Client Code 413

DEPARTMENT OF FINANCIAL INSTITUTIONS

BISMARCK, NORTH DAKOTA

Audit Report

Two-year Period Ended
June 30, 2010

ROBERT R. PETERSON
STATE AUDITOR

Office of the State Auditor
Division of State Audit

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Transmittal Letter

April 11, 2011

The Honorable Jack Dalrymple, Governor

Members of the North Dakota Legislative Assembly

Mr. Robert J. Entringer, Commissioner

We are pleased to submit this audit of the Department of Financial Institutions for the two-year period ended June 30, 2010. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

In determining the contents of the audits of state agencies, the primary consideration was to determine how we could best serve the citizens of the state of North Dakota. Naturally we determined financial accountability should play an important part of these audits. Additionally, operational accountability is addressed whenever possible to increase efficiency and effectiveness of state government.

The in-charge auditor for this audit was Richard Fuher, CPA. Lindsey Ressler was the staff auditor. Paul Welk, CPA, was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 328-2320. We wish to express our appreciation to Commissioner Entringer and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

Robert R. Peterson
State Auditor

Executive Summary

Introduction

The North Dakota Department of Financial Institutions is under the supervision of the State Banking Board, State Credit Union Board, and a chief officer designated as the Commissioner of Financial Institutions. The Department of Financial Institutions has charge of the execution of all laws relating to state banks, trust companies, credit unions, building and loan associations, mutual investment corporations, mutual savings corporations, banking institutions, and other financial corporations, exclusive of the Bank of North Dakota.

The Legislative Audit and Fiscal Review Committee (LAFRC) requests that certain items be addressed by auditors performing audits of state agencies. Those items and the Office of the State Auditor's response are noted below.

Responses to LAFRC Audit Questions

1. *What type of opinion was issued on the financial statements?*

   Financial statements were not prepared by the Department of Financial Institutions in accordance with generally accepted accounting principles so an opinion is not applicable. The agency's transactions were tested and included in the state's basic financial statements on which an unqualified opinion was issued.

2. *Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?*

   Yes.

3. *Was internal control adequate and functioning effectively?*

   Yes.

4. *Were there any indications of lack of efficiency in financial operations and management of the agency?*

   No.

5. *Has action been taken on findings and recommendations included in prior audit reports?*

   Yes, the Department of Financial Institutions has implemented all recommendations included in the prior audit report.

6. *Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.*

   Yes, a management letter was issued and is included on page 13 of this report, along with management's response.

LAFRC Audit Communications

7. *Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.*

   There were no significant changes in accounting policies, no management conflicts of interest were noted, no contingent liabilities were identified or significant unusual transactions.

8. *Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.*

   The Department of Financial Institutions' financial statements do not include any significant accounting estimates.

9. *Identify any significant audit adjustments.*

   Significant audit adjustments were not necessary.

10. *Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.*

    None.

11. *Identify any serious difficulties encountered in performing the audit.*

    None.

12. *Identify any major issues discussed with management prior to retention.*

    This is not applicable for audits conducted by the Office of the State Auditor.

13. *Identify any management consultations with other accountants about auditing and accounting matters.*

    None.

14. *Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.*

    ConnectND Finance, Human Resource Management System (HRMS), Department of Financial Institutions' Records Management System, and the Nationwide Mortgage Licensing and Registration system are high-risk information technology systems critical to the Department of Financial Institutions.

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the Department of Financial Institutions for the two-year period ended June 30, 2010 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the Department of Financial Institutions' operations and is internal control adequate in these areas?

2. What are the significant and high-risk areas of legislative intent applicable to the Department of Financial Institutions and are they in compliance with these laws?

3. Are there areas of the Department of Financial Institutions' operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the Department of Financial Institutions is for the two-year period ended June 30, 2010. 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 Department of Financial Institutions has examiners based in Fargo and Grand Forks, in addition to the central office in Bismarck. Each location will be included in the audit scope.

Audit Methodology

To meet the objectives outlined above, we:

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and developed a discussion and analysis of the financial statements.
- Performed detailed analytical procedures including computer-assisted auditing techniques. These procedures were used to identify high-risk transactions and potential problem areas for additional testing.
- Tested internal control and compliance with laws and regulations which included selecting representative samples to determine if controls were operating effectively and to determine if laws were being followed consistently. Non-statistical sampling was used and the results were projected to the population. Where applicable, populations were stratified to ensure that particular groups within a population were adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.

- Interviewed appropriate agency personnel.
- Queried the ConnectND (PeopleSoft) system. Significant evidence was obtained from ConnectND.
- Observed Department of Financial Institutions' processes and procedures.

In aggregate there were no significant limitations or uncertainties related to our overall assessment of the sufficiency and appropriateness of audit evidence.

