REPORT BY THE

AUDITOR GENERAL

OF CALIFORNIA

A REVIEW OF
EXAMINER, AUDITOR, AND APPRAISER ATTRITION
IN THE STATE BANKING DEPARTMENT,
THE DEPARTMENT OF SAVINGS AND LOAN,
THE DEPARTMENT OF CORPORATIONS,
AND THE DEPARTMENT OF REAL ESTATE

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SEPTEMBER 1987

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Thomas W. Hayes
Auditor General

September 2, 1987 P-756

Honorable Art Agnos, Chairman
Members, Joint Legislative
Audit Committee
State Capitol, Room 3151
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning attrition among examiners, auditors, and appraisers at the State Banking Department, the Department of Savings and Loan, the Department of Corporations, and the Department of Real Estate.

Respectfully submitted,

Thomas W. Hayes

THOMAS W. HAYES
Auditor General

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SUMMARY

RESULTS IN BRIEF

The Legislature asked the Office of the Auditor General to answer certain questions related to staff turnover in the State Banking Department, the Department of Savings and Loan, the Department of Corporations, and the Department of Real Estate. These four state departments regulate much of California's financial industry. During our analysis, we noted the following specific conditions:

- During fiscal years 1985-86 and 1986-87, attrition among examiners of the State Banking Department was higher than attrition among all state employees in similar jobs. However, attrition among examiners, auditors, and appraisers in the other three departments slowed from 1985-86 to 1986-87 so that in 1986-87 attrition at these departments was less than attrition among all state employees in similar jobs;

- In fiscal years 1985-86 and 1986-87, 56 (74 percent) of the 76 employees who left employment with one of the four state departments left state government for other employment or left the work force;

- Based on our limited assessment of examination records for fiscal years 1985-86 and 1986-87, the State Banking Department, the Department of Savings and Loan, and the Department of Corporations met their statutory requirements and departmental goals for performing examinations and audits and did not appear to be hampered by staff turnover. Nevertheless, department officials noted that the turnover of staff slows down the examination process because new staff are inexperienced;

- These three departments and the Department of Personnel Administration have implemented two of three of the legislative analyst's recommendations to reduce staff turnover;

- Various provisions of state and federal law require examinations and audits of state-chartered financial institutions. In several instances, both state and federal departments may examine or audit the same state-chartered financial institution. To avoid duplication of effort, state examiners regularly meet with their federal counterparts to coordinate examinations and audits;

- During their examinations, none of the four state departments relies on reports prepared by internal auditors of the financial institutions, but the departments do use the work performed by independent auditors; and

- During fiscal years 1985-86 and 1986-87, none of the four departments loaned examiners or auditors among themselves.

BACKGROUND

The State Banking Department, the Department of Savings and Loan, the Department of Corporations, and the Department of Real Estate are primarily responsible for protecting the public from losses that occur when a financial institution fails and from unfair or fraudulent business practices.

In calendar year 1986, the State Banking Department regulated 287 state-chartered banks and 102 subsidiaries of foreign banks. The department employed 126 examiners who conducted 173 examinations in calendar year 1986. The Department of Savings and Loan regulates 146 state-chartered savings and loan associations and employs 83 examiners and 21 real-estate appraisers. In fiscal year 1986-87, the department conducted 191 examinations. The Department of Corporations regulates credit unions, industrial loan companies, and a variety of other financial service firms. In fiscal year 1986-87, the department's 138 examiners conducted 1,817 examinations. In fiscal year 1986-87, the Department of Real Estate's 41 auditors and appraisers conducted 1,173 reviews of certain trust accounts maintained by real-estate brokers.

PRINCIPAL ISSUES

Attrition Among Examiners, Auditors, and Appraisers

Attrition among examiners of the State Banking Department is higher than attrition among those state employees in similar jobs. However, attrition among examiners, auditors, and appraisers at the Department of Savings and Loan, the Department of Corporations, and the Department of Real Estate slowed from fiscal year 1985-86 to fiscal year 1986-87 so that in 1986-87 attrition at these departments was less than that for all state employees in similar jobs. In fiscal years 1985-86 and 1986-87, 56 (74 percent) of the 76 employees who left employment with the four state departments left state government for other employment or left the work force. Former employees cited higher pay and better benefits elsewhere as two of their reasons for leaving state service. For fiscal years 1985-86 and 1986-87, the State Banking Department, the Department of Savings and Loan, and the Department of Corporations substantially met their statutory requirements and departmental goals for performing examinations and audits and did not appear to be hampered by staff turnover. Nevertheless, department officials noted that the turnover of staff slows down the examination process because new staff are inexperienced.

Actions Addressing Attrition Among Examiners, Auditors, and Appraisers

In the analysis of the Governor's Budget for fiscal year 1987-88, the legislative analyst reported a high level of employee turnover. To alleviate the problem, the legislative analyst also made certain recommendations to the State Banking Department, the Department of Savings and Loan, the Department of Corporations, and the Department of Personnel Administration (DPA). These departments have taken steps to implement two of three of these recommendations. In February and May 1987, the

DPA created expanded job classifications for examiners, which have increased their promotional opportunities. Further, the DPA is conducting a salary and benefits survey of comparable positions in the regulatory departments of other states and the federal government. Officials of the DPA anticipate that these steps will reduce staff turnover. The legislative analyst did not make recommendations concerning the Department of Real Estate.

