



A REPORT
TO THE
ARIZONA LEGISLATURE

Performance Audit Division

Performance Audit

Registrar of Contractors

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Debra K. Davenport
Auditor General

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STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

April 3, 2003

Members of the Arizona Legislature

The Honorable Janet Napolitano, Governor

Mr. Israel Torres, Director
Registrar of Contractors

Transmitted herewith is a report of the Auditor General, A Performance Audit and Sunset Review of the Registrar of Contractors pursuant to a May 14, 2002, resolution of the Joint Legislative Audit Committee. The performance audit was conducted as part of the Sunset review process prescribed 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 Registrar of Contractors agrees with most of the findings and recommendations, but states that it will not implement two recommendations related to its use of state vehicles. First, the agency states that it will not return all vehicles to the Department of Administration that are not used efficiently because its staff need an adequate pool of vehicles available to perform their duties. However, maintaining its own large pool of vehicles at the agency is costly, and other more efficient transportation options exist. Second, the agency states that it will not monitor the use of vehicles through detailed mileage logs. Keeping detailed mileage logs would help prevent misuse and better ensure efficient vehicle use.

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

This report will be released to the public on April 4, 2003.

Sincerely,

Debbie Davenport
Auditor General

Enclosure

SUMMARY

The Office of the Auditor General has conducted a performance audit and Sunset review of the Registrar of Contractors pursuant to a May 14, 2002, resolution of the Joint Legislative Audit Committee. This audit was conducted as part of the Sunset review set forth in Arizona Revised Statutes (A.R.S.) §41-2951 et seq.

Arizona is one of 12 states that has a central regulatory body that regulates nearly all aspects of the construction industry. Created in 1931, the Registrar of Contractors (agency) regulates commercial and residential contractors. It issues licenses, performs inspections related to workmanship complaints, and investigates statutory violations such as contracting without a license. As of January 2003, it reports having over 41,000 active contractors' licenses.¹ To help consumers make informed decisions about contractors, the agency provides information to the public on licensees, including complaint histories. The agency also administers the Residential Contractors' Recovery Fund, which reimburses consumers for up to \$30,000 in financial losses resulting from a residential contractor's actions.

Consumer protection can be enhanced (see pages 9 through 13)

The agency needs to address three matters that limit the degree of protection it provides to consumers.

- **First**, the agency needs to ensure that problem contractors, such as those with serious or multiple complaints, are disciplined. The majority of contractors do not have complaints filed against them. However, contractors who do have complaints filed against them can avoid disciplinary action by addressing the complaints before the complaints progress to an administrative hearing. Although this may satisfy the consumer, it can allow a problem contractor to continue to operate. The agency needs to develop criteria for determining when to pursue disciplinary action.
- **Second**, the agency does not report information to the public regarding the nature of valid complaints against contractors. This information can be impor-

¹ One contractor may hold more than one license, therefore, this number does not represent the number of contractors.

tant to consumers when choosing a contractor. Without it, consumers are unaware if a valid complaint concerned issues such as minor quality workmanship problems or more serious issues such as breach of contract or project abandonment. The agency recently began reporting the total number of complaints against a contractor, including cases where the agency did not find that the contractor had committed a violation. Because contractors can fix problems before an inspection happens, inspectors often cannot confirm complaints, and consumers were unaware that a problem may have existed because the agency did not report unconfirmed complaints.

- **Finally**, for several years, the agency performed “courtesy inspections” designed to help resolve workmanship disputes between contractors and their customers informally. In fiscal year 2002, the agency performed about 1,100 of these inspections. During the audit, the agency discontinued this practice when auditors informed the agency that it does not have the statutory authority to conduct informal complaint resolution. If the agency wishes to resume courtesy inspections, it needs to seek statutory authority from the Legislature and develop procedures for making the results available to all consumers.

Some Recovery Fund changes needed (see pages 15 through 21)

The Registrar of Contractors needs to change some aspects of the way it manages the Residential Contractors’ Recovery Fund. The Legislature established the Fund to assist consumers who suffer financial loss due to the actions of a licensed residential contractor. The Fund pays about 500 claims per year. The agency has maintained the Fund on a pay-as-you-go basis, maintaining a sufficient cash balance to pay claims as they come in. Although the Fund has been able to pay all claims as it received them, it does not have enough assets to pay for all its liabilities, which include instances where consumers have suffered losses for which they have not yet filed a claim. Similar to casualty insurance companies, which are required to maintain sufficient reserves to cover claims that have not yet been reported, the Fund is statutorily required to maintain adequate claims reserves. To establish required claims reserves, the agency needs a \$5.7 million increase in the Fund’s assets. To resolve this situation, the agency needs to do the following:

- **Hire a qualified actuary**—The Fund’s obligations include claims actually received from consumers and claims that consumers will file in the next 2 years—the length of time that consumers have to file a claim after their loss occurs. Statutes require that the agency base these anticipated future claims on

actuarial projections. However, the agency has relied on its auditor, a Certified Public Accountant (CPA), to make the projections. These projections have consistently and significantly underestimated the Fund's anticipated claims. Further, the agency uses the same CPA to perform projections and to audit the Fund's financial position, which could impair the CPA's independence in auditing the Fund's financial statements. To establish proper reserves, the agency should use a qualified actuary for the projections.

- **Assess residential contractors an additional amount to make up the deficit**—The money in the Fund comes mainly from annual assessments paid by residential contractors. To return the Fund's fund balance to an appropriate level based on the CPA's most recent projections, the agency would need to levy an estimated additional \$220 assessment from each of the 26,000 contractors currently participating in the Fund. The actual assessment could differ if the new actuarial estimates change the size of the Fund's deficit.

Two other changes would improve additional aspects of the Fund's management. One change involves discontinuing the outside CPA's preparation of agency financial statements in nonaudit years. Statutes require that the agency have an examination of the Fund every 3 years, and the agency has hired an independent CPA to perform the examination. The agency pays the CPA to compile financial statements in nonaudit years as well, but CPAs already on the current staff can also complete this task.

In addition, the Legislature should consider modifying the statute that limits the Fund's administrative expenses. Statutes limit the agency's administrative expenses to 10 percent of the Fund's fund balance in any fiscal year. However, the Fund has been in deficit for several years, and therefore, this approach does not work. Even if the Fund achieves its minimum required balance of \$200,000, this would only allow an insufficient amount of \$20,000 for the Fund's administrative expenses. In fiscal year 2002, the Fund's operating expenses were approximately \$534,000. Other similar funds' administrative cost limits are linked to percentages of the funds' revenues. Therefore, the Legislature should consider limiting the Fund's administrative expenses in a similar manner. However, because the Fund's revenues are likely to change significantly due to fee increases, an interim change may be necessary before the Legislature makes a more permanent change to this statute.

The agency's vehicle usage is inappropriate and inefficient (see pages 23 through 25)

The Registrar of Contractors should end its practice of providing take-home vehicles to many of its employees and should eliminate inefficiently used vehicles. The

agency leases 65 vehicles from the Department of Administration (DOA) and assigns nearly all of them to its employees for take-home use. During the audit, 61 of the agency's 145 staff had personally assigned take-home vehicles. However, this use violates state law, is a constitutionally prohibited use of state resources, and should be eliminated. In addition to ending the use of take-home vehicles, the agency should also eliminate vehicles that are inefficiently used. Approximately one-third of the agency's vehicles are driven less than 10,000 miles per year and can be returned to DOA. Other vehicles may also fall below this efficient-use guideline after the agency eliminates inappropriate personal use. The agency should closely monitor vehicle use to identify inefficiently used vehicles that could also be eliminated. By eliminating vehicles, the agency will save resources, as well as provide monies to support the General Fund.

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concluded ♦

INTRODUCTION & BACKGROUND

The Office of the Auditor General has conducted a performance audit and Sunset review of the Registrar of Contractors pursuant to a May 14, 2002, resolution of the Joint Legislative Audit Committee. This audit was conducted as part of the Sunset review set forth in Arizona Revised Statutes (A.R.S.) §41-2951 et seq.

Purpose and responsibilities

The Legislature created the Registrar of Contractors (agency) in 1931 (Laws 1931, Chapter 2) to regulate construction contractors. Arizona is one of 12 states that has a central regulatory body that regulates nearly all aspects of the construction industry. Other states leave this regulation to local government or share the regulatory responsibilities among multiple state agencies. Further, the extent of regulation varies significantly. Some states limit regulation to certain trades such as plumbing or electrical work. Other states only regulate construction projects with costs that exceed several thousand dollars.

The agency issues both commercial and residential contracting licenses and a dual license that allows a contractor to work on commercial and residential properties. Within the commercial, residential, and dual license categories are several license classifications ranging from general contracting to more than 100 specialty trade classifications such as home painting, roofing, or tiling.

The Governor appoints the Registrar to oversee the agency's day-to-day operations and the administration of the Residential Contractors' Recovery Fund. The agency's primary responsibilities include the following:

- **Licensing**—Statutes and administrative rules establish licensing requirements for contractors. All contractors must be licensed with some exceptions, such as “handymen” who limit themselves to jobs valued at less than \$750, including

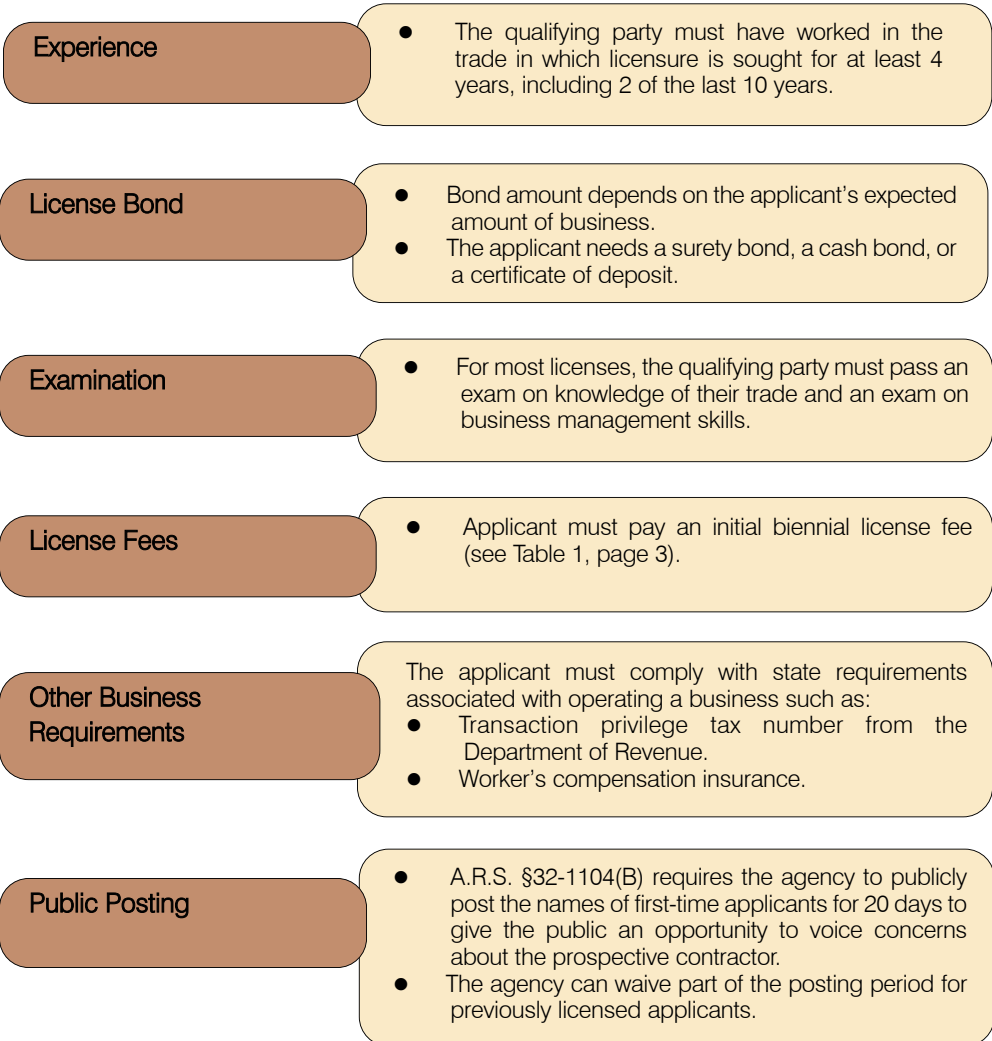
Mission

To promote quality construction by Arizona contractors through a licensing and regulatory system designed to protect the health, safety, and welfare of the public.

cost of materials and labor. The agency issues licenses to contracting entities, including construction firms and individuals who own contracting businesses as sole proprietors. Entities must have a designated “qualifying party,” to manage the construction aspects of the entity (see Figure 1 for licensing requirements).