Discussion and Analysis

The accompanying financial statements have been prepared to present the Department of Financial Institutions' revenues and expenditures on the legal (budget) basis. The accompanying financial statements are not intended to be presented in accordance with generally accepted accounting principles (GAAP).

For the two-year period June 30, 2010, operations of the Department of Financial Institutions were primarily supported by the collection of annual assessments and investigation, license, and special examination fees.

Financial Summary

Revenues consisted primarily of examination fees from bank and credit union assessments, investigation fees, and special examination fees. Other revenues during the audited period included consumer license fees, interest income earned on the Department of Financial Institutions' operating fund, and civil money penalties and late fees. Total revenues were $2,831,505 for the year ended June 30, 2010 as compared to $2,582,244 for the year ended June 30, 3009. The increase in revenues for licenses, permits, and fees was primarily due to Senate Bill 2160 of the 2009 Session Laws which granted a six month extension of money broker licenses effective after July 1, 2008 and delayed the timing of money broker licenses and renewals. This change resulted in revenue normally collected by June 30 to be collected by December 31. All other revenues remained fairly constant.

Total expenditures for the Department of Financial Institutions were $2,742,233 for the year ended June 30, 2010 as compared to $2,469,264 for the prior year. The increase in expenditures for salaries and benefits reflected the general salary increases and two additional full-time employees. All other expenditures remained fairly constant.

Financial Statements

Statement of Revenues and Expenditures

	June 30, 2010	June 30, 2009
Revenues:		
Examination Fees	$2,437,649	$2,347,301
Consumer License Fees	377,005	210,460
Interest on Investments	8,101	22,140
Penalties and Late Fees	8,750	2,343
Total Revenues	$2,831,505	$2,582,244
Expenditures:		
Salaries and Benefits	$2,182,278	$1,918,413
Travel	186,054	144,524
IT- Data Processing and Communication	152,790	76,901
Rentals/Leases – Building/Land	88,981	70,977
Professional Development	52,996	65,805
Operating Fees and Services	25,543	41,017
IT Contractual Services		45,000
Equipment under $5,000	5,840	37,955
Miscellaneous Supplies	14,334	26,562
Fees – Professional Services	17,451	20,831
Other Operating Expenditures	15,966	13,476
Extraordinary Repairs		7,803
Total Expenditures	$2,742,233	$2,469,264

Statement of Appropriations

For The Year Ended June 30, 2010

Expenditures by Line Item:	Original Appropriation	Adjustments	Final Appropriation	Expenditures	Unexpended Appropriation
Salaries and Benefits	$ 4,762,225	$ 100,000	$ 4,862,225	$ 2,182,278	$ 2,679,947
Operating Expenses	1,304,263		1,304,263	559,955	744,308
Contingency	20,000		20,000		20,000
Totals	$ 6,086,488	$ 100,000	$ 6,186,488	$ 2,742,233	$ 3,444,255
Expenditures by Source:					
Other Funds	$ 6,086,488	$ 100,000	$ 6,186,488	$ 2,742,233	$ 3,444,255
Totals	$ 6,086,488	$ 100,000	$ 6,186,488	$ 2,742,233	$ 3,444,255

Appropriation Adjustments:

Increases to the salaries and wages line is due to additional appropriation authority granted by House Bill 1018 for market equity increases.

For The Biennium Ended June 30, 2009

Expenditures by Line Item:	Original Appropriation	Adjustments	Final Appropriation	Expenditures	Unexpended Appropriation
Salaries and Benefits	$ 4,126,408	$ (19,420)	$ 4,106,988	$ 3,843,008	$ 263,980
Operating Expenses	1,031,014	71,700	1,102,714	1,084,906	17,808
Contingency	20,000		20,000	16,443	3,557
Totals	$ 5,177,422	$ 52,280	$ 5,229,702	$ 4,944,357	$ 285,345
Expenditures by Source:					
Other Funds	$ 5,177,422	$ 52,280	$ 5,229,702	$ 4,944,357	$ 285,345
Totals	$ 5,177,422	$ 52,280	$ 5,229,702	$ 4,994,357	$ 285,345

Appropriation Adjustments:

The ($19,420) adjustment is made up of two adjustments. $26,700 was transferred from the salaries and benefits line to the operating expenses line for the purchase of furniture and equipment. This adjustment was approved by the Emergency Commission. The salaries and benefits line was increased by $7,280 due to additional appropriation authority granted by Senate Bill 2189 for market equity increases.

The $71,700 adjustment is made up of two adjustments. $26,700 was transferred from the salaries and benefits line to the operating line for the purchase of furniture and equipment. This adjustment was approved by the Emergency Commission. Additional appropriation authority of $45,000 was granted by the Emergency Commission to be used for the Nationwide Mortgage Licensing System and Registry (NMLS).

