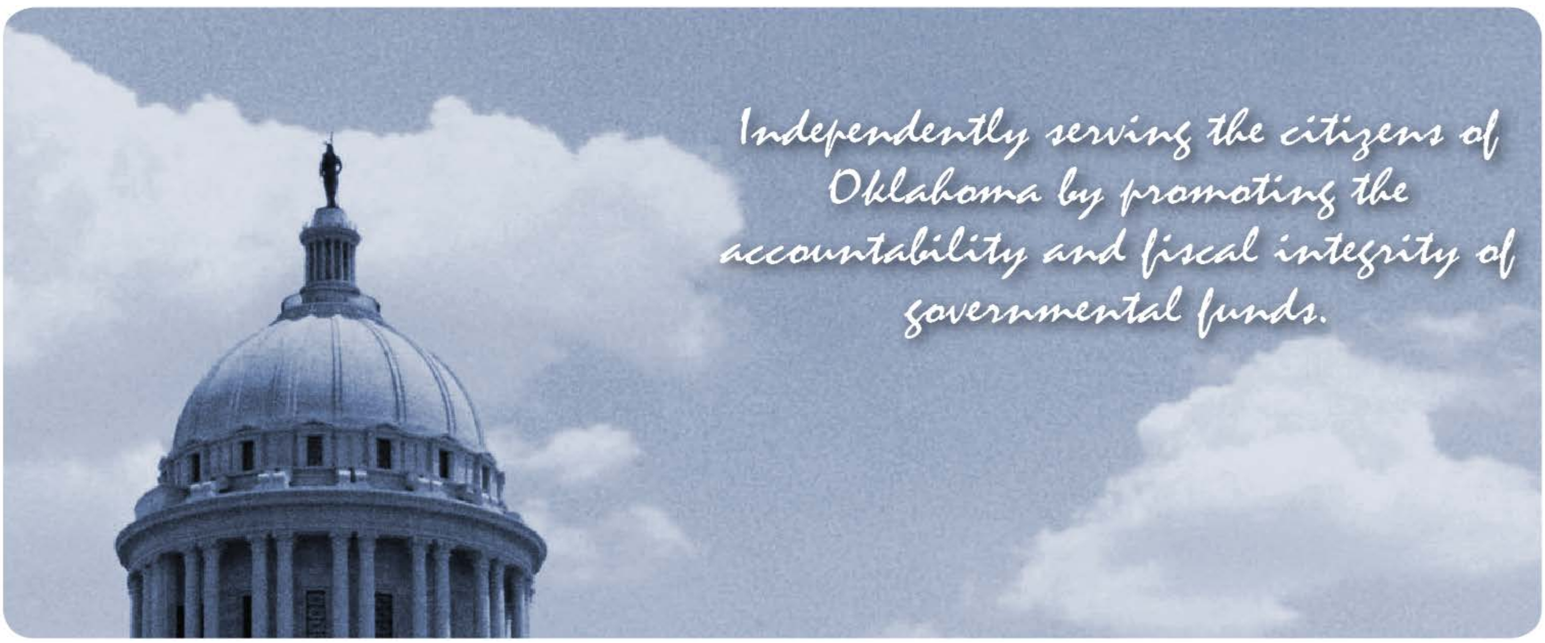
OPERATIONAL AUDIT

Oklahoma State Banking Department

For the period July 1, 2012 through December 31, 2017



Oklahoma State
Auditor & Inspector
Gary A. Jones, CPA, CFE

Audit Report of the Oklahoma State Banking Department

For the Period July 1, 2012 through December 31, 2017

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Oklahoma State Auditor & Inspector

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September 19, 2018

TO THE OKLAHOMA STATE BANKING BOARD

This is the audit report of the Oklahoma State Banking Department for the period July 1, 2012 through December 31, 2017. The goal of the State Auditor and Inspector is to promote accountability and fiscal integrity in state and local government. Maintaining our independence as we provide this service to the taxpayers of Oklahoma is of utmost importance.

We wish to take this opportunity to express our appreciation for the assistance and cooperation extended to our office during our engagement.

This report is a public document pursuant to the Oklahoma Open Records Act (51 O.S. § 24A.1 et seq.) and shall be open to any person for inspection and copying.

