



PERFORMANCE AUDIT REPORT

**Financial Regulatory Agencies in Kansas: A K-GOAL
Audit Determining Whether Functions Could Be
Combined To Gain Cost Efficiencies**

Executive Summary
with Conclusions and Recommendations

**A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
September 2008**

Legislative Post Audit Committee

Legislative Division of Post Audit

THE LEGISLATIVE POST Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about \$13 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of governmental agencies. The audit work performed by Legislative Post Audit helps provide that information.

We conduct our audit work in accordance with applicable government auditing standards set forth by the U.S. Government Accountability Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. The standards also have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

The Legislative Post Audit Committee is a bipartisan committee comprising five senators and five representatives. Of the Senate members, three are appointed by the President of the Senate and two are appointed by the Senate Minority Leader. Of the Representatives, three are appointed by the Speaker of the House and two are appointed by the Minority Leader.

Audits are performed at the direction of the Legislative Post Audit Committee. Legislators

or committees should make their requests for performance audits through the Chairman or any other member of the Committee. Copies of all completed performance audits are available from the Division's office.

LEGISLATIVE POST AUDIT COMMITTEE

Senator Derek Schmidt, Chair
Senator Nick Jordan
Senator Les Donovan
Senator Anthony Hensley
Senator Chris Steineger

Representative Virgil Peck Jr., Vice-Chair
Representative Tom Burroughs
Representative John Grange
Representative Peggy Mast
Representative Tom Sawyer

LEGISLATIVE DIVISION OF POST AUDIT

800 SW Jackson
Suite 1200
Topeka, Kansas 66612-2212
Telephone (785) 296-3792
FAX (785) 296-4482
E-mail: LPA@lpa.state.ks.us
Website:
<http://kslegislature.org/postaudit>

DO YOU HAVE AN IDEA FOR IMPROVED GOVERNMENT EFFICIENCY OR COST SAVINGS?

The Legislative Post Audit Committee and the Legislative Division of Post Audit have launched an initiative to identify ways to help make State government more efficient. If you have an idea to share with us, send it to ideas@lpa.state.ks.us, or write to us at the address above.

You won't receive an individual response, but all ideas will be reviewed, and Legislative Post Audit will pass along the best ones to the Legislative Post Audit Committee.

The Legislative Division of Post Audit supports full access to the services of State government for all citizens. Upon request, Legislative Post Audit can provide its audit reports in large print, audio, or other appropriate alternative format to accommodate persons with visual impairments. Persons with hearing or speech disabilities may reach us through the Kansas Relay Center at 1-800-766-3777. Our office hours are 8:00 a.m. to 5:00 p.m., Monday through Friday.



LEGISLATURE OF KANSAS

LEGISLATIVE DIVISION OF POST AUDIT

800 SOUTHWEST JACKSON STREET, SUITE 1200
TOPEKA, KANSAS 66612-2212
TELEPHONE (785) 296-3792
FAX (785) 296-4482
E-MAIL: lpa@lpa.state.ks.us

September 17, 2008

To: Members of the Kansas Legislature

This executive summary contains the findings and conclusions, together with a summary of our recommendations and the agency responses, from our completed performance audit, *Financial Regulatory Agencies in Kansas: A K-GOAL Audit Determining Whether Functions Could Be Combined to Gain Cost Efficiencies*.

The report also contains appendices showing the various federal regulators and national associations, the financial regulatory agencies in each state, and the assumptions and methodologies used to estimate the cost savings reported in the audit.

This report includes several recommendations for the Legislature, Office of the Bank Commissioner, Department of Credit Unions, and for the Office of the Securities Commissioner. We would be happy to discuss these recommendations or any other items in the report with any legislative committees, individual legislators, or other State officials.

If you would like a copy of the full audit report, please call our office and we will send you one right away.

A handwritten signature in black ink that reads "Barbara J. Hinton". The signature is written in a cursive, flowing style.

