



Thomas A. Schweich
Missouri State Auditor

INSURANCE, FINANCIAL
INSTITUTIONS AND
PROFESSIONAL
REGISTRATION

Division of Finance

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CITIZENS SUMMARY

Audit of the Department of Insurance, Financial Institutions and Professional Registration, Division of Finance

Background	The Division of Finance (DOF) of the Department of Insurance, Financial Institutions and Professional Registration incorporates, regulates and licenses Missouri financial institutions, including residential mortgage brokers, state-chartered banks and savings and loan associations, non-depository trust companies, Missouri Certified Capital Companies and consumer credit companies. The DOF is required by state law to periodically examine these institutions to assess their solvency and ensure they are abiding by state laws and regulations. The DOF helps protect the financial interests of Missouri's citizens by taking actions to merge, close or otherwise address institutions with severe financial difficulties.
Access to Information	This report is a continuation of the State Auditor's office audit of the DOF released in May 2011 (Report No. 2011-17). That report noted the audit scope was limited because the DOF did not provide full access to financial institution examination records or consumer complaints. The results of initial tests performed on the limited data disclosed various instances of noncompliance with state law and internal policies. Ultimately, the DOF and the State Auditor's office reached an agreement allowing the State Auditor's office access to additional examination information. This audit reports follow-up action taken by the DOF on findings contained in the initial report.
Financial Institution Examinations	DOF personnel are now ensuring savings and loan association examinations are performed timely, and have made improvements in documenting examination procedures and supervisory reviews, but in one instance auditors found the current version of the examination work program was not used. The DOF has also made improvements in the accuracy and completeness of its examination reports, but auditors found one financial institution's CAMELS rating was improperly recorded as a 2 instead of a 1. The DOF has not yet implemented the prior recommendation to update its written agreements with the federal agencies that also conduct financial institution examinations.
Financial Institution Assessments	The DOF overcharged banks more than \$1.5 million during the three years ended June 30, 2010. Although the DOF used \$589,335 related to fiscal year 2010 over-assessments to offset fiscal year 2011 amounts assessed banks, the DOF had transferred \$956,697 to the state's General Revenue Fund. In accordance with our prior audit recommendations, the DOF has altered its assessment methodology, but it has not worked with the General Assembly to transfer over-assessments from the state's General Revenue Fund to the Division of Finance Fund to reduce future bank assessments. The DOF did implement the prior recommendation to re-calculate the overhead rate for fiscal year 2012 association and non-depository trust assessments.

In the areas audited, the overall performance of this entity was **Good**.*

American Recovery and
Reinvestment Act
(Federal Stimulus)

Not Applicable.

*The rating(s) cover only audited areas and do not reflect an opinion on the overall operation of the entity. Within that context, the rating scale indicates the following:

- Excellent:** The audit results indicate this entity is very well managed. The report contains no findings. In addition, if applicable, prior recommendations have been implemented.
- Good:** The audit results indicate this entity is well managed. The report contains few findings, and the entity has indicated most or all recommendations have already been, or will be, implemented. In addition, if applicable, many of the prior recommendations have been implemented.
- Fair:** The audit results indicate this entity needs to improve operations in several areas. The report contains several findings, or one or more findings that require management's immediate attention, and/or the entity has indicated several recommendations will not be implemented. In addition, if applicable, several prior recommendations have not been implemented.
- Poor:** The audit results indicate this entity needs to significantly improve operations. The report contains numerous findings that require management's immediate attention, and/or the entity has indicated most recommendations will not be implemented. In addition, if applicable, most prior recommendations have not been implemented.

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THOMAS A. SCHWEICH

Missouri State Auditor

Honorable Jeremiah W. (Jay) Nixon, Governor
and
John M. Huff, Director
Department of Insurance, Financial Institutions and Professional Registration
and
Richard J. Weaver, Commissioner
Division of Finance
Jefferson City, Missouri

We have audited certain operations related to the monitoring of financial institutions regulated by the Department of Insurance, Financial Institutions and Professional Registration, Division of Finance, in fulfillment of our duties under Chapter 29, RSMo. The objectives of our audit were to:

1. Evaluate the division's internal controls over examinations of financial institutions.
2. Evaluate the division's compliance with certain statutory requirements regarding examinations of financial institutions.
3. Evaluate the economy and efficiency of certain management practices and operations regarding examinations of financial institutions.
4. Follow up on the action taken on findings in the Management Advisory Report of our prior audit report issued for the years ended June 30, 2010, 2009, and 2008.

Citing confidentiality requirements and pursuant to the amended confidentiality agreement entered into between the division and the State Auditor, the division did not permit us full access to the examination history tracking report or examination reports and related documentation. In addition, the division did not permit us to retain documentation of the work performed to support significant judgments and conclusions. As a result, we could not audit certain information because of the limitations the agreement imposed on the scope of our audit, and were unable to document specific records examined.

