



DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

MELANIE M. CHESNEY
DEPUTY AUDITOR GENERAL

May 4, 2015

The Honorable Judy Burges, Chair
Joint Legislative Audit Committee

The Honorable John Allen, Vice Chair
Joint Legislative Audit Committee

Dear Senator Burges and Representative Allen:

Our Office has recently completed an 18-month followup of the Arizona Department of Financial Institutions regarding the implementation status of the 40 audit recommendations (including sub-parts of the recommendations) presented in the performance audit report released in August 2013 (Auditor General Report No. 13-05). As the attached grid indicates:

- 28 have been implemented;
- 8 are in the process of being implemented; and
- 4 are not yet applicable.

Our Office will conduct a 24-month followup with the Department on the status of those recommendations that have not yet been fully implemented.

Sincerely,

Dale Chapman, Director
Performance Audit Division

DC:ss
Attachment

cc: Lauren W. Kingry, Superintendent
Arizona Department of Financial Institutions

Arizona Department of Financial Institutions

Auditor General Report No. 13-05

18-Month Follow-Up Report

Recommendation	Status/Additional Explanation
Finding 1: Department should enhance its financial enterprise examination strategy	
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.	Implemented at 6 months
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;	Implemented at 6 months
b. Periodically assess whether, when appropriately applied, the e-exam is still effective in detecting violations when compared to the on-site examination; and,	Implemented at 18 months
c. Once formal policies and procedures are established, consider extending the e-exam to other license types to assist in reducing its backlog.	Implemented at 6 months
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 reexamination.	Implemented at 18 months
1.4 The Department should revise its post-examination, 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 and controls, are included in all worksheets;	Implemented at 6 months
• All risk-rating worksheets consider the seriousness of the potential violations; and	Implemented at 6 months
• Risk factors are appropriately weighed.	Implemented at 6 months
1.5 The Department should enhance its processes for identifying risks prior to an examination, and in doing so, should consider:	
• Expanding the use of 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	Implemented at 18 months

Recommendation	Status/Additional Explanation
<ul style="list-style-type: none"> Identifying financial products that pose the most financial harm to Arizona consumers. 	<p>Implemented at 18 months</p>
<p>1.6 The Department should develop and implement written policies and procedures for conducting followups, including when verification of corrective action or reexamination 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.</p>	<p>Implemented at 18 months</p>
<p>Finding 2: Department should enhance its complaint-handling process</p>	
<p>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:</p> <ul style="list-style-type: none"> a. Standardize complaint investigation steps and include these steps in its policies and procedures; b. Establish criteria for documenting suspected unlicensed activity on the Watch List; 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 appropriate timeliness goals for resolving complaints, and use the data to identify the specific time frames for completing the various steps of its complaint-handling process. 	<p>Implemented at 18 months</p> <p>Implemented at 18 months</p> <p>Implemented at 18 months</p> <p>Implemented at 18 months</p>
<p>2.2 The Department should improve its oversight of 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 its available resources, and should document the results of these supervisory reviews in its complaint case files. Specifically, the Department should develop and implement written policies and procedures that require the following:</p> <ul style="list-style-type: none"> a. Verification that all complaints received that are within its jurisdiction are entered into the case management system for investigation; 	<p>Implemented at 6 months</p>

Recommendation	Status/Additional Explanation
<ul style="list-style-type: none"> b. Periodic review of complaint investigations to ensure that these investigations are progressing in a timely manner, documenting these reviews and any associated decisions, and for any cases that have been open for a long time, guidelines on whether they should be further investigated or closed; and 	<p>Implemented at 18 months</p>
<ul style="list-style-type: none"> c. Review of investigation 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. 	<p>Implemented at 18 months</p>
<p>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.</p>	<p>Implemented at 18 months</p>
<p>2.4 To help ensure the completeness and accuracy of complaint information in its case management system, the Department should:</p> <ul style="list-style-type: none"> 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 a risk-based review of data entry based on its available resources, including a review of the accuracy of case status designations recorded in the case management system. 	<p>Implemented at 18 months</p> <p>Implemented at 18 months</p>

Finding 3: Department should establish a structured approach to set appropriate fees

3.1 To ensure its fees more fully reflect its 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 department funding needs. In developing this approach, the Department should do the following:

Recommendation

Status/Additional Explanation

- a. Assess the efficiency of its operations to ensure costs are as low as possible while considering service quality, and document the results of its assessment. As the Department assesses the efficiency of its operations, it should continue seeking to minimize costs where possible.

Implementation in process

The Department reported that it is still in the process of assessing its operations' efficiency and making changes that will result in greater efficiencies. For example, in May 2014, the Department restructured its licensing division to better focus on specializing duties and to combine two sections that performed similar functions. According to the Department, by making these changes, it completed the 2014 calendar year-end license renewal process without using any temporary staff, which had been the standard practice in recent years. Although the Department added one full-time licensing staff in May 2014, it reported that the efficiencies gained in restructuring the division also may have contributed to allowing the division to complete year-end processing without temporary staff. In addition, the Department began implementing a new e-licensing system during fiscal year 2015 that it reported will modernize business processes department-wide.

- 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.

