

State of Arizona  
Office  
of the  
Auditor General

**PERFORMANCE AUDIT**

**ARIZONA  
DEPARTMENT  
OF  
REAL ESTATE**

**Report to the Arizona Legislature  
By Debra K. Davenport  
Auditor General**

**August 2001  
Report No. 01-15**

*The Auditor General is appointed by the Joint Legislative Audit Committee, a bipartisan committee composed of five senators and five representatives. Her mission is to provide independent and impartial information and specific recommendations to improve the operations of state and local government entities. To this end, she provides financial audits and accounting services to the state and political subdivisions and performance audits of state agencies and the programs they administer.*

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AUDITOR GENERAL

STATE OF ARIZONA  
OFFICE OF THE  
AUDITOR GENERAL

WILLIAM THOMSON  
DEPUTY AUDITOR GENERAL

August 2, 2001

Members of the Arizona Legislature

The Honorable Jane Dee Hull, Governor

Mr. Jerry Holt, Commissioner  
Department of Real Estate

Transmitted herewith is a report of the Auditor General, A Performance Audit of the Department of Real Estate. This report is in response to a June 16, 1999, resolution of the Joint Legislative Audit Committee. The performance audit was conducted as part of the Sunset review set forth in A.R.S. §41-2951 et seq. I am also transmitting with this report a copy of the Report Highlights for this audit to provide a quick summary for your convenience.

As outlined in its response, the Department of Real Estate has agreed to implement 17 of the 23 recommendations but does not agree with the remaining 6 recommendations.

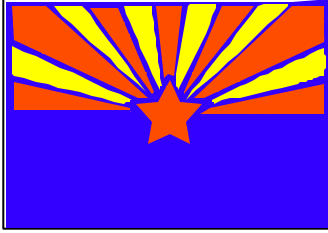
My staff and I will be pleased to discuss or clarify items in the report.

This report will be released to the public on August 3, 2001.

Sincerely,

Debbie Davenport  
Auditor General

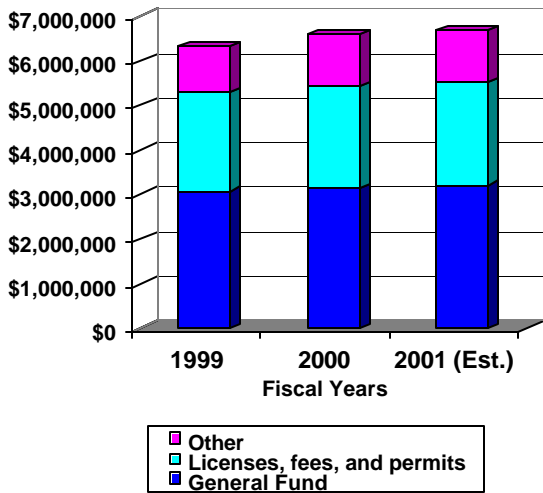
Enclosure



# Department of Real Estate

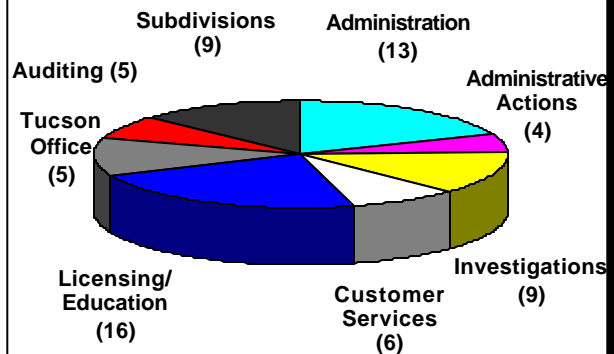
**Services:** The Department operates as one program offering the following services through five subprograms: **1) Central Administrative Services**—Provides budget, customer, computer information, and other services; **2) Education and Licensing**—Licenses real estate, cemetery, and membership camping salespersons and brokers, as well as entities, such as corporations and limited liability companies; and approves schools providing real estate licensure education, as well as courses and instructors; **3) Regulation**—Conducts investigations in response to public complaints or on its own initiative, prosecutes licensees to resolve violations of real estate laws, and audits brokers' business records to ensure that brokers properly handle client monies; **4) Land Development**—Examines and issues subdivision, time-share, unsubdivided land, and membership camping public reports and cemetery certificates of authority; **5) Recovery Assistance**—Determines the validity of claims against the Real Estate Recovery Fund to compensate people who have suffered financial losses due to the illegal acts of licensees.

**General Fund Revenues<sup>1</sup>: \$3.2 million**  
(Estimated for fiscal year 2001)



<sup>1</sup> The Department must deposit most revenues collected through licenses, fees, and permits and other sources into the State General Fund.

**Personnel: 67 full-time staff**  
(fiscal year 2001)



**Facilities:**

Department employees are located at 2 state-owned facilities. The Department houses 59 of its 67 employees at 2910 North 44<sup>th</sup> Street in Phoenix. An additional 8 employees are housed at 400 West Congress in Tucson, including 3 employees from Auditing.

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## Program Goals (fiscal year 2000-2001)

### Subprogram: Education and Licensing

1. To review and approve new courses quickly and efficiently.
2. To improve the quality of class offerings and instructors by monitoring and auditing more classes.
3. To create and maintain procedures to process and print a license in an efficient and timely manner.
4. To provide better customer service to licensees.

### Subprogram Regulation

1. To audit and document brokers' compliance with timely maintenance of legally required records.
2. To reduce the hearing caseload through viable alternatives to the hearing process.
3. To coordinate and facilitate the Department's administrative hearings.
4. To monitor and enforce compliance with ordered or stipulated terms or provisions.
5. To maintain a firm but fair enforcement policy.
6. To maintain the timeliness of the investigative process.

### Subprogram: Land Development

1. To issue timely public reports.

### Subprogram: Recovery Assistance

1. To efficiently serve the public interest by administering the Real Estate Recovery Fund.

## Adequacy of Goals and Performance Measures:

The Department could make some improvements to the goals for its five subprograms and their associated performance measures. For example:

- Some of the Department's goals do not accurately capture the Department's responsibilities or mission. For example, while the Regulation subprogram has a goal of maintaining the timeliness of the investigative process, this goal does not address the quality or thoroughness of the Department's complaint investigations. Similarly, the Land Development subprogram has one goal, focusing on its timeliness in issuing public reports, but this goal does not address the appropriateness and accuracy of these reports.
- The Department does not have sufficient measures to report on the activities and the outcomes of its subprograms. Most of the Department's performance measures are focused on inputs or timeliness. However, the Department lacks needed output, outcome, and efficiency measures that would provide a more complete picture of Department activities to oversight bodies and other interested persons. For example, the Department's Regulation subprogram has no outcome measures that report problems identified in broker audits or the results of its complaint investigations; or efficiency measures that report the efficiency with which broker audits and complaint investigations are conducted. Additionally, within the Education and Licensing subprogram, the Department lacks outcome measures on the number of real estate courses approved or rejected, the results of its class monitoring efforts, and the percentage of licensees approved, denied, or the subject of disciplinary action.

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## SUMMARY

The Office of the Auditor General has conducted a performance audit of the Department of Real Estate pursuant to a June 16, 1999, resolution of the Joint Legislative Audit Committee. This audit was conducted as part of the Sunset review set forth in A.R.S. §41-2951 et seq.

The Department of Real Estate (Department) licenses and regulates more than 46,200 real estate salespersons and brokers, including salespersons and brokers for cemeteries and membership campgrounds, and more than 9,560 corporations and other entities engaged in the sale of real property. The Department is responsible for investigating public complaints against licensees and taking appropriate disciplinary actions against those who have violated Arizona's real estate laws. The Department is also responsible for providing consumers with public information on licensees and approving all of the real estate schools and courses offered in Arizona.

### **The Department Needs to Improve Its Complaint- Handling Practices (See pages 11 through 22)**

The Department has the authority to receive and investigate consumer complaints about fraud, misrepresentation, and negligence. However, the Department has established complaint-handling policies and procedures that can discourage the filing of some complaints and do not ensure that all complaints are thoroughly investigated.

The Department's practices for receiving complaints include some barriers that can discourage legitimate complaints. These practices were established to help manage the Department's workload by screening out complaints over which the Department has no jurisdiction. However, these practices may also

screen out valid complaints. For example, the Department, against the recommendations of its Attorney General representatives, has listed on its complaint form eight broad areas, such as “ethical/performance issues” and “deposits/refunds,” in which the Department claims to have no jurisdiction. However, there are cases within the Department’s jurisdiction that may fall within the areas listed.

The Department’s investigative procedures further limit its public protection efforts. Auditors were unable to determine the Department’s investigation rate because the Department does not track or report the number of complaints it receives. However, auditors’ review of 16 dismissed complaints found 2 that merited the Department’s further investigation. Further, when the Department does investigate complaints, these investigations are often inadequate or are not thoroughly documented. A review of 30 complaint investigations from fiscal years 1998 through 2000 showed that most did not contain documentation that complainants were interviewed or that all pertinent documentation was collected and reviewed. For example, the Department did not interview the complainant in 16 (53 percent) of the cases reviewed.

### **Department Inconsistently Disciplines Real Estate Law Violators (See pages 23 through 27)**

Licenses who violate real estate laws are not treated equitably. Auditors found that the Department’s actions in 28 cases involving licensees who breached their fiduciary duties were inconsistent. For example, a licensee who failed to inform his client that the buyer did not make a \$5,000 earnest payment received an 18-month suspension, while a licensee who forged his client’s name on a contract received a 60-day suspension.

To assist it in making consistent and appropriate disciplinary decisions, the Department should adopt disciplinary guidelines. Although the Department’s procedure manual states that it should take aggravating and mitigating circumstances into consideration when determining disciplinary actions, the manual

does not provide the Department specific guidelines to direct it in applying these factors. To strengthen its enforcement efforts, the Department should develop and implement disciplinary guidelines and adopt these guidelines into a substantive policy statement.

### **Recovery Fund Is Costly and Cumbersome to Administer (See pages 29 through 36)**

Costs to operate the Real Estate Recovery Fund can be reduced. The Fund pays part or all of a person's losses when the losses cannot be recovered from a licensee who has engaged in wrongdoing, such as fraud or misrepresentation. However, the Department's costs to administer the Fund in fiscal years 1998-2000 have been greater than the amount paid out to claimants. In addition, the Fund's balance has decreased by over \$185,000 during the same period.

The Department incurs high administrative costs mainly because of the steps it takes to follow potential claims as they move through the court system and to resolve claims once the courts authorize them. This includes time spent on cases that never result in a claim. Administrative costs could be reduced if the Department, rather than the courts, had the responsibility for approving or denying a claim against the Fund. This change would reduce both the amount of time the Fund Administrator spends following cases in process and the amount of legal assistance needed from the Attorney General's Office. California has used this alternative approach for the past several years, thus reducing its administrative costs.

Another way to decrease these administrative costs is to charge only Fund-related personnel costs to the Fund. The Fund pays the cost of a full-time Fund Administrator and a half-time Assistant Attorney General. Although both employees spend part of their time on other duties, their full costs are charged to the Fund. Based on the reported time spent on these other duties and the personnel costs of these positions, in fiscal year 2000, the costs inappropriately charged to the Fund totaled approximately \$31,000.



**Department's Public  
Information Practices Impede  
Consumers' Access to  
Licensee Information  
(See pages 37 through 41)**

The Department does not provide consumers with ready and sufficient access to information on licensees' complaint and disciplinary histories. The Department does not follow its stated policy for making disciplinary information available over the telephone. Instead, consumers must make an advance request in writing and wait several weeks for the Department to prepare the licensee's file. They must then travel to the Department's office to view the information, and provide picture identification and log in before the Department will make this information available for review. Other Arizona regulatory agencies are doing more than the Department to make such information more readily available, such as requiring staff to provide the public with information over the telephone regarding the number and type of both dismissed and pending complaints, and the resolution of closed complaints.

When consumers do review files, the Department needs to make certain that files prepared for consumer review contain complete complaint and disciplinary information and that all confidential information, such as licensees' home addresses and social security numbers, are removed.

**Sunset Factors  
(See pages 43 through 51)**

As part of the Sunset Review process, this audit recommends that the Department revise Commissioner's Rule R4-28-1303 to clarify the rule and make it consistent with public records laws. Currently, this rule restricts public access to any information or document obtained in an investigation unless it is made a matter of public record. However, this rule contradicts public records laws, which already make Department investigation information and documents public record.

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# INTRODUCTION AND BACKGROUND

The Office of the Auditor General has conducted a performance audit of the Department of Real Estate pursuant to a June 16, 1999, resolution of the Joint Legislative Audit Committee. This audit was conducted as part of the Sunset review set forth in A.R.S. §41-2951 et seq.