Figure 1 Statutory Requirements to Receive a Contracting License

The Arizona Registrar of Contractors grants licenses to contracting entities. Each contracting entity must designate a “qualifying party” who manages the construction aspect of the entity. The licensure requirements are as follows:



Source: Auditor General staff analysis of A.R.S. §§32-1101 through 32-1170.03.

The agency typically reviews and approves licenses within 4 days after receiving a complete application. After the required posting period is completed, the agency may issue the license. As of January 2003, the agency reports having over 41,000 active contractors' licenses, as shown in Table 1.¹

Table 1 Fees for and Number of Licenses by Contractor Type
As of January 2003

Contractor Type	Biennial Fee		Number
	Initial	Renewal	
General			
Residential	\$ 445	\$290	6,659
Commercial	890	580	5,340
Dual ¹	1,105	860	<u>1,739</u>
Subtotal			<u>13,738</u>
Specialty			
Residential	320	240	12,444
Commercial	645	490	10,191
Dual ¹	815	730	<u>4,972</u>
Subtotal			<u>27,607</u>
Total			<u>41,345</u>

¹ Contractors who hold a dual license are authorized to work on both commercial and residential projects.

Source: Auditor General staff analysis of the Registrar of Contractors' administrative rules, agency reports, and license database as of January 2003.

- **Inspections**—In addition to licensing contractors, the agency inspects licensed contractors' workmanship. The agency has 29 inspectors who are required to be certified through the International Conference of Building Officials and must have at least 2 years experience managing construction projects. Currently, the agency performs various types of inspections including workmanship complaint inspections as well as inspections related to Recovery Fund claims. The agency reported handling over 10,000 complaints during fiscal year 2002. The inspector may require the contractor to fix the problem after validating a complaint. Consumers or contractors may appeal inspectors' decisions to the Office of Administrative Hearings (OAH). OAH reports receiving over a total of 1,600 cases generated from the Registrar of Contractors during fiscal year 2002.
- **Investigations**—The agency has 26 staff who investigate statute violations such as allegations of unlicensed contracting, abetting an unlicensed contractor,

¹ One contractor may hold more than one license; therefore, this number does not represent the total number of contractors.

unlawful advertising, and providing false information on a license application. In addition, investigators may perform background checks on license applicants. Further, the agency has the authority to investigate fraudulent acts that any contractor commits. Investigators must have previous training as investigators and nearly all have law enforcement experience. In fiscal year 2002, the agency reports that it received 2,900 cases that involved allegations of unlawful activities.

- **Residential Contractors' Recovery Fund**—The agency administers the Residential Contractors' Recovery Fund, which provides financial relief to consumers who suffer a loss due to a licensed residential contractor's actions. All residential contractors must either self-insure through large surety bonds or cash deposits or pay special fees to participate in the Fund. Consumers who wish to file a claim must do so within 2 years after the loss occurred. A consumer may recover a maximum of \$30,000 per residence. Total claims against any one license may not exceed \$200,000. If the agency pays a consumer for a claim, it suspends the contractor's license until the contractor repays the full amount of the claim plus interest at the rate of 10 percent per year. The Fund's seven staff determine the eligibility and validity of Recovery Fund claims, process claims for payment, and seek reimbursement from contractors who have had valid claims paid against them. The agency's Attorney General representative provides legal assistance in cases where claim eligibility or amounts are in dispute and when the agency is seeking reimbursement to the Fund from contractors who have had claims paid against them.

Staffing and budget

As of January 1, 2003, the agency was appropriated 138 full-time equivalents (FTE) and had five vacancies. In addition, the Residential Contractors' Recovery Fund had 7 FTE paid by residential contractors' fund participation fees. As of January 1, 2003, the Fund had one vacant position. The agency's staff operate out of 11 locations state-wide including the Phoenix central office (see Figure 2 on page 5).

As illustrated in Table 2 (see page 6), the agency generated approximately \$10.5 million in fiscal year 2002 from licensing fees, fines, and interest. Revenues from licenses increased from approximately \$6.5 million in fiscal year 2000 to more than \$10.2 million in fiscal year 2002. The agency had significantly reduced license fees in 1998, and since then, license fees have steadily increased, but are still lower than they were in 1998. The agency deposits 90 percent of its license revenues in its operating funds to provide its services and remits the remaining 10 percent to the General Fund along with all its revenues from administrative penalties and interest. In fiscal year 2002, the agency remitted approximately \$1.2 million to the General Fund.

The agency has 11 offices state-wide.

The agency administers the Residential Contractors' Recovery Fund (Fund) separately from its operating funds. In addition to new or renewal licensing fees, residential contractors pay fund participation fees, which amount to \$300 for the initial year and \$150 for the renewal years. Although the agency collected \$3.5 million for the Fund in fiscal year 2002, the Fund has a deficit of approximately \$5.5 million for fiscal year 2002 as shown in Table 3 (see page 7). This deficit includes all unpaid claims, including estimated liabilities. Finding 2 (see pages 15 through 21) provides additional information on the Fund and recommendations for addressing the deficit.

Audit scope and methodology

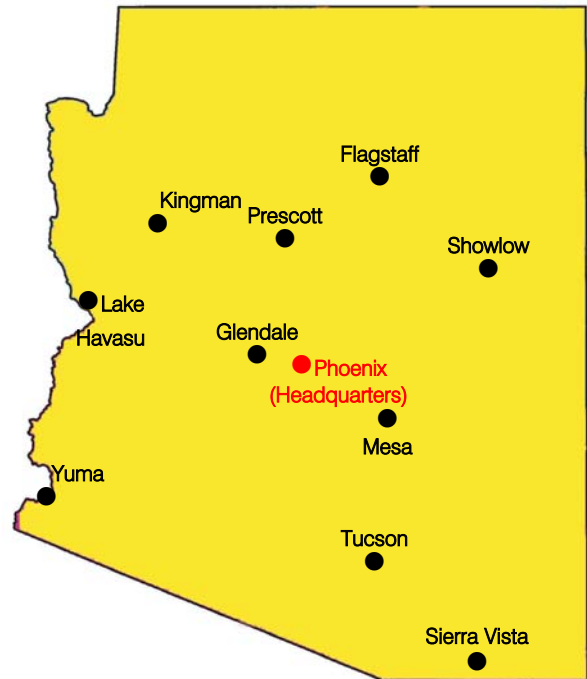
This audit focused on the Registrar of Contractors' efforts to protect consumers, its management of the Residential Contractors' Recovery Fund, and the appropriateness of agency staff taking agency cars home. This report includes findings and recommendations in the following three areas:

- The Registrar of Contractors should increase the level of its consumer protection.
- The Registrar of Contractors needs to change some aspects of the way it manages the Residential Contractors' Recovery Fund to resolve a large deficit and to better protect consumers.
- The Registrar of Contractors needs to discontinue providing take-home vehicles to its employees and eliminate inefficiently used vehicles.

Auditors used a variety of methods to study the issues addressed in this report:

- To determine the extent to which the agency protects the public, auditors interviewed agency staff, the State Ombudsman—Citizen's Aide, legislative staff members, and the agency's Attorney General representative. Auditors also reviewed internal agency documents presented by agency staff. For example, auditors reviewed a sample of the agency's recent special investigation files to determine the types of cases that the agency's Investigations Department

Figure 2 Arizona Registrar of Contractors Office Locations



Source: The Arizona Registrar of Contractors.

Table 2 **Operating Funds** ¹
Schedule of Revenues, Expenditures, and Changes in Fund Balance
Years Ended June 30, 2000, 2001, and 2002
(Unaudited)

	2000	2001	2002
Revenues:			
Licenses ²	\$6,489,426	\$8,144,321	\$10,239,970
Fines, forfeits, and penalties	231,292	288,766	275,056
Interest	43,941	53,142	27,123
Other	<u>16,248</u>	<u>14,184</u>	<u>12,731</u>
Total revenues	<u>6,780,907</u>	<u>8,500,413</u>	<u>10,554,880</u>
Expenditures: ³			
Personal services and employee-related	4,665,270	5,197,756	5,651,820
Professional and outside services	48,662	32,701	65,311
Travel	223,560	414,775	435,294
Other operating	1,073,172	1,315,532	1,342,693
Equipment	<u>646,954</u>	<u>530,542</u>	<u>140,632</u>
Total expenditures	<u>6,657,618</u>	<u>7,491,306</u>	<u>7,635,750</u>
Excess of revenues over (under) expenditures	<u>123,289</u>	<u>1,009,107</u>	<u>2,919,130</u>
Other financial uses:			
Net operating transfers out ⁴	835,120	808,795	832,610
Remittances to the State General Fund ⁵	<u>833,033</u>	<u>1,038,377</u>	<u>1,210,397</u>
Total other financial uses	<u>1,668,153</u>	<u>1,847,172</u>	<u>2,043,007</u>
Excess of revenues over (under) expenditures and other financing uses	(1,544,864)	(838,065)	876,123
Fund balance, beginning of year	<u>6,038,308</u>	<u>4,493,444</u>	<u>3,655,379</u>
Fund balance, end of year	<u>\$4,493,444</u>	<u>\$3,655,379</u>	<u>\$ 4,531,502</u>

¹ This schedule excludes the financial activity of the Cash Bond Fund since the Registrar is only a custodian of these monies. In addition, it excludes the financial activity of the Residential Contractors' Recovery Fund, which is reported separately in Table 3 (see page 7).

² Increases in recent years result from the agency steadily increasing fees since 1998, when the agency significantly reduced fees.

³ Includes administrative adjustments from the prior year.