Sincerely,

GARY A. JONES, CPA, CFE
OKLAHOMA STATE AUDITOR & INSPECTOR

Background

The Oklahoma State Banking Department is one of just a few state agencies originally authorized by the Oklahoma Constitution in 1907. The Banking Department supervises 158 state-chartered banks, 13 state-chartered credit unions, 8 trust companies, and 1 savings association. It also licenses 14 money order companies and 106 money transmission companies. The principal effort of the Banking Department is directed toward the examination of banks, credit unions, trust companies, and savings associations. The Department is also responsible for determining whether new institutions are approved to operate in Oklahoma – and whether existing institutions are allowed to expand operations. The Department shares supervision of depository institutions with the following federal bank regulators: The Federal Deposit Insurance Corporation, Federal Reserve Bank of Kansas City, and the National Credit Union Administration.

The Oklahoma Banking Department Board consist of seven members appointed by the governor. The State Banking Commissioner is the Chairman and votes only in case of a tie on any question requiring action by the Board.

The Oklahoma State Credit Union Board consists of five members appointed by the Governor. The State Banking Commissioner is Chairman of the State Credit Union Board.

Banking Board members as of July 2018 are:

Mick Thompson .... Chairman
Sandy Bracken .... Member
Dennis Brand. .... Member
Wade Huckabay .... Member
Brad Krieger. .... Member
Bob Newcomb. .... Member
Tom Thompson .... Member

Credit Union Board members as of July 2018 are:

Mick Thompson .... Chairman
Jason Boesch. .... Member
Eddie Foreman. .... Member
Mark Kelly .... Member
Gina Wilson. .... Member

The following table summarizes the Agency's sources and uses of funds for fiscal years 2016 and 2017 (July 1, 2015 through June 30, 2017).

Sources and Uses of Funds for FY 2016 and FY 2017

		2016		2017
Sources:				
Appropriations	$	-	$	-
Taxes	$	-	$	-
Licenses, Permits, Fees	$	6,487,776	$	5,548,216
Fines, Forfeits, Penalties			$	-
Income from Money and Property	$	-	$	-
Grants, Refunds, Reimbursements	$	2,393	$	2,849
Total Sources	**$**	**6,490,169**	**$**	**5,551,065**
Uses:				
Personnel Services	$	5,670,661	$	5,937,281
Professional Services	$	142,349	$	143,862
Travel	$	470,946	$	427,812
Administrative Expenses	$	270,570	$	269,932
Property, Furniture, Equipment	$	2,316	$	56,439
Assistance, Payments to Local Govn'ts	$	4,900	$	50
Transfers and Other Disbursements	$	-	$	-
Total Uses	**$**	**6,561,742**	**$**	**6,835,376**

Source: Oklahoma Statewide Accounting System (unaudited, for informational purposes only)

Scope and Methodology

Our audit was conducted in response to 74 O.S. § 212, which requires the State Auditor and Inspector's office to audit the books and accounts of all state agencies whose duty it is to collect, disburse, or manage funds of the state

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.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessment of materiality and risk for the period July 1, 2012 through December 31, 2017.

Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of the Oklahoma State Banking Department's operations. Further details regarding our methodology are included under each conclusion.

We utilized sampling of transactions to achieve our objectives. To ensure the samples were representative of the population and provided sufficient, appropriate evidence, the random sample methodology was used. We identified specific attributes for testing each of the samples and when appropriate, we projected our results to the population.

Because of the inherent limitations of an audit, combined with the inherent limitations of internal control, errors or fraud may occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

OBJECTIVE I	Determine whether the Agency's internal controls provide reasonable assurance that revenue, expenditures (both miscellaneous and payroll), and inventory were accurately reported in the accounting records.

Conclusion

The Agency's internal controls generally provide reasonable assurance that payroll was accurately reported in the accounting records. However, the agency's internal controls do not provide reasonable assurance that revenues, expenditures, and inventory were accurately reported in the accounting records.

Financial operations complied with the following statutes:

- 74 O.S. § 3601.2 – Director's Salary
- 6 O.S. § 211.A.3 – 10% of all Bank Assessment revenue deposited to the General Fund
- 6 O.S. § 2001.2.A.10 – 10% of all Credit Union Assessment revenue deposited to the General Revenue Fund
- 18 O.S. § 381.15.B – 20% of all Savings and Loan Assessment revenue deposited to the General Revenue Fund

Objective Methodology

To accomplish our objective, we performed the following:

- Documented significant internal controls related to revenue; see results in related finding.
- Documented significant internal controls related to miscellaneous expenditures and tested those controls, which included:
    - Selecting and testing a random sample of twenty-eight monthly expenditure reconciliations/detailed expenditure reports (42% of audit period months) to ensure they were independently reviewed, as reflected by evidence of review by the Commissioner. See results in related finding.
- Documented significant internal controls related to payroll expenditures and tested those controls, which included:
    - Selecting and testing a random sample of seventeen payroll claims and supporting documentation (out of sixty-six claims or 25% of audit period months) to ensure they were reviewed and approved by the Commissioner, or his designee, who is independent from processing payroll.
    - Selecting and testing a random sample of fourteen payroll changes (out of 268 payroll change transactions or 5% of audit period payroll change records) to ensure the change was properly documented on the HCM-14 and/or the HCM-92 and approved when applicable.

- Documented significant internal controls related to inventory; see results in related finding.
- Determined Compliance with 74 O.S. §3601.2A – Salaries of Chief Executive Officers, which included:
    - Reviewing HR Records on the *HR ALL Actions* report from the Statewide Accounting System for all months during the audit period and comparing it to approved salary ranges established by the Office of Management and Enterprise Services.
- Determined Compliance with 6 O.S. § 211.A.3 – 10% of all Bank Assessment revenue deposited to the General Fund, 6 O.S. § 2001.2.A.10 – 10% of all Credit Union Assessment revenue deposited to the General Revenue Fund, 18 O.S. § 381.15.B – 20% of all Savings and Loan Assessment revenue deposited to the General Revenue Fund, which included:
    - Reviewing the amount deposited by the agency to the State of Oklahoma's General Revenue Fund for all applicable months during the audit period and comparing it to our recalculation of the amounts that should have been transferred based on internal agency records and the Statewide Accounting System to ensure 10% and/or 20% of all assessment fees charged, collected, and received by the Agency were transferred as required.

FINDINGS AND RECOMMENDATIONS

Inadequate Segregation of Duties related to Revenues

The United States Government Accountability Office's *Standards for Internal Control in the Federal Government*[1] (GAO Standards) state that, "Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling and related assets. No one individual should control all key aspects of a transaction or event."

Payments received by mail and walk-in customers are opened by the mail clerk. Because the mail is opened by one person, without sufficient additional checks and balances or oversight, there is a risk that the mail clerk could misappropriate funds without detection. This could be potentially mitigated by the spreadsheets maintained by the agency which shows expected revenues for most revenue sources and which also tracks when payments are received. However, we could not confirm from the documentation provided to us that those spreadsheets were used to reconcile expected revenues to actual deposits, who prepared them, and when they were prepared. This mitigating control does not appear to be adequately designed and implemented.

There is an additional risk of misappropriation and concealment due to the fact that individuals responsible for making deposits also record the deposits in the statewide accounting system. This could be potentially mitigated by the fact that the mail clerk maintains a spreadsheet of checks received and runs a tape total at the end of the month which is provided to the Budget Director for reconciliation purposes. However, during our review of reconciliations, we could not verify from the documentation provided that the Budget Director was reconciling deposits to the mail clerk's tape totals. This mitigating control does not appear to be adequately designed and implemented.

These deficiencies also increase the risk that deposits to the state's general revenue fund required by 6 O.S. §211.A.3, 6 O.S. § 2001.2.A.10 and 18 O.S. § 381.15.B could be incomplete, as a result of the mandated portion of misappropriated fees not being included in the deposit. This would place the agency out of compliance with state statute.

[1] Although this publication addresses controls in the federal government, this criterion can be treated as best practices. The theory of controls applies uniformly to federal or state government.

Recommendation

We recommend management segregate duties to ensure that individuals responsible for preparing the deposit do not have access to record payments or deposits. Additionally, mail should be opened, and payments logged and processed, with at least two individuals present. All receipts should be reconciled by someone independent of the receipting process using reliable supporting documentation. Reconciliations should provide assurance that all funds expected are received and that all funds received are deposited.

Views of Responsible Officials

Because the Banking Department is a small agency, it is not always feasible to perform the mail opening function with two individuals present. However, when funds are received in the mail, the amount received may be reconciled and confirmed as follows: First, all payments received are associated with either (i) annual assessment payments, or (ii) an application initiated by a regulated entity. The Banking Department will directly contact an institution for which it does not reflect payment of assessment and will not process an application for which there is no associated payment. If there has been misappropriation of a payment instrument, (i) the Department will contact the institution for which it does not reflect payment of assessment, or (ii) the institution will contact the Department if an application has not been approved or denied in a timely manner. In either of those situations, the payor of the instrument will confirm payment through its copy of a cancelled check.