Except as discussed in the second paragraph, 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.

Our audit identified (1) no significant deficiencies in internal controls, (2) no significant noncompliance with statutory requirements, and (3) no significant deficiencies in management practices and procedures. In addition, while the division implemented some of our prior audit recommendations, other recommendations have not yet been fully implemented.

No findings resulted from our audit of the Department of Insurance, Financial Institutions and Professional Registration, Division of Finance.



Thomas A. Schweich
State Auditor

The following auditors participated in the preparation of this report:

Deputy State Auditor:	Harry J. Otto, CPA
Director of Audits:	John Luetkemeyer, CPA
Audit Manager:	Jeannette Eaves, CPA
In-Charge Auditor:	Robyn Lamb
Audit Staff:	Matthew Schulenberg, CFE

Division of Finance

Introduction

Background

The Division of Finance (DOF) incorporates, regulates, and licenses various financial institutions of the state. As of April 30, 2012, the DOF regulated 2,888 licensed consumer credit companies, 363 licensed residential mortgage brokers, 2,933 mortgage loan originators, 274 state-chartered banks, 6 state-chartered savings and loan associations, 6 non-depository trust companies, and 2 Missouri Certified Capital Companies. The 2,888 licensed consumer credit companies consisted of 935 payday lenders, 845 consumer installment lenders, 460 small loan companies, 261 title lenders, 147 motor vehicle time sales businesses, 77 retail installment businesses, 65 premium finance companies, 66 sale of checks businesses, and 32 credit service organizations.

State statutes provide that each state-chartered bank and trust company be examined by staff of the DOF at least once each year to determine each institution's solvency, safety of operations, and adherence to applicable state laws and regulations, except those institutions receiving a satisfactory examination rating may be reviewed once in an 18 month period. These examinations are accomplished with alternating examination agreements with the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve Banks. The DOF may also take action to merge, close, or otherwise address institutions with severe financial difficulties. State-chartered savings and loan associations are examined by DOF staff in accordance with the state-chartered bank and trust company statutes. These examinations are accomplished with alternating examination agreements with the FDIC. Non-depository trust companies are examined by DOF staff in accordance with internal policies requiring a review once in an 18 month period. A composite CAMELS rating of 1 to 5 is assigned to each financial institution based on an evaluation and rating of six components: capital adequacy (C), asset quality (A), management (M), earnings (E), liquidity (L), and sensitivity to market risk (S). Composite ratings of 1 or 2 are considered satisfactory examination ratings, while composite ratings of 3, 4, or 5 are considered non-satisfactory examination ratings.

The DOF is organized into several main areas including Fiscal and Administration, Mortgage Licensing, Consumer Credit, and an Examination section. At April 30, 2012, the DOF had 111 full-time employees and 5 part-time employees, with a majority of these consisting of bank and trust examination section employees (92) and consumer credit section employees (14). The DOF maintains five examination field offices in Kansas City, St. Louis, Springfield, Jefferson City, and Sikeston. The Commissioner is appointed by the Governor with the advice and consent of the Senate. Richard J. Weaver was appointed Commissioner of Finance on April 17, 2009, and continues in that position.



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Previous SAO Audit

This report is the continuation of a prior State Auditor's Office audit of the DOF for the years ended June 30, 2010, 2009, and 2008, (see Report No. 2011-17, Department of Insurance, Financial Institutions and Professional Registration, Division of Finance, issued in May 2011). The May 2011 report included information regarding an audit scope limitation because the DOF did not provide full access to financial institution examination records or consumer complaints.

The SAO initiated a follow-up audit of the DOF the day the prior audit report was released, and issued a subpoena requesting access to the previously denied records. The DOF and the SAO entered into a confidentiality agreement (agreement) in June 2011 allowing access to certain previously denied records, and audit fieldwork began in July 2011.

In August 2011, the Missouri Banker's Association (MBA), a trade group for the banking industry, took legal action against the SAO and obtained a temporary restraining order in the 19th Judicial Circuit Court (Court). In September 2011, the Court granted the MBA a preliminary injunction which halted fieldwork, and settlement negotiations ensued. In March 2012, all parties involved approved the first amendment to the original agreement entered into between the DOF and our office resulting in the dismissal of the MBA's lawsuit in April 2012. Audit fieldwork resumed in May 2012.

Scope and Methodology

Our methodology included reviewing pertinent state statutes, written policies and procedures regarding examinations of financial institutions, financial records, and other pertinent documents; interviewing various personnel of the division; testing the DOF examination history tracking report which lists financial institution examinations performed by the DOF and federal agencies; and reviewing financial institution examination reports and examination work programs.

