June 30, 2015. No documentation exists to support the disposal of the asset from Core-CT.

During the 2014-2015 fiscal year, we found assets totaling $12,872 that were incorrectly categorized in Core-CT as equipment and reported on the CO-59. The assets each had individual values of less than $1000 and did not meet the threshold of capitalization required for the personal property equipment category.

Effect: Asset values reported to the State Comptroller were understated for the fiscal years ended June 30, 2014 and 2015. Assets at DOB are at a higher risk of errors due to reporting and internal control deficiencies.

Cause: The department does not have significant inventory and in the past, asset management was not a key operational concern.

Recommendation: 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. (See Recommendation 4)

Agency Response: “We agree. After the last audit report (fiscal year 2011-2012 and 2012-2013, dated October 1, 2015) the agency has created an Asset Management process flow, addressing the issues stated in the above recommendation. The results of which will be apparent in the next audit.”

Quality Assurance in Examination Process

Background: The Department of Banking acts as the regulatory agency for securities, consumer financial transactions, and banking in the State of Connecticut under Title 36a of the Connecticut General Statutes – "The Banking Law of Connecticut" and Title 36b "Connecticut Securities and Business Opportunity Investment Act". Under its regulatory authority, DOB conducts examinations that are used to attest to compliance with the General Statutes and federal regulatory requirements.

Criteria: The Conference of State Banks Supervisors (CSBS), accreditation entity for banking regulators, has released the *MMC Mortgage Examination Manual*, which provides best practices that can be applied to all divisions at DOB. The manual states, "quality control over examination work products represent a fundamental element of generally accepted auditing standards and are crucial to the integrity of the examination process." The manual also states, "Examination risk can be reduced by having an effective quality assurance program."

The CSBS examination manual requires each examiner in charge to have effective and efficient means for completing reviews. The CSBS manual states, "Documentation of which evidences completion of review should be placed in the work paper files."

The U.S. Government Accountability Office *Standards for Internal Control in the Federal Government* has designated a key component of internal control as control environment. A principle of control environment is the enforcement of accountability, which means management holds the entity personnel accountable for performing its assigned internal control responsibilities. The standards also state that documentation is required for effective design, implementation, and operating effectiveness of an entity's internal control system.

Conditions: During our audit, we became aware that the DOB currently does not have a quality assurance program for examinations. Each division has the authority to set policy and procedures over the examination process. This has created significant inconsistencies in examination documentation obtained and the quality of support available for review.

During our audit, we reviewed 40 examinations across the Financial Institution, Consumer Credit, and Securities and Business Investment Divisions. In the course of the audit of examinations, we noted the following:

- We noted 18 instances in which an examiner in charge did not sign the examination report or document acceptance of the examination. In 5 instances, we noted examiners in the Securities Division were not required to sign the examination reports. In 11 instances, we noted examiners in the Consumer Credit Division were not required to sign the examination reports. Two instances were noted in the Financial Institution Division in which a memo was signed by the division director, but the examiner in charge's acceptance of final results was not documented.

- We noted 5 instances in the Securities Division in which the examination results were not summarized in a final examination report. The examination file contained a draft memo, but a final memo was not prepared to summarize the exam after the examiner and banking manager approved the examination.

- We noted 5 instances in the Securities Division in which formal quality control review documentation was not available. We could not attest to the review and acceptance of examinations, as no positive statements or sign-offs for reviews were documented.

- We noted 15 instances in the Consumer Credit Division in which no documentation of quality control review was available. The procedures in the division did not require documentation of the review process. We could not attest to the completion of the review process.

- We noted 5 instances in the Financial Institution Division in which no quality control review documentation was available. The division has created a review checklist to document the review process. However, the type of examinations conducted did not require this checklist per division procedures. We could not attest to the completion of the review process. The final examination results were documented as being approved by the division director via report or memo.

- We noted 4 instances in the Financial Institution Division in which the quality control review checklist was required but could not be located. We could not attest to the completion of the review process. The final examination results were documented as being approved by the division director via report or memo.

- We noted 2 instances in the Consumer Credit Division in which the division director's approval of the examination results were not documented. The examinations reviewed were multi-state exams in which DOB was only participating in the exam and did not sign the examination report. No billings or results memos were required for these examinations, as DOB was not the lead regulator. The division director, after the fact, confirmed he approved the examination results conducted by examiners for the multi-state exams. We could not attest to the approval of examination work at the time of report issuance since approval was not documented.

