

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.