## Mission and Purpose

The Department of Real Estate (Department) was established in 1921 and administered by the State Land Commission until 1947, when the Legislature created a seven-member Real Estate Board with a Real Estate Commissioner as chairman. In 1950, the Board was given authority to appoint the Real Estate Commissioner, who was no longer a member of the Board. In 1975, in response to concerns that the Real Estate Board inadequately regulated real estate licensees, statutes were changed to reduce the Board's role to an advisory capacity. At the same time, the Real Estate Commissioner became a Governor-appointed position.

The Department's mission is:

*To safeguard and promote the public interest through timely and capable assistance, fair and balanced regulation, and sound and effective education.*

To accomplish this, the Department is responsible for a number of functions, including:

- Licensing and regulating Arizona real estate, cemetery, and membership camping salespersons and brokers.<sup>1</sup>

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<sup>1</sup> Membership camping refers to campgrounds that solicit paid memberships for the purposes of camping or outdoor recreation, including the use of camping sites primarily by members.

- Investigating complaints from the public and licensees regarding real estate transactions.
- Prosecuting licensees to resolve alleged violations of real estate statutes and Commissioner's rules.
- Providing information to the public on Department licensees, including complaints filed and disciplinary history.

In addition, the Department is responsible for the oversight and regulation of all the real estate schools and instructors in the State, and the issuance of public reports for subdivisions and un-subdivided land, which provide buyers with information needed for purchasing decisions, including information on road access to the property, water sources, and sewage disposal. The Department also audits brokers' records and their handling of client monies to ensure compliance with statutory requirements.

### **Licensee Information and Licensing Requirements**

As of June 29, 2001, the Department reports having over 46,200 licensees. Table 1 (see page 3) depicts the number of individual real estate professionals by different license types who are licensed by the Department, along with licensing requirements and associated licensing fees.

#### **Item 1: Licensee Definitions**

- **Salesperson**—Engage in a variety of activities, including selling, negotiating offers to sell, and listing for sale real estate, time-share interval, cemetery, and membership camping properties.
- **Broker**—Employ or supervise salespersons and can also engage in the same types of activities as salespersons.

In addition to individuals, the Department also licenses approximately 9,560 entities that are engaged in selling or leasing real property, including corporations, limited liability companies, and partnerships. Finally, the Department is responsible for regulating and approving real estate schools, including courses and instructors. Currently, there are 96 active real estate schools in Arizona that are approved by the Department.

*The Department has over 46,200 active licensees.*

**Table 1**

**Department of Real Estate  
Number of Licensees, Initial Licensure Requirements, and  
License Fees  
As of June 29, 2001**

<b>Type of License</b>	<b>Number of Licensees</b>	<b>Initial Licensure Requirements</b>	<b>Fees</b>
<b>Salespersons</b>			
Real Estate Salesperson	34,326	<ul style="list-style-type: none"> <li>■ Complete a required 90-hour salesperson pre-licensure education program at a real estate school certified by the Commissioner.</li> <li>■ Pass that school's examination.</li> <li>■ Pass a two-part examination that has general questions and state-specific questions.</li> </ul>	<ul style="list-style-type: none"> <li>■ Initial license—\$114.</li> <li>■ Renewal license—\$60 (must be renewed every 2 years).</li> </ul>
Cemetery Salesperson <sup>1</sup>	429		
Membership Camping Salesperson <sup>1</sup>	85		
Total salesperson licenses	<u>34,840</u>		
<b>Brokers</b>			
Real Estate Brokers	11,387	<ul style="list-style-type: none"> <li>■ Complete a required 90-hour broker pre-licensure education program at a real estate school certified by the Commissioner.</li> <li>■ Pass that school's exam.</li> <li>■ Demonstrate at least three years' experience as a licensed real estate salesperson or broker in the preceding five years.</li> <li>■ Pass a two-part examination that has general questions and state-specific questions.</li> </ul>	<ul style="list-style-type: none"> <li>■ Initial license ranges from \$169 to \$189.</li> <li>■ Renewal license—\$125 (must be renewed every 2 years).</li> </ul>
Cemetery Brokers <sup>1</sup>	41		
Membership Camping Brokers <sup>1</sup>	14		
Total broker licenses	<u>11,442</u>		
Total licensees	<u>46,282</u>		

<sup>1</sup> Cemetery and Membership Camping salesperson and broker applicants are not required to have pre-licensure education or pass a school examination. However, they must pass the state exam.

Source: Auditor General staff analysis and summary of licensure requirements identified in A.R.S. §32-2124 and Department-reported licensure numbers, and current licensure fees.



### **Organization**

The Department of Real Estate is charged with the regulation of real estate licensees. To do this, the Department has divided its responsibilities into the following seven divisions located at its main office in Phoenix:

- **Administration (13 FTEs)**—This division sets the Department’s overall regulatory and fiscal policies and strategic direction. In addition, it can grant licensing requirement waivers to current licensees and eligible license applicants, such as individuals who have been licensed in other states and have completed that state’s requirements for education and testing, and wish to become licensed in Arizona.
- **Licensing and Education (16 FTEs)**—This division protects the public by issuing licenses to qualified persons and entities and ensures the accuracy of licensing records. The division also renews licenses in compliance with statutes, rules, and procedures and oversees the administration of licensing examinations. The Department reports that it typically issues licenses within three to five days of receiving applications. Auditors found that in some instances, if all license application information and fees are submitted, the Department issues a license the same day an application is received. Promptly issuing licenses allows individuals to quickly begin working in the real estate industry.
- **Investigations (9 FTEs)**—This division is responsible for investigating complaints regarding real estate and land development transactions. Additionally, this division conducts investigations of licensure applicants when an applicant’s background check reveals criminal convictions. During fiscal year 2000, the Department investigated approximately 500 cases, including investigations arising from consumer complaints and license applicant background checks.
- **Administrative Actions (4 FTEs)**—Administrative Actions reviews completed investigations and proposes disciplinary actions to the Commissioner. This division also monitors licensees’ compliance with consent orders and Commissioner’s orders and administers the Real Estate Recovery

Fund, which is designed to cover losses that result from the wrongdoing of a licensed real estate agent, such as fraud or misrepresentation. For more information on the Recovery Fund, see Finding III, pages 29 through 36.

- **Customer Services (6 FTEs)**—Customer Services provides a single point of contact for the public and licensees by answering questions; giving instructions on how to file a complaint; and disseminating information, such as laws, rules, and other real-estate-related topics. In addition, Customer Services responds to public assistance requests, which are any type of written communication from a consumer or a licensee who has asked for information from the Department.
- **Subdivisions (9 FTEs)**—This division is responsible for reviewing and approving applications for subdivision, time-share, unsubdivided land, and membership camping public reports, and cemetery certificates of authority, which serve as permission to operate a cemetery.<sup>1</sup> Public reports and certificates of authority are required before developers or cemeteries can begin offering these types of real property for sale or lease in Arizona.
- **Auditing (5 FTEs)**—This division audits brokers' records to ensure that brokers are in compliance with the law and are properly handling client monies.

In addition, the Department has a branch office in Tucson where eight staff persons work. Three of these staff are part of the Auditing Division. The other five staff provide licensing, investigation, subdivision, and customer services to Southern Arizona licensees and residents.

### **Real Estate Advisory Board**

The Real Estate Advisory Board comprises nine volunteer members who are appointed by the Governor and serve six-year terms. The Board is charged with providing the Real Estate

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<sup>1</sup> Land is considered subdivided when it has been divided into six or more parcels that are less than 36 acres each in size. Unsubdivided land contains parcels that are 36 acres or larger in size.

Commissioner with such recommendations as it deems necessary and beneficial to the best interests of the public. According to statute, the Board shall meet at least four times each year.

### **Department Budget**

As illustrated in Table 2 (see page 7), during fiscal year 2001, the Department was appropriated \$3,218,700 in General Fund monies for Department operations. Although it receives these monies for its operations, the Department also generates revenues, primarily through the collection of licensing fees and charges for the sale of goods and services. In fiscal year 2001, the Department estimated it would generate approximately \$3,458,000 in revenue. However, according to statute, the Department is required to deposit most of the revenues it generates into the General Fund. In addition, statute requires that the revenue generated by the Department be at least 95 percent but not more than 110 percent of the succeeding year's anticipated General Fund appropriation. If revenues fall outside this range, the Department must examine its fees and determine if they should be lowered or raised in order to bring revenues back in line with the 95 to 110 percent requirement. The Department estimates it will remit \$3,281,400 to the General Fund in fiscal year 2001.

### **Audit Scope and Methodology**

This performance audit and Sunset review includes findings and recommendations in the following four areas:

- The need for the Department to improve its complaint-handling practices by implementing procedures that facilitate the filing of complaints, investigating all complaints that warrant investigation, and developing and implementing policies for more effective and consistent investigations;
- The need for the Department to provide consistent enforcement of real estate laws by developing and implementing disciplinary guidelines;

**Table 2**

**Department of Real Estate  
Statement of Revenues, Expenditures, and Changes in Fund Balance  
Years Ended June 30, 1999, 2000, and 2001  
(Unaudited)**

	<b>1999 (Actual)</b>	<b>2000 (Actual)</b>	<b>2001 (Estimated)</b>
Revenues:			
State General Fund appropriation	\$3,074,600	\$3,136,200	\$3,218,700
Licenses, fees, and permits	2,220,962	2,303,487	2,313,000
Sales and charges for goods and services:			
Filing fees	605,767	591,577	605,900
Examination fees	200,279	233,308	234,000
Other	29,397	64,475	57,600
Fines and forfeits	48,697	114,062	110,000
Earnings on investments	71,900	70,384	70,700
Other	<u>60,644</u>	<u>82,747</u>	<u>67,600</u>
Total revenues	<u>6,312,246</u>	<u>6,596,240</u>	<u>6,677,500</u>
Expenditures:			
Personal services	1,990,883	2,045,757	2,162,400
Employee-related	432,840	443,833	478,900
Professional and outside services	75,710	80,488	81,600
Travel, in-state	52,249	47,059	58,900
Travel, out-of-state	3,773	2,289	5,000
Other operating	648,975	544,216	573,000
Equipment	<u>165,538</u>	<u>147,294</u>	<u>77,100</u>
Total expenditures	3,369,968	3,310,936	3,436,900
Excess of revenues over expenditures	<u>2,942,278</u>	<u>3,285,304</u>	<u>3,240,600</u>
Other financial uses:			
Remittances to the State General Fund <sup>1</sup>	3,081,810	3,272,289	3,281,400
Reversions to the State General Fund	<u>1,979</u>	<u>11,449</u>	
Total other financing uses	<u>3,083,789</u>	<u>3,283,738</u>	<u>3,281,400</u>
Excess of revenues over (under) expenditures and other financing uses	(141,511)	1,566	(40,800)
Fund balance, beginning of year	<u>1,406,486</u>	<u>1,264,975</u>	<u>1,266,541</u>
Fund balance, end of year <sup>2</sup>	\$1,264,975	\$1,266,541	\$1,225,741

<sup>1</sup> The Department is required to remit most revenues collected into the State General Fund. These collections are required to be between 95 and 110 percent of the Department's General Fund appropriation.

<sup>2</sup> The Real Estate Recovery Fund accounts for approximately \$1,262,400, \$1,242,700, and \$1,193,700 of the 1999, 2000, and 2001 ending fund balance, respectively. This portion of the fund balance is reserved for liabilities resulting from court-ordered damage settlements relating to real estate and cemetery transactions and other allowed expenditures in accordance with A.R.S. §32-2186.

Source: Auditor General staff analysis of the Arizona Financial Information System *Revenues and Expenditures by Fund, Program, Organization, and Object* and *Trial Balance by Fund* reports for the years ended June 30, 1999 and 2000; the *State of Arizona Appropriations Report* for the year ended June 30, 2000; and Department revenue and expenditure estimates for the year ending June 30, 2001.

- The need for the Legislature to consider providing the Department with the authority to accept or deny Recovery Fund claims in order to address the cumbersome and inefficient claims process; and
- The need for the Department to implement policies and procedures to provide complete and accurate information to the public over the phone.

This audit used a variety of methods to study the issues addressed in this report. These methods included interviewing Advisory Board members, representatives of the Arizona Association of Realtors, the Phoenix Association of Realtors, and the Tucson Association of Realtors, as well as the Department's Attorney General representatives; attending Real Estate Advisory Board meetings; and contacting 12 different states regarding Recovery Fund issues.<sup>1</sup> In addition, the following specific methods were used:

- Auditors reviewed a randomly selected sample of 38 investigative cases from fiscal years 1998, 1999, and 2000. In addition, auditors reviewed 16 randomly selected public complaints from fiscal year 2000 that the Department deemed were outside its jurisdiction.
- To estimate the number of telephone calls the Department receives annually from consumers wishing to file complaints against Department licensees, auditors reviewed a random sample of 1,362 calls received and logged by the Department between October 16 through December 15, 2000. To develop this sample, auditors randomly pre-selected two to three half-days each week during the time period reviewed and randomly requested one of the Department's three customer services representatives to log all of the calls he/she received for each of the selected half-days.