Effect: The lack of documentation of review limits accountability that can be placed on examiners and managers performing examinations.

Cause: The individual divisions at DOB have discretion on setting examination procedures and documentation. This resulted in discrepancies in policies and significant variances in the quality of examination documentation.

Recommendation: 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. (See Recommendation 5)

Agency Response: "We agree with the Auditor's findings. We will review current process for all divisions and will make necessary changes to strengthen internal controls by requiring the proper documentation of exam reviews, and developing a standardized process to be used by all agency divisions."

Securities and Business Investment Division Policy and Procedures

Background: The Securities and Business Investment Division at the Department of Banking conducts examinations under Section 36b-14 of the General Statutes for compliance with records and financial reports.

The division processes licenses under Section 36b-6 of the General Statutes for agent of issuers and broker dealers that do not register with the Financial Industry Regulatory Authority. DOB has an in-house legacy information system called Business Integrated Public Service System (BIPSS) that is used to maintain records for these licenses. BIPSS has a separate module used to track and monitor notice of filer submissions under Section 36b-19 of the General Statutes.

Criteria: The U.S. Government Accountability Office *Standards for Internal Control in the Federal Government* has designated a key component of internal control as control activities. A principle of control activities is documentation of responsibilities through policies. Management must document the internal control responsibilities of employees for the organization. Another key component of internal control is control environment. A principle in control environment is enforcement of accountability. Management holds entity personnel accountable for performing their assigned internal control responsibilities. The standards also state that documentation is required for effective design, implementation, and operating effectiveness of an entity's internal control system.

Conditions: During the audit of the DOB Securities and Business Investment Division, it came to our attention that no procedure manual exists for examinations. The current procedures, as implemented, allow for a banking manager in the securities division to approve examination results and close the examinations without the division director's review. The current authority being executed by banking managers is not documented as being authorized in any policies or procedures.

During the audit of the licensing process through BIPSS, it came to our attention that a documented policies or procedures manual does not exist. We reviewed 10 licenses processed through BIPSS and noted the following:

- We noted 6 instances in which no documentation exists demonstrating the review and approval of the renewal or termination by authorized individuals. The licenses were identified as being either approved or terminated in BIPSS, but the system does not have information system controls to support the approval process.

- We noted one instance in which the license had a termination date of July 15, 2014, but was not identified as being processed until February 18, 2015 in BIPSS. Documentation to support the termination and the termination date entered into BIPSS was lacking.

- We also noted one instance in which a license was last renewed on June 11, 2012 and was identified as active in BIPSS as of September 2016. The license had expired and should have been subjected to termination.

Effect: Without documentation of policies and procedures, internal control cannot be effectively implemented to achieve control objectives. Accountability for internal controls cannot be enforced to ensure proper approval of operational activities.

Cause: The department has depended on undocumented procedures and is relying on information system controls for licensing in BIPSS that do not exist.

Recommendation: The Department of Banking should strengthen internal controls by documenting policies and procedures and requiring adequate documentation to support internal controls activities. (See Recommendation 6)

Agency Response: "We agree with the Auditor's findings. Current procedures will be reviewed and modified as necessary, and in those instances where procedures currently do not exist or are not documented they will be produced."

Examinations Conducted for Consumer Credit

Criteria: The Conference of State Banks Supervisors (CSBS) offers accreditation for regulators of banks and mortgage (non-depository) institutions. The Department of Banking Financial Institution Division currently holds accreditation for banks. The DOB Division of Consumer Credit falls under mortgage accreditation. The CSBS has established a best practice for exam frequency as part of its accreditation process. The CSBS accreditation states "agencies must examine each of their licensed entities within a sixty month interval". The sixty-month or five-year interval for examinations on licensees is considered a best practice in the industry and results in 20% of all licensees being examined per year.

Condition: During the audit of examinations in the Consumer Credit Division, we noted 67 examinations were closed in the 2013-2014 fiscal year and 56 were closed in the 2014-2015 fiscal year. The total of examinations closed to estimated eligible licenses was 4.4% and 3.6% during the 2013-2014 and 2014-2015 fiscal years, respectively. This was estimated to be 16% below the industry best practice of 20%. The examinations being completed on a yearly basis do not conform to industry best practice.