Implementation in process

The Department has begun developing a method for allocating costs that is currently under management review. This method is designed to estimate and track costs by license type. However, the Governor's 2016 Executive Budget proposed a funding structure change for the Department, which the Department reported would substantially change its cost allocation method if enacted. Although the Legislature did not enact the proposed funding structure change, the Department delayed further development of its cost allocation methodology while the Governor's proposal was considered. The Department anticipates that its cost allocation method will be implemented in the first half of fiscal year 2016.

- c. Establish an allocation methodology for assigning direct payroll costs to licensee category within its currently established accounting system.

Implementation in process

At the beginning of fiscal year 2015, the Department implemented a methodology for allocating direct payroll costs to the loan originator program. The Department also has developed a preliminary methodology for allocating direct payroll costs across its remaining licensing categories, and it plans to implement this methodology once it is finalized. However, the State's conversion to a new accounting system may delay this implementation.

- 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.

Not yet applicable

This recommendation is dependent upon implementation of Rec. 3.1b and c.

- e. Include in its policies and procedures a time frame by which it will reevaluate its fees to ensure its fees continue to align with its costs.

Not yet applicable

This recommendation is dependent upon implementation of Rec. 3.1b, c, and d.

Recommendation	Status/Additional Explanation
3.2 When warranted and based on its cost and fee assessment, the Department should propose legislative changes to its statutorily established fee amounts or make appropriate rule changes to revise its fees.	Not yet applicable This recommendation is dependent upon implementation of Rec. 3.1, including all of its sub-parts.
3.3 The Department should consider the effect that the proposed fee changes may have on the affected financial institutions and enterprises and obtain their input when reviewing the fees.	Not yet applicable This recommendation is dependent upon implementation of Recs. 3.1 and 3.2.

Sunset factor #2 The extent to which the Department has met its statutory objective and purpose and the efficiency with which it has operated.

<ul style="list-style-type: none"> Separate cash receipts responsibilities to ensure that one employee collects receipts and a different employee records the receipts in the accounting records; 	<p>Implementation in process</p> <p>The Department reported that it is in the process of procuring a new e-licensing system that will incorporate appropriate segregation of duties, and anticipates that the new system’s accounting functions will be operational in the first half of calendar year 2016. To mitigate the risk associated with the lack of separated cash-handling responsibilities, the Department began accepting credit cards in April 2014. In addition, the Department established a process in February 2015 requiring staff to document deposit amounts on customer sign-in sheets and for different staff to reconcile these deposit amounts with the actual deposits made. Auditors will follow up at 24 months to assess this process’ implementation.</p>
<ul style="list-style-type: none"> Require two employees to open the mail and record mail receipts; 	<p>Implemented at 6 months</p>
<ul style="list-style-type: none"> Require checks received to be locked in a safe prior to deposit; 	<p>Implemented at 6 months</p>
<ul style="list-style-type: none"> 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 	<p>Implemented at 6 months</p>
<ul style="list-style-type: none"> Maintain all supporting documentation for disposed capital assets and update the State’s Fixed Asset System within 5 working days of the disposal. 	<p>Implemented at 6 months</p>

Sunset factor #5 The extent to which the Department has encouraged input from the public before adopting its rules and the extent to which it has informed the public as to its actions and their expected impact on the public.

<ul style="list-style-type: none"> Develop and implement written policies and procedures to guide the determination of whether or not to provide information to the public, including factors that should be considered when doing so. 	<p>Implemented at 6 months</p>
---	---------------------------------------

Recommendation	Status/Additional Explanation
<ul style="list-style-type: none"> Establish and implement a supervisory review process based on its available resources to ensure that information in the database related to the final action taken on a case is complete and accurate. 	<p>Implemented at 18 months</p>
<ul style="list-style-type: none"> Include a public disclosure on its Web site that its listings of enforcement actions are not complete. 	<p>Implemented at 6 months</p>
<p>Sunset factor #12 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.</p>	
<ul style="list-style-type: none"> 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; 	<p>Implementation in process The Department completed a Project Investment Justification (PIJ) for an e-licensing system in March 2014, which included system requirements, compatibility with the Department's present system, and data conversion requirements for the project. However, the Department has not yet developed a formal policy to ensure all future projects the Department initiates require a PIJ that includes system requirements, compatibility with the Department's present system, and data conversion requirements.</p>
<ul style="list-style-type: none"> Develop and implement a formal system development lifecycle (SDLC) methodology; 	<p>Implementation in process The Department drafted an SDLC methodology policy in November 2014. Auditors reviewed and provided feedback on the policy, and the Department provided auditors with a revised version in April 2015. Auditors will review the revised policy during the next followup.</p>
<ul style="list-style-type: none"> Ensure future IT procurement contracts include provisions for phased payments rather than lump-sum payments prior to work commencing; and 	<p>Implementation in process The Department is working on an IT contract that includes provisions for phased payments based on specific project milestones. However, the Department has not yet developed a formal policy to ensure all projects it contracts for require phased payments and prohibit lump sum payments.</p>
<ul style="list-style-type: none"> Closely monitor contractor performance and progress toward meeting milestones to ensure projects progress according to agreed-upon contract terms. 	<p>Implementation in process The Department has retained a contractor to develop and implement a new e-licensing system and is monitoring the contractor's performance and progress based on the agreed-upon contract terms. However, the Department has not yet developed a formal policy to ensure all projects have established performance and progress milestones, or how the Department will monitor these milestones.</p>