

Department of
Financial Institutions
BISMARCK, NORTH DAKOTA

Audit Report

For the Two-year Period Ended
June 30, 2012

ROBERT R. PETERSON
STATE AUDITOR



Office of the State Auditor
Division of State Audit

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Transmittal Letter

April 24, 2013

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, 2012. 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 Lindsey Ulrich. Kevin Scherbenske, CPA, 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) 328-2241. 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,

A handwritten signature in cursive script that reads "Bob Peterson".

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 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 responses 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?

There were no 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 12 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), 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, 2012 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, 2012. 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, 2012, 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, civil penalties, and late fees. Total revenues were \$3,012,703 for the year ended June 30, 2012 as compared to \$2,993,085 for the year ended June 30, 2011. The increase in revenue for licenses, permits, and fees was primarily due to a new Mortgage Loan Originator needing regulation. All other revenues remained fairly constant.

Total expenditures for the Department of Financial Institutions were \$3,094,001 for the year ended June 30, 2012 as compared to \$2,903,981 for the prior year. The increase in expenditures for salaries and benefits reflected general salary increases and an additional full-time employee. All other expenditures remained fairly constant.

Financial Statements

Statement of Revenues and Expenditures

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
<u>Revenues:</u>		
Regulatory Fees	\$2,475,289	\$2,633,771
Consumer License Fees	519,052	337,539
Penalties and Late Fees	15,249	15,802
Interest on Investments	3,113	5,973
Total Revenues	<u>\$3,012,703</u>	<u>\$2,993,085</u>
<u>Expenditures:</u>		
Salaries and Benefits	\$2,484,217	\$2,354,353
Travel	200,020	194,102
Rent of Office Space	105,638	77,517
IT- Data Processing and Communication	98,979	93,256
Professional Development	71,269	76,729
Operating Fees and Services	33,659	28,395
Equipment under \$5,000	48,631	31,763
Miscellaneous Supplies	21,547	12,072
Fees-Professional Services	18,687	25,697
Other Operating Expenditures	11,354	10,097
Total Expenditures	<u>\$3,094,001</u>	<u>\$2,903,981</u>

Statement of Appropriations

For The Year Ended June 30, 2012

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Benefits	\$ 5,356,855		\$ 5,356,855	\$ 2,481,617	\$ 2,875,238
Operating Expenses	1,459,463		1,459,463	612,384	847,079
Contingency	20,000		20,000		20,000
Totals	<u>\$ 6,836,318</u>	<u>\$ 0</u>	<u>\$ 6,836,318</u>	<u>\$ 3,094,001</u>	<u>\$ 3,742,317</u>
Expenditures by Source:					
Other Funds	\$ 6,836,318		\$ 6,836,318	\$ 3,094,001	\$ 3,094,001
Totals	<u>\$ 6,836,318</u>	<u>\$ 0</u>	<u>\$ 6,836,318</u>	<u>\$ 3,094,001</u>	<u>\$ 3,094,001</u>

For The Biennium Ended June 30, 2011

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Benefits	\$ 4,762,225	\$ 100,000	\$ 4,862,225	\$ 4,533,463	\$ 328,762
Operating Expenses	1,304,263		1,304,263	1,112,751	191,512
Contingency	20,000		20,000		20,000
Totals	<u>\$ 6,086,488</u>	<u>\$ 100,000</u>	<u>\$ 6,186,488</u>	<u>\$ 5,646,214</u>	<u>\$ 540,274</u>
Expenditures by Source:					
Other Funds	\$ 6,086,488	\$ 100,000	\$ 6,186,488	\$ 5,646,214	\$ 540,274
Totals	<u>\$ 6,086,488</u>	<u>\$ 100,000</u>	<u>\$ 6,186,488</u>	<u>\$ 5,646,214</u>	<u>\$ 540,274</u>

Appropriation Adjustments:

Increases to the salaries and wages line is due to additional appropriation authority granted by House Bill 1018 of the 2009 Legislative session for market equity increases.

Internal Control

In our audit for the two-year period ended June 30, 2012, 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 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 24, 2013.

Compliance With Legislative Intent

In our audit for the two-year period ended June 30, 2012, we identified and tested the 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)
- Monitored money brokers to verify a \$25,000 net worth was maintained or a plan to increase net worth was in place. (NDCC section 13-04.1-04.2)
- Proper assessments, penalties, application fees, and examiner fees were charged. (Various sections of NDCC Title 6)
- Proper use of the State Treasurer. (State Constitution, article X, section 12)
- Compliance with agency appropriation laws. (2009 North Dakota Session Laws chapter 8 and 2011 North Dakota Session Laws Chapter 8)
- 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.
- 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.

While we did not find any items that were required to be reported in accordance with *Government Auditing Standards*, we noted certain inconsequential or insignificant instances of non-compliance that we have reported to management of the Department of Financial Institutions in a management letter dated April 24, 2013.

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.

Management Letter (Informal Recommendations)

April 24, 2013

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, 2012, 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. These conditions relate to areas of general business practice or control issues that have no significant bearing on the administration of federal funds. 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.

LEGISLATIVE INTENT

Informal Recommendation 12-1: We recommend the Department of Financial Institutions ensure all expenditures are properly supported and coded in Peoplesoft in relation to Department ID.

ACCOUNTS PAYABLE/EXPENDITURES

Informal Recommendation 12-2: We recommend the Department of Financial Institutions ensure that all purchase card purchases are supported by a receipt.

REVENUE

Informal Recommendation 12-3: We recommend the Department of Financial Institutions properly segregate duties so the individual doing the reconciliation of receipts and monitoring to ensure all assessment fees are received, does not have access to checks.

Informal Recommendation 12-4: We recommend the Department of Financial Institutions properly deposit revenue into the correct fund.

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,



Lindsey Ulrich
Auditor in-charge

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or by contacting the
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