

Audit Report

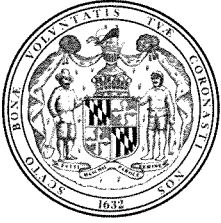
**Department of Labor, Licensing and Regulation
Division of Occupational and Professional Licensing**

February 2014



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

February 27, 2014

Karl S. Aro
Executive Director

Thomas J. Barnickel III, CPA
Legislative Auditor

Senator James C. Rosapepe, Co-Chair, Joint Audit Committee
Delegate Guy J. Guzzone, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the Division of Occupational and Professional Licensing (DOPL) of the Department of Labor, Licensing and Regulation for the period beginning March 29, 2010 and ending April 2, 2013. DOPL licenses, regulates, and monitors 24 business occupations and professions in concert with 23 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 fees from the specific professional or trade group regulated.

Our audit again disclosed that DOPL did not establish proper internal controls over collections received by certain boards and commissions. For example, DOPL did not ensure all recorded collections were deposited. The findings related to certain of these internal control deficiencies have been commented upon in our preceding audit reports dating back as early as 1999. Also, adequate recordkeeping and related controls were not established over the Home Improvement and Real Estate Guaranty Funds. Specifically, accounts receivable and cash balance records for these Funds were not established.

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,

Thomas J. Barnickel III, CPA
Legislative Auditor

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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 24 business occupations and professions in concert with 23 boards and commissions whose members are appointed by the Governor. According to DLLR records, as of July 15, 2013, DOPL regulated more than 227,000 licensees. Furthermore, according to the State's records, DOPL's expenditures for fiscal year 2013 totaled approximately \$9.7 million. These expenditures were funded by general funds (\$3.1 million), licensing and exam fees (\$5.2 million), and reimbursable funds received by DOPL (\$1.4 million).

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the four findings contained in our preceding audit report dated October 22, 2010. We determined that DOPL satisfactorily addressed one of these findings. The remaining three findings are repeated in this report.

Findings and Recommendations

Cash Receipts

Finding 1

Proper controls had not been established over certain collections.

Analysis

The Division of Occupational and Professional Licensing (DOPL) had not established adequate accountability and control over collections for the four boards and commissions that we reviewed. According to its records, DOPL's various boards and commissions directly collected approximately \$1.1 million during fiscal year 2013, of which these four boards and commissions collected approximately \$757,500. These receipts were processed using remote deposit, which scans the images of checks and money orders and electronically transmits the images to the State's bank for deposit. The collections of the boards and commissions do not include the receipts received through the Department of Labor, Licensing and Regulation's (DLLR) online licensing system and via bank lockbox accounts, both of which were processed directly by DLLR – Office of the Secretary. These receipts are subject to review during our separate audit of DLLR – Office of the Secretary. Our review disclosed the following conditions:

- Three of the four boards and commissions we reviewed did not independently verify that all recorded cash collections were deposited.
- One employee, who had access to the cash receipts collected by three of these boards and commissions, also had the ability to process and approve licenses online through DOPL's automated licensing system.
- The electronic record used to initially record cash receipt collections was maintained on DOPL's internal network without proper access restrictions. Consequently, DOPL employees with access to cash receipts could misappropriate receipts and avoid detection by altering the electronic record.
- Checks scanned into the remote deposit system were not always properly destroyed after deposit. For example, as of May 15, 2013, one commission had not destroyed more than 120 checks totaling approximately \$46,600 processed through the remote deposit system during the period from September 20, 2012 to April 5, 2013. Consequently, sensitive banking information recorded on these checks was unnecessarily retained, increasing the risk of unauthorized disclosure. The Office of the State Treasurer's *Policy on the Use of Remote Deposit Services by Maryland State Agencies* requires

scanned and transmitted checks to be stored no longer than 30 days before they are destroyed.

Because of these deficiencies, assurance was lacking that all collections received were ultimately deposited, and that licenses were issued only after the required fees had been collected. The conditions concerning the verification that recorded collections were deposited and the ability of certain employees to record collections and process licenses have been commented upon in our five preceding audit reports dating back to 1999.