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<sup>1</sup> The following 12 states were contacted to gain more information on their Recovery Funds because their claim payment limits were equal to or greater than Arizona's, or because of geographic proximity: Alabama, California, Colorado, Hawaii, Kansas, New Mexico, Nevada, Pennsylvania, Rhode Island, Tennessee, Texas, and Utah.

## ***Introduction and Background***

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- To assess the consistency of the Department's adjudication process, auditors reviewed the 167 cases containing disciplinary actions taken by the Department through consent orders as reported in the February 1998 through February 2001 issues of the *Arizona Real Estate Bulletin*.
- Auditors reviewed all 26 Recovery Fund claims from fiscal years 1998, 1999, and 2000 that resulted in payment to the claimant, as well as all 72 cases that did not result in payment.
- Auditors posing as members of the public made five calls to the Department requesting information on seven licensees and also visited the Department to view the licensees' files. Information supplied to the auditors was compared to information obtained from the Department's complaint records.

This audit was conducted in accordance with government auditing standards.

The Auditor General and staff express appreciation to the Commissioner and staff of the Department of Real Estate, as well as the Real Estate Advisory Board, for their cooperation and assistance throughout the audit.

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## FINDING I

# DEPARTMENT NEEDS TO IMPROVE ITS COMPLAINT- HANDLING PRACTICES

Improvements are needed in the ways the Department receives and investigates complaints. One of the primary roles of a regulatory agency is to protect the public through investigating and adjudicating public complaints. However, the Department's practices include a number of barriers to filing a complaint. Similarly, barriers exist for successfully resolving the complaints that make it into the system. For example, the Department does not track or report the number of complaints received or percentage investigated, while investigations that are conducted are often inadequate.

### **Department Responsible for Protecting Public from Unscrupulous Licensees**

The Department is responsible for protecting the public through the enforcement of real estate statutes and rules, detection of violations, and the pursuit of administrative sanctions. To fulfill this responsibility, the Department has the authority to receive and investigate consumer complaints made against licensees alleging actions, such as fraud, misrepresentation, incompetence, or negligence. The following case example illustrates the type of consumer complaints the Department receives:

- A complainant gave a \$500 check to a licensed real estate salesperson as a deposit on a property. Instead of depositing the check in the appropriate trust account, the licensee cashed the check for his own personal use. The Department's investigation of this complaint confirmed several violations of state statutes, including unlawful retention of earnest money for personal use and failure to act as a person of honesty, truthfulness, and good character.



*The Department's public protection responsibilities include enforcing real estate laws.*

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If an investigation proves that a licensee committed a violation, the Department may take disciplinary action, such as issuing civil penalties or suspending or revoking a license. In addition to investigating consumer complaints, the Department also has the authority to conduct background investigations of licensees or applicants for licensure to assess their suitability to hold a license. This includes obtaining criminal history reports and court records to determine whether the licensee or applicant has any criminal arrests or convictions.

### **Department Has Some Practices That Make It Difficult for the Public to File Complaints**

The Department's practices present barriers that members of the public must overcome in order to file complaints. These barriers are the result of the Department's efforts to manage its workload, but may have discouraged or prevented consumers from filing complaints.

***Several barriers exist that may discourage or prevent the public from making complaints***—The following practices are obstacles that members of the public must overcome in order to file a complaint against a licensee:

- **Screening procedures may exclude legitimate complaints**—When the Department's customer services representatives answer consumers' calls, they use procedures that may discourage consumers from filing legitimate complaints. According to the Department's customer services procedure manual, staff are required to determine if callers' complaints about licensees are within the Department's jurisdiction. However, the procedures they apply may discourage consumers from filing complaints that are actually within the Department's jurisdiction. For example, the procedure manual lists several broad categories that the Department claims not to have jurisdiction over, including ethical issues, contract disputes, and commission disputes. Should a consumer call wishing to complain about one of these areas, such as an unethical licensee or contract dispute, the customer services

representative may inform the consumer that his/her complaint is outside the Department's jurisdiction because it involves ethics or contracts. However, without further, in-depth discussion with the complainant, the Department is unable to truly determine whether the complaint does include licensee actions that fall within the Department's jurisdiction and, therefore, the consumer should file the complaint.

- **Complaint form discourages complaint filings**—In a similar way, the Department's complaint form further discourages the public from filing complaints. The form contains a disclaimer that lists eight broad areas for which the Department claims to have no jurisdiction (see Item 2, page 14). However, this disclaimer may be misleading. While the Department does not have jurisdiction in some of the indicated areas, such as homeowner's associations and landlord/tenant disputes, it may have jurisdiction in others. For example, the form claims that the Department has no jurisdiction over complaints involving ethical or contractual issues. However, complaints involving either ethical or contractual issues could also include licensee actions, such as misrepresentation, fraud, or incompetence, all of which fall within the Department's jurisdiction.

The Department's Attorney General representatives raised this same point in reacting to the disclaimer when it was first proposed. When the Department redesigned its complaint form in 2000 to include the disclaimer, the Attorney General representatives recommended excluding it from the form, stating that there are cases over which the Department has jurisdiction that may fit under some of the eight broad categories. However, the Department chose to retain the disclaimer.

**Item 2: Department of Real Estate  
Notice of Jurisdiction and  
Department Requirements**

A.R.S. §32-2108(A) requires that all complaints to the Department must be in writing, signed, and notarized before a notary public. A.R.S. §32-2108(B) provides the Department with jurisdiction to investigate complaints against all real estate licenses and against all persons engaged in real estate where a license is required.

The Department does **NOT** have jurisdiction in the following areas:

Service and Warranty	Ethical/Performance Issues
Contract/Listing Disputes	Landlord/Tenant Disputes
Commission Disputes	Homeowner Association Issues
Deposits/Refunds	Unpaid Bills

Source: Department of Real Estate complaint form.

- **Department required complaints to be notarized**—Finally, until April 2001, the Department required complaints to be notarized. Although A.R.S. §32-2108(A) states that the Department must investigate complaints that are written and verified (notarized), it does not preclude the Department from accepting and investigating complaints in other forms, such as written complaints that are not notarized. However, the Department had interpreted this statute to mean that in order to make a complaint against a licensee, a person must complete a Department complaint form and have it notarized. In April 2001, the Department changed its policy and no longer requires complaints to be notarized.

***Complaint barriers result from Department's efforts to manage workload***—The Department established its current complaint practices in an effort to manage its workload. The Department reports that since it changed its complaint form to include areas where it lacks jurisdiction, the number of frivolous complaints it receives has decreased significantly. The Department took such measures because it faced an increase in its investigative workload, but a decrease in the number of investigators available to investigate complaints. In 1995, the Department had a backlog of 500 cases, and in 1997, it assumed responsibility for cases involving subdivisions. Further, its current investigative staff of six FTEs is one fewer than in 1990. The Department now has no case

investigation backlog, and its workload of cases is much smaller than in 1995.

### **Department Does Not Know How Many Complaints It Receives and Does Not Conduct Thorough Investigations**

In addition to the complaint-filing barriers, the Department's investigative procedures further limit its public protection efforts. For example, because the Department does not track or report the number of complaints it receives, it cannot provide complete information on its complaint-handling activities, such as its investigation rate, to oversight bodies or the public. In addition, the Department screens out some complaints it receives, even though some appear to warrant further investigation. Even when complaints are investigated, the Department's investigations are often inadequate or not thoroughly documented. These problems are not new. A 1991 Auditor General report pointed out similar concerns with the Department's investigative practices, but the Department has not taken any action to improve them.

***Department cannot determine the number of complaints it receives***—Currently, the Department does not track or record the number of complaints it receives or the disposition of those complaints. The Department investigated 297 complaints during fiscal year 2000. Auditors estimate that the Department receives as many as 7,300 calls annually from consumers wishing to complain about licensees.<sup>1</sup> Although all of these callers likely do not file written complaints, since the Department does not track the total number of complaints received, auditors were unable to determine what percentage of received complaints were actually investigated by the Department. The ability to report the number and disposition of complaints received, as well as its overall in-

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<sup>1</sup> This estimate is based on a random sample of 1,362 telephone calls received by the Department between October 16 through December 15, 2000. Of the 1,362 calls in the sample, 82 (6 percent) were categorized as consumers wishing to complain about licensees. Therefore, auditors extrapolated that of the approximately 120,000 calls the Department reports receiving in fiscal year 2000, as many as 7,300 were calls from consumers wishing to complain about licensees.

vestigation rate, would assist the Department in providing valuable information to oversight bodies and the public regarding its complaint-handling activities.

**Screening procedures eliminate complaints that appear to warrant investigation**—Currently, one Department employee has been screening all written complaints the Department receives to determine whether they will be investigated. Auditors reviewed a sample of 16 complaints that were screened out of the investigation process. However, two of these complaints should have been investigated to determine if they involved fraud, misrepresentation, or other statutory violations:

- A complainant alleged that a licensee refused to provide agreed-upon services, such as listing the property being offered for sale and placing a “for sale” sign on the property. When the complainant requested that the licensee cancel his agreement due to failing to provide these services, the licensee refused. Although the licensee’s failure to provide basic services could indicate substantial misrepresentation, dishonest dealings, or incompetence, all of which are within the Department’s jurisdiction, the Department chose not to investigate this complaint because it viewed the complaint as a contract dispute.
- A complainant alleged that a licensee altered a legal document. Specifically, the licensee offered to purchase the complainant’s property. However, the complainant alleged that the licensee altered the complainant’s counteroffer on the property by inappropriately changing a date in order to extend the deadline for responding to the counteroffer and then the licensee allegedly filed a lawsuit to enforce the altered document. While the licensee’s alleged actions in this complaint could constitute fraud, which is within the Department’s jurisdiction, the Department did not investigate this complaint because it classified it as an ethics issue.

**Department’s complaint investigations are inadequate**—Although thoroughly investigating public complaints is an important responsibility, the Department’s complaint investigations are inadequate. Auditors reviewed a random sample of 30 closed complaint investigation cases to determine the adequacy

of the Department's investigations. Although some cases appeared to have been thoroughly investigated and documented, the Department did not interview the complainant to confirm the allegations being made in 16 cases. In addition, some of the case files reviewed did not contain sufficient documentation to demonstrate the investigator's efforts or explain their actions or decisions. For example, in 3 cases, auditors found no evidence that an investigation was conducted. Specifically, these complaint files indicated that the investigator merely read the complaint and determined that there was no reason to investigate the case any further. Department officials said that the investigator performed some investigative work on these complaints, but there was no evidence to that effect in the files.

The Department's failure to thoroughly investigate complaints stems from its lack of sufficient procedures to guide investigators through the investigative process. While the Department has compiled a handbook for investigators, the handbook does not include all of the procedures on the various activities that must be undertaken to thoroughly investigate a complaint, such as interviewing the complainant to ascertain and confirm all allegations and collecting all necessary documentary evidence. Instead, as depicted in Item 3, the handbook lists only six procedures that it characterizes as common to all types of investigations. Without adequate procedures, investigations and resulting conclusions may be inconsistent and/or inappropriate, as the investigator must determine what steps to take in order to investigate a complaint.

**Item 3: Department of Real Estate  
Investigative Procedures**

- All respondents must receive correspondence from the investigator outlining the charges against them.
- As appropriate, the licensee's broker should receive copies of complaints and requirements.
- All oral communications should be followed up with written communications.
- No investigation should be closed until all parties receive written findings.
- All open investigation files are confidential.
- Investigators should use the form letter templates contained in the Department's computer system.

Source: Department of Real Estate, Investigator's Handbook.

***Department's complaint-handling problems have persisted since 1991***—A 1991 Auditor General report also found that the Department needed to strengthen its handling of consumer complaints, citing many of the same problems that are identified in the current audit (see Report No. 91-8). The report found that the Department did not investigate all complaints meriting investigation and identified instances in which the Department dismissed complaints without an investigation because it inappropriately claimed to lack jurisdiction. Additionally, the 1991 report noted that a system where decisions to investigate complaints were made solely by one person may have contributed to the Department's failure to fully investigate all complaints. The report recommended that the Department establish written criteria to ensure that complaints are thoroughly investigated, based on the issues raised in the complaint.