During the audit of examinations in consumer credit, it was noted that examinations are scheduled on a 3 to 6 month cycle. Monitoring of examinations is not conducted on a long-term basis. The

Consumer Credit Division does not use non-financial performance indicators to ensure that each licensee has met the sixty month best practice cycle for examination.

Effect: DOB is reliant on complaints and referrals from other regulators to become aware of compliance issues on a large percentage of licensees. The department does not meet the threshold of examinations conducted necessary to receive accreditation for mortgage regulators.

Cause: The underlying causes appear to be an increase in licensing since 2008, a lack of use of non-financial performance indicators to monitor examinations being conducted on a long term basis, and other unidentified factors in the Consumer Credit Division.

Recommendation: The Department of Banking should institute the use of non-financial performance indicators to monitor examinations conducted on a long-term basis. DOB 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. (See Recommendation 7)

Agency Response: "We agree with the Auditor's finding. The primary reason that the division is unable to meet the best practice requirement of examining all licensees within a sixty (60) month period (20% per year) is due to limited resources. While it is true that the Division has the ability to bill licensees for the actual cost of an examination, the DOB does not have control over the number of staff that can be employed. For this reason, limited resources should not be discounted as the primary reason that the Division is unable to examine twenty percent (20%) of its licensees per year.

The agency will continue to review the division to achieve efficiencies (through initiatives such as LEAN). We will also continue to request new positions and fill as allowed by Office of Policy and Management (OPM) and the Legislature. Our primary issue is not available funding but the authority to create additional positions and for OPM to allow us to fill them (we are 100% industry funded and currently generate substantially higher revenues than the amount we spend). We have been able to get new positions allocated to the agency; however, we have not been allowed to fill them by OPM. Until such time as we are allowed to fill positions we are not going to be able to meet all of our examinations schedules.

Billing for Examinations

Criteria:

Section 36a-65 subsection (6) of the Connecticut General Statutes states "A licensee under section 36a-489, 36a-541, 36a-556, 36a-581, 36a-600, 36a-628, 36a-656, 36a-671, 36a-719 or 36a-801 shall pay to the commissioner the actual cost of any examination of the licensee, as such cost is determined by the commissioner. If the licensee fails to pay such cost not later than sixty days after receipt of demand from the commissioner, the commissioner may suspend the license until such costs are paid."

The U.S. Government Accountability Office *Standards for Internal Control in the Federal Government* has designated a key component of internal control as control activities. A principle of control activity is the design of control activities implemented by management. Management should clearly document the internal controls, all transactions and other significant events in a manner that allows the documentation to be readily available.

Conditions:

During the audit of examinations determined to be billed, we noted that a salary cap had been implemented, which limits full cost recovery on examinations in the Consumer Credit Division. Upon request, we were provided a draft Department of Banking memorandum dated December 28, 2012. The cap applied in the memo stated an hourly rate cap of $35.86 plus 70% of fringe benefit costs associated with examinations. The department was unable to provide documentation demonstrating approval by the commissioner, as per the authority within Section 36a-65 of the General Statutes. During the audit, we noted that the cap from the December 2012 draft memorandum was not used during the 2013-2014 and 2014-2015 fiscal years. DOB used a schedule of examiner hourly rates with full fringe benefit cost recovery. Examiners with hourly rates exceeding $35.86 were only applied at rates ranging from 64% to 88% of full rates. Documentation to demonstrate approval by the commissioner was not available.

During the audit, we reviewed 15 billings for cost recovery for examinations closed in the 2013-2014 and 2014-2015 fiscal years.

We noted the following during our review:

- We noted 9 instances in which inconsistent billing rates for salary and fringe benefits were applied. A detailed billing policy was not in effect and rates applied varied based on when and who processed the billings.

- We noted 1 instance in which a salary cap was applied to the total examination salary cost recovery. The salary was capped at approximately 83% of full cost recovery, which resulted in costs of $1,887 not being recovered. The examiners in the supporting documentation were not included in the schedule for salary caps and no documentation was provided to justify the reduction.

Effect: Without documentation of internal controls, the efficiency and effectiveness of DOB cost recovery objectives are negatively affected, resulting in various rates for billing being applied.

