



ARIZONA DEPARTMENT OF FINANCIAL INSTITUTIONS

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August 26, 2013

Debra K. Davenport
Auditor General
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Ms. Davenport:

Please accept this letter as our response to the Sunset Review of the Arizona Department of Financial Institutions (DFI). DFI understands the need for periodic reviews of state agencies, and we respectfully respond to those findings by the following comments:

FINDING 1

1.1 The Department should develop and implement written policies and procedures for varying the scope of its examinations based on the financial enterprise's assessed risk. These policies and procedures should identify the types of limited examinations that department staff could perform and the risk ratings that would qualify for the limited examinations.

DFI agrees the current practice of examination could be updated and therefore agrees with the findings 1.1, and will complete as recommended.

- 1.2 To improve the e-exam program, the Department should:*
- a. Develop and implement written policies and procedures on when it is appropriate to use e-exams;*
 - b. Periodically assess whether, when appropriately applied, the e-exam is still effective in detecting violations when compared to the on-site examination; and,*
 - c. Once formal policies and procedures are established, consider extending the e-exam to other license types to assist in reducing its backlog.*

DFI is pleased that the Auditor General recognizes the e-exam as acceptable and also acknowledges that DFI needs to formalize the program. DFI agrees with the findings of 1.2, and will complete as recommended.

1.3 The Department should better prioritize the scheduling of financial enterprise examinations to ensure that low-risk licensees are not examined sooner than is needed, while high-risk licensees receive more timely re-examinations.

DFI agrees with the findings of 1.3, and will complete as recommended.

- 1.4 *The Department should revise its risk-rating worksheets to ensure risk can be compared across license types. In revising its risk-rating worksheets, the Department should ensure that:*
- *Common risk factors, such as management controls, are included in all worksheets;*
 - *All risk-rating worksheets consider the seriousness of the potential violations; and*
 - *Risk factors are appropriately weighed*

DFI agrees with findings 1.4, and will complete as recommended.

- 1.5 *The Department should enhance its processes for identifying financial enterprise risks prior to an examination, and in doing so, the Department should consider:*
- *Using existing financial reports that are already submitted by most of its licensees to assess the size and financial performance of licensees compared to their peers; and*
 - *Identifying financial products that pose the most financial harm to Arizona consumers.*

DFI agrees with findings 1.5, and will complete as recommended.

- 1.6 *The Department should develop and implement written policies and procedures for conducting follow-ups, including when verification of corrective action or re-examination may be necessary. The Department's procedures should identify what types of violations should be followed up on, what level of verification is required, and the time frame for when it should verify that licensees have corrected violations.*

DFI agrees with the findings of 1.6 and will complete as recommended.

FINDING 2

- 2.1 *The Department should enhance its complaint-handling policies and procedures to ensure that department staff consistently and adequately process all complaints in a timely manner. Specifically, the Department should:*
- a. *Standardize complaint investigation steps and include these steps in its policies and procedures;*
 - b. *Establish criteria for documentation suspected unlicensed activity on the Watch List; and*
 - c. *Establish and track time frames for resolving complaints, which should include the entire complaint-handling process of opening, investigating, and resolving the complaint, and specific time frames for completing the various steps of its complaint-handling procedures; and*
 - d. *Analyze its complaint-handling data to assist in determining an appropriate timeliness goal for resolving complaints, and use the data to identify the specific time frames for completing the various steps of its complaint-handling process.*

DFI has long been concerned that an antiquated computer system would handicap timely and accurate tracking as well as other efficiencies in this program. DFI agrees with the findings of 2.1, and will complete as recommended.

- 2.2 *The department should improve its oversight over its complaint handling function by enhancing its supervisory review process to evaluate the adequacy and timely handling of complaint investigations in a way that is feasible given available resources, and should document the results of these supervisory reviews in its complaint case files. This enhanced supervisory review process should include:*
- a. *Verification that all complaints received are within its jurisdiction are entered in the case management system for investigation ;*
 - b. *Periodic review of ongoing complaint investigations to ensure that these investigations are progressing in a timely manner, and for any cases that have been open for a long time, determine whether they should be further investigated or closed; and*
 - c. *Review of investigative sufficiency to ensure that the Department's investigative policies and procedures are being followed, including reviewing the steps taken to investigate a complaint and ensuring that identified entities are placed in the Watch List.*

DFI agrees with the findings of 2.2, and will implement as recommended.

- 2.3 *The Department should develop and implement performance measures to ensure that investigators adhere to the Department's investigative time frames, once these time frames have been established.*

DFI is excited to use the tools of the newly established personnel performance system known as MAP. DFI agrees with the findings of 2.3, and will implement as recommended.