### **Department Can Strengthen Its Public Protection Efforts Through Improved Complaint-Handling Practices**

The Department could better protect the public through improved complaint-handling practices. Specifically, the Department should remove existing barriers and accept all legitimate public complaints. Further, the Department should take steps to improve its investigative practices by strengthening its complaint screening criteria and its investigative procedures.

***Department should ensure that it accepts all legitimate public complaints***—To fulfill its role as a public protection agency, the Department should ensure that it facilitates the filing of complaints and accepts all legitimate public complaints. To do this, the Department should take the following steps:

- **Revise customer services procedures**—The Department should adopt procedures that require its customer services representatives to assist consumers who may wish to file complaints, and no longer make the determination that a complaint may or may not be within the Department's jurisdiction. Additionally, the Department should train its customer services representatives on how to assist consumers in filing a written complaint.

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*The Department should revise its customer services practices and its complaint form.*

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- **Revise jurisdictional disclaimer on complaint form**—The Department should revise its complaint form disclaimer that inappropriately lists the eight areas that it believes are outside of its jurisdiction. Specifically, the Department should retain the disclaimer only for those areas where in no case it has jurisdiction, such as complaints involving homeowners' associations and landlord/tenant dispute issues. However, the Department should exclude from the disclaimer those areas where, depending on the nature of the complaint, the Department may have jurisdiction, such as complaints involving contract/listing disputes or ethical/performance issues.
- **Track all complaints**—The Department should begin tracking and reporting the number of complaints it receives and the disposition of these complaints. This would ensure that the Department has accurate information on its complaint processing activities to report to oversight bodies and other stakeholders.

***Department should review and investigate all complaints***—The Department should review and investigate all of the complaints it receives from the public. Specifically, the Department should develop appropriate complaint-screening and investigative policies and procedures and train its investigative staff on the policies and procedures developed. The policies and procedures should address the following areas:

*The Department should review and investigate all public complaints.*

- **Complaint screening**—The Department's policies and procedures should require that the Department conduct sufficient work to fully understand each complaint and enable it to determine whether the complaint should be investigated. For example, these procedures should include requirements that investigative staff contact the complainant to confirm the nature of the complaint and all of the allegations being made.
- **Investigations**—The Department's policies and procedures should include the specific steps or tasks investigators should undertake when investigating a complaint. For example, the Department should develop procedures to ensure that complainants are always interviewed as part of an investigation to ascertain and confirm all allegations, that investigators obtain and review all relevant documentary evidence, and that



each allegation in a complaint is investigated to determine if a violation was committed. Other regulatory agencies and boards have developed and implemented investigative policies and procedures. For example, BOMEX implemented procedures that require investigators to identify and investigate each allegation made in a complaint and determine whether statutory violations have been committed. Further, to ensure complete investigations, the Board's investigative staff are required to confirm all allegations with the complainant.

### **The Department Should Study Workload to Determine Future Resource Needs**

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*The Department may need additional investigative resources.*

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Although the Department currently handles its investigations in a timely manner, the recommendations made in this report suggest that the Department's investigative caseload could increase, as could its need for additional investigative resources. However, because the Department currently screens out most of the complaints it receives and does not adequately investigate the complaints it accepts, auditors could not estimate what the Department's workload will be once the Department implements all recommendations. Therefore, once the Department has implemented the recommendations to improve complaint handling and investigations and assesses the impact of these recommendations on its workload, it should determine if additional resources are needed and request them from the Legislature.

In addition, current real estate activity levels further indicate that adjustments in investigative resources may be needed. Specifically, over the past 15 years, the real estate sales activity level in the Phoenix metropolitan area has risen significantly, while at the same time, the Department's investigative resources have decreased. For example, in 1986, the Department employed 11 investigators, while during 1986, only 59,420 real estate sales were transacted in the Phoenix metropolitan area.<sup>1</sup> In contrast, the Department currently employs only 6 investigators; how-

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<sup>1</sup> Real estate sales activity numbers provided by the Arizona Real Estate Center, Arizona State University. These figures consist of sales of new and used single-family homes, townhomes, and condominiums.

## ***Finding I***

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ever, the number of real estate sales in the Phoenix metropolitan area during 2000 amounted to 97,620. Industry members have expressed their concern that the Department lacks sufficient investigative staff to provide adequate public protection, and indicate that they support an increase in license renewal fees to allow the Department to obtain additional staff and increase its public protection efforts.

## **Recommendations**

1. The Department should:
  - a. Revise its policies and procedures to require its customer services representatives to assist consumers who may wish to file complaints and discontinue making determinations whether complaints may or may not be within the Department's jurisdiction; and
  - b. Train its customer services representatives on how to assist consumers who wish to file written complaints.
2. The Department should revise its complaint form disclaimer to exclude the broad categories of complaints for which it may have jurisdiction, including complaints involving contract/listing disputes and ethical/performance issues.
3. The Department should track and report on the number of complaints it receives and the disposition of those complaints.
4. The Department should review and investigate all of the complaints it receives from consumers by developing and implementing policies and procedures that include the following:
  - a. Specific criteria and guidelines for the screening of complaints to include requirements, such as contacting the complainant to confirm the nature of the complaint and all of the allegations being made; and
  - b. Specific steps or tasks that comprise a thorough investigation, such as interviewing the complainant, obtaining and reviewing all relevant documentary evidence, and investigating each allegation in a complaint to determine if a violation was committed.
5. The Department should train the appropriate investigative staff on how to properly screen and investigate complaints.
6. The Department should assess the impact that implementation of the recommendations made in this report has on its workload, determine if additional investigative resources are needed, and, if so, request them from the Legislature.

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## FINDING II

# DEPARTMENT INCONSISTENTLY DISCIPLINES REAL ESTATE LAW VIOLATORS

The Department of Real Estate inconsistently enforces real estate laws. One of the Department's primary responsibilities is to protect the public through the adjudication of cases involving real estate law violations. However, the Department inconsistently disciplines violators of real estate laws, resulting in inequitable treatment of licensees. To promote consistent enforcement, the Department should take several steps, including establishing a substantive policy statement containing guidelines to assist in disciplinary decision making.

### **Department Is Responsible for Disciplining Violators**

As a regulatory agency, one of the Department's main responsibilities is to protect the public by disciplining licensees who have violated Arizona's real estate laws. For example, A.R.S. §32-2153 provides 35 violations that are grounds for denial, suspension, or revocation of licenses, such as misrepresentation, negligence, and incompetence. The Department's administrative rules further define actions which could constitute violations, including actions related to professional conduct and property advertisements. In addition to taking action against a licensee, statute provides a variety of disciplinary options that the Department can use to fulfill its public protection mandate, including civil penalties of up to \$1,000 for each infraction, cease-and-desist orders, and consent orders.

Statutes give the Real Estate Commissioner authority to make the final decisions regarding all Department disciplinary actions, including administrative law judge findings.

## **Department Inconsistently Applies Disciplinary Actions**

The Department does not consistently apply disciplinary actions to violators of the State's real estate laws. Based on a review of 167 cases with disciplinary actions settled through consent orders between November 1997 and December 2000, the Department's disciplinary actions were fairly consistent for certain types of violations, but inconsistent for other violations.<sup>1</sup> For example, one group of 11 cases involving licensees who failed to renew their licenses in a timely manner received fairly consistent disciplinary actions. In 9 of these cases, the Department issued penalties consisting of \$500 fines and three to six hours of additional continuing education. In 1 of the cases, the Department increased the fine to \$1,000 because the licensee involved had committed the same violation previously. Finally, 1 case resulted in a penalty of \$1,000 and three hours of additional continuing education, although the case contained no explanation for the increased penalty.

*The Department inconsistently disciplined licensees or applicants with criminal convictions.*

Despite the fairly consistent action taken for this group of violations, many inconsistencies were noted in other groups of cases. Specifically, the Department has inconsistently taken disciplinary action against license applicants who filed false applications because they did not disclose misdemeanor or felony convictions, such as theft. For example, of the eight licensees who were disciplined for false applications because they did not disclose theft convictions, disciplinary actions ranged from license suspensions of 20 days to 13 months and civil penalties of \$100 to \$4,000.<sup>2</sup> Further, one licensee was required to complete an additional two hours of continuing education. The following example illustrates the Department's inconsistencies in disciplining license applicants who failed to disclose theft convictions:

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<sup>1</sup> The Department reported the 167 cases resolved through consent orders in the 19 issues of its bimonthly newsletter, the *Arizona Real Estate Bulletin*, published between February 1998 and February 2001.

<sup>2</sup> The Department revoked one license during this same time period for a similar violation. However, the licensee specifically requested that the license be revoked.

- In 1999, the Department agreed to a \$500 fine for a licensee who failed to disclose a simple larceny conviction from 1975. However, another licensee, who did not disclose a 1969 larceny-shoplifting conviction, received more severe discipline in the form of a 30-day license suspension and a \$200 fine.

Another group of licensees who committed similar violations but were disciplined in an inconsistent manner were licensees who breached their fiduciary duties by failing to protect and promote their clients' interests. Violations in this group of 28 cases include failing to properly account for monies in a trust account and failing to provide clients with all relevant information. However, Department disciplinary actions for this group ranged from a 10-day license suspension to revocation. Additionally, civil penalties ranged from \$100 to \$8,000 and continuing education requirements ranged from 6 to 12 hours. For example:

- In 1999, the Department agreed to an 18-month suspension and \$500 fine for a licensee who failed to protect his client's interest because he did not inform his client, the seller, that the buyer failed to make a \$5,000 earnest payment. However, one month later, the Department agreed to a lesser action of a 60-day suspension and \$500 fine for a licensee who failed to protect his client's interest by forging the client's name on a contract.

### **Department Should Take Steps to Ensure More Consistent Actions**

The Department should strengthen its enforcement efforts to ensure the consistent and fair treatment of licensees. First, the Department should adopt formal disciplinary guidelines. Second, the Department should document the factors that influence its disciplinary actions.

***Department should establish formal disciplinary guidelines—***  
The Department should develop and implement disciplinary guidelines to assist it in making consistent and appropriate disciplinary decisions and adopt these guidelines into a substantive policy statement. According to the Department's *Administrative*

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*The Department lacks guidelines to help it render fair and consistent discipline.*

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*Actions Division Procedure Manual*, the disciplinary action taken “is dependent upon the facts and seriousness of the alleged violations, the potential for harm to the public, and aggravating or mitigating circumstances, including previous violations by the parties involved.” However, the manual does not provide specific guidelines to direct the Department in applying these factors to its disciplinary decisions. For example, the manual does not provide specific means, such as a point system or specific disciplinary actions, to be considered based on these factors.

The Department’s disciplinary guidelines need to enforce consistent discipline by 1) defining the violation’s severity; 2) considering the licensee’s history; and 3) offering a range of appropriate options. Further, the guidelines should require the Department to also consider any aggravating or mitigating factors, such as the presence or absence of public harm. Adopting disciplinary guidelines into a substantive policy statement would inform the public of the Department’s disciplinary practices, while maintaining the Department’s ability to base its enforcement actions on the merits of each case, and allow for less or more severe sanctions, depending on the violation.

Disciplinary guidelines are especially important, given that the Department settles the majority of its disciplinary cases through informal means, including consent orders. The lack of disciplinary guidelines contributes to inconsistent disciplinary actions in these cases because it allows the licensee’s negotiating skills to become the determining factor in the penalty received, rather than the actions that resulted in the violation. For example, in the following cases involving two licensees who were disciplined for failing to disclose prior criminal convictions, both licensees were able to negotiate lesser disciplinary actions. Specifically:

- One licensee was originally offered disciplinary terms of a 45-day suspension, \$750 fine, and 12 hours of continuing education. However, through the negotiations process, the licensee and Department agreed to reduce the length of suspension to only 10 days by agreeing to pay a higher fine of \$1,500 and complete 15 hours of continuing education.
- The other licensee was originally offered a 30-day suspension, \$500 fine, and 12 hours of continuing education, but

was able to reduce this to a 7-day suspension, \$250 fine, and 15 hours of continuing education.

Other regulatory agencies, such as the Department of Liquor Licenses and Control, have established substantive policy statements containing disciplinary guidelines that include such things as the range of appropriate disciplinary actions for different types of violations, including minimum and maximum penalties for various violations, and the consideration of aggravating and mitigating factors. Further, BOMEX is mandated by statute to use disciplinary guidelines that consider violation severity and disciplinary history when imposing discipline.

***Department should document reasons for setting penalties***—In addition to developing and implementing formal disciplinary guidelines, the Department should document in its files the factors that influence each enforcement action to improve controls over the penalties it sets. Currently, the Department does not document reasons why some licensees receive more or less discipline than other licensees who violate the same or similar real estate laws.