Barbara J. Hinton
Legislative Post Auditor

EXECUTIVE SUMMARY

LEGISLATIVE DIVISION OF POST AUDIT

Overview of Kansas' Financial Regulatory Agencies

Three agencies regulate banks and trusts, consumer and mortgage lending entities, credit unions, and the securities industry in Kansas. *All three agencies share similar missions to safeguard assets and investments and to protect customers through similar regulatory functions such as conducting routine exams, investigating fraud, and taking enforcement actions. During fiscal year 2007, the three agencies combined spent about \$11.9 million on their regulatory activities. All three agencies are entirely fee-funded, and some of the excess revenues are transferred to the State General Fund.*

Over time, financial regulatory agencies in Kansas have undergone several structural changes. *Since the late 1800s, financial regulation in Kansas has evolved and undergone a series of changes in the way its financial regulatory agencies have been structured. At various times, the regulatory functions of one agency have been part of other agencies, and then split apart. For example, the regulation of credit unions was performed through the Office of the Bank Commissioner in 1929, but was moved into a newly created Department of Credit Unions in 1968. The latest change involved moving the responsibilities of the stand-alone Office of the Consumer Credit Commissioner into a division in the Office of the Bank Commissioner in 1999.*

Question 1: Could the Department of Credit Unions, the Office of the Bank Commissioner, and the Office of the Securities Commissioner Be Combined To Achieve Operating Efficiencies and Reduce Costs?

Many states organize financial regulatory functions under a single agency. *Several federal reports have noted that consolidation of financial regulatory agencies could enhance efficiency and produce cost savings, and could result in a more comprehensive regulatory approach. Kansas is one of only five states that have three or more separate agencies overseeing banks, credit unions, consumer mortgage lenders, and securities.*

Banks and credit unions are regulated by a single agency in 43 states. Securities regulation is housed in the same agency that regulates banks and credit unions in 21 states and the District of Columbia. In 29 states, securities regulation is housed separately from bank and credit union regulators. Often securities regulation is housed within the Secretary of State's Office or the Attorney General's Office; in 6 states, it is housed in a separate stand-alone agency.

In Kansas, the three financial regulatory agencies could save at least \$555,000 a year through consolidation and other efficiency efforts. *Of this amount, we estimated that at least \$260,000 in savings could be achieved through consolidation, and about \$295,000 could be saved through other operational efficiencies. Our estimates are conservative; they could be higher if the head of a consolidated agency explored other savings possibilities. We didn't include any one-time moving or training costs related to combining these agencies into a single office, but we think these one-time costs would be quickly offset by the annual cost savings we identified.*

Consolidating the three agencies could save at least \$260,000 a year in salaries, benefits, and other operating costs. *Most of the savings our model would generate come from eliminating or restructuring staff positions that would no longer be needed. For example, based on a review of other states' structures, our model assumes that a consolidated agency could operate with a single agency head and deputy director – which would result in the elimination of one agency head position and the associated salary and benefits. Other significant cost savings come from reducing the number of supervisory positions in the legal and registration functions of a consolidated agency.*

Incidental cost savings associated with a combined agency would total about \$10,000 annually. Cross-training bank and credit union examiners could provide additional savings, but those savings are difficult to quantify and appear limited in the short run. However, we think the larger payout likely would come through more efficient scheduling and use of staff over time.

If the agencies are combined, several issues regarding how they are governed and operated will need to be addressed. *For example, a decision would need to be made about whether a board is needed, and how it would be structured. Also, consolidating agencies could result in several challenges, such as balancing the differing philosophies of the individual agencies, and establishing appropriate accounting procedures to ensure that the fees generated by one industry don't subsidize another.*

At least \$295,000 could be saved annually by making existing agency operations more efficient. *Conducting credit union examinations only as often as required by law or as needed for problem entities could eliminate the need for two examiners and generate an estimated \$107,000 in annual savings. Additional savings could be achieved by eliminating routine trips to credit union branch locations, but we couldn't quantify the savings.*

Having examiners at the Office of the Bank Commissioner work from home – as credit union examiners and inspectors in other agencies currently do – could save an estimated \$106,000. Also, the agencies could save at least \$80,000 a year by adhering to the space standards

recommended by the Department of Administration. Finally, for a small sample of staff, we identified about \$2,700 in travel expenditures that didn't comply with travel reimbursement regulations or that didn't appear necessary.