- 2.4 *To help ensure the completeness and accuracy of complaint information in its case management system, the Department should:*
- a. *Update its complaint-handling policies and procedures to include specific definitions for each of its case status designations, including those related to the final outcome of a complaint investigation; and*
 - b. *Develop and implement policies and procedures that require secondary review of data entry that is feasible given the Department's available resources, including a review of the accuracy of case status designations recorded in the case management system.*

DFI agrees with findings of 2.4, and will implement as recommended.

FINDING 3

- 3.1 *To ensure its fees more fully reflect costs, the Department should develop a structured approach to evaluate current fees and propose legislative or rule changes that would*

more closely align its fees with the department funding needs. In developing this approach, the Department should do the following:

- a. Assess the efficiency of its operations to ensure costs are as low as possible while considering service quality, and should document the results of its assessment.*
- b. Develop and implement a method for estimating department costs, including both direct and indirect costs, and create policies and procedures for using this method.*
- c. Establish an allocation methodology for assigning direct payroll costs to licensee category within its currently established accounting system.*
- d. After the method is developed and costs are appropriately tracked, the Department should use the costs to analyze its fee structure and determine the appropriate fees to charge.*
- e. Include in its policies and procedures a timeframe by which it will reevaluate its fees to ensure its fees continue to align with its costs.*

DFI agrees with the findings of 3.1, a through e, and will complete as recommended.

- 3.2 *When warranted and based on its cost and fee assessment, the Department should propose legislative changes to its statutory established fee amounts or make appropriate rule changes to revise its fees.*

DFI agrees with the findings of 3.2 and will complete as recommended, when warranted.

- 3.3 *The Department should consider the effect that the proposed fee changes may have on the affected financial institution and enterprises and obtain their input when reviewing fees.*

DFI has consistently communicated with the industries that it serves and will continue to do so during the review of fees. DFI agrees with the findings of 3.3 and will complete as recommended.

Sunset Factor 2. (SF #2)

To the extent to which the Department has met its statutory objective and purpose and the efficiency with which it has operated: Recommendations:

- *Separate cash receipts responsibilities to ensure that one employee collects receipts and a different employee records the receipts in the accounting records;*
 - *Require two employees to open the mail and record mail receipts;*
 - *Require checks received to be located in a safe prior to deposit;*
 - *Conduct a complete physical inventory of all capital assets at least annually and update the State's Fixed Asset System for any corrections needed based on the results of the inventory; and*

- *Maintain all supporting documentation for disposed capital assets and update the State's Fixed Asset System within 5 working days of the disposal.*

DFI agrees with the findings of SF # 2, and will complete as recommended. A physical inventory was completed, by DFI personnel, prior to the end of the exam.

Sunset Factor 5. (SF #5)

To the extent to which the Department has encouraged input from the public before adopting rules and the extent to which it has informed the public as to its actions and their expected impact on the public.

- *Department should formalize its process for deciding when it will provide financial enterprise information to the public-*
- *Department should ensure that it can provide the public with a complete and accurate listing of its enforcement actions-*
- *Department should provide a clear disclosure on its Web site that its listing of enforcement actions is not complete-*

DFI agrees with the findings of SF #5, and will complete as recommended. DFI has completed the disclosure on the Web site as of this writing.

Sunset Factor 12. (SF #12)

To the extent to which the Department has used private contractors in the performance of its duties as compared to other states and how more effective use of private contractors could be accomplished.

- *Department should work with the State Procurement Office and ASET to ensure that future contracts to procure IT systems protect the State's financial resources.*
- *The Department should ensure that future PIJs include adequate assessments of the new systems' suitability for the Department's needs, including compatibility with the Department's present database to ensure data conversion is successful and that system requirements are clearly defined within the scope of work.*
- *The Department should develop and implement a formal system development lifecycle (SDLC) methodology.*
- *The Department should ensure future IT procurement contracts include provisions for phased payments rather than lump sum payments prior to work commencing. In addition, the Department should closely monitor contractor performance and progress toward meeting milestones to ensure projects progress according to agreed-upon contract items.*

DFI agrees with the findings of SF #12, and will complete as recommended.

On behalf of the DFI staff and myself, I want to express my appreciation for the thorough review and the professionalism of those that represented the Auditor General's office.

With few exceptions, DFI has agreed with discussions that have led up to the writing of the Performance Audit and Sunset Review, which we now represent with our final response in agreement to the recommendations.

During the period of time which is incorporated in this Sunset Review, the Department, the State, and the Industries that we serve, have experienced the most significant economic challenge that all of us have ever encountered. DFI recognizes that we can always improve the service that we have been mandated to perform and respectfully plan to use these and all recommendations in pursuit of this responsibility.

Respectfully submitted,

Mr. Lauren W. Kingry
Superintendent
Department of Financial Institutions