## **Recommendations**

1. The Department should develop and implement disciplinary guidelines that include consideration of the violation's severity, the licensee's violation history, any other aggravating or mitigating factors, and a range of appropriate disciplinary actions. In addition, the Department should adopt these guidelines in a substantive policy statement.
2. The Department should consistently record and document in its files factors, such as previous violations and other aggravating and mitigating circumstances, that influence a licensee's penalties.



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## FINDING III

# RECOVERY FUND IS COSTLY AND CUMBERSOME TO ADMINISTER

Currently, the costs to administer the Recovery Fund exceed the payments for claims. However, a change in the Recovery Fund statutes could reduce administrative costs by simplifying the steps the Department must take to process claims against the Fund. The Department could further reduce administrative costs by ensuring that staff do not charge any of their non-Recovery Fund activities to the Fund.

### Recovery Fund Assists People with Real Estate Losses

The Recovery Fund compensates consumers who suffer losses due to a licensee's wrongdoing.

The Real Estate Recovery Fund is designed to cover losses that result from a licensed real estate agent's wrongdoing, such as fraud or misrepresentation. The Fund covers direct out-of-pocket losses (that is, the amount of the actual and direct loss arising out of a transaction), as well as reasonable attorneys' fees and court costs. Until recently, the Fund would pay these costs up to \$20,000 per real estate transaction or \$40,000 per licensee. In cases where an individual licensee has harmed a large number of claimants, claimants could collectively receive no more than \$40,000 from the Fund, regardless of their total loss. However, during the 2001 legislative session, the Legislature increased the Fund's claim limits to \$30,000 per transaction and \$90,000 per licensee. The Fund does not cover punitive damages.

The Fund's fund balance was \$1.2 million as of February 28, 2001. The Fund generates its revenue primarily through a \$10 surcharge on the initial license for real estate salespersons and a \$20 surcharge on the initial license for a real estate broker. These two sources supply approximately \$142,000 in revenue each year.

### **Costs of Administering the Fund Exceed Claims Paid**

The Department's administrative costs for fiscal years 1998 through 2000 exceeded claim payments by over \$126,000, while the Fund's balance has declined from \$1.4 million to \$1.2 million during this time.

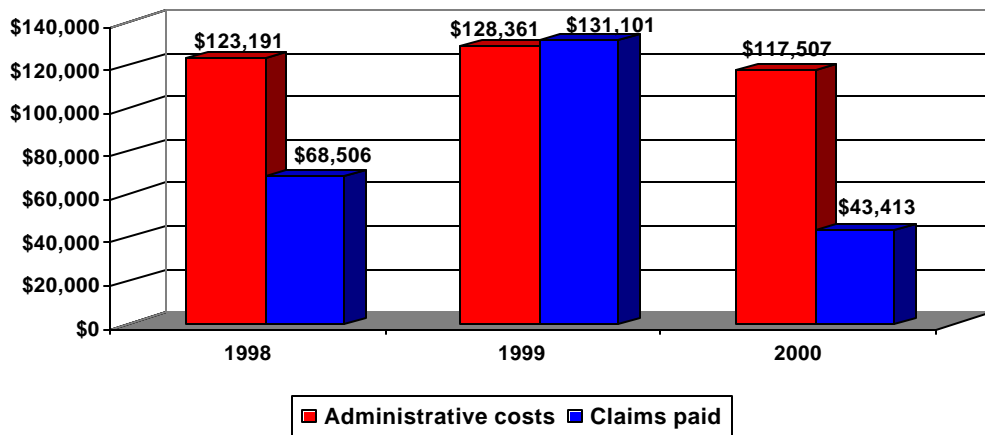
**Administrative costs for Fund exceed claim payments**—As illustrated in Figure 1, during fiscal years 1998 through 2000, the Department charged approximately \$369,000 in administrative costs to the Fund. During this same period, it paid out \$243,000 in claims. For fiscal year 2001, the Fund had paid one \$20,000 claim and had accrued over \$90,000 in administrative costs as of February 2001.

Fund administrative costs were \$126,000 more than the amount paid to claimants.

The Fund's largest administrative expense is the cost of an intergovernmental service agreement for a half-time Assistant Attorney General. This agreement, which totals \$74,600 for fiscal year 2001, includes the salary and employee-related expenses for the Assistant Attorney General, as well as other charges for items

**Figure 1**

**Department of Real Estate  
Real Estate Recovery Fund  
Administrative Costs and Claims  
Years Ended June 30, 1998, 1999, and 2000  
(Unaudited)**



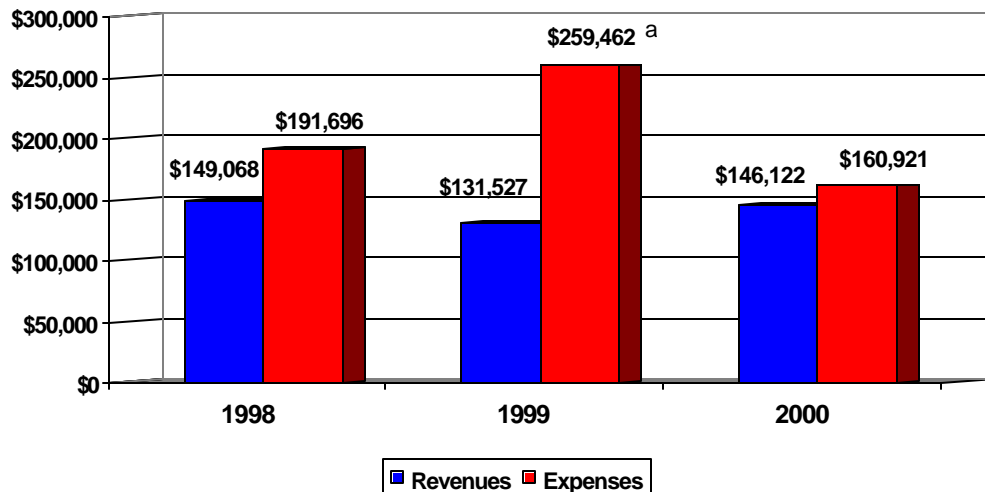
Source: Auditor General staff analysis of the Arizona Financial Information System Accounting Event Extract Files reports for the years ended June 30, 1998, 1999, and 2000.

such as support staff, office space, and telephone use. In addition, the Fund also supports the cost of a full-time administrator as well as miscellaneous costs, such as a portion of the Department’s risk management costs and some minor travel costs.

**High administrative costs are depleting the Department’s Fund balance**—While all agencies incur administrative costs, the Department’s high administrative costs for the Fund have an even more significant impact because they are contributing to the decline of the Fund’s fund balance. Figure 2 shows that from the beginning of fiscal year 1998 to the end of fiscal year 2000, expenses have consistently exceeded revenues. For example, during fiscal year 2000, the Fund received only \$146,122 in revenues but paid out \$160,921 in administrative costs and claims. During this three-year period, the Fund’s fund balance decreased by more than \$185,000, from \$1,428,041 to \$1,242,679.

**Figure 2**

**Department of Real Estate  
Real Estate Recovery Fund  
Revenues and Expenses  
Years Ended June 30, 1998, 1999, and 2000**



<sup>a</sup> Expenses were significantly higher than revenues in fiscal year 1998-99 because the Department paid the maximum amount of \$40,000 per licensee on claims against two licensees.

Source: Auditor General staff analysis of the Arizona Financial Information System Accounting Event Extract Files reports for the years ended June 30, 1998, 1999, and 2000.

## **Several Factors Contribute to High Costs**

Two main factors contribute to the high costs associated with administering the Recovery Fund. First, because of statutory and Department requirements, the process for handling Recovery Fund claims is cumbersome. Second, the Department is charging more personnel costs against the Fund than are actually being spent to administer it.

***Statutory requirements and Department practices lead to inefficiencies***—While a review of all cases filed in fiscal years 1998, 1999, and 2000 found that the Department appropriately processed these cases and ensured that Fund monies were only expended for qualifying claims, certain statutory requirements and Department practices create inefficiency in the process for handling claims against the Recovery Fund. Currently, the authority for approving Fund claims rests with the courts. Specifically, A.R.S. §§32-2186 through 32-2193.02 requires that all potential claimants sue the licensee, obtain a judgment, and try to collect that judgment from the licensee. If the judgment is not recoverable, the claimant can attempt to obtain payment from the Recovery Fund by filing a claim with the court. These requirements add costs in the following ways:

- **Department spends considerable time on cases that never result in claims**—To ensure it responds to claims within statutory time frames, the Department becomes involved with cases well before any claims are filed. However, this is an inefficient use of resources, because many of these cases will never result in claims against the Fund. Under current statutes, a plaintiff must notify the Department immediately upon filing a lawsuit that may result in a claim against the Fund. At that time, the Department begins to process the case. The Fund Administrator reviews the potential claim, collects needed documents, and works with potential claimants. The Fund Administrator estimates that more than 50 percent of her time is spent on cases that have not yet resulted in a claim against the Fund. Such lawsuits often go on for several years. In the meantime, many are resolved and never reach the claims process. For example, in fiscal years 1998-2000, almost half of the 72 cases closed without payment

never resulted in a claim, because the claimant and the licensee reached a settlement or the court dismissed the lawsuit.

- **Attorney General must be involved with all claims**— Responding to court-ordered decisions requires considerable services from an Assistant Attorney General. If the Department wants to oppose a claim, the Assistant Attorney General must research and review the claim, file legal briefs, appear in court, and litigate the application. In the last three fiscal years, the Department has successfully challenged four claims.<sup>1</sup> Even if the Department agrees with the court's directive to award payment from the Fund, significant legal assistance is needed. The Assistant Attorney General must consult with the claimant and the claimant's attorney to settle on the amount that all parties agree can be paid to the claimant from the Fund. The settlement paperwork must then be filed with the court for approval.

***Department assesses Fund for personnel costs not related to Fund activities***—Costs are also high because the Department charges more personnel costs against the Fund than are actually involved in Fund-related activities. In fiscal year 2000, these excess costs amounted to about \$31,000, as follows:

- **Assistant Attorney General's costs**—The Department's contract with the Attorney General for legal services totaled \$73,700 in fiscal year 2000. The Department charges the full cost of this agreement to the Fund. However, an Attorney General official indicated that the Assistant Attorney General does not spend all of her time on Recovery Fund issues. The Assistant Attorney General estimates she spends approximately two-thirds of her time working directly with the Recovery Fund. The remainder of her time is spent working on other cases for the Department. Charging the Fund for two-thirds of the agreement rather than the full amount would reduce the amount to approximately \$50,000, a savings to the Fund of \$24,000.

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<sup>1</sup> The Department challenged these claims for several reasons, including no proof of out-of-pocket losses, insufficient collection efforts, and lack of all statutorily required information.

- **Fund administrator's costs**—Similarly, the Department charges 100 percent of the costs for the Fund Administrator to the Fund, although a Department Division Director estimates that 15 percent of the Administrator's time is spent on duties unrelated to the Fund's administration. This includes responsibilities such as drafting consent orders for licensees who have been disciplined by the Department. Charging the Fund for 85 percent of the administrator's cost would result in a savings to the Fund of approximately \$7,000.

While all of the Attorney General and Fund Administrator costs are charged against the Fund, the Department has identified Fund-related costs that are not charged to the Fund. Specifically, the Department developed a memo listing indirect Fund costs, such as computer-related costs, totaling over \$16,600 for fiscal year 2000. However, these costs are allocated to other areas of the Department's operations. The Department reports that by not charging these Fund-related indirect costs to the Fund, it is justified in charging the full amount of the Fund Administrator costs to the Fund.

### **Several Recommendations Can Simplify Fund Administration and Decrease Administrative Costs**

The Department and the Legislature can take several steps to reduce the Fund's administrative costs. First, to simplify the Fund's operations, the Legislature should consider amending statutes to allow the Department to approve or deny claims against the Fund. This approach is now being used in California, where it lowered operating costs. If statutes are amended, the Department would need to promulgate rules addressing the needs of the new process and reexamine its agreement with the Attorney General's Office. Finally, the Department should take steps to decrease the Fund's administrative costs by ensuring that all administrative costs charged against it are appropriate.

***Moving decision making to Department would simplify Fund administration***—The Legislature should consider amending statutes to authorize the Department to approve claims made against the Fund, an approach used in California since 1987. Be-

### ***Finding III***

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*Moving the Fund decision-making authority to the Department would simplify operations and lower administrative costs.*

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cause the California Department of Real Estate has the authority to approve or deny claims, the agency does not review claim applications until the claimant has gone through the entire court process and exhausted all collection efforts. As a result, California now has a more simplified process and has reduced its recovery account costs.