Federal and State Coordination of Regulatory Efforts and the State's Use of Work Performed by Independent Auditors

Various provisions of federal and state law require examinations and audits of state-chartered financial institutions. Laws requiring examinations and audits of state-chartered institutions range in content from the requirement that the institution provide an independent audit report to the requirement that, in addition to an audit report, the institution provide a report on various operational aspects of its business. In several instances, both federal and state departments may examine the same state-chartered institution. To avoid duplication of effort, state examiners coordinate their activities with their federal counterparts.

Finally, during their examinations, none of the four state departments relies on reports prepared by internal auditors of the financial institutions, but the departments do use the work performed by independent auditors.

AGENCY COMMENTS

We met with representatives of the Business, Transportation and Housing Agency and with representatives of the State Banking Department, the Department of Savings and Loan, the Department of Corporations, the Department of Real Estate, and the Department of Personnel Administration, and they agreed with our conclusions.

INTRODUCTION

The State Banking Department, the Department of Savings and Loan, the Department of Corporations, and the Department of Real Estate regulate much of California's financial industry. The primary responsibility of these four state departments is to protect the public from losses that occur when a financial institution fails and from unfair or fraudulent business practices.

In calendar year 1986, the State Banking Department regulated over 287 state-chartered banks with assets of $92 billion, 102 subsidiaries of foreign banks with assets of $54 billion, companies that sell money orders, and business and industrial development corporations. The department also certifies securities as legal investments for public agencies. To ensure that the institutions it regulates meet the State's regulatory requirements, the department employed 126 examiners who conducted 173 examinations in calendar year 1986. The examiners review the institutions' financial stability, management quality, and compliance with regulatory requirements.

In 1986, the Department of Savings and Loan regulated 146 state-chartered savings and loan associations. In 1986, these associations had total assets of $132 billion. For fiscal year 1986-87, the department had 83 authorized examiner positions and 21 authorized real-estate appraiser positions to conduct approximately 191 examinations of savings and loan associations. The examiners evaluate the associations' financial stability, management quality, and compliance with legal requirements. The department's real-estate appraisers verify and monitor the market value of real estate held as security by savings and loan institutions.

The Department of Corporations regulates, among other financial institutions, credit unions, industrial loan institutions, and escrow companies. The department employs an average of 138 examiners, and, in fiscal year 1986-87, it conducted 1,817 examinations. The examinations range in scope from a review of bank and escrow accounts at escrow companies to the review of a credit union's financial stability, management quality, and regulatory compliance.

Finally, the Department of Real Estate is responsible for protecting the public from economic loss related to certain real-estate transactions such as the purchase of subdivided property and real property securities. In fiscal year 1986-87, the department had 41 auditors and real-estate appraisers who conducted 1,173 specialized audits of trust accounts. The auditors reviewed certain trust-fund accounts maintained by real-estate brokers. Appendix A lists the financial institutions regulated by the State Banking Department, the Department of Savings and Loan, the Department of Corporations, and the Department of Real Estate.

The State interacts with four federal regulatory agencies: the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the National Credit Union Administration. More detail on the responsibilities of these organizations is contained in Appendix B.

The 1980 deregulation of the financial services industry has placed greater demands on financial examiners and appraisers to protect consumers from economic loss and to maintain stability in the financial marketplace. Recognizing the impact that deregulation has had, the Legislature authorized an increase in the number of examiners in the various regulatory departments.

SCOPE AND METHODOLOGY

The Legislature asked the Office of the Auditor General to answer certain questions related to staff turnover in the four state departments that regulate much of the State's financial industry. We were asked to determine how many examiners, auditors, and appraisers left the four state departments during fiscal years 1985-86 and 1986-87 and where these employees sought new employment. Also, we were asked to determine why these employees left and whether there were any problems associated with hiring and maintaining quality staff. Next, we were asked to determine what actions have been taken to address attrition among the examiners, auditors, and appraisers. In addition, we were asked to review those examinations and audits of state-chartered financial institutions that are mandated by federal or state law and to determine the extent to which information from these examinations and audits is shared between federal and state departments that perform these examinations and audits. Further, the Legislature asked us to review whether, during their examinations, the four departments use audit work that has been performed by the financial institution's internal auditors or audit work that has been performed by independent auditors.

Finally, the Legislature asked us to determine whether these departments have worked out agreements to loan examiners, auditors, and appraisers among themselves. However, we found that none of the four departments loaned examiners, auditors, or appraisers among themselves during fiscal years 1985-86 and 1986-87.

To determine how many examiners, auditors, and appraisers left the four state departments in fiscal years 1985-86 and 1986-87 and where, when, and why the employees sought new employment, we reviewed the employees' personnel files. We telephoned employees when their personnel files did not identify where the employees obtained new employment. The State Personnel Board also provided us with data on the rate at which employees in similar jobs leave state employment.

To determine what actions have been taken to address attrition among examiners, auditors, and appraisers, we asked the Department of Personnel Administration, the State Banking Department, the Department of Savings and Loan, and the Department of Corporations what steps they have taken to implement recommendations that were recently made by the legislative analyst to address the attrition problem. The legislative analyst did not make recommendations concerning the Department of Real Estate.

