Client Code 413

Department of Financial Institutions

BISMARCK, NORTH DAKOTA

Audit Report

For the Two-year Period Ended
June 30, 2014

ROBERT R. PETERSON
STATE AUDITOR

Office of the State Auditor
Division of State Audit

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Transmittal Letter

July 15, 2015

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, 2014. 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 Alec Grande, CPA. 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,

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 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 unmodified 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 (NMLS) 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 Institution for the two-year period ended June 30, 2014 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, 2014. 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 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 located in Bismarck. Each location was 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, 2014, 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 fees from banks and credit union assessments, collection agencies, and other financial institutions. Other revenue consists of interest income earned on the Department of Financial Institutions' operating fund in addition to penalties and late fees. Total revenue for the year ended June 30, 2014 was $3,097,550 as compared to $3,481,338 for the year ended June 30, 2013. The decrease in revenue was primarily attributable to some additional license fees being processed by the NMLS system which extended the due date of these fees beyond the end of fiscal year 2014.

Total Expenditures for the Department of Financial Institutions were $3,286,764 for the year ended June 30, 2014 as compared to $3,075,837 for the prior year. The increase in expenditures is primarily attributable to increases in salaries and benefits. All other expenditures remained fairly constant.

Financial Statements

Statement of Revenues and Expenditures

	June 30, 2014	June 30, 2013
Revenues:		
Examiner Fees	$2,655,240	$2,817,217
Consumer License Fees	429,980	658,404
Penalties and Late Fees	5,956	3,671
Miscellaneous Revenue	4,925	
Interest on Investments	1,449	2,046
Total Revenues	$3,097,550	$3,481,338
Expenditures:		
Salaries and Benefits	$2,653,198	$2,537,261
Travel	230,472	200,240
Office Space Rent	110,508	89,386
IT- Data Processing and Communication	104,800	93,514
Professional Development	93,177	61,492
Operating Fees and Service	45,648	38,777
Fees Professional Services	18,458	20,420
Miscellaneous Supplies	16,797	16,586
Other operating expenditures	9,915	12,824
Equipment under $5,000	3,790	5,337
Total Expenditures	$3,286,763	$3,075,837

Statement of Appropriations

For The Year Ended June 30, 2014

Expenditures by Line Item:	Original Appropriation	Adjustments	Final Appropriation	Expenditures	Unexpended Appropriation
Salaries and Benefits	$ 5,874,989		$ 5,874,989	$ 2,631,710	$ 3,243,279
Accrued Leave Payments	120,783		120,783	21,489	99,294
Operating Expenses	1,428,445		1,428,445	616,855	811,590
Contingency	156,000		156,000	13,277	142,723
Totals	$ 7,580,217	$ 0	$ 7,580,217	$ 3,283,331	$ 4,296,886
Expenditures by Source:					
Other Funds	$ 7,580,217		$ 7,580,217	$ 3,283,331	$ 4,296,886
Totals	$ 7,580,217	$ 0	$ 7,580,217	$ 3,283,331	$ 4,296,886

Expenditures without Appropriations of Specific Amounts

Conference Fund has a continuing appropriation authorized by OMB Policy 211 ($3,433 of expenditures for this fiscal year)

For the Biennium Ended June 30, 2013

Expenditures by Line Item:	Original Appropriation	Adjustments	Final Appropriation	Expenditures	Unexpended Appropriation
Salaries and Benefits	$ 5,356,855		$ 5,356,855	$ 5,018,878	$ 337,977
Operating Expenses	1,459,463		1,459,463	1,150,960	308,503
Contingency	20,000		20,000		20,000
Totals	$ 6,836,318	$ 0	$ 6,836,318	$ 6,169,838	$ 666,480
Expenditures by Source:					
Other Funds	$ 6,836,318		$ 6,836,318	$ 6,169,838	$ 666,480
Totals	$ 6,836,318	$ 0	$ 6,836,318	$ 6,169,838	$ 666,480

Internal Control

In our audit for the two-year period ended June 30, 2014, 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.

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.

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).
- Verify that the Department of Financial Institutions is maintaining surety deposits within the agency (NDCC Section 6-05-04.1).
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with appropriations and related transfers (2011 North Dakota Session Laws chapter 8 and 2013 North Dakota Session Laws chapter 39).
- Compliance with OMB's Purchasing Procedures Manual.
- Proper authorization of the Department of Financial Institutions' funds.
- Properly retaining investment income in the Financial Institutions' regulatory fund (NDCC 6-01-01(4)).
- 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, annual inventory, 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.

Operations

Our audit of the Department of Financial Institutions' identified an area of potential improvement to the agency's operations relating to the bank and credit union examination function. The criteria used included the following: *Good Practices for Regulatory Inspections: Guidelines for Reformers* from international consultants in regulatory reform Jacobs & Associates as prepared for the World Bank, *Carrying Out a State Regulatory Program* from the National State Auditors Association, and *Best Practice Principles for Regulatory Policy* from the Council on Regulatory Policy & Governance.

Our operational audit objective was to answer the questions:

- Was professional competence upheld (through the hiring, training, and evaluating processes) so as to ensure effective compliance with rules and regulations by all staff?

- Are regulated individuals/entities required to get and maintain a current state charter so as to certify that certain standards are met for operation within the financial services industry?

- Has a systematic process been developed to monitor the activities of state chartered banks and credit unions to ensure applicable requirements are being followed so as to adequately protect the public?

- Were complaints handled (through receiving, processing, and investigating) so as to ensure the individuals/entities operating within the financial services industry are in compliance with all applicable requirements and standards?

- Are regulations properly and effectively enforced in order to achieve the goals intended by the government to maintain a stable financial system?

- Is there a systematic process for analyzing program-related information, making appropriate adjustments to improve the effectiveness and efficiency of the program and reporting relevant summary information to the public and policy-makers about the results of the bank and credit union examination program?

We concluded the bank and credit union examination function by the Department of Financial Institutions' was operating efficiently and effectively and in compliance with significant high-risk laws.

We noted a certain insignificant issue involving operations that we have reported to management of the Department of Financial Institutions' in a management letter dated July 15, 2015.

Management Letter (Informal Recommendations)

July 15, 2015

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, 2014, 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 recommendation to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if this recommendation has been implemented, and if not, we will reconsider its status. The following presents our informal recommendation.

Informal Recommendation 14-1: We recommend the Department of Financial Institutions implement a formal policy regarding the rotation of examiners and the handling of complaints.

Management of Department of Financial Institutions agreed with the recommendation.

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,

Alec Grande, CPA
Auditor in-charge

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or by contacting the
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