⁴ Consists primarily of operating transfers to the Office of Administrative Hearings for services it provided.

⁵ As a 90/10 agency, the agency remits all of its interest, administrative penalties, and 10 percent of all other revenues to the State General Fund.

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, 2000, 2001, and 2002.

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**Table 3 Residential Contractors' Recovery Fund
Schedule of Revenues, Expenses, and Changes in Net Assets
Years Ended June 30, 2000, 2001, and 2002
(Unaudited)**

	2000	2001	2002
Revenues:			
Initial and renewal fees earned ¹	\$ 3,456,692	\$ 3,648,725	\$ 3,467,083
Civil penalties	9,000	800	9,475
Total operating revenues	<u>3,465,692</u>	<u>3,649,525</u>	<u>3,476,558</u>
Loss expense:			
Current-period claims ²	2,769,892	3,100,130	3,979,222
Adjustment for prior periods ³	(375,747)	990,696	780,813
Repayments and recoveries ⁴	<u>(466,855)</u>	<u>(256,845)</u>	<u>(290,447)</u>
Net loss expense	<u>1,927,290</u>	<u>3,833,981</u>	<u>4,469,588</u>
Net operating revenues	<u>1,538,402</u>	<u>(184,456)</u>	<u>(993,030)</u>
Other operating expenses:			
Personal services and employee-related	344,042	382,573	392,484
Professional and outside services	5,500	8,500	6,461
Equipment	88,670	67,070	61,910
Other	<u>83,114</u>	<u>73,731</u>	<u>73,464</u>
Total other operating expenses	<u>521,326</u>	<u>531,874</u>	<u>534,319</u>
Net operating profit (loss)	1,017,076	(716,330)	(1,527,349)
Other income:			
Interest	<u>290,309</u>	<u>413,484</u>	<u>228,085</u>
Increase (Decrease) in net assets	1,307,385	(302,846)	(1,299,264)
Restricted net asset deficit, beginning of year ⁵	<u>(5,193,756)</u>	<u>(3,886,371)</u>	<u>(4,189,217)</u>
Restricted net asset deficit, end of year ⁵	<u>\$(3,886,371)</u>	<u>\$(4,189,217)</u>	<u>\$(5,488,481)</u>

¹ Amounts are fees assessed on each individual applicant for a residential contractor license in accordance with A.R.S. §32-1132.

² Amounts are awards for damages resulting from a contractor's violation of statutes. Awards are limited to \$20,000 per claim and \$100,000 per contractor. As of September 1, 2002, limits were increased to \$30,000 per claim and \$200,000 per contractor.

³ Amounts are adjustments of estimated losses reported as expenses in prior years.

⁴ Amounts are reimbursements from contractors seeking to have suspended licenses reinstated after payments were made from the Fund on their behalf.

⁵ Amounts for 2000 and 2001 were previously reported as fund equity and have been restated as net assets for comparability purposes.

Source: Auditor General staff analysis of the Arizona Registrar of Contractors *Residential Contractors' Recovery Fund Financial Statements* for the year ended June 30, 2000, audited by an independent Certified Public Accountant, and *Residential Contractors' Recovery Fund Financial Statements* for the years ended June 30, 2001 and 2002, compiled by an independent Certified Public Accountant.

addressed. Auditors also reviewed state statutes and administrative rules to determine the legal basis for various agency procedures. Finally, auditors reviewed the agency's Web site as well as other regulatory agencies' Web sites to determine whether the agency should provide the nature of valid complaints against licensed contractors on its Web site.

- To determine whether the agency appropriately estimates potential liabilities and maintains adequate assets in the Recovery Fund, auditors reviewed state laws, accounting standards, and Recovery Fund policies and procedures. In addition, auditors reviewed Recovery Fund accounting practices, internal management reports, contracts for financial services, and financial statements since 1985, and literature regarding other similar funds to evaluate the agency's management of the Fund. Auditors also reviewed working papers related to the Recovery Fund that were prepared by the agency's contracted Certified Public Accountant. Further, auditors consulted with representatives of international and regional actuarial organizations and the Arizona Department of Insurance to identify recommendations for improvement.
- To determine whether agency vehicle use is efficient and appropriate, auditors reviewed the State Constitution and pertinent statutes and rules regarding the legality of providing take-home vehicles to agency employees. In addition, auditors reviewed agency vehicle reports and documents provided by the Department of Administration and interviewed agency and Department of Administration staff.

This audit was conducted in accordance with government auditing standards.

The Auditor General and staff express appreciation to the Registrar and his staff for their cooperation and assistance throughout the audit.

FINDING 1

Consumer protection can be enhanced

The agency inspects contractor workmanship when consumers file complaints and investigates violations of its statutes such as contracting without a license, but the agency needs to address three matters that limit the degree of protection that it provides to consumers. First, the agency needs to ensure that problem contractors, such as those with serious or multiple complaints, are disciplined. Second, the agency should report more complaint information to the public to better protect consumers. Finally, if the agency wishes to resume its recently discontinued practice of conducting “courtesy inspections” to informally resolve disputes between contractors and customers, it needs to obtain the necessary statutory authority and take steps to make this information available to the public.

Agency inspects workmanship and investigates violations

The agency performs inspections of contractors' workmanship when consumers file complaints and investigates violations of its statutes such as contracting without a license, abetting an unlicensed contractor, unlawful advertising, and providing false information on a license application. According to its fiscal year 2002 performance measures, the agency reduced the average number of days it takes between receiving a workmanship complaint to conducting a jobsite inspection from 37 days in fiscal year 2000 to 17 days. Additionally, 79 percent of complainants reported that the agency provided excellent service. Further, related to investigating allegations of violations of its statutes, the agency reports that in fiscal year 2002, it took an average of 8 days to complete an investigation once receiving an allegation. This was reduced from an average of 18 days in fiscal year 2000.

Agency should discipline problem contractors

The agency should ensure that problem contractors, such as those with serious or multiple complaints, are disciplined. A large majority of contractors, regardless of the

volume of work they perform, have not had complaints filed against them in the past 2 years. However, contractors who do receive complaints can avoid discipline by addressing problems before their disciplinary hearing date, and can therefore commit multiple violations and go undisciplined. The agency needs to develop criteria for identifying and disciplining problem contractors.

Most contractors never receive complaints—Only about 8 percent of all licenses have had complaints filed against them in the past 2 years. Further, only a few ever receive multiple complaints against their license in a 2-year period. For example, during the time period from September 2000 through September 2002, only 490 licenses had three or more complaints filed against them.

Contractors who commit violations may avoid discipline—When an inspector confirms a complaint, the agency sends the contractor an order to correct the violation. If the contractor corrects the problem at any time prior to a disciplinary hearing, the complainant may tell the agency to close the complaint. When a complaint is closed in this manner, the contractor is not disciplined for the violation. This process allows contractors to commit multiple violations but never receive discipline. While the complainant may be satisfied, this process fails to protect future consumers who may hire such a contractor.

Agency can do more to ensure problem contractors receive discipline—The agency can keep complaints open regardless of whether or not the original complainant has dropped the complaint, but rarely does so. Keeping a complaint open ensures that a contractor faces a disciplinary hearing. Additionally, the agency has the authority to summarily suspend a contractor's license for very serious problems that imminently threaten public safety, such as failing to meet basic electrical or plumbing standards. However, the agency has not established criteria for when it should use summary suspensions, and agency officials could not recall the last time the agency issued a summary suspension.

The agency should establish criteria for when it should pursue disciplinary action. Criteria should consider such factors as the severity of an individual complaint, the amount of money likely needed to correct problems, or the number of previously received complaints. For example, the agency could establish criteria to help inspectors identify individual workmanship violations that are serious enough to warrant license suspension, revocation, or other discipline.

Agency should continue efforts to better inform consumers

The agency could better protect consumers by reporting more complaint information to the public through its phone center and on its Web site.

Contractors can avoid discipline.

Nature of complaints is not readily available—Currently, the agency reports the number of complaints each contractor has received in the past 2 years through its phone center and on its Web site. However, because the agency does not currently record information about the nature of complaints on its database, it does not report this information. Instead, consumers who wish to know the nature of complaints must visit one of the agency’s 12 offices and review complaint files themselves. This information can be important to consumers when choosing a contractor. Without this information, a consumer is unaware if a valid complaint concerned issues such as minor quality workmanship problems or more serious issues such as breach of contract or project abandonment. Having to visit one of the agency’s offices to obtain such information can significantly inconvenience consumers, especially in rural areas. The agency reports that in fiscal year 2002, it received nearly 230,000 inquiries to its phone center and over 248,000 hits on its Web site. Other state regulatory agencies make the nature of valid complaints available by telephone and on their Web sites. For example, the Board of Technical Registration, the Board of Psychologist Examiners, and the Arizona Medical Board all offer an explanation of the violation that led to a licensee’s discipline. According to agency staff, the agency would need to add this information to its database before it could easily share it with the public, and it has the resources to do so, but this would be a difficult and time-consuming process.

Agency should report all complaints—Prior to the audit, the agency did not report the number of unconfirmed complaints to the public but recently began to do so. Prior to this change, if an inspector did not find that a contractor had committed a violation, the complaint was classified as unconfirmed, and the agency did not report the number of unconfirmed complaints to the public. Reporting this information is important because contractors can fix problems before an inspection, and as a result, inspectors often cannot confirm complaints. Without reporting the number of unconfirmed complaints, members of the public would be unaware that a problem may have ever existed and therefore, this practice deprived the public of useful information when choosing a contractor. Agencies such as the Arizona Medical Board report to the public the number of unsubstantiated complaints. In February 2003, the agency began publicly reporting all complaints, including cases where an inspector could not identify that a contractor committed a violation.

Agency stopped unauthorized, unreported courtesy inspections during audit

During this audit, the agency stopped conducting informal “courtesy inspections” that it did not have statutory authority to perform. The agency would like to begin conducting these inspections again. However, it first needs to obtain statutory authority and should make the inspections more valuable to consumers in general.

Courtesy inspections were informal, unreported efforts to resolve disputes—Courtesy inspections were an informal step to resolve disputes between contractors and consumers. According to the agency, they began in the 1980s because contractors wanted a method of resolving workmanship issues without receiving formal complaints. Either the contractor or the consumer could request a courtesy inspection. An agency inspector would assess the quality of work compared to workmanship standards and issue a nonbinding opinion. If both parties were satisfied, the matter was resolved without a formal complaint and did not become part of the contractor's record. In fiscal year 2002, the agency performed approximately 1,100 courtesy inspections. Auditors could not assess these inspections' results due to the limited data the agency maintained about them.

Agency lacks statutory authority for courtesy inspections—While the agency considered these inspections a public service that addressed simple workmanship issues in a more timely manner than formal inspections, it does not have the statutory authority to conduct them. A.R.S. §32-1154(B) authorizes the agency to investigate a contractor's acts on its own motion or when any person files a written complaint. However, courtesy inspections were not initiated by a written complaint or on the motion of the agency, but by a consumer or contractor's informal request. Further, there is no process for informal complaint resolution such as courtesy inspections outlined elsewhere in the agency's statutes or in its administrative rules.