Cause: DOB has relied upon informal and undocumented policies for processing billings in the past.

Recommendation: 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. (See Recommendation 8)

Agency Response: "We agree the agency has adopted a billing process that includes billing at the last salary of the examiner; we will review with the Divisional Directors and seek approval of the Commissioner."

Collection Efforts for Accounts Receivable

Criteria: Per the State Accounting Manual, there are established minimum collections procedures departments must make before writing off funds due to the State of Connecticut. Section 4.1 within the management of receivables section, presents the minimum collection efforts for the write-off of receivables that exceed $25. The debtor should be contacted a minimum of 3 times by the state for collection, use of the state's right to offset debts owed against payments to such debtors should be made, and departments may contact the Collection Services Division of the Department of Administrative Services (DAS) for collection of debts owed to the state.

Conditions: During the audit, we noted that the current collection efforts at the Department of Banking do not follow the minimum collection procedures as required by the State Accounting Manual. The current procedure is that 30 days after the due date of a receivable, an asset search is conducted on a legal database. If the asset search is unsuccessful, the receivables are deemed uncollectible and no further action is taken. The Consumer Credit Division has stated they examine regulated entity records for bank account information and will contact the Department of Labor for possible wage garnishments. The consumer credit procedures are undocumented and no evidence of these steps is provided to the business office for accounts receivable write-off support. We could not verify that the Consumer Credit Division performed stated procedures, as the only supporting documentation available were memorandums stating the results of the asset searches.

Effect: During the 2014-2015 fiscal year, DOB wrote off approximately $2.7 million in receivables. It is unknown if any additional revenue could have been collected if minimum collection efforts were performed.

Cause: DOB relied upon the results of asset searches in determining the collectability of receivables, instead of performing minimum collection efforts defined in the State Accounting Manual.

Recommendation: The Department of Banking should improve collection efforts by adhering to the minimum collection procedures established by the Office of the State Comptroller. (See Recommendation 9)

Agency Response: "We agree with the Auditor's finding. Procedures will be developed to document compliance with state accounting manual and steps taken to determine that the debt is uncollectable."

Management of Accounts Receivable

Criteria: Per Section 2 of the State Accounting Manual, accounts receivable records should be accurate, complete, and maintained in a manner to indicate the length the debt has been outstanding.

Section 4.2 requires departments to request approval to write off receivables over $1,000 from the Office of Policy and Management (OPM) when a valid receivable exists and is past due. In addition, the department must maintain all information relating to receivables that are written off.

Section 4.3 requires each agency to report its fiscal year-end receivables transactions and balances (GAAP Form 2) to the Office of the State Comptroller, Budget & Financial Analysis Division.

Conditions: During the audit of accounts receivables for the 2013-2014 and 2014-2015 fiscal years, we noted the following:

- We noted one instance in which a $50,000 receivable was submitted and approved for write-off by OPM. DOB could not provide a record of the asset search results to support the write-off of the accounts receivable.

- We noted one instance in which a $200,000 receivable was written off by the department. The consent order underlying the receivable was for $230,000. The department did not accurately report the receivable and the write-off of $30,000.

- We noted one instance in which a $100,000 receivable was approved for write-off by OPM in the 2014-2015 fiscal year but was not reported on GAAP form 2 for the same year. This resulted in understated receivable write-offs by $100,000 reported to the Office of the State Comptroller.

- We noted one instance in which the department's OPM write-off approvals form combined two receivables into one line. The receivable due from each debtor was $100,000 for a total of $200,000. The approval given by OPM for both receivables was $100,000. The department understated its receivables write-off submitted for approval by $100,000.

- We noted two instances in which the department had invalid receivables totaling $8,500 reported on GAAP form 2 for the 2014-2015 fiscal year. In one instance, the receivable of $1,000 was made payable to the Office of the Attorney General and not to the Department of Banking. The other instance was for a $7,500 civil penalty reported as part of a criminal case and was not payable due to the department.

- We noted one instance in which the DOB receivable log was understated by $200,000. The underlying support named 3 individual payees with a civil penalty of $100,000 each. The receivable log maintained by the department to track receivables due to the department had 1 entry for all 3 payees with a total receivable of $100,000. This understated the total receivable by $200,000.