Recommendation 1

We recommend that DOPL

- a. perform documented and independent verifications to ensure that all recorded collections were deposited (repeat),**
- b. ensure employees involved with cash receipts processing are independent of the license application processing function (repeat),**
- c. restrict access to the electronic record used to initially record cash receipt collections to only those employees requiring such access to perform their job duties, and**
- d. comply with the State Treasurer's *Policy on the Use of Remote Deposit Services by Maryland State Agencies*.**

We advised DOPL on accomplishing the necessary separation of duties using existing personnel.

Guaranty Funds

Background

The Home Improvement Guaranty Fund and the Real Estate Guaranty Fund were established by State law to compensate individuals who are financially injured because of faulty work performed by a licensed home improvement contractor or 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 Fund. In accordance with State law, the Home Improvement and Real Estate Commissions, which administer these Funds, require that the licensees responsible for these losses reimburse the Fund for amounts paid plus interest, as ordered by the Commissions. Generally, the claimant presents his or her claim and evidence to an Administrative Law Judge of the Office of Administrative Hearings, and a recommended award amount is made to the applicable Commission, which may affirm or change the recommendation, and which pays the claim from the Fund. The Commissions may also impose monetary penalties for certain violations.

According to the State's accounting records, during the fiscal year ending June 30, 2013, disbursements (claim payments and refunds) made from the Home Improvement and Real Estate Guaranty Funds totaled approximately \$1.3 million and \$344,200, respectively. Additionally, according to the State's accounting records, the cash balances in the Home Improvement Guaranty Fund and the Real Estate Guaranty Fund totaled approximately \$634,200, and \$1.6 million, respectively.

Finding 2

DOPL had not established detail accounts receivable records and cash control accounts for the Home Improvement and the Real Estate Guaranty Funds.

Analysis

DOPL had not established detail accounts receivable records and cash control accounts for the Home Improvement and the Real Estate Guaranty Funds. Specifically, we noted the following conditions:

- DOPL maintained a record of Real Estate Guaranty Fund accounts that were sent to the Central Collections Unit (CCU); however, DOPL did not maintain detail accounts receivable records of amounts due from licensees that had not yet been forwarded to CCU or a related control account. DOPL also lacked certain records for amounts due to the Home Improvement Guaranty Fund. In this regard, DOPL maintained a spreadsheet listing amounts due to the Home Improvement Guaranty Fund; however, the records did not include whether any of the accounts had been forwarded to CCU and a related control account was not maintained.
- DOPL had not established cash control accounts reflecting the related balances on hand for the Guaranty Funds. Consequently, DOPL could not periodically reconcile the Guaranty Funds' respective cash balances with the corresponding State accounting records to ensure that all related cash activities were properly accounted for and recorded. Specifically, for fiscal year 2013 (through March 2013), the total excess of disbursements over receipts for the two Guaranty Funds was \$339,000 according to the State's accounting records while this excess was \$226,000 according to DOPL's records. This indicates a \$113,000 difference in cash activities for that period.

When testing claim disbursements, we discovered that a duplicate \$20,000 claim payment was mistakenly processed by the Home Improvement Commission in July 2010 and remained undetected. This duplicate payment remained undetected by DOPL due in part to the lack of adequate records. Upon bringing this duplicate payment to DOPL's attention, on July 17, 2013 a letter was sent to the

claimant requesting recovery of the payment. As of September 2013, DOPL had not recovered the duplicate payment from the claimant and had referred the claimant to the Department of Budget and Management's Central Collection Unit (CCU).

The Comptroller of Maryland's *Accounting Procedures Manual* requires that detail accounts receivable records and a control account be maintained and the aggregate balance of the detail records should be periodically reconciled to the control account balance. Similar conditions have been commented upon in our three preceding audit reports.

Recommendation 2

We recommend that DOPL

- a. establish and maintain detail accounts receivable records and related control accounts for amounts due the Home Improvement and Real Estate Guaranty Funds, and periodically reconcile the control account balances to the related detail records (repeat); and**
- b. 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).**

Finding 3

DOPL did not always timely refer licensees to CCU for unreimbursed Guaranty Fund claims paid on the licensees' behalf.

Analysis

DOPL did not always timely refer licensees to CCU for unreimbursed Guaranty Fund claims paid on the licensees' behalf. Our test of 20 claim payments totaling approximately \$360,000 made from the Home Improvement and Real Estate Guaranty Funds (10 payments from each totaling \$183,000 and \$177,000, respectively) disclosed the following conditions:

- Licensees for eight Home Improvement Guaranty Fund payments totaling approximately \$147,000 were not referred to CCU until 40 to 241 days after they should have been.

