

Audit Report

Department of Labor, Licensing and Regulation Division of Occupational and Professional Licensing

November 2017



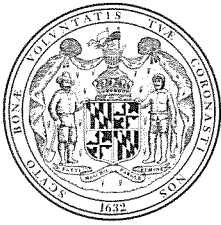
OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Warren G. Deschenaux
Executive Director

Thomas J. Barnickel III, CPA
Legislative Auditor

November 28, 2017

Senator Craig J. Zucker, Co-Chair, Joint Audit Committee
Delegate C. William Frick, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

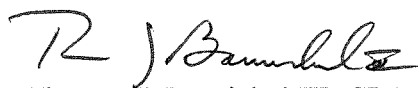
We have conducted a fiscal compliance audit of the Department of Labor, Licensing and Regulation – Division of Occupational and Professional Licensing (DOPL) for the period beginning April 3, 2013 and ending January 29, 2017. DOPL licenses, regulates, and monitors 25 business occupations and professions in concert with the applicable boards and commissions whose members are appointed by the Governor. Each of these boards and commissions is funded either by general funds or by license and exam fees from the specific professional or trade group regulated.

Our audit disclosed that DOPL did not take sufficient steps to ensure that real estate and home improvement licenses were issued only to applicants who met all education and experience requirements stipulated in State law. In addition, we found that collection procedures in place at three of four boards and commissions we examined were not sufficient to ensure that all collections were deposited. Finally, cash control accounts were not maintained for the Home Improvement and Real Estate Guaranty Funds and, consequently, DOPL was unable to adequately reconcile these Funds' records to the State's records to ensure that all Fund activity had been properly accounted for and recorded.

The response from the Department of Labor, Licensing and Regulation – Office of the Secretary, on behalf of DOPL, is included as an appendix to this report.

We wish to acknowledge the cooperation extended to us during this audit by DOPL.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "T J Barnickel III". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Thomas J. Barnickel III, CPA
Legislative Auditor

Table of Contents

Background Information	4
Agency Responsibilities	4
Status of Findings From Preceding Audit Report	4
Findings and Recommendations	5
Licensing	
Finding 1 – The Division of Occupational and Professional Licensing (DOPL) did not have sufficient procedures to ensure that real estate broker and salesperson licenses, and home improvement contractor licenses were issued only to individuals who had met all required qualifications.	5
Cash Receipts	
Finding 2 – DOPL did not have adequate processes in place to ensure that certain collections were deposited.	6
Guaranty Funds	
* Finding 3 – DOPL had not established cash control accounts for the Home Improvement and the Real Estate Guaranty Funds, and did not reconcile cash transactions to the State’s records.	8
Audit Scope, Objectives, and Methodology	9
Agency Response	Appendix

* Denotes item repeated in full or part from preceding audit report

Background Information

Agency Responsibilities

The Division of Occupational and Professional Licensing (DOPL) of the Department of Labor, Licensing and Regulation (DLLR) licenses, regulates, and monitors 25 business occupations and professions in concert with the applicable boards and commissions whose members are appointed by the Governor. According to DLLR records, as of June 30, 2016, DOPL regulated more than 237,000 licensees. Furthermore, according to the State's records, DOPL's expenditures for fiscal year 2016 totaled approximately \$10.7 million. These expenditures were funded by general funds, as well as licensing and exam fees.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the three findings contained in our preceding audit report dated February 27, 2014. We determined that DOPL satisfactorily addressed two of these three findings. The remaining finding is repeated in this report.

Findings and Recommendations

Licensing

Finding 1

The Division of Occupational and Professional Licensing (DOPL) did not have sufficient procedures to ensure that real estate broker and salesperson licenses, and home improvement contractor licenses were issued only to individuals who had met all required qualifications.

Analysis

DOPL did not have sufficient procedures to ensure that individuals who were issued real estate broker and salesperson licenses, as well as home improvement contractor licenses, had met all required qualifications for licensure as stipulated in the law. The Department of Labor, Licensing and Regulation (DLLR), on behalf of DOPL, contracted with a vendor that was responsible for ensuring that applicants for licenses from the Maryland Real Estate Commission (MREC) and Maryland Home Improvement Commission (MHIC) met certain education and experience requirements, and for administering the applicable examinations required for licensure. However, DOPL did not take any steps to ensure that the vendor was properly performing these responsibilities. For example, MREC and MHIC did not conduct any independent reviews, as permitted by the contracts, to ensure that the vendor adequately verified the qualifications of applicants.