To determine those examinations or audits of state-chartered institutions that are mandated, we reviewed state and federal laws and regulations. We also interviewed officials from the four state departments and the federal regulatory agencies to determine the schedules for and the frequencies of the required reviews. In addition, we reviewed a limited sample of examination records at each department to determine if the staff turnover affected the ability of these departments to complete all of their examinations or audits. We did not review the adequacy of the four departments' examinations and audits.

ANALYSIS

I

ATTRITION AMONG EXAMINERS OF THE STATE BANKING DEPARTMENT IS HIGHER THAN ATTRITION AMONG THOSE STATE EMPLOYEES IN SIMILAR JOBS

Examiners at the State Banking Department are leaving the department at a faster rate than all state employees in similar jobs. However, attrition among examiners, auditors, and appraisers in the Department of Savings and Loan, the Department of Corporations, and the Department of Real Estate slowed from fiscal year 1985-86 to fiscal year 1986-87 so that in 1986-87 attrition at these departments was less than attrition among all state employees in similar jobs.

In fiscal years 1985-86 and 1986-87, 56 (74 percent) of the 76 employees who left employment with one of the four state departments left state government for other employment or left the work force. However, during this period, the State Banking Department, the Department of Savings and Loan, and the Department of Corporations met their statutory requirements and departmental goals for performing examinations and audits and did not appear to be hampered by staff turnover. Nevertheless, department officials noted that the turnover of staff slows down the examination process because new staff are inexperienced. Consequently, to reduce staff turnover, these three departments and the Department of Personnel Administration have implemented two of three of the legislative analyst's recommendations.

Attrition Rate

Table 1 shows the number of examiners, auditors, and appraisers who left employment with the State Banking Department, the Department of Savings and Loan, the Department of Corporations, and the Department of Real Estate during fiscal years 1985-86 and 1986-87. Table 1 also shows, for the same period, the number of these examiners, auditors, and appraisers who left state government. We obtained information for this table from personnel files from each department. The percentage of employees who left employment was determined by dividing the number of employees who left state government by the number of authorized positions at each department.

TABLE 1

NUMBER AND PERCENT OF EXAMINERS, AUDITORS, AND APPRAISERS WHO LEFT EMPLOYMENT WITH THE FOUR DEPARTMENTS AND THE NUMBER AND PERCENT WHO LEFT STATE GOVERNMENT FISCAL YEARS 1985-86 AND 1986-87

Department	Number of Examiners, Auditors, and Appraisers Who Left Employment With the Four Departments		Number of Examiners, Auditors, and Appraisers Who Left State Government		Percent of Examiners, Auditors, and Appraisers Who Left Employment With the Four Departments		Percent of Examiners, Auditors, and Appraisers Who Left State Government	
	Fiscal Year		Fiscal Year		Fiscal Year		Fiscal Year	
	1985-86	1986-87	1985-86	1986-87	1985-86	1986-87	1985-86	1986-87
State Banking	14	17	13	14	11.2%	13.5%	10.4%	11.1%
Savings and Loan	11	5	7	3	14.5%	4.8%	9.2%	2.9%
Corporations	11	12	8	6	7.8%	8.7%	5.7%	4.3%
Real Estate	3	3	3	2	7.1%	7.3%	7.1%	4.9%
Total	39	37	31	25				

We obtained information on state employees in similar jobs who left state government from the State Personnel Board.

By dividing the number of state employees in similar jobs by the number of authorized positions statewide, we determined that, in fiscal year 1985-86, 6 percent of state employees in similar jobs left state government and, in fiscal year 1986-87, 6.5 percent left state government. As Table 1 shows, in fiscal year 1985-86, examiners, auditors, and appraisers at the State Banking Department, the Department of Savings and Loan, and the Department of Real Estate left state employment at a faster rate than all the state employees in similar jobs. In fiscal year 1986-87, examiners, auditors, and appraisers at the Department of Corporations, the Department of Real Estate, and the Department of Savings and Loan left state employment at a slower rate than all the state employees in similar jobs. Table 1 also shows that during the two-year period from fiscal year 1985-86 through fiscal year 1986-87, 56 (74 percent) of the 76 employees who left employment with the four departments did not transfer to other state departments but left state government entirely.

Where Examiners, Auditors, and Appraisers Went After Employment With the Four Departments

We reviewed the personnel files for the 76 examiners, auditors, and appraisers whom the four state departments identified as having left the departments in fiscal years 1985-86 and 1986-87. As part of our review, we attempted to determine why the employees left and where the employees sought new employment. We could not determine from the personnel files where some of these employees went after leaving state service. Therefore, we conducted a telephone survey and obtained information from 15 of these employees. Table 2 shows the results of our telephone survey and our review of employee personnel files at the four departments.

TABLE 2

WHERE EXAMINERS, AUDITORS, AND APPRAISERS WENT AFTER EMPLOYMENT WITH THE FOUR DEPARTMENTS FISCAL YEARS 1985-86 AND 1986-87

Where Employees Went	Departments That Employees Left: State Banking	Savings and Loan	Corporations	Real Estate	Total
Left the State entirely					
Federal regulatory agencies	10	3	1		14
Public accounting or bank	1	1	2		4
Self-employed	1			1	2
Death			1		1
Retirement	3	2	3	4	12
Poor performance		1	3		4
Personal reasons	1	2	1	_	4
Subtotal	16	9	11	5	41
Transferred to other state departments	2	6	9	1	18
Unknown	13	1	3	_	17
Total	31	16	23	6	76

As Table 2 shows, 14 (18 percent) of the 76 employees who left the four state departments went to work for federal agencies that regulate financial institutions. Ten employees of the State Banking Department went to work for federal agencies, 8 of these 10 to the Federal Home Loan Bank Board and 2 to the Federal Reserve Board. Three employees of the Department of Savings and Loan also went to work for the Federal Home Loan Bank Board, and one employee of the Department of Corporations went to the Internal Revenue Service.