CCU regulations, as amended for DOPL's Home Improvement Guaranty Fund, require that accounts of contractors that fail to reimburse that Fund within 30 days of a Final Order be immediately referred to CCU.

- Licensees for eight Real Estate Guaranty Fund payments totaling approximately \$154,000 were not referred to CCU until 15 to 374 days after they should have been. In addition, one other account totaling \$8,000 had been delinquent for at least nine months as of June 27, 2013, but had not been referred to CCU.

CCU regulations for amounts due the Real Estate Guaranty Fund require the issuance of three written demands for payment at 30-day intervals and, immediately thereafter, referral to CCU for any such accounts remaining unpaid.

A similar condition was commented upon in our two preceding audit reports.

Recommendation 3

We recommend that DOPL timely refer all delinquent accounts applicable to the Home Improvement and Real Estate Guaranty Funds to CCU as required (repeat).

Audit Scope, Objectives, and Methodology

We have audited the Division of Occupational and Professional Licensing (DOPL) of the Department of Labor, Licensing and Regulation for the period beginning March 29, 2010 and ending April 2, 2013. 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 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. We also determined the status of the findings included in our preceding audit report.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. The areas addressed by the audit included cash receipts, licensing, and guaranty funds.

To accomplish our audit objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of DOPL's operations and tests of transactions. 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 various 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 objectives. The reliability of data used in this report for background or informational purposes was not assessed.

Our audit did not include certain support services provided by the Department of Labor, Licensing and Regulation (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 bank lockbox accounts) are included within the scope of our audits of the Office of the Secretary.

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.

February 24, 2014

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

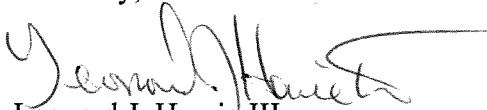
Dear Mr. Barnickel:

We are providing this letter as the official agency response to the draft audit report comments and recommendations for the Department of Labor, Licensing and Regulation – Division of Occupational and Professional Licensing (DOPL) for the period beginning March 29, 2010 and ending April 3, 2013.

The Department appreciates the thorough examination of our DOPL financial transactions, records and internal controls, and the evaluation of its compliance with applicable State laws, rules and regulations, professionally conducted by your staff. The Agency and Division will work toward compliance with the report's recommendations in a manner outlined in the final responses.

Enclosed is our detailed agency response. As requested, an electronic version has also been forwarded by e-mail. If you have any questions regarding this process, do not hesitate to contact me.

Sincerely,


Leonard J. Howie III
Secretary

Enclosure

cc: Scott R. Jensen, Deputy Secretary, DLLR
Michael Vorgetts, Acting Commissioner, DOPL
Barbara A. Kittrell, Director, Office of Budget and Fiscal Services, DLLR
Samuel K. Smith, Internal Auditor Officer, DLLR

PHONE: 410-230-6020 • FAX: 410-333-0853 • INTERNET: www.dllr.maryland.gov

MARTIN O'MALLEY, GOVERNOR • ANTHONY G. BROWN, LT. GOVERNOR • LEONARD J. HOWIE III, SECRETARY

**DEPARTMENT OF LABOR LICENSING AND REGULATION
DIVISION OF OCCUPATIONAL AND PROFESSIONAL LICENSING**

Agency Response to Audit Report
Audit Period: March 29, 2010 to April 3, 2013

Finding 1
Proper controls had not been established over certain collections.

Recommendation 1

- a. perform documented and independent verifications to ensure that all recorded collections were deposited (repeat),
- b. ensure employees involved with cash receipts processing are independent of the license application processing function (repeat),
- c. restrict access to the electronic record used to initially record cash receipt collections to only those employees requiring such access to perform their job duties, and
- d. comply with the State Treasurer's *Policy on the Use of Remote Deposit Services by Maryland State Agencies*.

We advised DOPL on accomplishing the necessary separation of duties using existing personnel.

Response – DLLR agrees with the recommendations:

- a. Effective April 15, 2014, the Division will work with departmental staff who possess specific knowledge and expertise to develop a comprehensive remediation plan that will allow existing personnel to accomplish the necessary separation of duties. Such plan will provide practical and realistic approach on how to perform documented and independent verifications to ensure that all recorded collections are deposited.