Our test of the vendor's records for 20 individuals that were issued either a real estate salesperson or broker license, or a home improvement contractor license during our audit period disclosed 2 home improvement contractor licensees for whom documentation was not on file to substantiate that the vendor verified the experience requirements for licensure.

State law requires applicants for a real estate broker and salesperson license to successfully complete a course on real estate approved by MREC prior to taking an examination to obtain a license. The law further requires that an applicant for a broker's license have at least three years of brokerage service experience (affiliated with a licensed real estate broker). State law relating to home improvement contractor licensure requires applicants to obtain at least two years of trade experience that is satisfactory to MHIC prior to taking the examination to obtain a contractor's license.

As of June 30, 2016, there were 41,442 and 29,137 individuals in Maryland who held active real estate (broker and salesperson) and home improvement contractor licenses, respectively. During fiscal year 2016, MREC and MHIC issued 7,021

and 3,163 new real estate and home improvement contractor licenses, respectively.

Recommendation 1

We recommend that DOPL establish procedures to ensure that applicants for real estate and home improvement contractor licenses met all required qualifications in accordance with State law. Specifically, we recommend that DOPL

- a. inspect, at least on a test basis, the aforementioned vendor's records to ensure that applicants met the education and experience requirements for licensure;**
- b. maintain documentation of the results of these inspections for future reference; and**
- c. follow up on the aforementioned two licensees for which documentation was not on file and take appropriate action.**

Cash Receipts

Finding 2

DOPL did not have adequate processes in place to ensure that certain collections were deposited.

DOPL did not adequately verify that collections received centrally for three of the four boards and commissions we reviewed were deposited. DOPL collected \$375,000 for these four units during fiscal year 2016, of which \$339,000 was collected for these three units. Checks received were initially recorded at a central location and then transferred, along with the related documentation, to the applicable units for processing. The checks were then returned to the central location for deposit processing. Each unit was responsible for performing the validated deposit verification for its collections. However, for three of the four units reviewed, the initial record of collections was not subsequently used to validate the bank deposits. Instead, these units compared a copy of the prepared bank deposit slips and other related documentation to the validated bank deposit documentation. Because this comparison did not include the initial record of collections, there was a lack of assurance as to the proper disposition of all receipts.

Our test of collections totaling \$95,000, received during the period between July 2015 and January 2017, disclosed six checks totaling \$1,800 that had not been deposited in the State's bank account for two of these three units' and DOPL could not readily determine the disposition of the checks. Subsequent to our

inquiries, DOPL determined that the checks had been either returned to the sender or deposited to a separate lockbox account, which is used when a check cannot be immediately processed.

The Comptroller of Maryland's *Accounting Procedures Manual* requires an independent verification of collections to deposit, which should be performed from the record of checks received.

According to its records, DOPL collected approximately \$1.2 million during fiscal year 2016 for its boards and commissions. Our audit did not include collections of the boards and commissions received through the DLLR online licensing system and collections received through the bank lockbox account, both of which are processed by DLLR – Office of the Secretary and are included in the scope of that audit.

Recommendation 2

We recommend that DOPL ensure that the initial record of collections received for the boards and commissions is used by independent employees for verification to validated bank deposit documentation.

Guaranty Funds

Background

The Home Improvement and Real Estate Guaranty Funds were established by State law to compensate individuals who are financially injured because of faulty work performed by a licensed home improvement contractor and because of the wrongful acts of a licensed real estate broker or salesperson, respectively. A portion of each license application fee (for example, \$100 for a contractor license) is credited to the applicable Guaranty Fund. In accordance with State law, MHIC and MREC, which administer these Funds, require that the licensees responsible for these losses reimburse the Funds for amounts paid plus interest, as ordered by the Commissions.

According to the State's accounting records, during the fiscal year ending June 30, 2016, disbursements (claim payments and refunds) made from the Home Improvement Guaranty Fund and the Real Estate Guaranty Fund totaled approximately \$782,000 and \$193,000, respectively. Additionally, as of June 30, 2016, the cash balances in the Home Improvement Guaranty Fund and the Real Estate Guaranty Fund totaled approximately \$1.6 million, and \$930,000, respectively.