The agency discontinued courtesy inspections after auditors identified this lack of statutory authority. However, the agency continues to believe that these inspections are a valuable service and would like to resume offering them. To do so, the agency needs to seek and obtain statutory authority from the Legislature.

Public disclosure of results needed—A second problem with courtesy inspections was that because the results were not publicly reported, other consumers could not use the information in choosing a contractor. The lack of reporting creates a situation where contractors who want to avoid valid complaints on their records could suggest courtesy inspections when problems arise, and then fix any problems that an agency inspector may have identified. Consequently, while the specific consumer may be helped, other consumers are deprived of helpful information in choosing a contractor. If the agency obtains statutory authority to resume courtesy inspections, it should better protect the public by reporting the results of the courtesy inspections in the same manner as other inspection results.

Courtesy inspections are not authorized by statute.

Recommendations

1. The Registrar of Contractors should develop criteria for determining when it should pursue discipline against contractors with serious or multiple complaints.
2. The Registrar of Contractors should make the nature of valid complaints available to consumers through its phone center and Web site.
3. If the Registrar of Contractors wishes to reintroduce courtesy inspections, it should seek statutory authority from the Legislature and make the results available to all consumers.

FINDING 2

Some Recovery Fund changes needed

The Registrar of Contractors needs to change some aspects of the way it manages the Residential Contractors' Recovery Fund. The Legislature established the Fund to assist consumers who suffer financial loss due to the actions of a licensed residential contractor. There are two main problems with the Fund's long-term ability to meet this goal. First, although statute requires the Fund to have sufficient resources to cover all liabilities, the Fund's assets are only about half the current estimate of the Fund's total liabilities. Second, the estimated liabilities themselves are likely to be understated. To resolve these issues, the Registrar needs to hire an actuary to develop better estimates of potential liabilities and then increase the Fund's assets to meet them. Further, the agency could use its own staff to compile financial statements in nonaudit years to save money, and the Legislature should consider establishing a more appropriate method of setting limits on the Fund's administrative costs.

Fund protects consumers financially

The Legislature established the Residential Contractors' Recovery Fund in 1981 to provide recourse to consumers who have suffered a financial loss due to the actions of a licensed residential contractor. Such consumers can recover the actual damages they suffered up to 2 years after the loss occurred. Fund payouts are limited to \$30,000 per consumer and \$200,000 for the life of a contractor's license.¹ In fiscal year 2002, the agency reports that the Fund paid approximately \$3.9 million for 515 claims. Agency reports show that in fiscal year 2002 the low and high monthly average time to process a Recovery Fund claim was 114 to 153 days.

The Fund's revenues come mainly from annual fees paid by residential contractors. All residential contractors are required to participate in the Fund unless they can show that they are able to maintain financial resources in an amount of at least

The Fund provides financial protection to consumers.

¹ Laws 2002, Ch. 179 §§1 and 5 increased the limit on the amount an individual consumer can claim from \$20,000 to \$30,000 and the amount that the Fund can pay against one contractor license from \$100,000 to \$200,000, effective September 1, 2002. Based on the agency's payout data, the new limits appear to provide greater coverage to more consumers with approved claims.

\$200,000, and as of November 2002, only one residential contractor did not participate in the Fund. The agency determines the fee amounts annually based on projected needs. Currently, the fees are \$300 for the initial year of licensure and \$150 each ensuing year. A.R.S. §32-1132(B) limits these fees to \$600 per contractor in any 2-year period. In addition, the Fund earns interest income and recovers some money from contractors or their bonding companies after the Fund has paid a claim against them. Statute requires contractors to reimburse the Fund for the actual amount paid on claims against them plus interest at the rate of 10 percent per year before the agency can reinstate their license. In fiscal year 2002, the Fund's revenues and interest totaled approximately \$3.7 million.

Fund resources do not cover all liabilities

The Agency has operated the Fund on a pay-as-you-go basis, maintaining a sufficient cash balance to pay claims as they come in rather than on the basis of maintaining sufficient resources to cover all liabilities. The Fund has been able to pay all valid claims using the pay-as-you-go basis; however, Arizona statute requires the latter approach. As of June 30, 2002, total liabilities, which include both submitted claims and estimates of claims that will be submitted within the next 2 years, totaled \$11.6 million, but the Fund's total assets were only \$6.1 million. To comply with statute and ensure it can continue to protect consumers, the agency needs to increase the Fund's fund balance so that it has enough reserves to cover all of its liabilities.

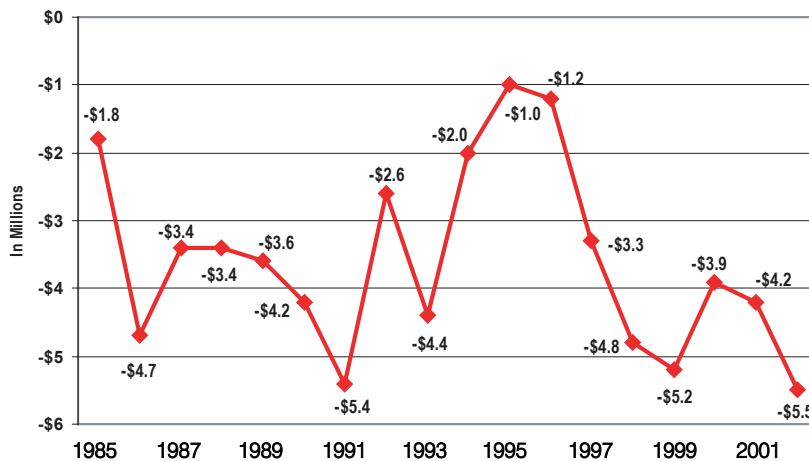
Fund has large deficit—According to the Fund's financial statements, the Fund had an approximate \$5.5 million deficit as of June 30, 2002, and has had a deficit since 1985. Although as of June 30, 2002, the Fund had cash and other assets of approximately \$6.1 million and has been able to pay all its past valid claims, its total estimated liabilities totaled approximately \$11.6 million. These liabilities include actual claims and estimates of claims that will likely be filed in the next 2 years. A primary reason for the deficit is management's decision to set fees sufficient to pay claims as they are due rather than assessing fees to cover all liabilities of the Fund. A.R.S. §32-1134(A)(2) requires the Registrar to set these fees based on an actuarial projection of anticipated claims. While the agency hires a Certified Public Accountant (CPA) to make these projections, the agency has not set fees high enough to allow it to pay all claims it will likely have to pay (see Figure 3, page 17).

Statutes and good business practices require claims reserves—The Fund's statutes and insurance industry standards require that the Fund establish resources sufficient to cover all liabilities. A.R.S. §§32-1134(A)(1) and (3) require the agency to maintain the Fund's fund balance at a minimum of \$200,000 and to "establish claims reserves based on the incurral date of claims." Because consumers have up to 2 years to file a claim after suffering a loss, the Fund must main-

The Fund has been in deficit since 1985.

The Fund lacks adequate claim reserves.

Figure 3 Recovery Fund's Year-End Fund Deficit
Years Ended June 30, 1985, through June 30, 2002



Source: Auditor General staff analysis of the Recovery Fund's financial statements for fiscal years 1985 through 2002 compiled annually and audited triennially by a contracted CPA firm.

tain resources sufficient to pay for all valid claims resulting from such losses in the past 2 years, even if the losses have not yet been reported.

Although statutes could be changed to allow the Fund to operate on a cash pay-as-you-go basis, good business practices call for establishing appropriate claims reserves. Auditors interviewed representatives of the Arizona Department of Insurance who stated that the Fund should function similar to casualty insurance companies. Casualty insurance companies are required to maintain reserves for all claims, including claims that have not yet been reported.

Maintaining appropriate reserves has three main benefits:

- **Better consumer protection**—Establishing claims reserves will better ensure sufficient funds to pay all valid claims. Severe economic difficulty could cause the number of valid claims to increase as contractors go out of business with partially completed jobs. Additionally, if the Fund were terminated, claims reserves would provide sufficient resources to pay all valid claims resulting from contractor actions.
- **Fairness to contractors**—Assessing sufficient fees to establish claims reserves better correlates contractors' responsibilities with the future costs of claims resulting from their actions. Similar to insurance premiums, contractor fees are pooled to cover acts of the current group of residential contractors. Without claims reserves, future contractors can be assessed larger fees to make up for past contractors who did not pay high enough fees to cover their own risks.

- **Increase investment revenue**—By maintaining claims reserves sufficient to cover all of the Fund’s liabilities, the agency would earn additional investment income, which could help keep the Fund’s participation fees lower. In fiscal year 2002, the Fund’s financial records show it always had a monthly cash balance of at least \$5.7 million and earned approximately \$228,000 in investment income that year. Increasing the Fund’s claims reserves would provide additional investment income that could be used to pay its liabilities.

Agency should reassess contractors to resolve the Fund’s deficit—

When the Fund’s fund balance drops below \$200,000, A.R.S. §32-1134.01 requires the agency to make reassessments against all contractors participating in the Fund in order to bring the fund balance back to the minimum required level. For example, auditors estimate that the agency would need to reassess roughly \$220 from each of the approximately 26,000 contractors currently participating in the Fund to resolve the Fund’s estimated deficit of approximately \$5.5 million and to achieve the Fund’s statutorily required \$200,000 fund balance. However, before the agency can determine the exact amount to reassess contractors, it must first be certain that it has accurately determined the size of its deficit. As the next section of this finding discusses, current estimates of the Fund’s liabilities may be substantially understated.

The agency needs to reassess fees from contractors.

Agency should hire a qualified actuary

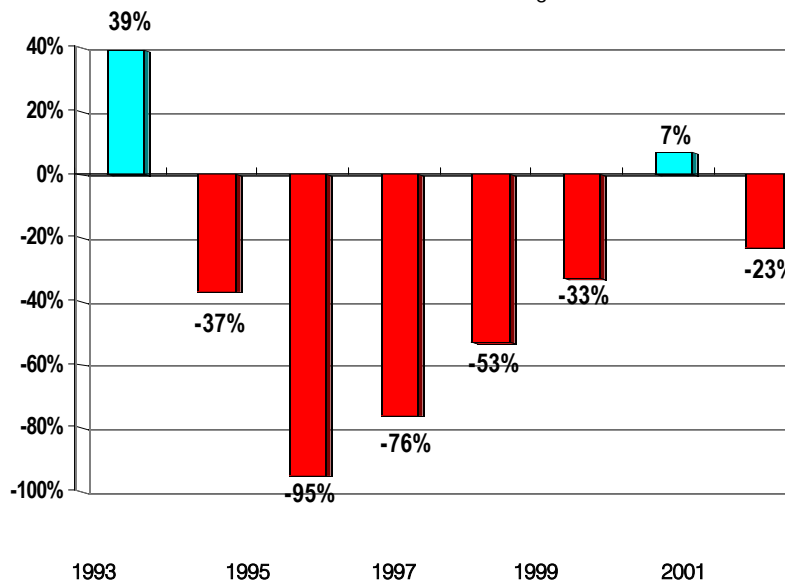
For several reasons, the agency needs to hire a qualified actuary to project the Fund’s future liabilities.