Internal Control

In our audit for the two-year period ended June 30, 2010, we identified the following areas of the Department of Financial Institutions' internal control as being the highest risk:

Internal Controls Subjected to Testing:

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls effecting the safeguarding of assets.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the Records Management system.
- Controls surrounding the Nationwide Mortgage Licensing system.

The criteria used to evaluate internal control is published in the publication *Internal Control – Integrated Framework* from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

We gained an understanding of internal control surrounding these areas and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered necessary based on our assessment of audit risk. We concluded internal control was adequate.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect: (1) misstatements in financial or performance information; (2) violations of laws and regulations; or (3) impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we did not identify any significant deficiencies in internal control. However, we noted other matters involving internal control that we have reported to management of the Department of Financial Institutions in a management letter dated April 11, 2011.

Compliance With Legislative Intent

In our audit for the two-year period ended June 30, 2010, we identified and tested Department of Financial Institutions' compliance with legislative intent for the following areas we determined to be significant and of higher risk of noncompliance:

- Maintained proper cash balance in the Department of Financial Institutions Regulator Fund at the close of the biennium (NDCC section 6-01-01.1).
- Proper assessments, penalties, application fees, and examiner fees were charged (Various sections of NDCC Title 6).
- Proper bond or other security device is collected with the application NDCC 6-10-02).
- Compliance with agency appropriation laws (2007 North Dakota Session Laws chapter 8 and 2009 North Dakota Session Laws chapter 36).
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Proper use of the Bank of North Dakota (NDCC section 54-06-08.2).
- Proper authority for interest deposited into the regulatory fund (NDCC section 6-01-01.1 subsection 4).
- Compliance with OMB's Purchasing Procedures Manual.
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record-keeping and surplus property requirements.
- Compliance with payroll-related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.

The criteria used to evaluate legislative intent are the laws as published in the *North Dakota Century Code* and the *North Dakota Session Laws*.

Government Auditing Standards require auditors to report all instances of fraud and illegal acts unless they are inconsequential within the context of the audit objectives. Further, auditors are required to report significant violations of provisions of contracts or grant agreements, and significant abuse that has occurred or is likely to have occurred.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards.* Thus, we concluded there was compliance with the legislative intent identified above.

Operations

This audit did not identify areas of Department of Financial Institutions' operations where we determined it was practical at this time to help to improve efficiency or effectiveness. However, we did note a certain matter involving operations that we have reported to management of the Department of Financial Institutions in a management letter dated April 11, 2011.

Management Letter (Informal Recommendations)

April 11, 2011

Mr. Robert J. Entringer, Commissioner
Department of Financial Institutions
2000 Schafer Street, Suite G
Bismarck, ND 58501

Dear Mr. Entringer:

We have performed an audit of the Department of Financial Institutions for the two-year period ended June 30, 2010, and have issued a report thereon. As part of our audit, we gained an understanding of the Department of Financial Institutions' internal control structure to the extent we considered necessary to achieve our audit objectives. We also performed tests of compliance as described in the same report.

Our audit procedures are designed primarily to enable us to report on our objectives including those related to internal control and compliance with laws and regulations and may not bring to light all weaknesses in systems and procedures or noncompliance with laws and regulations which may exist. We aim, however, to use our knowledge of your organization gained during our work to make comments and suggestions which we hope will be useful to you.

In connection with the audit, gaining an understanding of the internal control structure, and tests of compliance with laws and regulations referred to above, we noted certain conditions we did not consider reportable within the context of your audit report. We do, however, want to present our recommendations to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if these recommendations have been implemented, and if not, we will reconsider their status.

The following present our informal recommendations.

ACCOUNTS PAYABLE/EXPENDITURES

Informal Recommendation 10-1: We recommend the Department of Financial Institutions implement procedures to ensure expenditures are properly coded.

PAYROLL

Informal Recommendation 10-2: We recommend the Department of Financial Institutions implement procedures to ensure timecards are being approved by a supervisor.

INFORMATION SYSTEMS

Informal Recommendation 10-3: We recommend the Department of Financial Institutions reconcile approved applications in the Nationwide Mortgage Licensing System and Records Management System to cash collections recorded on PeopleSoft.

OPERATIONS

Informal Recommendation 10-4: We recommend the Department of Financial Institutions use their P-card as a form of payment to all vendors accepting P-cards.

Management of Department of Financial Institutions agreed with these recommendations.

I encourage you to call myself or an audit manager at 328-2241 if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,

Richard Fuher, CPA
Auditor in-charge

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