Finding 3

DOPL had not established cash control accounts for the Home Improvement and the Real Estate Guaranty Funds, and did not reconcile cash transactions to the State's records.

Analysis

DOPL had not established cash control accounts reflecting the related balances on hand for the Home Improvement and the Real Estate Guaranty Funds.

Consequently, DOPL could not periodically reconcile the respective cash balances of the Funds with the corresponding State accounting records to ensure that all related cash transactions were properly accounted for and recorded.

In this regard, for fiscal year 2016, the total balance of receipts over disbursements for the two Guaranty Funds was \$620,000 according to the State's accounting records, while the balance was \$441,000 according to DOPL's records. This indicates a \$179,000 net difference in recorded cash activity between the two records for the year. Although there may be legitimate reasons for this difference, such as the timing of transactions, without adequate records and controls in place to ensure that all transactions were properly recorded, differences between DOPL's and the State's records may not be readily identified, investigated, and resolved. Similar conditions have been commented upon in our four preceding audit reports dating back to May 2005.

Recommendation 3

We recommend that DOPL establish and maintain cash control accounts for the Home Improvement and Real Estate Guaranty Funds, and periodically reconcile the balances of those accounts to the respective balances recorded in the State's accounting records (repeat).

Audit Scope, Objectives, and Methodology

We have conducted a fiscal compliance audit of the Department of Labor, Licensing and Regulation (DLLR) – Division of Occupational and Professional Licensing (DOPL) for the period beginning April 3, 2013 and ending January 29, 2017. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine DOPL's financial transactions, records, and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of significance and risk. The areas addressed by the audit included cash receipts, licensing, and guaranty funds. We also determined the status of the findings contained in our preceding audit report.

Our audit did not include certain support services provided by the DLLR – Office of the Secretary. These support services (such as payroll, purchasing, data processing, maintenance of accounting records, and related fiscal functions including cash receipts processed through DLLR's online licensing system and certain bank lockbox account transactions) are included within the scope of our audits of the Office of the Secretary.

To accomplish our audit objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, observations of DOPL's operations, and tests of transactions. Generally, transactions were selected for testing based on auditor judgment, which primarily considers risk. Unless otherwise specifically indicated, neither statistical nor non-statistical audit sampling was used to select the transactions tested. Therefore, the results of the tests cannot be used to project those results to the entire population from which the test items were selected.

We also performed various data extracts of pertinent information from the State's Financial Management Information System (such as revenue and expenditure data). The extracts are performed as part of ongoing internal processes established by the Office of Legislative Audits and were subject to various tests to

determine data reliability. We determined that the data extracted from these sources were sufficiently reliable for the purposes the data were used during this audit. We also extracted data from DOPL's automated licensing system for the purpose of testing cash receipts, licensing, and guaranty funds. We performed various tests of the relevant data and determined that the data were sufficiently reliable for the purposes the data were used during the audit. Finally, we performed other auditing procedures that we considered necessary to achieve our audit objectives. The reliability of data used in this report for background or informational purposes was not assessed.

DOPL's management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations are achieved.

Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes findings relating to conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect DOPL's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our report also includes findings regarding significant instances of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to DOPL that did not warrant inclusion in this report.

The DLLR – Office of the Secretary's response, on behalf of DOPL, to our findings and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise the Office of the Secretary regarding the results of our review of its response.

APPENDIX



OFFICE OF THE SECRETARY
500 North Calvert Street
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November 16, 2017

Mr. Thomas J. Barnickel III, CPA
Legislative Auditor
Department of Legislative Services
Office of Legislative Audits
301 West Preston Street, Room 1202
Baltimore, MD 21201

The Department of Labor, Licensing, and Regulation (DLLR) respectfully submits the enclosed response to the Office of Legislative Auditor's (OLA) report on the Division of Occupational and Professional Licensing for a period beginning April 03, 2013 and ending January 29, 2017.

For all three (3) audit findings, the Department has initiated measures to strengthen internal controls and improve processes to mitigate the deficiencies identified in your discussion notes.

DLLR would like to thank the audit staff who conducted the audit of the Division of Occupational and Professional Licensing. Their professionalism and respect to our staff and processes is much appreciated.