We also determined that 4 (5 percent) of the 76 employees who left the four departments obtained employment in the private sector. Three of these 4 employees, 2 from the Department of Corporations and one from the Department of Savings and Loan, went to work for public accounting firms. One employee of the State Banking Department was hired by a bank. In addition, two (3 percent) of the 76 employees who left the departments are now self-employed.

The employees who left the departments for jobs with federal agencies or with the private sector or who became self-employed gave several reasons for leaving state government. Some employees who had been junior examiners cited low pay and insufficient benefits. However, as Appendix C shows, these departments are losing more than just their junior examiners and auditors. Thirty-six (47 percent) of the 76 employees who left had three or more years of experience with these departments when they left. Some of these former employees also cited the lack of promotional opportunities at the four state departments as another reason for leaving state government. Almost all of those employees who obtained federal employment noted that they received higher salaries and better benefits in their new positions. Some of the employees also told us that, in federal service, they received better travel reimbursements and improved training opportunities.

For another 21 of the 76 employees who left, one died while employed by one of the departments, 12 (16 percent) retired, 4

(5 percent) were dismissed because of poor performance, and another 4 (5 percent) left for personal reasons such as an illness in the family. Furthermore, we found that an additional 18 (24 percent) of the 76 employees transferred to other state departments. Of these 18 employees, one transferred to another state department to receive a promotion, 3 simply moved from one of the four departments to another of the four, and 14 received transfers to other state departments. The Department of Corporations and the Department of Savings and Loan experienced the largest number of transfers of employees to other departments. Moreover, many of the employee transfers originated in Los Angeles. According to the chief examiner of the Department of Corporations, employees accepted entry-level positions with the Los Angeles Office of the Department of Corporations with the goal of transferring to other departments in Sacramento as soon as their one-year probations were successfully completed. The chief examiner concluded that these employees wanted to move to Sacramento because of the high cost of living and the difficulties of commuting in Los Angeles.

Finally, we were unable to determine why the remaining 17 (22 percent) of the 76 employees left state service or where they found new employment. (While 2 of these 17 employees were eventually reinstated after they left the State Banking Department, we were unable to determine where they went during the interim.) Appendix C lists, whenever possible, where each of the 76 examiners, auditors, and appraisers went after he or she left employment with one of the four departments.

Effects of Employee Turnover on Regulatory Requirements

We conducted a limited assessment of examination records at the State Banking Department, the Department of Savings and Loan, and the Department of Corporations to determine whether the departments promptly conducted their regulatory reviews. For fiscal years 1985-86 and 1986-87, the three state departments substantially met their statutory requirements and departmental goals for examinations and audits and did not appear to be hampered by staff turnover. Nevertheless, officials of the State Banking Department, the Department of Savings and Loan, and the Department of Corporations noted that the turnover of staff slows down the examination process because new staff are inexperienced and require more training from their supervisors.

Actions Addressing Attrition Among the State's Examiners, Auditors, and Appraisers

In the analysis of the Governor's Budget for 1987-88, the legislative analyst reported that the State Banking Department, the Department of Savings and Loan, and the Department of Corporations had each experienced a high turnover among their examiners and appraisers during the past two to three years. The legislative analyst attributed the high turnover to two major causes: better salary and benefit offers by private and other public employers and the promotional and salary limitations within the state civil service system. The Business, Transportation and Housing Agency had also recognized the problems that the State Banking Department, the Department of Savings and Loan, and the Department of Corporations had experienced in retaining its examiners and appraisers; in June 1986, the agency convened a task force to address the problem.

Also, to address the turnover problem, the legislative analyst made three recommendations that would have to be implemented by the Department of Personnel Administration (DPA) in cooperation with the State Banking Department, the Department of Savings and Loan, and the Department of Corporations. These recommendations had also been presented by the agency's task force in August 1986 to one of the agency's deputy secretaries and in September 1986 to officials at the DPA. The legislative analyst recommended that the DPA expand the job classification of examiner at these three departments to provide greater promotional opportunities for these departments' examiners to reach the journey level of the examiner classification. The legislative analyst also recommended that the DPA conduct a salary and benefits survey that compares the salaries and benefits of state examiners, auditors, and appraisers with the salaries and benefits of examiners, auditors, and appraisers in the regulatory departments of other states and the federal government. Finally, the legislative analyst recommended that the DPA delegate more authority to these three departments for filling and reclassifying vacant examiner positions.

The DPA and the three departments have taken steps to implement two of these three recommendations. In February and

May 1987, the DPA created an expanded job classification or "deep class" for examiners at each of these three departments. A job classification represents a job that is made up of one set of duties and responsibilities, for which the DPA has established one pay range. When the DPA creates a deep class, it combines what were once two or more separate job classifications into one multi-level job classification.