Making this change in Arizona would simplify the Recovery Fund's operations and benefit the Department in two ways. First, the Fund Administrator would only review and process actual claims against the Fund. Second, the need for Attorney General assistance would be diminished, since the process would no longer require significant court involvement. As a result, the Department should experience a reduction in costs associated with administering the Fund.

To make this change, the Legislature would need to amend A.R.S. §§32-2186 through 32-2193.02 by authorizing the Department to approve Fund claims.

***Several Department actions needed to implement statutory change***—If the Legislature amends statute, authorizing the Department to approve or deny all claims, the Department would need to take several steps to implement the change. These steps should include the following:

- **Promulgating rules**—The Department should promulgate rules to establish timelines for both applicants to follow for submitting documentation as well as for departmental decision making. Further, the Department should establish rules outlining what documentation is required from claimants when filing a claim with the Fund.
  
- **Reevaluating the agreement with the Attorney General's Office**—The Department should reevaluate the intergovernmental service agreement with the Attorney General's Office and determine whether changes are necessary. Providing the Department with the authority to approve Fund claims would lessen the need for legal assistance, since it would no longer be a court-driven process. Under a simplified process, the Department would only need legal advice to assist it in reviewing the appropriateness of claims.



**Department should properly allocate Fund administrative costs**—Regardless of whether the Legislature decides to transfer approval authority to the Department, the Department can further decrease the Fund’s administrative costs through proper allocation of Fund personnel costs. Specifically, the Department should ensure that costs associated with the Fund’s operation are charged to the Fund. This would include charging the Fund only for the portion of costs arising from its contract with the Attorney General’s Office and its Fund Administrator that are related to the Fund. Further, the Department should charge any indirect costs associated with the Fund’s operation to the Fund.

### **Recommendations**

1. The Legislature should consider revising A.R.S. §§32-2186 through 32-2193.02 to transfer authority for approving Recovery Fund claims from the courts to the Real Estate Commissioner.
2. If statute is amended, the Department should promulgate rules to establish timelines for applicants to submit documentation as well as timelines for the Department to make decisions on claim applications. Rules should also address what documentation the Department needs to collect.
3. If statute is amended, the Department should examine its intergovernmental service agreement with the Attorney General’s Office and determine if changes are necessary.
4. The Department should properly allocate the Fund Administrator’s and Assistant Attorney General’s personnel expenses so that only the portion of these expenses that are attributable to the Fund are charged to the Fund.
5. The Department should properly charge indirect costs associated with the Fund to the Fund.

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## FINDING IV

# DEPARTMENT'S PUBLIC INFORMATION PRACTICES IMPEDE CONSUMERS' ACCESS TO LICENSEE INFORMATION

Currently, to find out about any complaints or disciplinary actions against a licensee, a consumer must make an advance request in writing, wait several weeks, and travel to the Department's Phoenix office to view the information. Other Arizona regulatory agencies are doing more than the Department to make such information more readily available. The Department should strengthen its policies to detail what information should be made available by telephone and provide information in a more timely manner.

### **Providing Public Information Is An Important Part of Regulatory Agency Responsibilities**

One important part of a regulatory agency's responsibilities is providing information that allows the public to make informed decisions about utilizing the services of licensees regulated by the agency. For example, by informing the public of the disciplinary actions taken against licensees, agencies assist consumers in selecting competent and ethical professional services. Public records laws were developed in part to help ensure that agencies make this necessary information available.

### **Department Does Not Provide Sufficient Access to Public Information**

The Department's practices and policies do not provide sufficient access to public information that helps consumers make informed decisions about real estate licensees. The Department

does not follow its stated policy for making disciplinary information available over the telephone, requiring consumers to come to the Department's office in Phoenix instead. In the test cases auditors conducted, the Department did not make these files available for up to six weeks. Finally, the Department will not release information about pending complaints—a potentially important component of being able to make an informed decision about a licensee. To ensure that consumers have sufficient access to public information, the Department should strengthen its current public information policies.

***Department not following its policy on information released over the phone***—Although the Department's formal public information policy states that, if requested to do so, the Department will provide a telephone caller with information about a licensee's disciplinary history, in practice, the Department does not allow staff to provide disciplinary action information over the phone. Auditors confirmed this practice through test calls. Five auditors posing as members of the public phoned the Department and requested information on seven different licensees with complaint histories and, in some cases, disciplinary actions. None of the five auditors received any complaint or disciplinary information about the licensees over the phone. Auditors were told that this information could be obtained only by coming into the office to view licensees' files.

Having to go to the Department's office is a decided limitation on consumers' access to complaint information, especially if they live outside the Phoenix metropolitan area. Consumers who cannot or do not make this extra effort are unable to obtain information about the licensee's complaint and disciplinary history. In addition, those consumers who decide to make the effort to view the records face additional barriers. Under Department policy, they must submit a written request for the information and then wait another week before being able to view the information. Before being able to view it, they must also provide picture identification and sign in on a log sheet that also requests personal information, such as address, phone number, driver's license number, and the reason for requesting the files.

## **Finding IV**

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Consumers are required to provide picture identification to view public records.

**Files not available for several weeks**—Auditors found the process further complicated by additional delays in being able to review the information. Despite Department policy that licensee files will be ready for viewing within five to seven working days from the date a request is received, auditors had to wait approximately two to six weeks before their requested files were ready for review. One licensee’s files were requested on December 26. However, despite follow-up calls to the Department, the files were not ready for review until February 5, almost six weeks after they were requested.

**Information on pending complaints not made available**—The Department’s policies do not permit information regarding pending complaints against a licensee, such as the nature and number, to be provided to a consumer, either over the phone or in person. Therefore, consumers may not be able to get a complete picture of a licensee’s complaint history if they are not able to obtain information on pending complaints. As recommended in the Auditor General’s *Special Study of Health Regulatory Agencies* (Report No. 95-13), the information that regulatory agencies should make available to the public includes the number and nature of dismissed and pending complaints.

The Department should take steps to facilitate access to public information.

**Department should strengthen public information policies**—The Department should establish policies to detail the information that will be made available to the public by telephone and direct staff to provide this information. To help ensure consumers have access to all public information by telephone, other state agencies and boards have developed written policies that specify the information that should be made available. In so doing, the Department should ensure that the policy includes providing information about the number and nature of complaints and disciplinary actions. This policy should include complaints and actions that are pending or that have been dismissed, as well as the resolution of closed complaints. For instance, the Board of Psychologist Examiners has policies requiring staff to provide the public with information over the telephone regarding the number and type of both dismissed and pending complaints, and the resolution of closed complaints. The Department’s computer system contains screens that summarize complaint and disciplinary action information that can be used to fulfill consumers’ telephone information requests.

## **Review of Licensee Files Showed Additional Problems with Information Provided**

Review of the files themselves showed several additional problems with the information the Department actually provided. The information was sometimes incomplete or inappropriate for public review, and the files lacked summaries that would make them easier to review and interpret.

- **Incomplete or inappropriate information released**— Several of the licensee files reviewed by auditors posing as consumers contained incomplete or inappropriate confidential information. In one instance, an auditor reviewed a file that should have contained documentation on a dismissed complaint. However, this documentation was absent from the file. When following up with the Department to determine why the dismissed complaint was missing from the file, the Department indicated that there was no other information available on that particular licensee. In addition, another licensee's file did not contain a consent order despite the fact that the Department's database showed that one was issued as a result of a complaint. While some files were incomplete, others contained confidential information that should have been removed from the file prior to allowing it to be reviewed by members of the public. For example, three licensee files contained confidential home addresses, even though business addresses were available in all three cases. Finally, in one instance, the Department failed to remove a licensee's social security number and birth date from the file.
  
- **Lack of summary information hindered file reviews**— Finally, audit staff had difficulty reviewing complaint information because the Department does not maintain summaries of a licensee's complaint history in the licensee's files. Rather, each complaint against an individual licensee is filed separately, so a consumer must look through each file and attempt to identify the nature and outcome of the complaint based on the documentation in the file. A number of auditors noted that files were disorganized and the specific complaint and disciplinary information on licensees was hard to identify.

## **Recommendations**

1. The Department should strengthen its public information policies to direct staff to provide all public information to consumers over the telephone, including information on the number and nature of closed, dismissed, and pending complaints and disciplinary actions.
2. The Department should discontinue its restrictive policies requiring consumers to request files in writing and provide photo identification and other personal information when visiting the office to view licensee files.
3. The Department should make certain that files prepared for consumers have the licensee's complete complaint and disciplinary history information.
4. The Department should ensure that confidential information on licensees is removed from files before consumers view them.
5. Department management should ensure staff are properly trained in procedures for removing confidential information and periodically monitor files that are scheduled for consumer review.
6. The Department should adhere to the five- to seven-day time frame it has already established in policy for preparing files for public review.
7. The Department should provide complaint summaries in licensee files to provide consumers with a complete overview of the licensee's complaint and disciplinary history.

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## SUNSET FACTORS

In accordance with A.R.S. §41-2954, the Legislature should consider the following 12 factors in determining whether the Arizona Department of Real Estate (Department) should be continued or terminated.

1. **The objective and purpose of establishing the Department.**

The Department of Real Estate was established in 1921 and its mission is to safeguard and promote the public interest through timely and capable assistance, fair and balanced regulation, and sound and effective education. To fulfill this mission, the Department has established goals addressing public protection, increased proficiency and integrity of licensees, and regulation of the real estate industry consistent with existing laws.

In support of the Department's mission and goals, the following essential functions are carried out:

- **Licensing**—The Department licenses and regulates over 46,200 active salespersons and brokers and approximately 9,560 entities that are engaged in selling or leasing real property, such as corporations and limited liability companies. In addition, the Department approves and oversees all real estate schools and instructors in the State.
- **Investigation**—The Department has the authority to investigate complaints against licensees from the public and on its own initiative. The Department also audits brokers' accounts to ensure statutory compliance.
- **Adjudication**—The Department conducts hearings to resolve violations of departmental statutes and rules by licensees.



- **Public Information**—The Department provides information to the public on licensees.

**2. The effectiveness with which the Department has met its objective and purpose and the efficiency with which it has operated.**

The Department performs some responsibilities in an effective and efficient manner, but can improve in others. For example, the Department issues licenses in a timely manner. If a licensure applicant provides all required application materials and fees, the Department can immediately review the information and issue a receipt for the fees, which allows the applicant to begin working in real estate that same day.

However, the audit found that the Department needs to improve its efficiency and effectiveness in other areas. Specifically:

- The Department's complaint practices contain barriers that discourage or prevent consumers from filing complaints, and the Department's complaint investigations are inadequate. To improve the efficiency and effectiveness of the Department's complaint processing practices, the Department should revise its customer services procedures and complaint form that currently discourage some consumers from filing complaints. Further, the Department should develop and implement policies and procedures to ensure thorough, consistent investigations, such as interviewing the complainant and obtaining and reviewing all pertinent documentation, when investigating a complaint (see Finding I, pages 11 through 22).
- The Department's process for adjudicating complaints against licensees who violate statute or rule is inconsistent and does not treat licensees fairly. To address this concern, the Department should develop and implement disciplinary guidelines in a substantive policy statement to guide Department officials in making

equitable, consistent disciplinary decisions (see Finding II, pages 23 through 27).

- The process for handling Real Estate Recovery Fund claims is cumbersome and costly. To improve the Fund's operations, the Legislature should consider amending A.R.S. §§32-2186 through 32-2193.02 to give the Real Estate Commissioner the authority to determine payment of Recovery Fund claims. Further, the Department should examine its current agreement with the Attorney General's Office for the Fund's half-time Assistant Attorney General and the manner in which Recovery Fund costs are accounted for (see Finding IV, pages 37 through 41).

**3. The extent to which the Department has operated within the public interest.**

The Department operates in the public interest in some ways, but improvements in two areas are necessary. For example, the Department's licensing process ensures that only qualified licensees work in real estate. The Department also audits broker records to ensure that brokers are appropriately handling their clients' monies. In addition, the Department's Web site contains a directory of licensees, which allows members of the public to look up particular licensees to obtain information on their licensing status. Finally, the Customer Services Division provides a central location for all telephone calls to the Department and answers basic questions on issues such as obtaining licensure and education requirements.

However, auditors identified areas in which the public interest could be better served. Specifically:

- The Department employs complaint practices that discourage or prevent consumers from filing complaints. Specifically, the Department screens out complaints over the phone, inappropriately identifies areas where it lacks jurisdiction on its complaint form, and until April 2001, required all complaints to be notarized. Additionally, complaint investigations con-

ducted by the Department are inadequate. To ensure proper protection of the public, the Department should remove existing barriers that prevent the filing of complaints and review and investigate all complaints that warrant investigation (see Finding I, pages 11 through 22).