Second, since January 1, 2018, the Department's Budget Director now reconciles each month the revenue reported as received with the revenue codes established for each application and confirms that total with the amount reported by the person opening the mail.

In summary, there are safeguards in place that will expose, on a monthly basis, any mismanagement of funds received by mail.

Auditor Response

We agree with management’s description of controls **currently** in place to mitigate the risk associated with one individual opening the mail and the lack of appropriate segregation of duties in the revenue/receipting process. However, we could not verify the process of reconciling internal records to the deposits during the time period covered by our audit.

Inadequate Segregation of Duties related to Expenditures *(repeat finding)*

The United States Government Accountability Office's (GAO) Standards for Internal Control in the Federal Government states, "Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transaction, processing and recording them, reviewing the transactions, and handling any related assets. No one individual should control all key aspects of a transaction or event."

An effective internal control system provides for accurate and reliable records. The Oklahoma Archives and Records Commission Consolidated Records Disposal Schedule requires expenditure documentation be retained in office until after audit completion.

The Budget director approves requisitions, prepares purchase orders, approves invoices (secondary approval), posts expenditures to PeopleSoft, and has the authority to approve claims/vouchers. This creates the risk that he could initiate, inappropriately authorize, process, and record an expenditure without detection.

The Commissioner is performing a detailed review of expenditures, including the 6-digit report, which would potentially mitigate the risk created by this arrangement of duties. However, documentation of this review was not retained by the agency prior to fiscal year 2018 and therefore this control could not be relied upon in our procedures for the entire audit period.

Recommendation

The agency should establish proper segregation of key duties related to the expenditures process to ensure that a single individual would not be able to initiate, authorize, process and record an expenditure transaction. Alternatively, as a mitigating control, the agency should ensure that documentation of the Commissioner's detailed review of the 6-digit report and other documentation be maintained for all periods until an audit has been completed for those periods and the review is documented by initialing and dating appropriate records.

Views of Responsible Officials

The Commissioner currently reviews and initials all purchase orders to confirm the actual product or service for which an expenditure is made - because the "6-digit report" does not provide adequate information regarding the substance of the expenditure. However, going forward the Banking Department will retain the 6-digit report indicating the Commissioner's review for all periods between audits. The Banking Department will retain the initialed 6-digit reports in an imaged format.

Inadequate Segregation of Duties related to Inventory
(repeat finding)

The United States Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* (2014 Revision) state that, "Management must establish physical control to secure and safeguard vulnerable assets. . . Management periodically counts and compares such assets to control records." Furthermore, the *Standards* state that management should design "an internal control system to provide reasonable assurance regarding prevention or prompt detection and correction of unauthorized acquisition, use, or disposition of an entity's assets."

Office of Administrative Rule 260:105-3-1 states that, "to request official approval to dispose of surplus property, a state agency must submit a form, prescribed by the Office, to the Administrator for approval. A surplus property transfer form must be signed by the chief administrative officer of the agency or an authorized agent."

Although it appears the agency did perform an inventory count for one year of the audit period, there was no signature, initials, or other identifying information to confirm who performed the count or when it was performed. Without a regular appropriately documented count, the inventory listing may be inaccurate or incomplete. In addition, without an inventory count to identify discrepancies, property may be lost or misappropriated without detection. We also noted that one surplus property transaction did not have a properly authorized form.

Recommendation
We recommend that management ensure a comprehensive annual physical inventory count is performed and documented, and that the employees responsible for performing the count do not have access to modify inventory records.

The results of each inventory count, and any resulting modifications to inventory records, should be reviewed and approved by management, and documentation of the review should be maintained. After a full inventory count has been performed to confirm the current records are accurate and complete, each year the reviewer should compare the results of the count to the previous year, ensuring that any significant purchases are reflected in the records and that any items removed are supported by approved surplus documentation. In addition, management should ensure that surplus property forms are appropriately authorized and approved by the State Surplus Administrator for the Office of Management and Enterprise Services for each surplus property transaction.

Views of Responsible Officials
Two individuals from the Banking Department perform the annual inventory review for the Banking Department. All work papers from the

inventory review are retained by the Banking Department, including those relating to new purchases and items removed to surplus. However, in the future, the inventory review work papers will be initialed by the individuals performing the review to verify their review and the approval of management.

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