- **First**, A.R.S. §32-1134(A)(2) requires the agency to set fund participation fees using actuarial projections. Instead, the agency relies on its auditor, an external CPA who is not a qualified actuary, to prepare an annual projection of anticipated claims. According to several actuaries interviewed during the audit, CPAs without actuarial training are not qualified to produce actuarial projections.
- **Second**, while using a CPA rather than a qualified actuary, the Fund’s anticipated claims were underestimated by 23 percent or more seven times between 1993 and 2001 (see Figure 4, page 19). In 1995, claims were underestimated by approximately 95 percent.
- **Finally**, hiring an actuary would also allow the agency to discontinue having the contracted CPA audit his own projections of anticipated claims, which could impair his independence.

Hiring an actuary may increase administrative costs as actuaries charge between \$250 and \$300 per hour for their services, and one actuary estimated that actuarial costs for the Fund could exceed \$20,000 in the first year. However, this would only

Figure 4

Percentage Difference Between Actual Payments and Estimated Payments from the Recovery Fund¹
Fiscal Years 1993 through 2001



¹ Negative numbers indicate more paid out than the estimate.

Source: Auditor General staff analysis of the Recovery Fund's financial statements for fiscal years 1993 through 2001 compiled annually and audited triennially by a contracted CPA firm.

increase the Fund's total administrative costs—which in fiscal year 2002 were approximately \$534,000—by about 4 percent. Further, costs could decline in subsequent years after the actuary develops a model for projecting the claims. More important, hiring an actuary would help ensure that the millions of dollars in fund liabilities are projected more accurately.

Other modifications needed to improve fund management

In addition to modifying the Fund's practice of accounting for and estimating future claims, two additional modifications are needed to improve fund management.

Agency employees can perform some contracted work—Agency employees can perform some accounting functions currently contracted out to the agency's CPA. The agency contracts with a CPA to audit the Fund once every 3 years. However, the agency also pays the contracted CPA in nonaudit years to compile financial statements that are filed with the Department of Insurance. These non-

audit-year financial statements are primarily compilations of data assembled from the State's accounting system as well as some additional work. At least two agency staff members who are CPAs could perform all of this work, reducing the contract fees provided to the external CPA (currently \$6,500 per year in nonaudited years for both the compilations and the projections of anticipated claims).

Legislature should modify the Fund's administrative expense statute—The Legislature should consider modifying statute to establish a more appropriate method of setting limits on the Fund's administrative costs. A.R.S. §32-1134(A)(7) requires the agency to limit these administrative expenses to 10 percent of the Fund's fund balance. However, the Fund has been in deficit for several years and therefore, calculating administrative expenses on the fund balance would provide no money for administering the Fund. Additionally, even if the Fund did maintain its required \$200,000 balance, it would only provide \$20,000 for administrative expenses. This amount would be insufficient. In fiscal year 2002, the Fund's operating expenses were approximately \$534,000. The administrative limits for other funds with administrative expense limits, such as the State Assurance Fund for cleaning up leaking underground storage tanks and the State Lottery Fund, are linked to annual revenues. For example, the State Lottery must limit its administrative costs to 18.5 percent of its gross revenues.

Linking the Fund's administrative expense limit to a percentage of revenue the Fund received during the previous fiscal year would provide a sufficient amount of money for administrative expenses for the Fund while reflecting its workload; however, it is unclear what that percentage should be. During fiscal years 2000 to 2002, the Fund's expenses ranged from 14.6 percent to 18.3 percent of the Fund's revenues from the previous fiscal year. If the Fund's fiscal year 2003 administrative expenses had been limited to 15.5 percent of the previous year's revenue, the Fund would have had nearly \$539,000 for administrative expenses, slightly more than it spent in fiscal year 2002. However, because the Fund's participation renewal fees were changed in July 2002 to accommodate increases in claims limits, it is unclear what the Fund's revenue will be. Therefore, it may be necessary to revisit the issue of the Fund's administrative cost limits during the 2004 regular legislative session when a complete fiscal year's revenue figures are available under the new fee amount. In the meantime, the Legislature should consider amending A.R.S. §32-1134(A)(7) to limit the Fund's administrative expenses to a percentage of the Fund's revenues from the previous fiscal year. Additionally, in September 2003, 1 year after the fee increases and claims limits were increased, the agency should report its revenues and administrative costs to the Joint Legislative Budget Committee staff to help the Legislature determine if it should consider any additional changes to the Fund's administrative expense limit statute.

Recommendations

1. The Registrar of Contractors should ensure that the Residential Contractors' Recovery Fund's balance is sufficient to account for all financial liabilities, including anticipated claims, to comply with A.R.S. §32-1134.
2. The Registrar of Contractors should contract with a qualified actuary to project anticipated future claims and to help set appropriate fee amounts necessary to establish sufficient claim reserves.
3. After the actuary has determined the estimate for anticipated future claims, the Registrar of Contractors should comply with A.R.S. §32-1134.01 by reassessing all licensed residential contractors in Arizona who have paid into the Fund to resolve the Fund's deficit and to achieve the Fund's statutorily required \$200,000 fund balance.
4. The Registrar of Contractors should use its own internal Certified Public Accountants (CPAs) to compile and produce the Recovery Fund's annual financial statement in nonaudit years and discontinue paying its contracted CPA for these services.
5. The Legislature should consider amending A.R.S. §32-1134(A)(7) to limit the Fund's administrative expenses to a percentage of the Fund's revenues from the previous fiscal year to enable the Fund to cover its 2003 and 2004 fiscal year administrative expenses.
6. In September 2003, 1 year after the fee increases and claims limits were increased, the Registrar of Contractors should report its revenues and administrative costs to the Joint Legislative Budget Committee staff to help the Legislature determine if it should consider any additional changes to the Fund's administrative expense limit statute.

FINDING 3

Agency's vehicle use is inappropriate and inefficient

The Registrar of Contractors should stop providing take-home vehicles to many of its employees and should eliminate inefficiently used vehicles. The agency leases 65 vehicles from the Department of Administration (DOA) and assigns nearly all of them to its employees for take-home use. However, this use violates state law, is a constitutionally prohibited use of state resources, and should be eliminated. The agency should also eliminate vehicles that are inefficiently used and should reevaluate future usage to identify any additional inefficiencies. By eliminating vehicles, the agency will save resources, as well as provide monies to the General Fund.

Take-home vehicles are inappropriate

Since 1985, the agency has provided personally assigned take-home vehicles to many of its employees, but this practice violates statute and the State Constitution. A.R.S. §38-538.02 forbids using state vehicles for personal uses, such as commuting to and from an employee's residence, unless the employee is on duty during the time the employee is at home. However, during the audit, 61 of the agency's 145 employees, including 12 administrators such as the former director and deputy director, had personally assigned take-home vehicles. In addition to violating statute, the take-home use of these vehicles constitutes a gift of public resources, in violation of the State Constitution, because this use of state vehicles is not necessary for state business and allows employees to avoid costs such as car payments, insurance, fuel, and maintenance. The agency discontinued providing take-home cars to 11 administrators in November 2002 when auditors identified the impropriety of this use. However, as of March 18, 2003, 49 employees still had personally assigned take-home vehicles.¹ The agency should immediately end its practice of providing take-home vehicles to its employees.

Take-home vehicles violate statute and the State Constitution.

¹ The former director discontinued using a take-home vehicle on February 1, 2003.

Many state vehicles not used efficiently

The agency also needs to eliminate inefficiently used vehicles and better monitor the use of all its vehicles to prevent abuse and ensure that vehicles are used efficiently. Doing so will save agency resources and provide monies to the General Fund.

One-third of the agency's vehicles do not meet efficient use standards—According to DOA representatives, a fleet vehicle should be used a minimum of 10,000 to 15,000 miles per year to justify the cost of acquiring and maintaining it. However, from October 1, 2001, to September 30, 2002, 22 of the agency's 65 vehicles were driven fewer than 10,000 miles. Other options such as using State Motor Pool vehicles or reimbursing employees for personal mileage are more efficient than maintaining a fleet vehicle used for fewer than 10,000 miles. For example, the cost to operate each of these 22 vehicles ranged from 59 cents to \$1.22 per mile, which is significantly more costly than the State's travel reimbursement rate of 34.5 cents per mile when a state employee uses his or her own vehicle. The agency should return these 22 vehicles to DOA.

Twenty-two agency vehicles were not used efficiently.

After eliminating take-home use, many other vehicles may also be used inefficiently—In addition to the 22 vehicles that did not meet DOA's efficient use standard, an additional 27 vehicles were used between 10,000 and 15,000 miles during that same period. Once personal commuting miles are eliminated, the agency needs to monitor the use of these vehicles, and in January 2004 it should eliminate any of these vehicles that are used fewer than 10,000 miles per year.

Additional vehicles may not meet the efficient-use standard.

Agency should better monitor its use of vehicles—The agency does not require employees to track or report the mileage they place on their assigned vehicles. Requiring detailed mileage reports on all vehicles would have two benefits. First, it would help prevent employees' inappropriate personal usage of state vehicles. Second, it would help the agency identify how employees use vehicles and whether or not that use is efficient or practical. DOA recently recommended that the agency require its employees to maintain detailed mileage logs for these purposes. Closely monitoring vehicle usage will also better enable the agency to identify inefficiently used vehicles to eliminate.

Eliminating vehicles will save resources—Eliminating some of its vehicles will save the agency's resources as well as provide some financial benefits beyond the agency itself.

- **Save agency resources**—In fiscal year 2002, the agency paid more than \$127,500 for leasing, maintaining, and providing fuel for its 22 inefficiently used vehicles.

- **Other benefits to the State**—First, the returned vehicles could potentially be reassigned to other agencies, reducing the need for new fleet acquisitions or allowing DOA to use them as replacements for older vehicles. As of September 2002, no vehicle in the agency’s fleet was older than the 1997 model year, meaning that DOA would likely rotate the returned vehicles into other agencies’ fleets and in exchange receive older vehicles. Second, DOA sells vehicles that are not reassigned, and the proceeds are deposited in the General Fund. In fiscal year 2002, the State received an average of \$3,066 from each vehicle sold. If DOA sold 22 vehicles at this average return, the General Fund would receive approximately \$67,000.¹

Recommendations

1. To comply with A.R.S. §38-538.02, the Registrar of Contractors should immediately end its policy of providing personally assigned take-home vehicles to its staff.
2. The Registrar of Contractors should return its 22 vehicles that were driven fewer than 10,000 miles in the past year to the Department of Administration.
3. The Registrar of Contractors should monitor the efficiency of all vehicles that had been driven for employees’ personal commutes to and from work, and in January 2004, it should eliminate any of these vehicles that fall below the efficient-use guideline of 10,000 miles per year.
4. To ensure that its vehicles are appropriately and efficiently used in the future, the Registrar of Contractors should better monitor their use by requiring detailed mileage reports on all vehicles.

¹ Normally, a portion of vehicle sale proceeds goes to the Department’s Motor Pool Revolving Fund. However, beginning in June 2002, Laws 2002, Chapter 327 §117 required that all proceeds that would usually go to the Motor Pool Revolving Fund must instead go to the General Fund.