Specifically, a workgroup comprised of senior managerial staff will craft and implement the remediation plan. All relevant staff will be required to attend a series of training sessions where these individuals will be taught on how to perform documented and independent verifications to ensure that all recorded collections are deposited. After the training and expectations have been clearly communicated, spot checks will be conducted by specified Departmental staff and any individuals found to be in non-compliance will be subject to disciplinary actions on a progressive basis.

**DEPARTMENT OF LABOR LICENSING AND REGULATION
DIVISION OF OCCUPATIONAL AND PROFESSIONAL LICENSING**

Agency Response to Audit Report

Audit Period: March 29, 2010 to April 3, 2013

- b. As of January 1, 2014, the Division restricted the access of the individual who previously had access to the cash receipts collected by three boards and commissions and also had the ability to process and approve licenses online through the Division's automated licensing system. The Department advises that this finding has been remediated.

- c. On January 1, 2014, the Division requested the DLLR's Office of Information Technology to restrict access to specified electronic records used to initially record cash receipt collections to only those individuals who are required to perform their duties. All other employees will be restricted from accessing these records.

- d. As of January 1, 2014, the appropriate divisional staffs have received training on the State Treasurer's *Policy on the Use of Remote Deposit Services by Maryland State Agencies* on how to properly dispose of all checks that had been scanned into the remote deposit system. Employees in subsequent violation of the *Policy* will face progressive disciplinary actions.

**DEPARTMENT OF LABOR LICENSING AND REGULATION
DIVISION OF OCCUPATIONAL AND PROFESSIONAL LICENSING**

Agency Response to Audit Report

Audit Period: March 29, 2010 to April 3, 2013

Finding 2

DOPL had not established detail accounts receivable records and cash control accounts for the Home Improvement and the Real Estate Guaranty Funds.

Recommendation 2

- a. establish and maintain detail accounts receivable records and related control accounts for amounts due the Home Improvement and Real Estate Guaranty Funds, and periodically reconcile the control account balances to the related detail records (repeat); and**
- b. 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).**

Response – DLLR agrees with the recommendations:

Regarding Recommendations a and b, the Division has proposed to enhance the capabilities of its existing AS400 system to establish and maintain detailed accounts receivable records and cash control accounts respectively, for the two guaranty funds.

Specifically, the Division will augment its current AS400 information system to capture data relevant to the reconciliation of guaranty fund balances. The proposed system would incorporate additional data fields to capture revenues and disbursements made on behalf of licensees to complainants, and transfer bad debt accounts to the Central Collections Unit (CCU). This additional functionality will allow administrative staff to generate reports that will reflect actual and projected recoveries to the guaranty funds and allow a 'real-time' assessment of receivable status. In other words, the Division plans to program the AS400 to generate a specific cash control balance report for each guaranty fund. The cash balance control accounts will be maintained by the Division's budget and finance officer.

The augmentation to the AS400 may require collaboration with DLLR OIT and Procurement to determine specifications and possible contracted solicitations. The Division projects to implement this recommendation towards the end of the second quarter of fiscal year 2015, given sufficient funding.

**DEPARTMENT OF LABOR LICENSING AND REGULATION
DIVISION OF OCCUPATIONAL AND PROFESSIONAL LICENSING**

Agency Response to Audit Report

Audit Period: March 29, 2010 to April 3, 2013

Finding 3

DOPL did not always timely refer licensees to CCU for unreimbursed Guaranty Fund claims paid on the licensees' behalf.

Recommendation 3

We recommend that DOPL timely refer all delinquent accounts applicable to the Home Improvement and Real Estate Guaranty Funds to CCU as required (repeat).

Response – DLLR agrees with the recommendation:

The Real Estate Commission has purchased new complaint management software which will ultimately be used by the entire Division by April 15, 2014. This software includes capabilities for tracking, flagging, auto reminders and automatic letter generation. This software should significantly assist users in meeting their various time sensitive obligations including payout related suspensions and referrals to CCU referenced in this finding.

AUDIT TEAM

Matthew L. Streett, CPA, CFE
Audit Manager

Howard A. Marzolf III, CPA, CFE
Senior Auditor

Mary K. Davis, CPA
Staff Auditor