Effect: Without proper management of receivables, the department cannot ensure that all revenue due to the State of Connecticut is collected. DOB inaccurately reported write-offs and receivables to the Office of the State Comptroller for the 2014-2015 fiscal year for financial statement purposes, and inaccurately requested approval for a write-off by OPM.

Cause: The current internal control for receivables relies entirely on the business office to maintain the receivables manually. The business office actively searches for revenue-generating events, resulting in errors. The department does not perform reconciliations between receivables reported by the business office to those created by operational divisions.

Recommendation: 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. (See Recommendation 10)

Agency Response: "We agree with the recommendation. We will review current process and we will establish written procedures to strengthen internal controls over accounts receivable."

RECOMMENDATIONS

Our prior report on the Department of Banking contained one recommendation. The previously noted recommendation has not been implemented or otherwise resolved. As a result of our current examination, we have included one previous audit recommendation and nine new recommendations.

Status of Prior Audit Recommendation:

> The Department of Banking should strengthen internal controls to ensure that assets are properly recorded in Core-CT and asset balances are accurately reported to the State Comptroller as prescribed by the State Property Control Manual. **This finding is being repeated in a modified form. (See Recommendation 4)**

Current Audit Recommendations:

1. **The Department of Banking should determine whether audit trails can be established in current systems to comply with professional standards**.

   Comment:

   We found that the Department of Banking systems do not have audit trails in place to link user actions to user accounts, limiting user accountability for changes, decreasing accuracy of the data in the system, and limiting problem identification methods available.

2. **The Department of Banking should evaluate a replacement for its Business Integrated Public Service System with a business process management system that integrates documentation management to increase internal control capabilities and realize efficiencies in operational performance.**

   Comment:

   We found the Department of Banking maintains and uses a legacy system in its operations, resulting in the need for additional department resources to maintain the system. The concentration of knowledge for the legacy system also creates a high risk for the system as it relies on a single point of failure.

3. **The Department of Banking should develop an information technology strategic plan on the department level to address inefficiencies in the information technology environment.**

   Comment:

   We found that the Department of Banking is not realizing the cost and performance efficiencies that routinely should be obtained from information technology systems.

4. **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.**

   Comment:

   We founds asset values reported to the State Comptroller were understated for the fiscal years ended June 30, 2014 and 2015. Assets at the Department of Banking are at a higher risk of errors due to reporting and internal control deficiencies.

5. **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.**

   Comment:

   We found examination documentation requirements varied by division in the Department of Banking. This resulted in a lack of quality documentation available and missing documentation demonstrating review and approval of examinations conducted.

6. **The Department of Banking should strengthen internal controls by documenting policies and procedures and requiring adequate documentation to support internal controls activities.**

   Comment:

   We found that the Securities and Business Investment Division at the Department of Banking did not have documented policy and procedures manuals. Without documentation of policy and procedures, internal controls cannot be effectively implemented to achieve control objectives. Accountability for internal controls cannot be enforced to ensure proper approval of operational activities.

7. **The Department of Banking should institute the use of non-financial performance indicators to monitor examinations conducted on a long-term basis. DOB 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.**

   Comment:

   We found the Department of Banking does not meet the examinations conducted criterion established as best practice and the department do not meet one of the criteria necessary to receive accreditation for mortgage regulators.

8. **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.**

   Comment:

   We found that the Department of Banking did not have a detailed billing policy approved by the commissioner. We also noted several instances in which the department applied different billing rates for examinations conducted.

9. **The Department of Banking should improve collection efforts by adhering to the minimum collection procedures established by the Office of the State Comptroller.**

   Comment:

   We noted that during the 2014-2015 fiscal year, the Department of Banking wrote-off approximately $2.7 million of receivables. It is unknown if any additional revenue could have been collected if minimum collections efforts were followed.

10. **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.**

    Comment:

    We found that the Department of Banking inaccurately reported write-off and receivables to the Office of the State Comptroller in the 2014-2015 fiscal year for financial statement purposes, inaccurately maintained records of receivables, and requested an inaccurate amount for write-off by the Office of Policy and Management.

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.

Brian Michael Patrick Grabel
Auditor II

Approved:

John C. Geragosian
Auditor of Public Accounts

Robert J. Kane
Auditor of Public Accounts