The creation of a deep class for examiners at these three departments has streamlined the examiner's advancement from the entry level to the journey level. For example, the DPA created a deep class for bank examiners at the State Banking Department by consolidating what were once three separate job classifications into one three-level job classification consisting of an entry, intermediate, and journey level. The effect of this expanded job classification is that it is almost guaranteed that if the job performance of entry-level examiners at the State Banking Department is satisfactory, these entry-level examiners will advance to the journey level of the examiner classification within two years of when they were hired, which would mean a 31 percent increase in salary in two years excluding any possible cost-of-living adjustments. These employees could also receive a raise after each of the next four years. Therefore, after six years of satisfactory performance, these examiners could increase their salaries by approximately 58 percent without having to take a promotional examination. Before the expanded examiner classification, an entry-level examiner had to be promoted twice to reach the journey-level examiner classification. According to one of the section chiefs at the DPA, to obtain these promotions, an employee often had to wait until the next civil service examination could be scheduled and completed.

The Department of Savings and Loan and the Department of Corporations also have an expanded examiner classification although this classification consists of only two levels--an intermediate and a journey level. The Department of Savings and Loan and the Department of Corporations hire Auditor I's who, after 12 months of satisfactory performance, are eligible for promotion to the expanded examiner classification at the intermediate level. Under the new expanded examiner classification, an intermediate-level examiner can advance to the journey level within 12 months, which would mean a 20 percent increase in salary excluding any possible cost-of-living adjustments. These employees also could receive a merit raise after each of the next four years of service. Therefore, after five years of satisfactory performance as an examiner, these employees could increase their salaries by approximately 45 percent without having to take a promotional examination.

Our review of personnel files and our telephone survey of former employees revealed that, during fiscal years 1985-86 and 1986-87, these departments lost 41 percent of their examiners because the examiners left for opportunities in other state departments or in federal regulatory departments. Officials of these departments agree that expansion of the examiner job classifications will enable the departments to better retain their experienced examiner staff.

To implement the second recommendation made by the legislative analyst, the DPA is currently conducting a salary and benefits survey that compares the salaries of the State's examiners and appraisers with the salaries of examiners, auditors, and appraisers in the regulatory departments of other states and the federal government. The DPA will report its findings to the Legislature by November 1987.

The third recommendation by the legislative analyst was not implemented. The legislative analyst recommended that the DPA should delegate more authority to these three departments for filling and reclassifying vacant supervisory and specialist positions, which are referred to as "Examiner IV's." The State Banking Department, the Department of Savings and Loan, and the Department of Corporations already have the authority to fill and reclassify vacant examiner and auditor positions at the entry, intermediate, and journey levels without a review by the DPA. The purpose of the DPA's review for the Examiner IV classification is to ensure that a state employee in this position will not perform duties or assume responsibilities that are not described in the Examiner IV job classification. The DPA believes that because its review for the Examiner IV classification is complex, the review should be retained at the DPA.

However, the DPA implemented two additional changes beyond those recommended by the legislative analyst. The first of these changes is designed to improve the ability of these three departments to fill vacant positions. The DPA authorized an increase in the beginning salary for entry-level auditors at the Department of Savings and Loan and the Department of Corporations and for entry-level examiners at the State Banking Department. Also, during fiscal years 1985-86 and 1986-87, the Department of Savings and Loan and the Department of Corporations increased their number of Examiner IV positions. These increases improve the promotional opportunities for journey-level examiners at these departments.

Officials at these three departments welcome the creation of the deep class for examiners. In addition, according to officials at the DPA, the increase in the starting salary for entry-level examiners and auditors and the increase in the number of Examiner IV positions should enable these departments to present a more attractive career path to their examiners and auditors. However, the officials of the DPA also indicated that it is too early to determine whether these changes have enabled the departments to retain more of their experienced examiners and auditors.

CONCLUSION

Examiners at the State Banking Department are leaving state employment at a faster rate than all state employees who work in similar jobs. However, attrition among examiners, auditors, and appraisers in the Department of Savings and Loan, the Department of Corporations, and the Department of Real Estate slowed from fiscal year 1985-86 to fiscal year 1986-87 so that in 1986-87 attrition at these departments was less than attrition among all state employees in similar jobs. During fiscal years 1985-86 and 1986-87, 56 (74 percent) of the 76 employees who left employment with one of the four state departments left state government for other employment or left the work force. During this period, the State Banking Department, the Department of Savings and Loan, and the Department of Corporations met their statutory requirements and departmental goals for examinations and audits and did not appear to be hampered by staff turnover. Nevertheless, department officials noted that the turnover of staff slows down the examination process because new staff are inexperienced. Consequently, to reduce staff turnover, these three departments and the Department of Personnel Administration have implemented two of three of the legislative analyst's recommendations.

II

STATE EXAMINERS COORDINATE THEIR REGULATORY EFFORTS WITH FEDERAL EXAMINERS AND ALSO USE THE WORK PERFORMED BY INDEPENDENT AUDITORS

Various provisions of federal and state law require audits and examinations of state-chartered financial institutions. In several instances, both federal and state laws require an audit or an examination of the same financial institution. To avoid duplication of effort, state examiners regularly meet with their federal counterparts to coordinate audits and examinations. Furthermore, during their examinations, none of the four state departments relies on reports prepared by internal auditors at the financial institutions, but the four departments do use the work performed by independent auditors.