During our work we also found that a few banks and trusts weren't examined as often as required. State and federal law requires these entities to be examined every 18 months, and State and federal examiners alternate examinations to accomplish that. In reviewing the most recently completed examination cycles for the almost 300 entities examined, we noted that 4 exam cycles were more than 20 months apart; in three of those cases, the delays occurred because the federal exams didn't start on time.

Question 1 Conclusion. Over the years, the Legislature has created a number of individual agencies to regulate certain professions or activities and protect Kansas citizens from potential harm. Although a few of those agencies have been eliminated or consolidated over time, most continue to exist as separate, stand-alone agencies. Many other states have gone much farther in consolidating regulatory agencies—either by broad mission or in total. Consolidating such agencies offers significant potential for them to reduce their operating costs and increase their administrative efficiencies.

Housing all the functions of the Credit Union Department and the Offices of the Bank Commissioner and Securities Commissioner within a single agency could result in reduced costs and greater efficiencies, and would more closely align agencies with similar broad missions. Because all three agencies are fee-funded, the savings that could be achieved could be used to increase automation and make other technological improvements, improve other areas of oversight and enforcement, reduce fees to the regulated industry, or the like.

Given the similarities that exist between the regulation of banks and trusts and credit unions, and given that most states regulate these entities under a single agency, we concluded that those two agencies should be consolidated. Combining the regulation of securities with the other two agencies will achieve additional economies of scale, but the precedent for this organizational structure is not as clear cut. Although only six states have a stand-alone office for the Securities Commissioner, that office frequently is located within a secretary of state's office or an attorney general's office.

Finally, officials from the Office of the Securities Commissioner and the Department of Credit Unions have expressed concerns that their functions would be diluted if consolidation occurred, or that the services and protections they provide to the Kansans they serve might be diminished. These concerns should be fully aired in any legislative deliberations about the future organizational structure of the agencies.

However, given how common it is in other states for these functions to be consolidated under a larger agency umbrella, we are certain that agency staff working together to achieve a common goal can find workable solutions to such obstacles.

Recommendations for legislative action: *We recommended the Legislature consolidate the regulation of banks and credit unions under a single financial-regulatory agency, and consider consolidating the regulation of securities under that same agency. If a decision is made to consolidate, the Legislature will need to consider several issues such as board structure, executive director qualifications, the transition timetable, and whether statutory changes would be necessary.*

Recommendations for executive action: *We recommended that bank and credit union examiners become cross-trained if these agencies are combined. Even if consolidation doesn't occur, we recommended reviewing the current locations of examiners relative to the entities they regulate, and allowing bank examiners to work from home. We also recommended that the three agencies adjust their leased square footage to conform to the Department of Administration's space standards at the next lease renewal date, and that the Department of Credit Unions and Office of the Securities Commissioner ensure compliance with the State's travel reimbursement regulations. Finally, we recommended for the Office of the Bank Commissioner to adhere to the 18-month examination cycle prescribed by law.*

Appendix A: Scope Statement

Appendix B: Summary of Federal Regulators and National Associations in the Financial Industry

Appendix C: List of Financial Regulatory Agencies In All States and the District of Columbia

Appendix D: Assumptions and Methodologies

Appendix E: Agency Responses

This audit was conducted by Katrin Osterhaus, Nathan Ensz, Brad Hoff and Justin Stowe. Leo Hafner was the audit manager. If you need any additional information about the audit's findings, please contact Katrin Osterhaus at the Division's offices. Our address is: Legislative Division of Post Audit, 800 SW Jackson Street, Suite 1200, Topeka, Kansas 66612. You also may call us at (785) 296-3792, or contact us via the Internet at LPA@lpa.state.ks.us.