Should you have any questions, feel free to contact me or Commissioner Victoria Wilkins, of the Division.

Best Regards,

A handwritten signature in cursive script that reads "Kelly M. Schulz".

Kelly M. Schulz
Secretary

KMS/vw/jp/ss

Enclosures

cc: David McGlone, Deputy Secretary, DLLR
Victoria L. Wilkins, Commissioner, DOPL
John T. Papavasiliou, Deputy Commissioner, DOPL
Elizabeth T. Williams, Executive Director, Office of Administration, DLLR
Samuel K. Smith, Director, Office of Program Analysis and Audit, DLLR

Licensing

Finding 1

The Division of Occupational and Professional Licensing (DOPL) did not have sufficient procedures to ensure that real estate broker and salesperson licenses, and home improvement contractor licenses were issued only to individuals who had met all required qualifications.

Recommendation

We recommend that DOPL establish procedures to ensure that applicants for real estate and home improvement contractor licenses met all required qualifications in accordance with State law. Specifically, we recommend that DOPL

- a. inspect, at least on a test basis, the aforementioned vendor's records to ensure that applicants met the education and experience requirements for licensure;
- b. maintain documentation of the results of these inspections for future reference; and
- c. follow up on the aforementioned two licensees for which documentation was not on file and take appropriate action.

DOPL Response:

The division concurs with this finding and recognizes that further action must be taken to ensure that examinations for licenses are issued only to qualified applicants by the testing vendor.

- a. The division will create an audit system to test proper vendor verification of experience and other prerequisite requirements. On a quarterly basis, the division will send a randomly selected list of applicant names to the testing vendor. The testing vendor will be required to send electronic copies of approved applications to the board or commission for review. Discussions with the vice president of the testing vendor have already occurred. It is anticipated the new audit system will commence in early 2018.
- b. When the vendor's records are reviewed through the new audit system, we will maintain documentation of such results for future reference.
- c. We have contacted the two licensees regarding the application requirements. We are able to verify that both are currently qualified and maintaining active licenses, however complete documentation from the original application process is no longer available. In addition, both licensees originally passed the contractor examination and provided sufficient financials, surpassed credit score review and proved sufficient insurance coverage in their applications to support licensure with the commission. No additional actions are required.

Cash Receipts

Finding 2

DOPL did not have adequate processes in place to ensure that certain collections were deposited.

Recommendation

We recommend that DOPL ensure that the initial record of collections received for the boards and commissions is used by independent employees for verification to validated bank deposit documentation.

DOPL Response:

The division concurs with this finding and recognizes the importance of accounting for all collections and processing of payments. Changes to the cash handling process were made during the audit to ensure that proper standards are in place *vis-à-vis* accountability and control over certain collections.

To track these types of transactions, the payment center staff developed a log to capture all mailed manual deposit (lockbox) transactions, comparing that against the lockbox statement to verify receipt and deposit of each transaction. The log captures the signature of the person performing the verification.

If checks are returned to the sender, the boards and commissions will keep letters on file that the checks have been returned. If checks are mailed to the bank's lockbox, the division will keep records of what is sent and verify with the bank that the checks are received and properly processed. Both returned checks and lockbox transactions will appear on logs that are verified by independent employees.

Guaranty Funds

Finding 3

DOPL had not established cash control accounts for the Home Improvement and the Real Estate Guaranty Funds, and did not reconcile cash transactions to the State's records.

DOPL Response:

The division concurs with this recommendation and acknowledges corrective controls, under the advice and guidance of the auditors, were implemented during the audit.

The interpretation of the 2014 recommendation is that DOPL must verify the reconciliation performed by the fiscal team based upon the AS/400 data. To satisfy this issue, a new monthly report has been created from the AS/400. Data is entered in an Excel spreadsheet and reconciled against the OOA monthly report (FMIS). The information in the spreadsheet was backfilled to FY2016 during the audit and is currently being monitored on a monthly basis by a DOPL fiscal staff member. The variance between these reports is minimal and can be attributed to FMIS input timing during month-end or year-end closings. A fiscal services staff member is performing the reconciliation of DOPL's records with OOA reports and will report any deviations to the deputy commissioner.

AUDIT TEAM

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Jonathan H. Finglass, CPA
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