Federal and State Laws Requiring Audits and Examinations

To determine the applicable provisions of federal and state law that require audits and examinations of state-chartered financial institutions, we interviewed personnel from six federal regulatory agencies and each of the four state departments. In addition, we reviewed federal and state statutes and administrative regulations to identify mandated audits and examinations. Laws requiring audits and examinations of state-chartered financial institutions range in content from the requirement that the institution provide an independent audit report to the requirement that in addition to an independent audit report, the institution provide a report on various operational aspects of its business. Appendix B presents a summary of the federal and state laws requiring audits and examinations.

Federal and State Audit Coordination

In several instances, both federal and state departments may examine the same state-chartered financial institution. At the State Banking Department and the Department of Savings and Loan, the possibility exists that federal and state examiners could duplicate one another's efforts because the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board (FRB), and the Federal Home Loan Bank Board (FHLBB) also examine state-chartered financial institutions. According to department officials, the Department of Corporations and the Department of Real Estate do not have federal counterparts that regularly examine the same institutions that these two departments regulate.

To avoid duplication of effort, state examiners at the State Banking Department and the Department of Savings and Loan communicate regularly with their federal counterparts. State examiners at these departments confer with their federal counterparts at the FDIC, the FRB, and the FHLBB to jointly schedule upcoming examinations. According to department officials, state and federal examiners frequently conduct combined examinations of banks and savings and loan associations. State and federal examiners also exchange the results of their examinations with one another. Not only do these actions minimize overlap among state and federal regulators, but this coordination also allows the State to save some of its staff to perform other examinations. As a result, the State can examine more financial institutions annually than would be possible without coordination.

The chief deputy superintendent of banks in the State Banking Department and the deputy superintendents from each of the four regional offices of the State Banking Department meet quarterly with the FDIC to plan bank-examination schedules. The State Banking Department and the FDIC jointly examine banks with more than $1 billion in assets; usually, they separately examine banks with less than $1 billion. When the State Banking Department and the FDIC perform a separate examination, they share each other's examination report.

Similarly, the State Banking Department meets once a year with the FRB to plan examinations. In 1985, the FRB established a policy to increase the frequency of bank examinations. To implement this policy, the FRB plans to intensify its examinations of large banks and to rely on state examinations for the smaller banks. Finally, according to the chief deputy superintendent at the State Banking Department, the FRB and the State Banking Department are establishing written policies to conduct quarterly meetings to coordinate the scheduling of bank examinations.

The Department of Savings and Loan also exchanges information and coordinates its examinations of savings and loan associations with its federal counterpart, the FHLBB. Examiners at the Department of Savings and Loan are in daily contact with examiners from the FHLBB to coordinate examinations, review each other's drafts of examination reports, and share correspondence that is received from savings and loan associations. The Department of Savings and Loan and the FHLBB perform dual examinations whenever it is possible. For example, if the FHLBB is starting an examination and the Department of Savings and Loan has staff available, they perform a dual examination. In a dual examination, field supervisors and examiners from the two agencies share offices at the examination site. Examiners from both agencies divide the work among themselves and share the workpapers. Each agency writes a separate report, based on the shared workpapers, and they attend each other's exit conferences and exchange examination reports.

State Reliance on Internal and Independent Audits

According to department officials, none of the four departments relies on reports prepared by internal auditors at the financial institutions because each department independently examines the institutions it regulates. In addition, the assistant commissioner of the Department of Savings and Loan stated that many small and medium institutions do not have internal audits. However, each of the four state departments in our review relies, to some extent, on independent audits of the financial institutions that have been prepared by

Certified Public Accountant (CPA) firms. Each department reviews the findings of the most current CPA audit of a financial institution. The CPA audit aids these state departments in making decisions about the scope and frequency of their own examinations. Furthermore, the State Banking Department and the Department of Savings and Loan can require that a special examination or audit of a financial institution be performed by the department or by a CPA. However, the examinations conducted by each of the departments cover broader areas than the CPA audits. For example, the State Banking Department examines the operational aspects of a bank in addition to the bank's financial position whereas the CPA audit focuses on whether the bank has fairly presented its financial statements. The operational examination includes a review of management policy and procedures, an appraisal of the bank's assets, and a review of the quality of the bank's loans.

According to state law, state-chartered savings and loan associations must submit independent auditors' reports annually to the Department of Savings and Loan. Examiners at the department use the information in these audit reports to identify problems and to assist themselves in rating each savings and loan association every quarter. The department uses these ratings as a basis for scheduling savings and loan associations for examinations and monitoring visits.

To examine the State's credit unions, the Department of Corporations, in addition to other duties, verifies financial information and reviews whether the credit union complies with certain regulatory requirements. For certain credit unions, department examiners also review CPA reports. Since the independent CPAs have already attested to the accuracy of the credit union's financial information, the department's examiners then concentrate on the credit union's compliance with regulatory responsibilities.

According to the chief of audits at the Department of Real Estate, mortgage-loan brokers are not subject to federal regulation and are not normally required to have CPA firms conduct independent audits. Approximately 150 very large companies, called "threshold mortgage-loan brokers," are required to have an independent audit. These threshold mortgage-loan brokers submit these independent audit reports to the Department of Real Estate. Department staff review these reports, and, if the review identifies a possible violation of the law, the audit chief will initiate an audit. However, the department does not routinely audit the threshold mortgage-loan brokers.