Using the examination history tracking report, we reviewed and determined whether 278 examinations started by the DOF between April 15, 2010, and April 30, 2012, were conducted within timeframes required by state law and internal policies. We selected and reviewed 25 redacted DOF examination reports to determine whether the comments included in the reports adequately reflected the composite CAMELS ratings assigned the financial institutions. Also, for 5 of the 25 examinations selected, we obtained supporting examination work programs completed by DOF examiners and ensured the most recent work programs were used and contained documentation that required examination procedures were completed, and supervisory reviews were performed.

To evaluate the action taken on findings in the Management Advisory Report of our prior audit report issued for the years ended June 30, 2010,



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2009, and 2008, we obtained and reviewed financial records and other pertinent documents.

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Follow-up on Prior Audit Findings

This section reports follow-up on action taken by the Division of Finance (DOF) on findings in the Management Advisory Report (MAR) of our prior audit report issued for the years ended June 30, 2010, 2009, and 2008.

1. Access to Information

The results of initial tests performed on the limited information provided to us by the DOF disclosed instances of noncompliance with various state laws and internal policies and concerns with the accuracy of the information provided. Had we been able to fully test compliance with regulatory and procedural provisions applicable to DOF functions and verify the validity of the data provided by the DOF, other instances of noncompliance and concerns might have come to our attention that would have been included in the report.

Recommendation

The DOF reconsider providing the State Auditor the necessary access to division records and personnel to ensure the division is adequately protecting the financial interests of state citizens.

Status

Implemented. The DOF and the SAO ultimately reached an agreement allowing the SAO limited access to additional examination information.

2. Financial Institution Examinations

2.1 DOF personnel did not always ensure savings and loan association (association) examinations were performed in accordance with internal policies, resulting in untimely examinations.

2.2 DOF bank examiners did not always properly document on examination programs whether required examination procedures were performed, and examination programs sometimes lacked evidence of a supervisory review. In addition, the most current version of examination programs was not always used.

2.3 The report of the results of association examinations performed and the frequency of the examinations was not accurate or up-to-date.

2.4 The DOF did not have current written agreements with the federal agencies that also conducted financial institution examinations.

Recommendations

The DOF:

2.1 Review state law to determine whether annual examinations are required for associations, and monitor scheduled examination dates more closely to ensure compliance with applicable statutes and internal policies.

2.2 Ensure required examination procedures and supervisory reviews are performed and documented, and the most current version of the bank examination program is used.



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Follow-Up on Prior Audit Findings

	2.3	Ensure examination tracking reports are accurate and up-to-date.
	2.4	Ensure current association and bank examination written agreements are entered into with the applicable federal agencies.
Status	2.1	Implemented.
	2.2	Partially implemented. Improvement in examination program documentation was noted. Our review of examination work programs for five financial institution examinations determined examiners had documented required examination procedures were performed and supervisory reviews were properly documented. However, in one instance, the most current version of the examination work program was not used.
	2.3	Partially implemented. Of the 25 examination tracking reports reviewed, we noted 1 error. A financial institution's composite CAMELS rating of 1 was incorrectly recorded on the examination tracking report as a rating of 2.
	2.4	Not implemented. According to DOF personnel, the DOF has held discussions regarding the need for updated agreements; however, no further action has been taken. In addition, the DOF no longer alternates association examinations with the Office of Thrift Supervision (OTS). The Federal Deposit Insurance Company (FDIC) has assumed OTS duties related to alternating association examinations. However, the FDIC agreement was not updated to reflect the additional duties.
3. Financial Institution Assessments	3.1	The DOF misinterpreted statutory requirements when calculating bank assessments and determining transfers to be made to the General Revenue Fund. When calculating annual bank assessments for the 3 years ended June 30, 2010, the DOF assessed banks an additional 15 percent of examination costs to pay for various administrative costs. However, this assessment exceeded actual costs, and resulted in the DOF over-assessing banks \$589,335, \$484,483, and \$472,214 during the years ended June 30, 2010, 2009, and 2008, respectively. The DOF transferred the amounts related to the over-assessment to the state General Revenue Fund for the 2 years ended June 30, 2009.
	3.2	Overhead rates used when calculating association and non-depository trust assessments had not been changed in several years and there was no documentation that rates had been reviewed annually.



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Follow-Up on Prior Audit Findings

Recommendations

The DOF:

- 3.1 Comply with statutory provisions related to bank assessments. In addition, the DOF should work with the General Assembly to transfer \$956,697 from the state's General Revenue Fund to the Division of Finance Fund, and reduce future bank assessments by this amount.
- 3.2 Re-calculate the overhead rate for association and trust examination assessments on an annual basis and retain documentation.

Status

- 3.1 Partially implemented. The DOF altered the assessment methodology starting with the fiscal year 2011 assessment and is now in compliance with statutory provisions related to bank assessments. However, the DOF did not work with the General Assembly to transfer monies from the state's General Revenue Fund to the Division of Finance Fund or reduce future bank assessments by the amount overcharged related to fiscal years 2009 and 2008.
- 3.2 Implemented. Calculations of fiscal year 2012 assessments were documented and reviewed.