- Auditors tested the Department's public information practices and found that the Department does not disclose all public information to consumers over the phone. Specifically, consumers wishing to obtain a licensee's complaint and disciplinary history are required to visit the Department's Phoenix office to view the licensee's files, and must provide the Department with personal information, such as address and telephone number, in addition to photo identification, before files can be viewed. Further, some licensee files reviewed were incomplete, while others inappropriately contained confidential information, and auditors had to wait anywhere from two to six weeks for the Department to prepare the files for review. To ensure that it provides complete and accurate public information, the Department should revise its policies to provide information on licensees' complaint and disciplinary histories over the phone, and remove its requirements that consumers provide photo identification and personal information before being allowed to view public records (see Finding IV, pages 37 through 41).

**4. The extent to which rules adopted by the Department are consistent with the legislative mandate.**

The rules adopted by the Department are, for the most part, consistent with its legislative mandate. According to the Governor's Regulatory Review Council (GRRC), the Department underwent its last formal rule review in 1996. As a result of this review, the Department revised a number of its rules in 1999, and further amended rules in 2000.

However, the Department should revise Commissioner's Rule R4-28-1303, regarding the confidentiality of records obtained in an investigation, to clarify the rule and make it consistent with public records laws. The rule states that "the Department shall ensure that any information or document obtained in an investigation remains confidential, unless made a matter of public record...." While GRRC reviewed and approved this rule in 1996, GRRC now believes that the rule contradicts public records laws. According to these laws, Department investigation information and documents are already public records. Further, the rule contradicts public records laws because these laws presume that records are public unless disclosure would not be in the State's best interest. However, the Department's rule presumes that its records are confidential unless it makes them a matter of public record.

**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.**

According to the Department, it seeks input from stakeholders on proposed legislation and rules, largely through its Web site. The most recent proposed changes to rules were printed in the *Arizona Real Estate Bulletin*, the Department's online newsletter. The Department also maintains a lengthy list of stakeholders who are notified by mail regarding proposed rule and statute changes. In addition, the Department held two public forums in Phoenix and Tucson during 1999 to obtain public input regarding its proposed rules revisions.

Additionally, the Department has complied with the State's open meeting laws by posting public meeting notices at least 24 hours in advance at the required location, announcing upcoming Real Estate Advisory Board meetings on its Web site, and posting meeting agendas on the Web site the day before the meeting is scheduled. The Department also has the required statement on file with the Secretary of State that notes where meeting notices will be posted.

**6. The extent to which the Department has been able to investigate and resolve complaints that are within its jurisdiction.**

The Department has sufficient authority to investigate and resolve complaints within its jurisdiction. However, this audit found that the Department's complaint practices discourage or prevent consumers from filing complaints. Further, the Department does not conduct thorough investigations because it lacks adequate policies and procedures to guide its investigators through the investigative process (see Finding I, pages 11 through 22).

In addition, the Department's disciplinary actions against licensees are inconsistent because the Department lacks disciplinary guidelines to ensure fairness when disciplining licensees (see Finding II, pages 23 through 27).

**7. The extent to which the Attorney General or any other applicable agency of state government has the authority to prosecute actions under the enabling legislation.**

A.R.S. §32-2111 authorizes the Attorney General to act for the Real Estate Commissioner in all legal actions and proceedings as well as advise him on all questions of law.

The Department is currently represented by two full-time Assistant Attorneys General and by one half-time Assistant Attorney General who primarily represents the Department in Real Estate Recovery Fund issues.

**8. The extent to which the Department has addressed deficiencies in its enabling statutes which prevent it from fulfilling its statutory mandate.**

The Department has sought a number of changes to address deficiencies in its statutes. In 2000, the Department sought and received authority to issue a provisional license, which allows the Department to issue a license to an individual it wishes to monitor. For example, to ensure

the public is properly protected from licensees with substance abuse problems, the Department can issue a provisional license to an applicant who was previously convicted of a drug-related crime and require the applicant to submit to drug testing for a specified period. Also in 2000, legislation was passed which increased the number of Advisory Board members from seven to nine and required that two members have at least five years of residential real estate experience. This change was made in response to concerns from industry groups that the current Board composition was not representative of the industry as a whole.

In 2001, the Department proposed and the Legislature passed changes to the Department's statutes allowing electronic submission of licensing applications, clarifying the information required for processing Recovery Fund claims, and increasing the maximum amounts of Recovery Fund payouts (see Finding III, pages 29 through 36).

**9. The extent to which changes are necessary in the laws of the Department to adequately comply with the factors listed in the Sunset law.**

Based on audit work, the Legislature should consider amending A.R.S. §§32-2186 through 32-2193.02 to transfer authority for approving Recovery Fund claims from the courts to the Real Estate Commissioner (see Finding III, pages 29 through 36).

**10. The extent to which termination of the Department would significantly harm the public health, safety, or welfare.**

Terminating the Department could pose a threat to the public safety and welfare since real estate purchases are substantial and involve complex processes and contracts. For example, in 2000, over 97,620 real estate transactions involving single-family homes, townhomes, and condominiums occurred in the Phoenix Metropolitan area. These transactions averaged \$124,900. The amount of real

estate activity and the significant amount of transaction costs increase the need for qualified, regulated licensees.

In addition, there is no other agency that exists to license real estate professionals. The Department's process for licensing is designed to screen out unknowledgeable and potentially dangerous licensees. Also, the Department's review and approval of subdivision public report applications helps to protect the public by ensuring that required information is disclosed on subdivided and unsubdivided property before the consumer purchases that property. Finally, all 50 states license and regulate real estate professionals.

- 11. The extent to which the level of regulation exercised by the Department is appropriate and whether less or more stringent levels of regulation would be appropriate.**

This audit found that licensure is the appropriate level of regulation for real estate professionals. It helps ensure that applicants meet education and training requirements and prevents unqualified or unprofessional licensees from practicing.

- 12. The extent to which the Department has used private contractors in the performance of its duties and how effective use of private contractors could be accomplished.**

The Department has made use of private contractors to perform certain services. For example, the Department contracts with a private company to administer its licensure exams. In addition, as of November of 2000, various private real estate schools under contract with the Department administer Broker Management Clinics, which educate brokers on issues such as recordkeeping, trust fund accounts, fiduciary duties, and employee supervision. According to statute, all newly licensed brokers must attend a Broker Management Clinic prior to licensure and all current designated brokers must attend a

**Sunset Factors**

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Clinic once every two years. Currently, there do not appear to be any further opportunities to contract out services.



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# **AGENCY RESPONSE**

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**STATE OF ARIZONA**  
**DEPARTMENT OF REAL ESTATE**

JANE DEE HULL  
GOVERNOR

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Phoenix, Arizona  
July 26, 2001

Ms. Debra K. Davenport, CPA  
Arizona Auditor General  
2910 North 44 Street, 4<sup>th</sup> Floor  
Phoenix, AZ 85018

Re: Performance Audit of Department of Real Estate

Dear Ms. Davenport:

Enclosed is the Department's Response to the Auditor General's Performance Audit of the Arizona Department of Real Estate for inclusion in the published report. Members of your staff assigned to this task were very courteous and accommodating throughout the audit data gathering process including team discussions with my staff and me.

While the Department agrees with many of the audit recommendations, we also disagree with several. Additionally, we feel that the Report Highlights is a slanted, one-sided publicity piece that should be discontinued. If a shorter version of the report is desired, then the summary should be sufficient, rather than the unilateral headlines utilized in the Highlights.

Sincerely,

Jerry A. Holt  
Commissioner

enclosure

**ARIZONA DEPARTMENT OF REAL ESTATE  
RESPONSE TO PERFORMANCE REPORT  
BY AUDITOR GENERAL**

**FINDING I**

**Audit Recommendation 1**

The Department should:

a. Revise its policies and procedures to require its customer services representatives to assist consumers who may wish to file complaints and discontinue making determinations whether complaints may or may not be within the Department's jurisdiction; and

**Department Response**

The finding of the auditor general is not agreed to and will not be implemented. However, the Department will have its customer service representatives listen to a caller's entire complaint before concluding and advising that the matter is or is not within the Department's jurisdiction.

b. Train its customer services representatives on how to assist consumers who wish to file written complaints.

**Department Response**

The finding of the auditor general is agreed to and the audit recommendation will be implemented.

**Audit Recommendation 2**

The Department should revise its complaint form disclaimer to exclude the broad categories of complaints for which it may have jurisdiction (sic), including complaints involving contract/listing disputes and ethical/performance issues.

**Department Response**

The finding of the auditor general is agreed to and a different method of dealing with the finding will be implemented. The form is being revised to clarify that the Department has jurisdiction in contract disputes, ethical issues, and deposits/refunds when those issues rise to the level of fraud, misrepresentation or negligence.

**Audit Recommendation 3**

The Department should track and report on the number of complaints It receives and the disposition of those complaints.

**Department Response**

The finding of the auditor general is agreed to and the audit recommendation will be implemented.

#### **Audit Recommendation 4**

The Department should review and investigate all of the complaints it receives from consumers by developing and implementing policies and procedures that include the following:

- a. Specific criteria and guidelines for the screening of complaints to include requirements, such as contacting the complainant to confirm the nature of the complaint and all of the allegations being made; and
- b. Specific steps or tasks that comprise a thorough investigation, such as interviewing the complainant, obtaining and reviewing all relevant documentary evidence, and investigating each allegation in a complaint to determine if a violation was committed.

#### **Department Response**

The finding of the auditor general is not agreed to and the recommendation will not be implemented. In many cases, it is not necessary or appropriate to interview the complainant, such as in advertising complaints (in most advertising complaints, only the advertisement needs to be examined).

The Auditor General determined that, of the 16 they examined, 2 cases should have been investigated further. However the Attorney General's office determined that there was no need to investigate these cases further and concluded the Department had no basis for action. (See attached Exhibit 1.)

We agree that the investigators will better document the actions taken in investigating each case, but do not agree to developing specific procedures for each investigation because even minor departures from a list of specific steps or tasks could jeopardize an otherwise solid case. An investigator's failure to strictly adhere to the written procedures could result in dismissal of a case. We surveyed five western states' real estate departments (investigation divisions); none has a specific procedure manual. In fact the person from the State of Washington stated that they were directed by their attorneys specifically to not have such a manual. (See Exhibit 2 for the results of this survey.)

#### **Audit Recommendation 5**

The Department should train the appropriate investigative staff on how to properly screen and investigate complaints.

#### **Department Response**

The finding of the auditor general is not agreed to and the recommendation will not be implemented. Department investigators **are** properly trained but do not employ the documented procedures that the Auditor General's office recommends. Every investigator, in addition to following the Department's Investigator Training Manual, is guided by the ARELLO Investigator Training Manual and the manual published by the Council of Licensure, Enforcement and

Regulation (CLEAR). Each investigator is required to attend the CLEAR Investigator Training Course. Of the 5 states we called, none has its own written policy for investigative procedures. Utah relies **solely** on the ARELLO manual.

### **Audit Recommendation 6**

The Department should assess the impact that implementation of the recommendations made in this report has on its workload, determine if additional investigative resources are needed, and, if so, request them from the Legislature.

### **Department Response**

The finding of the auditor general is agreed to and a different method of dealing with the finding will be implemented. We will make the assessment after implementing the recommendations.

## **FINDING II**

### **Audit Recommendation 1**

The Department should develop and implement disciplinary guidelines that include consideration of the violation's severity, the licensee's violation history, any other aggravating or mitigating factors, and a range of appropriate disciplinary actions. In addition, the Department should adopt these guidelines in a substantive policy statement.

### **Department Response**

The finding of the auditor general is not agreed to and the recommendation will not be implemented. The person making the decision considers all of these factors but the Department objects to having a written policy. If a Respondent knew the strengths and weaknesses of the Department's previous cases, achieving a suitable resolution would be that much more difficult. Reasons for settling on a specific penalty in any given case typically have a multitude of elements, all of which are combined to determine the final resolution of each case. To attempt to standardize discipline to this degree would lead to a slowing of the process and render each case progressively more difficult to settle.

### **Audit Recommendation 2**

The Department should consistently record and document in its files factors, such as previous violations and other aggravating and mitigating circumstances, that influence a licensee's penalties.

### **Department Response**

The finding of the auditor general is agreed to and the audit recommendation will be implemented.

## **FINDING III**

### **Audit Recommendation 1**

The Legislature should consider revising A.R.S. §§ 32-2186 through 32-2193.02 to transfer authority for approving Recovery Fund claims from the courts to the Real Estate Commissioner.

### **Department Response**

The finding of the auditor general is agreed to and the audit recommendation will be implemented.

### **Audit Recommendation 2**

If statute is amended, the Department should promulgate rules to establish timelines for applicants to submit documentation as well as timelines for the Department to make decisions on claim applications. Rules should also address what documentation the Department needs to collect.