CONCLUSION

Various provisions of federal and state law require audits and examinations of state-chartered financial institutions. In several instances, both federal and state departments may examine the same state-chartered financial institution. To avoid duplication of effort, state examiners regularly meet with their federal counterparts to coordinate audits and examinations. Furthermore, during their examinations, none of the four state departments relies on reports prepared by internal auditors at the financial institutions, but the four departments do use the work performed by independent auditors.

We conducted this review under the authority vested in the Auditor General by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

Thomas W. Hayes

THOMAS W. HAYES
Auditor General

Date: August 31, 1987

Staff: Robert E. Christophel, Audit Manager
Steven M. Hendrickson
Clifton John Curry
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Gary Edwin Page
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APPENDIX A

FINANCIAL INSTITUTIONS REGULATED BY THE FOUR STATE DEPARTMENTS

State Banking Department

Banks

Business and industrial development corporations

Issuers of payment instruments (including money orders)

Issuers of travelers checks

Out-of-state and foreign banks

Trust companies

Department of Savings and Loan

Savings and loan associations

Department of Corporations

Brokers and dealers of securities

Check sellers, bill payers, and proraters

Commercial finance lenders

Consumer finance lenders

Credit unions

Escrow agents

Industrial lenders

Personal property brokers

Department of Real Estate

Mortgage-loan brokers

Mortgage bankers

FEDERAL AND STATE LAWS REQUIRING AUDITS AND EXAMINATIONS OF STATE-CHARTERED FINANCIAL INSTITUTIONS

Financial Institution	Federal and State Law	Description of Requirement
Banks	Title 12, Code of Federal Regulations (CFR), Section 208.8(k)(4)(iv)	State member banks of the Federal Reserve System entering "collective investment fund"* transactions must submit an annual report based on an audit done by a specified internal auditor or an independent public accountant.
	Title 12, CFR, Section 211.7(B)	Banks qualifying as "edge"* corporations must submit to annual examinations by appointees of the Federal Reserve Board.
Savings and loan associations	Title 12, CFR, Sections 563.17-1(a)(2)	Savings and loan associations insured by the Federal Savings and Loan Insurance Corporation (FSLIC) must submit to annual audits as prescribed by the Federal Home Loan Bank Board.
	Title 12, CFR, Section 569a.6	Savings and loan associations under the receivership of the FSLIC must have an audit by an independent Certified Public Accountant (CPA) or another auditor by the date of taking possession.
	Title 12, CFR, Section 569a.10	Savings and loan associations under the receivership of the FSLIC must be audited by an independent CPA or another auditor at least annually.
	Title 12, CFR, Section 569a.12	Savings and loan associations under the receivership of the FSLIC must have an audit by an independent CPA or another auditor when the receiver is discharged.
	Financial Code, Section 8156(a)	Savings and loan associations must have an annual independent audit of books and accounts.
	Title 10, California Administrative Code, Section 104.506	Trust departments of savings and loan associations must have an independent audit every calendar year.
Credit unions	Title 12, CFR, Section 725.4(d)	Credit unions that are members of the National Credit Union Administration Central Liquidity Facility* must have an annual third party independent audit.
	Financial Code, Sections 14250 and 14252	These credit unions are required to have either an examination by the Department of Corporations or an annual independent audit.
Trust companies	Financial Code, Section 1583	The Superintendent of banks of the State Banking Department must examine the "court trust business"* of trust companies at least once every two years.

*See Glossary of Terms (Appendix D) for definitions.

Financial Institution	Federal and State Law	Description of Requirement
Banks, trust companies, and title insurance companies	Financial Code, Sections 361 and 1585(c)	The State Banking Department must investigate the organizers of banks and trust companies applying for the authority to begin operating and determine whether there is a need for additional banking or trust facilities. Also, the State Banking Department must examine the trust departments of title insurance companies.
Travelers check issuers	Financial Code, Sections 1863.1(a) and 1856(a)	Vendors must submit a report with an application and must annually include an independently audited financial statement.
Banks, trust companies, title insurance companies, and foreign banks	Financial Code, Section 1900	At least every two years, an unspecified examiner must examine these institutions.
Business and industrial development corporations	Financial Code, Section 31504(a)	Licensees must submit an annual audit report with financial statements prepared by an independent CPA or an independent public accountant.
Payment instrument (money order) issuers	Financial Code, Section 33901	Licensees must submit an annual audit report with financial statements prepared by an independent CPA or an independent public accountant.
Industrial loan companies	Financial Code, Section 18405	These companies must submit annual audit reports of their financial statements with an opinion or a certificate from an independent CPA or an independent public accountant.
Escrow agents	Financial Code, Section 17406(a)	These agents must submit an annual audit report of their financial statements with an opinion or a certificate from an independent CPA or an independent public accountant.
Corporate securities, brokers, and investment advisors	Title 10, California Administrative Code, Section 260.241.2(a)	These agents must submit independently audited financial statements.
Check sellers	Financial Code, Section 12304(a)	These sellers must submit independently audited financial statements annually.
Mortgage-loan brokers	Business and Professions Code, Section 10232.2(a)	Specified brokers must submit independently reviewed financial statements annually.
Banks, savings and loan associations, and credit unions	Government Code, Section 53651.4	These depository institutions must have an annual independent CPA report or an examination of specified securities by the Administrator of Local Agency Security of California.
Bank-holding companies	Financial Code, Section 3704	These companies must have an examination by the superintendent of banks of the State Banking Department, by an independent CPA, or by a federal agency.