SUNSET FACTORS

In accordance with A.R.S. §41-2954, the Legislature should consider the following 12 factors in determining whether to continue or terminate the Arizona Registrar of Contractors (agency).

1. Objective and purpose in establishing the agency.

The Legislature established the Arizona Registrar of Contractors in 1931. Its mission is to “promote quality construction by Arizona contractors through a licensing and regulatory system designed to protect the health, safety, and welfare of the public.”

The Registrar of Contractors regulates contractors by licensing commercial and residential contractors, inspecting workmanship complaints filed by consumers, and investigating violations of its statutes such as contracting without a license, illegal advertising, and fraudulent acts committed by licensed contractors. The agency also administers the Residential Contractors’ Recovery Fund, which provides recourse to consumers who suffer financial losses related to licensed residential contractors’ work.

2. The effectiveness with which the agency has met its objective and purpose and the efficiency with which the agency has operated.

The agency has fulfilled its responsibilities effectively and efficiently in many areas, but has inefficiently used many state vehicles. The agency’s licensing, inspections, complaint handling, and Recovery Fund payout functions all appear to be done in a timely manner. For example, between September 2000 and August 2002, the monthly average time the agency took to approve a license was usually less than 4 days. Approved license applicants must then be posted publicly in newspapers to allow the public to notify the Registrar of Contractors of any concerns they would have with a particular individual or company being licensed. License applicants are required to be posted for 20 days unless they previously have had a license, in which case the agency can

waive part of all of the posting period. The agency issues a license following the required posting period.

The agency states that much of its effectiveness and efficiency in this area is due to document imaging technology it has implemented in recent years. The agency electronically stores nearly all documents associated with license applications, Recovery Fund claims, and some other functions. This allows staff to easily access files at their workstations, and the agency states that this has been instrumental in reducing its processing times, particularly in its licensing department.

The agency needs to improve its efficiency related to its use of state vehicles. The agency currently leases 65 vehicles from the Department of Administration (DOA), but many of those vehicles do not meet DOA's standard for efficient use and should be eliminated. According to representatives from DOA, a fleet vehicle should be used a minimum of 10,000 to 15,000 miles per year to justify the cost of acquiring and maintaining it. However, from October 1, 2001, to September 30, 2002, 22 of the agency's vehicles were driven fewer than 10,000 miles. In addition to these 22 vehicles, the agency is likely to find that several other vehicles will not meet the efficient use standard in the future. These vehicles were driven over 10,000 miles during that same 12-month period, but much of this usage was due to inappropriate personal use as nearly all the agency's vehicles are personally assigned to agency staff as take-home vehicles (see Finding 3, pages 23 through 25). The personal take-home use of the vehicles violates statute and the State Constitution's gift clause.

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

The agency operates in the public interest in many of its activities.

- **First**, the agency's licensing process helps to ensure that licensed contractors possess the skills and training necessary to perform their specific type of work. The agency requires contractors to document their past work experience, to pass appropriate trade and business exams, and to obtain bonds.
- **Second**, the agency identifies, pursues, and issues civil penalties to unlicensed contractors. Many unlicensed contractors have significantly harmed the public by doing such things as taking down payments on projects and then never completing the work. The agency can issue fines of up to \$2,000 and in fiscal year 2002, the agency issued 503 criminal and civil citations.

- **Third**, the agency provides information to the public in various ways. Its Web site contains information designed to help consumers by distributing information, such as advice on how to go about selecting a contractor, 2 years' worth of complaint histories for all licensed contractors, and information on how to file a complaint against a contractor. Consumers may also obtain some complaint history information by calling the agency's phone center. The agency's newsletter updates contractors on such things as new legislation, agency policy, and other general information. For example, the August 2001 and January 2002 newsletters provided maps showing pockets of expansive soil in the Phoenix and Tucson areas. Expansive soil can cause building foundations to crack prematurely and require specific design and construction modifications to help prevent cracking. The agency has also provided important information to the public in emergency situations. For example, in the summer of 2002, during the Rodeo-Chediski wildfires in the White Mountain area, the agency conducted a public awareness campaign designed to warn the public about unscrupulous contractors who tend to prey on the public following natural disasters.

While the agency has acted in the public interest in many ways, auditors identified areas in which the agency could better serve the public interest.

- **Better protecting consumers**—The agency can do more to protect consumers. First, the agency can do more to ensure that contractors with serious or multiple violations face discipline. Currently, if an agency inspector identifies a workmanship problem that a contractor fixes before the issue progresses to a hearing, and the complainant does not want to pursue the complaint further, the contractor will not be disciplined. While the complainant in each case may be satisfied, this process fails to protect future consumers who may hire the contractor. Further, the agency does not report the nature of complaints to consumers. Also, until December 2002, the agency performed informal complaint inspections that were not authorized by statute, did not become part of a contractor's record, and were not reported to the public.
- **Recovery Fund Deficit**—The Residential Contractors' Recovery Fund was established in 1981 to provide recourse to homeowners who suffer losses due to a licensed residential contractor's actions, and it is funded from residential contractors' participation fees. Although the Fund has been able to pay all claims as it receives them, it has operated in a deficit for several years because it has not maintained claims reserves sufficient to cover all fund obligations as required by statute. By not maintaining sufficient claims reserves, the Fund cannot guarantee that it will always be able to pay homeowners for valid claims as it receives them and would not be able to pay all valid claims if the Fund were phased out (see Finding 2, pages 15 through 21).

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

The agency has promulgated many of its required rules, but needs some additional rules. The agency underwent its last formal rule review in 2001. The Governor's Regulatory Review Council reviewed the agency's rules at the request of the Office of the Auditor General and concluded that the agency needs to make several changes to its rules. For example, the agency needs to develop rules related to specific license requirements, how to apply for a license, and how a licensee can apply to change license classifications. Additionally, the agency needs to adopt rules that address its hearing and investigation procedures.

5. The extent to which the agency has encouraged input from the public before promulgating its rules and regulations and the extent to which it has informed the public as to its actions and their expected impact on the public.

The agency has not made significant changes to its rules in the past 3 years. When changes were made in the past, the agency notified the public through its newsletter, Web site, and through the administrative register. Additionally, as required by A.R.S. §22-1104(A)(6)(a)(b), the agency sends copies of proposed rule changes to trade associations who have filed requests to receive such information.

6. The extent to which the agency has been able to investigate and resolve complaints within its jurisdiction.

The agency has sufficient authority to investigate and resolve complaints within its jurisdiction. A majority of the complaints the agency receives are workmanship complaints filed by homeowners. The agency uses trained and certified inspectors who visit the jobsite and determine if the contractor complied with minimum workmanship standards. If not, the inspector may issue an order requiring the contractor to correct the problem. The Office of Administrative Hearings adjudicates all appeals of agency actions.

The agency investigates allegations of unlicensed contracting, unlawful advertising, and falsifying information on license applications. In fiscal year 2002, the agency's Investigations Department handled approximately 2,900 such cases. The agency can issue cease and desist orders or citations to persons found to have contracted without a license or who have violated statutes relating to lawful contractor advertising. Additionally, the agency can refer information regarding falsified applications to an appropriate prosecutorial jurisdiction for possible prosecution.

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

The Registrar of Contractors has full authority to enforce its enabling statutes. A.R.S. §32-1166 authorizes the agency to seek injunctive relief against statutory violators and to issue fines of up to \$2,500. A.R.S. §32-1164 classifies some violations of the agency's enabling statutes as class 1 misdemeanors. A.R.S. §41-192 directs the Attorney General to act as legal advisor and render such legal services as the agency requires.

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

Several statutory changes were made to the agency's enabling statutes during the 2002 Legislative session.

- **First**, limits on the amounts that can be paid out from the Residential Contractor's Recovery Fund were increased. Laws 2002, Chapter 179 §§1 and 2 increased the amount that an individual homeowner can claim from \$20,000 to \$30,000 and increased the total amount that can be paid from the Fund against an individual license from \$100,000 to \$200,000. These changes will provide greater coverage to more consumers. In fiscal year 2002, before the change took effect, 67 consumers had valid claims that exceeded the \$20,000 cap on individual claims and therefore the claims were not fully covered, but only 34 consumers had valid claims that exceeded \$30,000. Additionally, there were 23 consumers with valid claims who did not receive full payment from the Fund because the total claims against their contractor had already reached the \$100,000 cap. However, had the new \$200,000 cap been in place during that year, all 23 consumers would have received full payment. This legislation also increased the minimum fund balance that the Fund must maintain from \$100,000 to \$200,000.
- **Second**, Laws 2002, Ch. 305 §1 strengthened penalties against unlicensed contractors who bid on a contract for a project. Now, if an unlicensed contractor submits a bid of \$20,000 or more on a project, that contractor will not be able to obtain a contractor's license for 1 year after the bid date.
- **Finally**, Laws 2002, Chapter 99 §10 gave the agency the authority to require license applicants to submit fingerprints and fees necessary to pay for a criminal fingerprint background check through the Arizona Department of Public Safety.

9. The extent to which changes are necessary in the laws of the agency to adequately comply with the factors listed in the Sunset review statute.

The Legislature should consider modifying the statute that limits the Residential Contractors' Recovery Fund's administrative expenses. A.R.S. §32-1134(A)(7) requires the agency to limit administrative expenses to 10 percent of the Fund's fund balance. However, the Fund has been in deficit for several years and, therefore, calculating administrative expenses on the fund balance would provide no money for administering the Fund. Additionally, even if the Fund did maintain its required fund balance of \$200,000, it would only provide \$20,000 for administrative expenses which is insufficient. In fiscal year 2002, the Fund's operating expenses were approximately \$534,000. Other similar funds' administrative cost limits are linked to revenue percentages. Therefore, the Legislature should consider limiting the Fund's administrative expenses in a similar manner. However, because the Fund's revenues are likely to change significantly due to fee increases, an interim change may be necessary before the Legislature makes a more permanent change to this statute (see Finding 2, pages 15 through 21).

For several years, the agency conducted informal courtesy inspections that were designed to help resolve disputes between contractors and their customers. During the audit, the agency stopped conducting them because it lacks the statutory authority to perform them. The agency would like to begin conducting these inspections again, however it first needs to obtain statutory authority to do so.

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

Terminating the Registrar of Contractors would likely pose some harm to the public health, safety, and welfare of Arizona citizens for several reasons.

- Without regulating contractors, Arizona citizens would have little assurance that a contractor they selected to build, remodel, or repair their home or business property has adequate experience and training. Many trades, such as electrical or plumbing work, can pose significant health and safety hazards to the public if not performed properly. The Registrar of Contractors, through its licensing function, requires license applicants to supply detailed documentation of their work history and to pass a trade and a business exam, which helps to ensure that contractors are properly trained to work in their specific trades.

Without regulation at the state level, consumers would get some protection from cities in Arizona that have inspectors who visit construction sites to enforce building codes. However, this only helps consumers once con-

struction has begun and cannot help consumers when hiring a contractor. Further, city building inspectors do not inspect work when it does not require a city permit, such as roofing an existing building.

- Because the agency can currently suspend or revoke a contractor's license, unscrupulous or improperly trained contractors could continue to perform contracting work in the absence of regulation.
- Without the agency's inspection and complaint resolution process, consumers would not have access to an inexpensive and timely means of resolving problems with contractors.
- The Residential Contractor's Recovery Fund provides financial restitution to consumers harmed by licensed residential contractors.