### **Department Response**

The finding of the auditor general is agreed to and the audit recommendation will be implemented.

### **Audit Recommendation 3**

If statute is amended, the Department should examine its intergovernmental service agreement with the Attorney General's Office and determine if changes are necessary.

### **Department Response**

The finding of the auditor general is agreed to and the audit recommendation will be implemented.

### **Audit Recommendation 4**

The Department should properly allocate the Fund Administrator's and Assistant Attorney General's personnel expenses so that only the portion of these expenses that are attributable to the Fund are charged to the Fund.

### **Department Response**

The finding of the auditor general is agreed to and the audit recommendation will be implemented. We questioned the Attorney General's expenses last year and in a letter dated July 12, 2000, the Attorney General's Office assured us that the expenses were appropriate. (See Exhibit 3.) With regard to the Fund Administrator's expenses, we reviewed these and gave a copy of our analysis to the auditor showing that there were offsetting expenses that were not being allocated to the Fund that could be and therefore the Fund was not being overcharged.



**Audit Recommendation 5**

The Department should properly charge indirect costs associated with the Fund to the Fund.

**Department Response**

The finding of the auditor general is agreed to and a different method of dealing with the finding will be implemented. This recommendation will be implemented when the requested statutory changes become effective.

**FINDING IV****Audit Recommendation 1**

The Department should strengthen its public information policies to direct staff to provide all public information to consumers over the telephone, including information on the number and nature of closed, dismissed, and pending complaints and disciplinary actions.

**Department Response**

The finding of the auditor general is agreed to and a different method of dealing with the finding will be implemented. The Department will begin making available over the telephone, by mail, and email a summary of the nature and number of closed and dismissed investigative files, pending hearings and closed disciplinary actions. The Department does not agree to disclosure of pending (open) investigations. First, our system of jurisprudence presumes innocence and secondly, disclosure of the existence and nature of a pending investigation could significantly hinder investigative efforts. This practice is consistent with R4-28-1303, which has been approved by GRRC; the Department is unaware of any official action by GRRC to change its 1996 position concerning this rule.

**Audit Recommendation 2**

The Department should discontinue its restrictive policies requiring consumers to request files in writing and provide photo identification and other personal information when visiting the office to view licensee files.

**Department Response**

The finding of the auditor general is agreed to and the audit recommendation will be implemented.

**Audit Recommendation 3**

The Department should make certain that files prepared for consumers have the licensee's complete complaint and disciplinary history information.

**Department Response**

The finding of the auditor general is agreed to and the audit recommendation will be implemented.

**Audit Recommendation 4**

The Department should ensure that confidential information on licensees is removed from files before consumers view them.

**Department Response**

The finding of the auditor general is agreed to and the audit recommendation will be implemented.

**Audit Recommendation 5**

Department management should ensure staff are properly trained in procedures for removing confidential information and periodically monitor files that are scheduled for consumer review.

**Department Response**

The finding of the auditor general is agreed to and the audit recommendation will be implemented.

**Audit Recommendation 6**

The Department should adhere to the five-to-seven-day time frame it has already established in policy for preparing files for public review.

**Department Response**

The finding of the auditor general is agreed to and a different method of dealing with the finding will be implemented. The Department will continue to follow its Substantive Policy Statement No. 12.

**Audit Recommendation 7**

The Department should provide complaint summaries in licensee files to provide consumers with a complete overview of the licensee's complaint and disciplinary history.

**Department Response**

The finding of the auditor general is agreed to and a different method of dealing with the finding will be implemented. The Department will summarize the public-record portions of closed investigative files and formal disciplinary actions that are pending or closed.



JANET GUSTAFSON  
ASSISTANT ATTORNEY GENERAL  
CONSUMER PROTECTION & ADVOCACY SECTION

1275 W. WASHINGTON  
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MEMORANDUM

DATE July 31, 2001  
TO: Jim Duke, Director of Investigations, Arizona Department of Real Estate  
RE: Legal Merits of Investigative Files

ISSUE PRESENTED:

You asked me to review two investigative files and recommend a legal disposition for the files.

SHORT ANSWER:

Based on the documents provided, I do not recommend legal action for either of these files.

DISCUSSION:

**Complaint 1:**

I have reviewed the complaint and documentation enclosed with the complaint. It appears that there are no real estate violations per se. The complainants are alleging that the licensee (i) acted unprofessionally (i.e. swearing, hanging up on them, possibly threatening them), (ii) is not marketing their property appropriately, (iii) refused to release the clients from their contract, and (iv) is somehow at fault for the buyers' failure to close escrow.

First, although swearing and hanging up on clients is inappropriate behavior, this is an issue of professionalism rather than statutory violations. Although rude, it cannot qualify even as negligence. Further, without a direct admission from the licensee, it appears there is no evidence other than the complainants' recollection that can substantiate these claims.

Second, the listing agreement that the sellers and the licensee signed will govern the 'marketing' of the property. It appears that although the complainants are unhappy with how the licensee is marketing their property, the contract terms will control how, what, when and where the property will be marketed to potential purchasers. A.R.S. §32-2151.02(A) requires that all real estate, employment agreements: (1) be written in clear and unambiguous language, (2) fully set forth all material terms, including compensation,

EXHIBIT 1

Duke, ADRE  
July 19, 2001  
Page 2

(3) have a definite duration or expiration date, and (4) be signed by all parties to the agreement. Therefore, the complainant should reference this agreement to determine what marketing obligations the licensee owes them, and then seek the appropriate channels to enforce their private contract rights. It would be difficult to argue that this is somehow a violation of A.R.S. § 32-2153(A)(22). and without other more solid violations, we would likely not prevail at hearing.

Third, ADRE does not have any statutory authority to require the licensee to release the complainant from a valid, lawful contract.

Fourth, the contract signed and placed into escrow by the buyers and sellers will control the seller's ability to "back out" of the contract. Again, these are private contractual rights exclusive to the parties, and therefore, the complainants should investigate what private channels of enforcement are available to them.

### **Complaint 2:**

I have reviewed the complaint and the documents enclosed with the complaint. It appears that there are no real estate violations per se. Although licensees have a duty to deal fairly with all parties to a transaction, there never was, in fact, a transaction between the parties. The complainant points this out several times in her complaint. For example, the complainant states "[t]his evidences to anyone with a remote understanding of real estate law that there never was a binding contract as there was no meeting of the minds"; then in regards to the licensee's request to extend the deadline to March 31st, the complainant states that "their amended addendum was not accepted and that further interactions between the parties were unnecessary".

Arizona Revised Statutes § 32-2153 (A)(1) prohibits licensees from pursuing a course of misrepresentation or making false promises either directly or through others whether acting in the role of a licensee or a principal in a transaction. If it is true that the licensee had no grounds to bring the private lawsuit discussed in the complaint, then it is arguable that the licensee pursued a course of misrepresentation, however, there is no evidence to show that a jury and/or court of competent jurisdiction has found that the licensee's private lawsuit was frivolous and without merit. At hearing we would have to prove that the licensee in fact knew that she had no legal or contractual rights to enforce against the complainant. It is likely that the licensee will claim that she filed the lawsuit based on legal advice from her attorney and therefore, her actions were reasonable although mistaken. Regardless, as with the duty to deal fairly, this violation only occurs when there is a transaction. The complainant herself acknowledges there never was a transaction.



**STATE OF ARIZONA  
DEPARTMENT OF REAL ESTATE**

JANE DEE HULL  
GOVERNOR  
JERRY A. HOLT  
COMMISSIONER

2910 NORTH 44<sup>TH</sup> STREET, SUITE 100 PHOENIX, ARIZONA 85018  
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June 15, 2001

I have called the following states Real Estate Departments with regard to the question "Do you have a manual for Investigators that provides step-by-step procedures". Of the five calls, all five stated emphatically that they did not.

- 1) Washington            Sandra Spencer            360-664-6508  
No. They have a general policy manual but do not have a step by step procedure manual. They send all their investigators to CLEAR Training. Their attorney has advised them to not have a step by step manual because it could result in "trouble" for them
- 2) Oregon                Jack Graham                503-378-4170 x 231  
No. "Investigators need latitude."
- 3) Colorado             Robert Volkert             303-894-2166  
No. "Each case is very different."
- 4) Nevada               Pam Rebe                    702-486-4033 x 224  
No. Policy Manual
- 5) Utah                   Jon Brown                    801-530-6747  
No. Use Arello and other training.

Richard C. Simmonds

**EXHIBIT 2**



STATE OF ARIZONA

OFFICE OF THE ATTORNEY GENERAL

1275 WEST WASHINGTON, PHOENIX, Az. 85007-2926

MAIN PHONE: (602) 542-5025  
FACSIMILE: (602) 542-4085

JANET NAPOLITANO  
ATTORNEY GENERAL

July 12, 2000

VIA HAND DELIVERY

Jerry Holt  
Real Estate Commissioner  
Department of Real Estate  
2910 N. 44th Street, #100  
Phoenix, Arizona 85018

Dear Commissioner Holt:

Deputy Commissioner John King has requested that I write to you discussing the Inter-Governmental Services Agreement between the Real Estate Department and the Attorney General under which Susan Lagerman is employed as a half-time attorney to provide legal services to the Real Estate Recovery Fund. A.R.S. § 32-2189(a) provides that monies in the Fund are to be used for carrying out the purposes of the Fund. For more than ten years the Attorney General and the Real Estate Department have considered the services provided by Susan Lagerman under our contract to be carrying out those purposes.

I believe that the purposes of the Real Estate Recovery Fund are being advanced in three fundamental ways. First, Susan provides very competent and efficient legal services directly to the Fund in cases in which persons have made claims against the Fund. Because years of experience, Susan is able to perform this work with a much higher level of efficiency than an attorney unfamiliar with the Fund.

Second, Susan provides other services to the Real Estate Department which significantly enhance the Department's regulation of the real estate profession, thus helping to deter and prevent violations which may result in claims against the Fund. Susan has provided considerable assistance and expertise in legislative drafting and analysis. Moreover, her efforts have been a substantial factor in the Department's successes in the Section 7 case and the Bastante case. In the Section 7 case she was responsible not only for enforcing the subdivision laws but for obtaining a very favorable published Court of Appeals decision interpreting those laws. To the extent that potential violators of the subdivision law's are deterred by the Department's actions in Bastante and Section 7, Susan has advanced the purposes of the Fund.

**EXHIBIT 3**

Jerry Holt  
July 12, 2000  
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Finally, the ISA under which Susan performs services for the Department gives the Department a total of two and one-half attorneys to represent it. This is more than any other agency represented by the Consumer Protection & Advocacy Section, even though the other agencies also contribute funds toward ISA's for legal services. Without Susan's substantial efforts, the other two assistant attorneys general representing the Department would be required to pick up the representation of the Fund and perform the other work currently being done by Susan. The result is that the overall representation of the Real Estate Department would be diminished as would be the Department's regulation of the real estate profession. Such diminution of the Department's regulation would inevitably result in increased violations and increased claims against the Fund.

For all of these reasons I urge the Department of Real Estate to continue to -participate in the ISA with the Attorney General. If you have any questions, please call me at (602) 542-7728.

Sincerely,

A handwritten signature in cursive script, appearing to read "Robert A. Zumoff".

Robert A. Zumoff  
Chief Counsel  
Consumer Protection & Advocacy Section

RAZ/ss

## Other Performance Audit Reports Issued Within the Last 12 Months

00-17	Arizona Department of Agriculture— Sunset Factors	01-05	Arizona Department of Public Safety—Telecommunications Bureau
00-18	Arizona State Boxing Commission	01-06	Board of Osteopathic Examiners in Medicine and Surgery
00-19	Department of Economic Security— Division of Developmental Disabilities	01-07	Arizona Department of Corrections—Support Services
00-20	Arizona Department of Corrections— Security Operations	01-08	Arizona Game and Fish Commission and Department—Wildlife Management Program
00-20	Universities—Funding Study	01-09	Arizona Game and Fish Commission—Heritage Fund
00-21	Annual Evaluation—Arizona’s Family Literacy Program	01-10	Department of Public Safety— Licensing Bureau
01-01	Department of Economic Security— Child Support Enforcement	01-11	Arizona Commission on the Arts
01-02	Department of Economic Security— Healthy Families Program	01-12	Board of Chiropractic Examiners
01-03	Arizona Department of Public Safety—Drug Abuse Resistance Education (D.A.R.E.) Program	01-13	Department of Corrections—Private Prisons
01-04	Arizona Department of Corrections—Human Resources Management	01-14	Arizona Automobile Theft Authority

## Future Performance Audit Reports

Department of Veterans Services

Arizona Board of Dispensing Opticians