REASONS WHY THE 76 EMPLOYEES LEFT EMPLOYMENT WITH THE FOUR DEPARTMENTS FISCAL YEARS 1985-86 AND 1986-87

Department	Title of Position Vacated	Employee's Reason For Leaving	Length of Time Employee Worked For Department: Less Than 1	1-3	More Than 3	Fiscal Year Employee Left
State Banking Department	Examiner II	Other employment			X	1985-86
	Examiner II	Personal			X	1985-86
	Examiner III	Other employment			X	1985-86
	Examiner II	Federal employment		X		1985-86
	Examiner II	Federal employment			X	1985-86
	Examiner III	Unknown			X	1985-86
	Examiner II	Federal Employment		X		1985-86
	Examiner II	Other location		X		1985-86
	Examiner IV	Unknown			X	1985-86
	Examiner III	Federal employment			X	1985-86
	Examiner III	Unknown			X	1985-86
	Examiner II	Transfer		X		1985-86
	Examiner IV	Retirement			X	1985-86
	Examiner IV	Retirement			X	1985-86
	Examiner III	Federal employment			X	1986-87
	Examiner II	Federal employment		X		1986-87
	Examiner II	Unknown		X		1986-87
	Examiner III	Federal employment			X	1986-87
	Examiner III	Other career path			X	1986-87
	Examiner III	Federal employment			X	1986-87
	Examiner III	Federal employment			X	1986-87
	Examiner II	Federal employment		X		1986-87
	Examiner I	Personal	X			1986-87
	Examiner III	Unknown			X	1986-87
	Examiner III	Now reinstated			X	1986-87
	Examiner II	Now reinstated		X		1986-87
	Examiner (A)*	Unknown	X			1986-87
	Examiner (A)*	Unknown	X			1986-87
	Examiner (C)*	Unknown			X	1986-87
	Examiner II	Transfer		X		1986-87
	Examiner IV	Retirement			X	1986-87
Department of Savings and Loan	Examiner III	Retirement			X	1985-86
	Auditor I	Transfer	X			1985-86
	Auditor I	Transfer	X			1985-86
	Associate Appraiser	Poor performance	X			1985-86
	Examiner III	Transfer	X			1985-86
	Examiner III	Federal employment			X	1985-86

*New levels under the new expanded job classification for examiners.

Department	Title of Position Vacated	Employee's Reason For Leaving	Length of Time Employee Worked for Department			Fiscal Year Employee Left
			Less Than 1	1-3	More Than 3	
	Examiner III	Federal employment			X	1985-86
	Examiner III	Federal employment			X	1985-86
	Auditor I	Personal	X			1985-86
	Examiner III	Transfer		X		1985-86
	Examiner IV	Retirement			X	1985-86
	Examiner II	Other employment		X		1986-87
	Auditor I	Transfer	X			1986-87
	Examiner (C)*	Other employment		X		1986-87
	Examiner (B)*	Illness	X			1986-87
	Associate Appraiser	Transfer	X			1986-87
Department of Corporations	Examiner II	Other employment		X		1985-86
	Examiner II	Transfer	X			1985-86
	Auditor I	Poor performance		X		1985-86
	Examiner III	Other employment			X	1985-86
	Supervisory Examiner	Deceased			X	1985-86
	Auditor I	Transfer	X			1985-86
	Supervisory Examiner	Retirement			X	1985-86
	Auditor I	Poor performance	X			1985-86
	Examiner II	Transfer		X		1985-86
	Examiner II	Poor performance		X		1985-86
	Supervisory Examiner	Retirement			X	1985-86
	Examiner III	Transfer		X		1986-87
	Examiner II	Transfer		X		1986-87
	Examiner III	Other employment			X	1986-87
	Supervisory Examiner	Retirement			X	1986-87
	Examiner II	Personal		X		1986-87
	Examiner II	Transfer		X		1986-87
	Examiner II	Transfer		X		1986-87
	Examiner II	Transfer		X		1986-87
	Examiner II	Transfer		X		1986-87
	Examiner III	Other employment			X	1986-87
	Auditor I	Federal employment	X			1986-87
	Examiner (B)*	Personal			X	1986-87
Department of Real Estate	Auditor I	Self employment	X			1985-86
	General Auditor II	Retirement			X	1985-86
	Senior Appraiser	Retirement			X	1985-86
	General Auditor II	Transfer		X		1986-87
	Associate Appraiser	Retirement			X	1986-87
	Senior Auditor II	Retirement			X	1986-87

*New levels under the new expanded job classification for examiners.

GLOSSARY OF TERMS

Collective investment fund: Consists of funds that are held by a bank, which acts as trustee, and invested collectively. (Title 12, Code of Federal Regulations, Section 208.8(k)(ii).

Court trust business: Business related to a trust created as a result of a court order (Financial Code, Section 1581).

Edge corporation: Certain corporations organized to engage in foreign banking or other financial operations (Title 12, United States Code, Section 611 et seq.).

National Credit Union Administration Central Liquidity Facility: Federal facility created to meet the liquidity needs of credit unions (Title 12, United States Code, Section 1795).

RESPONSE TO THE AUDITOR GENERAL'S REPORT

We met with representatives of the Business, Transportation and Housing Agency and with representatives of the State Banking Department, the Department of Savings and Loan, the Department of Corporations, the Department of Real Estate, and the Department of Personnel Administration, and they agreed with our conclusions.

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps