Client Code 413

# Department of Financial Institutions

BISMARCK, NORTH DAKOTA

# Audit Report

Two-year Period Ended
June 30, 2016

Office of the State Auditor
Division of State Audit

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# *Transmittal Letter*

April 19, 2016

The Honorable Doug Burgum, 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, 2016. 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 Dina Cashman, 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,

Joshua C. Gallion
State Auditor

# Executive Summary

## Introduction

The Department of Financial Institutions is responsible for enforcing all laws relating to state banks, trust companies, building and loan associations, mutual investment corporations, mutual savings corporations, banking institutions, and other financial corporations, exclusive of the Bank of North Dakota, and all credit unions organized or doing business under the laws of this State. The Department also issues licenses to money brokers, mortgage loan originators, collection agencies, deferred presentment service providers, money transmitter businesses, debt settlement providers, and agents for deposit.

The Commissioner, in conjunction with the State Banking Board (seven members) and State Credit Union Board (five members), provides supervisory authority over North Dakota state-chartered banks and credit unions. All members of these Boards are appointed by the Governor. The Commissioner is appointed by the Governor and confirmed by the North Dakota Senate and serves as the Chairperson of each Board.

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.*

   No, a management letter was not issued.

## *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 Institutions for two-year period ended June 30, 2016 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, 2016. We conducted our 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' central office is located in Bismarck with additional examiners based in Fargo and Grand Forks. 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 the 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, 2016, 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 and consumer license fees. Other revenue consists of interest income earned on the Department's operating fund in addition to penalties and late fees. Total revenue for the year ended June 30, 2016 was $ 4,311,207 as compared to $3,642,297 for the year ended June 30, 2015. The increase in revenue was primarily attributable to additional licenses and examination fees.

Total Expenditures for the Department of Financial Institutions were $3,810,882 for the year ended June 30, 2016 as compared to $3,479,009 for the prior year. The increase in expenditures is primarily attributable to increases in salaries and benefits. There was an increase in IT data processing in fiscal year 2016 since the Department began utilizing the Information Technology Department for desktop support. The remaining expenditures have remained fairly constant.

# Financial Statements

### Statement of Revenues and Expenditures

| | June 30, 2016 | June 30, 2015 |
|---|---|---|
| **Revenues:** | | |
| Examination Fees | $ 3,443,401 | $ 2,945,874 |
| Consumer License Fees | 864,336 | 692,508 |
| Penalties and Late Fees | 1,614 | 2,385 |
| Interest and Investment Earnings | 1,856 | 1,530 |
| **Total Revenues** | $ 4,311,207 | $ 3,642,297 |
| **Expenditures:** | | |
| Salaries and Benefits | $ 3,077,462 | $ 2,875,524 |
| Travel | 231,487 | 244,341 |
| IT - Data Processing and Communication | 206,289 | 91,602 |
| Rent of Building Space | 133,201 | 93,506 |
| Professional Development | 93,789 | 81,063 |
| Operating Fees and Services | 32,779 | 28,763 |
| Miscellaneous Supplies | 15,541 | 19,487 |
| Professional Services | 14,152 | 30,257 |
| Other Operating Expenditures | 4,052 | 8,863 |
| Equipment Under $5,000 | 2,130 | 5,603 |
| **Total Expenditures** | $ 3,810,882 | $ 3,479,009 |

## *Statement of Appropriations*

**For the Fiscal Year Ended June 30, 2016**

| **Expenditures by Line Item:** | Original Appropriation | Adjustments | Final Appropriation | Expenditures | Unexpended Appropriation |
|---|---|---|---|---|---|
| Salaries and Benefits | $ 6,737,190 | | $ 6,737,190 | $ 3,073,272 | $ 3,663,918 |
| Operating Expenses | 1,641,577 | | 1,641,577 | 737,610 | 903,967 |
| Contingency | 77,000 | | 77,000 | | 77,000 |
| **Totals** | $ 8,455,767 | $ 0 | $ 8,455,767 | $ 3,810,882 | $ 4,644,885 |
| **Expenditures by Source:** | | | | | |
| Other Funds | $ 8,455,767 | | $ 8,455,767 | $ 3,810,882 | $ 4,644,885 |
| **Totals** | $ 8,455,767 | $ 0 | $ 8,455,767 | $ 3,810,882 | $ 4,644,885 |

**For the Biennium Ended June 30, 2015**

| **Expenditures by Line Item:** | Original Appropriation | Adjustments | Final Appropriation | Expenditures | Unexpended Appropriation |
|---|---|---|---|---|---|
| Salaries and Benefits | $ 5,874,989 | | $ 5,874,989 | $ 5,496,199 | $ 378,790 |
| Accrued Leave Payments | 120,783 | | 120,783 | 32,523 | 88,260 |
| Operating Expenses | 1,428,445 | | 1,428,445 | 1,220,340 | 208,105 |
| Contingency | 156,000 | | 156,000 | 13,278 | 142,722 |
| **Totals** | $ 7,580,217 | $ 0 | $ 7,580,217 | $ 6,762,340 | $ 817,877 |
| **Expenditures by Source:** | | | | | |
| Other Funds | $ 7,580,217 | | $ 7,580,217 | $ 6,762,340 | $ 817,877 |
| **Totals** | $ 7,580,217 | $ 0 | $ 7,580,217 | $ 6,762,340 | $ 817,877 |

# *Internal Control*

In our audit for the two-year period ended June 30, 2016, 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 *Standards for Internal Control in the Federal Government* issued by the Comptroller General of the United States (Green Book, GAO-14-704G). Agency management must establish and maintain effective internal control in accordance with policy of the Office of Management and Budget (OMB Policy 216).

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, 2016, 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).
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with appropriations and related transfers (2015 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 section 6-01-01(4)).
- Utilized the Bank of North Dakota as credit card administrator (NDCC section 54-06-08.2).
- 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 payroll related laws concerning certification of payroll.
- Compliance with fixed asset requirements including record-keeping, annual inventory, and surplus property.

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 the Department of Financial Institutions’ operations where we determined it was practical at this time to help to improve efficiency or effectiveness.

You may obtain audit reports on the internet at:

www.nd.gov/auditor/

or by contacting the
Division of State Audit

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