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

The Registrar of Contractors provides an appropriate level of regulation. Arizona is one of 12 states that has a central regulatory body that regulates nearly all aspects of the construction industry. Other states leave this regulation to local government or share the regulatory responsibilities among multiple state agencies. Further, the extent of regulation varies significantly. In some states, regulation is limited to certain trades such as plumbing or electrical work. Other states only regulate construction projects with costs that exceed several thousand dollars.

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

The agency has used private contractors to perform various services. For several years the agency has contracted with a private company to administer the agency's trade and business exams. The agency has also contracted with a Certified Public Accountant (CPA) to perform examinations of the Residential Contractors' Recovery Fund. This CPA has also made projections of future claims the Fund may incur, which is necessary when setting fees against contractors to generate the revenues needed to support the Fund. However, as discussed in Finding 2 (see pages 15 through 21) of this report, the Registrar of Contractors should hire a qualified actuary to perform these duties.

This audit did not identify any additional opportunities for the agency to use private contractors.

AGENCY RESPONSE

March 31, 2003

Ms. Debbie Davenport
Auditor General of the State of Arizona
2910 North 44th Street
Phoenix, AZ 85018

Dear Ms. Davenport:

Enclosed is the final response to the final performance audit prepared by your office dated March 21, 2003. I am confident that your feedback will help to guide me in my efforts to improve agency services and to strengthen the protections provided to consumers of construction-related products and services in Arizona.

Although your office had concluded the audit before my official appointment by Governor Napolitano, I wish to thank you and your staff for the time that was taken to study our operations, and for the professionalism and courtesy demonstrated by your audit staff in working with the Registrar of Contractors' staff over the past several months.

If I can be of assistance in the future in any way, please do not hesitate to let me know.

Sincerely,

Israel G. Torres
Director

IT:mh

Enclosure

**State of Arizona
Registrar of Contractors**



**Final Response
Office of the Auditor General Performance Audit**

**Israel G. Torres
Director**

March 31, 2003

SUMMARY

The Arizona Registrar of Contractors (ROC) Office was established in 1931 to regulate the construction industry of Arizona. The mission of the ROC is to promote quality construction through a licensing and regulatory system designed to protect the health, safety, and welfare of the public. To this end, the agency licenses contractors and assists consumers in the resolution of construction defects. In addition, the agency disciplines contractors who fail to correct poor workmanship or fail to obtain the necessary contractor's license. Equally important, the agency provides consumers with financial relief through the ROC Residential Contractors' Recovery Fund should a licensed contractor not perform to minimum workmanship standards.

Although a change in the agency leadership occurred in February 2003, the agency stands committed to continue its mission to promote quality construction by Arizona contractors and to improve its ability to provide consumers with the best tools possible for selecting a contractor for their construction project.

AUDITOR GENERAL FINDING 1

Consumer protection can be enhanced

Consumer protection is paramount to the ROC

In keeping with its mission statement, protection has always been a matter of paramount concern for the ROC. The agency consistently seeks ways to make the agency's processes more efficient, understandable and accessible to the public within the framework of the statutes and rules pursuant to which it operates. Through the agency website, public awareness campaign, and other informational programs, the ROC strives to provide the public with useful and accurate information in formats designed to be easily understood. The ROC believes that its efforts in this regard, supported by a dedicated staff, have been extremely successful. However in keeping with the agency's own philosophy that there is always room for improvement, the ROC cannot help but agree with a finding that consumer protection can yet be enhanced. It is for this very reason that the agency's effort to improve and refine how it accomplishes the agency's mission is continually ongoing. The ROC believes that it can and will continue to improve.

Auditor General Finding 1, Recommendation 1 - The Registrar of Contractors should develop criteria for determining when it should pursue discipline against contractors with serious or multiple complaints.

Agency Response: The finding of the Auditor General is agreed to and the finding will be implemented.

The ROC effectively identifies problem contractors

The ROC is an active player in disciplining problem contractors. In FY 02, the ROC revoked or suspended 993 out of 40,930 licensees. By comparison, the State of California in FY 02 revoked or suspended 1072 out of 288,241 licensees. Hence, the ROC disciplined contractors over five times more frequently than California. This aggressive and effective rate of discipline is in line with the agency's mission. In addition, the agency aims to resolve consumer or contractor complaints at the lowest level to ensure a rapid and effective solution to consumer problems.

In addition to existing mechanisms, the ROC has further developed criteria for determining when it should pursue discipline against contractors with serious or multiple complaints. As indicated in the Auditor General report, a contractor could potentially fail to meet workmanship standards on a project and then settle the case before or during a formal hearing to avoid disciplinary action. To address this, cases scheduled for a hearing will be monitored to determine if a pattern of conduct is established by the contractor of attempting to avoid disciplinary action by settling with the complainant prior to or during a hearing. The agency has modified its computer codes to identify contractors who have more than six vacated or settled hearings per year and a printout will be generated on a monthly basis. These vacated and settled complaints will be reviewed by the legal department chief on a case-by-case basis to determine if the agency should cite a contractor and join as a co-complainant on future cases against that contractor.

Auditor General Finding 1, Recommendation 2 - The Registrar of Contractors should make the nature of valid complaints available to consumers through its phone center and web site.

Agency Response: The finding of the Auditor General is agreed to and the finding will be implemented.

The ROC call center and web site are currently being expanded to provide additional information.

Complaints filed with the ROC are public information and have always been available for public review at the ROC offices. As such, complaints filed against licensed contractors are reported on the website as open, closed, dismissed, unresolved or unverified complaints. The agency believes that website public disclosure is an important tool for licensed contractors to perform quality work as they are aware that potential customers may view the number of complaints appearing on their official record unfavorably.

The agency's long term goal is to maximize information disclosure and make all contractor complaints and findings of agency inspectors, plus subsequent complaint actions and adjudicated cases available to the public on the agency's website. The current ROC website receives approximately 350,000 hits annually. The agency is continually working to improve its ease of use and relevance. Although the current website provides important historical information and the agency believes information disseminated via the website can be expanded further, the agency is faced with limitations on existing hardware and software capabilities.

If approval is received from the Government Information Technology Agency (GITA) and if funds are appropriated by the legislature in FY 2006, the agency will be closer to reaching its goal. Due to the sheer volume of complaints, licensed contractors, and administrative hearings, preliminary cost estimates of the needed technology upgrades in line with the agency's vision for information disclosure are \$2.3 million for the hardware and software upgrades. Furthermore, an additional three FTEs will be needed to administer and update the additional systems. The ROC will continue to investigate avenues to minimize cost outlays while maximizing efficiency and public disclosure.

The ROC's telephone call center handles approximately 230,000 calls annually. As seamless customer service is our goal, we aim to answer calls within 4 minutes. Callers receive ROC general information on processes and contractors. For more specific complaint histories, callers are directed to their closest field office to review the requested file in person. Again, due to the sheer volume of complaints filed, providing callers with detailed complaint histories would require the customer service representatives to place the call on hold, walk to a different portion of the office, find the file, and research the requested complaint. Thus, providing more detailed information on contractor histories may, in fact, increase the time callers spend in a queue waiting for a customer service representative. Because a balance must be established between providing additional information and answering calls promptly, the agency is investigating other processes to strike this balance most effectively.

Auditor General Finding 1, Recommendation 3 - If the Registrar of Contractors wishes to reintroduce courtesy inspections, it should seek statutory authority from the Legislature and make the results available to all consumers.

Agency Response: The finding of the Auditor General is agreed to and the recommendation will be implemented.

Courtesy inspections are an effective tool for consumers

The agency is seeking statutory authority to perform courtesy inspections. The agency was performing courtesy inspections, however ceased when notified by the Auditor General that the agency lacked authority for such a program. If approved, the agency will reinstate the courtesy inspection model.

The courtesy inspection program is a valuable service to the consumer and contractor. It is an informal attempt to address the consumer's concerns regarding the workmanship of a

contractor. When both parties are willing to participate, the agency inspector can usually respond within seven to ten days, providing a quick and simple means to identify many of the construction problems a consumer may raise. At the courtesy inspection, a professional construction inspector will inspect and discuss any deficiencies in the contractor's workmanship, trying to arrive at a mutually acceptable resolution for both parties. Since the consumer's problem is handled in an informal setting, the consumer gets any workmanship problems corrected sooner, the contractor can restore the confidence of their client and the agency saves money because fewer employee hours are needed to work the complaint.

The inspections are highly valuable. Currently, most courtesy inspection requests come from contractors dealing with a homeowner that is unfamiliar with particular workmanship standards. The agency through this program is able to address a potential workmanship issue for a homeowner in a highly expedient manner.

AUDITOR GENERAL FINDING 2

Some Recovery Fund changes needed

ROC Recovery Fund provides consumer protection

According to leading expert and Executive Director of the National Association of State Contractors' Licensing Agencies (NASCLA), "...the Fund has operated successfully for over 21 years and with prudent enhancements has become the premier construction consumer protection vehicle in this country."

Auditor General Finding 2, Recommendation 1 - The Registrar of Contractors should ensure that the Residential Contractors' Recovery Fund balance is sufficient to account for all financial liabilities, including anticipated claims, to comply with A.R.S. § 32-1134.

Agency Response: The finding of the Auditor General is agreed to and the recommendation will be implemented.

The ROC Recovery Fund balance has been sufficient to pay all consumer claims as they are received

Operated on a cash basis of accounting since it was established in 1981, the Fund balance has always been sufficient to pay consumer claims and operating expenses when due.

Although the agency believes that the Fund balance is sufficient to pay anticipated liabilities, the agency will begin to account for the Fund on an accrual basis of accounting which appears to be in line with the A.R.S. § 32-1134. The agency would note however, that the position that the Fund should follow insurance industry accounting standards and accumulate a \$5.5 million reserve for anticipated claims which have not yet been filed—in

addition to its current \$6.1 million balance—ignores the nature and purpose of the Fund’s operations and the governmental environment in which it exists.

Nonetheless, absent statutory authority to operate the Fund on a cash basis, the agency concurs that A.R.S. § 32-1134 requires reserves to be maintained at a level sufficient to cover anticipated claims. The agency shall take the actions necessary to ensure that the Fund balance is sufficient to account for all financial liabilities, including anticipated claims.

Auditor General Finding 2, Recommendation 2 - The Registrar of Contractors should contract with a qualified actuary to project anticipated future claims and to help set appropriate fee amounts necessary to establish sufficient claim reserves.

Agency Response: The finding of the Auditor General is agreed to, and the recommendation will be implemented.

Actuary will be employed

Each year, the Fund has used qualified independent CPAs to prepare actuarial projections of anticipated future claims. Although CPAs are generally qualified to provide this service, the agency will contract with a qualified actuary to provide this service.

Auditor General Finding 2, Recommendation 3 - After the actuary has determined the estimate for anticipated future claims, the Registrar of Contractors should comply with A.R.S. § 32-1134.01 by reassessing all licensed residential contractors in Arizona who have paid into the Fund to resolve the fund's deficit and to achieve the fund's statutorily required \$200,000 fund balance.

Agency Response: The finding of the Auditor General is agreed to and a different method of dealing with the finding will be implemented.

Fund balance will increase to provide reserves for anticipated future claims

The ROC projects the current estimated deficit will be eliminated in four to five years with the fee increases initiated in July 2002. Although it can be argued that it is fair for contractors to assess sufficient fees to establish full claim reserves to correlate their costs to their responsibilities, Fund payouts have been fairly consistent in recent years and contractor assessments have been relatively uniform. This results in a balance of costs and responsibilities as would be expected on the accrual basis of accounting. Put another way, imposing a special assessment on the current population of contractors for under-funded reserves, existing since the Fund was established in 1981, does not correlate to their current responsibility.

Nonetheless, the ROC projects the current estimated deficit of \$5.5 million will be eliminated in four to five years with the current \$300 new license and \$150 annual renewal fees paid by residential contractors. Actuarial projections of the Fund’s deficit, performed by qualified CPAs, have ranged from \$3.9 to \$5.5 million in the past three years. Although

the agency believes the deficit will be eliminated, Fund revenues and expenditures will be closely monitored during this period.

Auditor General Finding 2, Recommendation 4 - The Registrar of Contractors should use its own internal Certified Public Accountants (CPAs) to compile and produce the Recovery Fund's annual financial statement in non-audit years and discontinue paying its contracted CPA for these services.

Agency Response: The finding of the Auditor General is not agreed to, but the recommendation will be implemented.

Independent CPAs provide added level of assurance in compiling the Fund's annual financial statements

The ROC takes its fiduciary responsibility very seriously. As such, the Agency believed it was prudent and beneficial to have the Fund's financial statements and operations reviewed annually by an independent CPA at a reasonable cost. However, since the Auditor General has offered to perform the required third-year audit at no cost to the Fund if in-house CPAs prepare the interim financial statement compilations, the agency will implement the recommendation.

Auditor General Finding 2, Recommendation 5 - The Legislature should consider amending A.R.S. § 32-1134(A)(7) to limit the Fund's administrative expenses to a percentage of the Fund's revenues from the previous fiscal year to enable the Fund to cover its 2003 and 2004 fiscal year administrative expenses.

Agency Response: The finding of the Auditor General is agreed to and the agency recommends the Legislature implement the recommendation.

The current statute, prescribing a ten percent limit of the Fund balance for operating expenses, has been effective since the Fund's 1981 inception, however, the agency believes the legislation can be implemented.

Auditor General Finding 2, Recommendation 6 - In September 2003, 1 year after the fee increases and claims limits were increased, the Registrar of Contractors should report its revenues and administrative costs to the Joint Legislative Budget Committee staff to help the Legislature determine if it should consider any additional changes to the Fund's administrative expense limit statute.

Agency Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Agency will report Fund revenues and administrative costs to JLBC

In September 2003, the agency will report Fund revenues and administrative costs to the Joint Legislative Budget Committee to help the Legislature determine if it should consider changes to the Fund's administrative expense limit statute.

AUDITOR GENERAL FINDING 3

Agency's vehicle use is inappropriate and inefficient

Agency's vehicle use is necessary to fully protect the public

ROC Inspectors and Investigators perform critical services in the area of public health and safety. They perform building inspections in trades that include electrical, plumbing, air conditioning, heating and structural steel for violations of building codes and evidence of poor workmanship. They investigate wrongful or fraudulent acts committed by licensed and unlicensed contractors and seek disciplinary action or criminal prosecution of these contractors. While some vehicles may not meet the criteria adopted by the auditor, the nature of the agency's law enforcement work and protection of public health and safety in construction matters must be given considerable weight. City, county and state police vehicles, emergency medical vehicles and road and building maintenance vehicles may be underutilized by the standards used by the Office of the Auditor General but such services are critical and should not be jeopardized.

Auditor General Finding 3, Recommendation 1 - To comply with A.R.S. § 38-538.02, the Registrar of Contractors should immediately end its policy of providing personally assigned take-home vehicles to its staff.

Agency Response: The finding of the Auditor General is agreed to and the recommendation will be implemented.

The agency will end its policy of domicile-to-duty use of state vehicles for inspectors and investigators on or before May 2, 2003. The new agency policy will be consistent with the ADOA rule interpretation provided to the ROC.

According to the ADOA rule interpretation and discussions with the Auditor General, inspectors and investigators may take their assigned state vehicle home in limited circumstances upon written approval by their supervisor. Further, an ROC Assistant Director will review take home vehicle requests on a monthly basis to ensure compliance with the policy.

Auditor General Finding 3, Recommendation 2 - The Registrar of Contractors should return its 22 vehicles that were driven fewer than 10,000 miles in the past year to the Department of Administration.

Agency Response: The finding of the Auditor General is not agreed to and the recommendation will not be implemented.

Agency's vehicle use is necessary to fully protect the public

As previously stated, ROC Inspectors and Investigators perform critical services in the area of public health and safety. They perform difficult building inspections and investigate wrongful or fraudulent acts committed by licensed and unlicensed contractors and seek disciplinary action or criminal prosecutions. They are often called to the field at moments notice. Thus, while some vehicles may not meet the mileage criteria adopted by the auditor, the nature of the agency's law enforcement work and protection of public health and safety in construction matters must be given considerable weight.

The ROC has 56 inspectors and investigators. These vehicles are used by Inspectors and Investigators on a daily basis to conduct prescheduled appointments which are scheduled many weeks in advance. Thus, an adequate pool of vehicles must be maintained. The agency receives over eleven thousand complaints per year. Scheduling appointments based on the future tentative availability of transportation would place severe limitations on the agency's ability to perform its duties. It is critical to provide inspection and investigation services to the public and to maximize the efficient use of ROC staff. Although the vehicle is not available on an every day take-home-basis, it is available as needed in their duties to fully protect the public during working hours.

In addition, the nine members of the ROC executive staff currently have assigned vehicles for use during working hours. Clearly executive staff perform duties that require regularly scheduled transportation. Attendance and participation is required at numerous functions, which include statewide governmental and legislative meetings, providing consumer education, speaking engagements to contractor organizations, travel to agency field offices for audit and supervisory functions and attending training seminars.

In an effort to reduce vehicle use, the nine executive staff members with assigned vehicles will now share from a pool of four vehicles to perform their duties. Therefore, the agency will return five agency vehicles to ADOA no later than Friday, April 11, 2003.

Auditor General Finding 3, Recommendation 3 - The Registrar of Contractors should monitor the efficiency of all vehicles that had been driven for employees' personal commutes to and from work, and in January 2004, it should eliminate any of these vehicles that fall below the efficient-use guideline of 10,000 miles per year.

Agency Response: The finding of the Auditor General is agreed to and a different method of dealing with the finding will be implemented.

The agency will end its policy of domicile-to-duty use of state vehicles for inspectors and investigators on or before May 2, 2003. The new agency policy will be consistent with the ADOA rule interpretation provided to the ROC and discussions with the Auditor General. Thus, because personal commutes to and from work will no longer be the case, the ROC believes this recommendation is no longer applicable in light of the agency's proposed policy.

Auditor General Finding 3, Recommendation 4 - To ensure that its vehicles are appropriately and efficiently used in the future, the Registrar of Contractors should better monitor their use by requiring detailed mileage reports on all vehicles.

Agency Response: The finding of the Auditor General is not agreed to and the recommendation will not be implemented.

The agency will end its policy of domicile-to-duty use of state vehicles for inspectors and investigators on or before May 2, 2003. The new agency policy will be consistent with the ADOA rule interpretation provided to the ROC and discussions with the Auditor General. Therefore, because detailed mileage logs were recommended because of take home personally assigned vehicles, the ROC believes this recommendation is not applicable in light of the agency's proposed policy.

SUNSET FACTORS

1. Objective and purpose in establishing the agency.

The agency agrees with the conclusions of the Office of the Auditor General.

2. The effectiveness with which the agency has met its objective and purpose and the efficiency with which the agency has operated.

The agency believes that it has been effective in meeting its objective and purpose in the manner in which it has operated. Further the agency believes it is imperative for personnel to have a sufficient number of vehicles to efficiently perform their duties and provide essential services to the public. The ROC Inspectors and Investigators perform critical services in the area of public health and safety. They perform difficult building inspections and investigate wrongful or fraudulent acts committed by licensed and unlicensed contractors and seek disciplinary action or criminal prosecutions. They are often called to the field at moments notice. Thus, while some vehicles may not meet the mileage criteria adopted by the auditor, the nature of the agency's law enforcement work and protection of public health and safety in construction matters must be given considerable weight.

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

The agency believes that it consistently operates in the public interest in all of its activities. The agency agrees that there is always room for improvement and aggressively pursues new opportunities to enhance consumer protection and increase public awareness regarding licensed contractors.

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

The agency disagrees with the Office of the Auditor General's comments. The areas identified by the Office of the Auditor General are already adequately covered by statute and do not require the promulgation of additional rules.

5. The extent to which the agency has encouraged input from the public before promulgating its rules and regulations and the extent to which it has informed the public as to its actions and their expected impact on the public.

The agency agrees with the conclusions of the Office of the Auditor General.

6. The extent to which the agency has been able to investigate and resolve complaints within its jurisdiction.

The agency agrees with the conclusions of the Office of the Auditor General.

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

The agency agrees with the conclusions of the Office of the Auditor General.

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

The agency agrees with the conclusions of the Office of the Auditor General.

9. The extent to which changes are necessary in the laws of the agency to adequately comply with the factors listed in the Sunset review statute.

The agency agrees with the conclusions of the Office of the Auditor General.

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

The agency disagrees with the conclusion of the Office of the Auditor General that termination of the Registrar of Contractors “*would likely pose some harm*” to the public health, safety and welfare of Arizona citizens. It is the agency’s position that sunseting would undoubtedly cause significant harm to the public health, safety and welfare of Arizona citizens for all of the reasons cited by the Office of the Auditor General.

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

The agency agrees with the conclusions of the Office of the Auditor General.

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

The agency agrees with the conclusions of the Office of the Auditor General.

Performance Audit Division reports issued within the last 12 months

02-01	Arizona Works	02-11	Department of Health Services—Health Start Program
02-02	Arizona State Lottery Commission	02-12	HB2003 Children’s Behavioral Health Services Monies
02-03	Department of Economic Security—Kinship Foster Care and Kinship Care Pilot Program	02-13	Department of Health Services—Office of Long Term Care
02-04	State Parks Board—Heritage Fund	03-01	Government Information Technology Agency—State-wide Technology Contracting Issues
02-05	Arizona Health Care Cost Containment System—Member Services Division		
02-06	Arizona Health Care Cost Containment System—Rate Setting Processes		
02-07	Arizona Health Care Cost Containment System—Medical Services Contracting		
02-08	Arizona Health Care Cost Containment System—Quality of Care		
02-09	Arizona Health Care Cost Containment System—Sunset Factors		
02-10	Department of Economic Security—Division of Children, Youth and Families, Child Protective Services		

Future Performance Audit Division reports

Water Infrastructure Finance Authority

Department of Commerce

State Board of Funeral Directors and Embalmers