Audit Report

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

October 2010

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

Karl S. Aro
Executive Director

October 22, 2010

Bruce A. Myers, CPA
Legislative Auditor

Senator Verna L. Jones, Co-Chair, Joint Audit Committee
Delegate Steven J. DeBoy, Sr., 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 September 1, 2007 and ending March 28, 2010. DOPL licenses, regulates, and monitors 24 business occupations and professions in concert with 20 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 disclosed that DOPL needs to improve its accountability and control over collections received by six boards and commissions. DOPL should also establish additional controls over the Home Improvement and Real Estate Guaranty Funds, which according to the State's accounting records, had June 30, 2010 cash balances of $620,000 and $2.3 million, respectively. Specifically, accounts receivable and cash balance records for these Funds were either not established or not properly maintained.

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,

Bruce A. Myers, CPA
Legislative Auditor

Table of Contents

Background Information 4

Agency Responsibilities 4

Status of Compliance with Established Legislation 4

Status of Findings From Preceding Audit Report 5

Findings and Recommendations 6

Cash Receipts

* Finding 1 – Adequate Accountability and Control Had Not Been Established Over Certain Collections 6

Guaranty Funds

* Finding 2 – Adequate Accounts Receivable Records and Cash Balance Control Accounts Were Not Maintained 8

* Finding 3 – Appropriate Actions Were Not Taken Against Licensees That Failed to Reimburse the Funds for Claim Payments Made 9

Licensing

* Finding 4 – Audits of Continuing Education Requirements for Certain Renewal Licenses Were Not Comprehensive or Timely 10

Audit Scope, Objectives, and Methodology 12

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 24 business occupations and professions in concert with 20 boards and commissions whose members are appointed by the Governor. According to DLLR records, during fiscal year 2009, DOPL regulated more than 225,000 licensees. Furthermore, according to the State's records, DOPL's expenditures for fiscal year 2009 totaled approximately $10.2 million. These expenditures were funded by general funds ($4.6 million), licensing and exam fees ($4.3 million), and reimbursable funds received by DOPL ($1.3 million).

Status of Compliance with Established Legislation

1. The Public Safety Article, Section 12-826, of the Annotated Code of Maryland, effective October 1, 2001, required the Elevator Safety Review Board to license and regulate elevator mechanics and contractors operating within the State. As of June 2010, DOPL had applications on hand from individuals who applied for a license prior to January 2005; however, DOPL had not processed any of the applications to determine if the individuals met licensing qualifications, nor issued any licenses or collected any related licensing fees. We were advised by DOPL management that, prior to fiscal year 2009, the Elevator Safety Review Board, which was originally established in 2001, was dissolved due to a lack of authorized funding and, therefore, DOPL could not implement the required licensing function. The Board has been reestablished but, as of the end of fiscal year 2010, had not been fully appointed. DOPL did not receive full funding for the Board's activities until fiscal year 2010. We were advised that DOPL expects to begin issuing the required licenses by the end of fiscal year 2011.

2. The Business Occupations and Professions Article, Section 21-301, of the Annotated Code of Maryland, effective June 1, 2008, requires that individual tax preparers register with the State Board of Individual Tax Preparers. While we were advised that funding had been requested for fiscal years 2009 and 2010, we noted that the funding needed to establish the related registration process was not received until fiscal year 2011. According to DOPL management, it expects to begin registering individuals in the second half of fiscal year 2011.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the six findings contained in our preceding audit report dated October 6, 2008. We determined that DOPL satisfactorily addressed three of these findings. The remaining three findings are repeated in this report and appear as four findings.

Findings and Recommendations

Cash Receipts

Finding 1
Adequate accountability and control 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 six of the seven boards and commissions that we reviewed. According to its records, DOPL's various boards and commissions directly collected approximately $1 million during fiscal year 2009, of which these six boards and commissions collected $981,000. These receipts were subsequently forwarded to the Department of Labor, Licensing and Regulation (DLLR) – Office of the Secretary for further processing and deposit. The collections of the boards and commissions excluded receipts received through DLLR's online licensing system and via bank lockbox accounts, both of which were processed by DLLR – Office of the Secretary. Our review disclosed the following conditions:

- One of the boards and commissions did not record certain collections upon receipt and, therefore, did not verify that such collections were subsequently deposited. The prompt recordation of receipts and the validation of recorded receipts to deposit provide initial accountability and proper control over collections.

- Two employees, who had access to the cash receipts collected by these six boards and commissions, also had the ability to process and approve licenses online through DOPL's automated licensing system.

- Five of the boards and commissions reviewed did not perform independent verifications to ensure that all recorded collections were subsequently forwarded to the Office of the Secretary for further processing and deposit.

- Two employees who routinely processed certain cash receipts also had access to the related accounts receivable records for the Real Estate Guaranty Fund. As a result, these two employees could potentially misappropriate cash receipts and conceal the misappropriation by altering the accounts receivable records.

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 initial recordation of collections, the verification that recorded collections were forwarded to the Office of the Secretary, and the ability of certain employees to record collections and process licenses have been commented upon in our four preceding audit reports dating back to 1999.

Recommendation 1
We recommend that

a. **collections be recorded immediately upon receipt and that employees involved with cash receipts processing be independent of the license application processing function (repeat),**
b. **employees independent of the cash receipts function verify that all recorded collections were subsequently forwarded to the Office of the Secretary for further processing and deposit (repeat), and**
c. **employees who have access to cash receipts not also have access to the related accounts receivable records.**

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 Funds 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, as of June 30, 2010, the cash balances in the Home

Improvement Guaranty Fund and the Real Estate Guaranty Fund totaled approximately $620,000 and $2.3 million, respectively.

Finding 2
DOPL did not maintain adequate accounts receivable records and cash balance control accounts for the Home Improvement and Real Estate Guaranty Funds.

Analysis
DOPL did not maintain adequate accounts receivable records for the Home Improvement and Real Estate Guaranty Funds. Specifically, DOPL maintained a record of claims paid from the Home Improvement Guaranty Fund, which was used to monitor reimbursements from licensed home improvement contractors for claim payments and for penalties assessed against them for violations of State law; however, DOPL did not maintain detail accounts receivable records and a related control account for amounts due the Fund. DOPL also lacked detail accounts receivable records for certain amounts due the Real Estate Guaranty Fund and a related control account for all amounts due that Fund. In this regard, detail accounts receivable records were not maintained for amounts applicable to civil penalties assessed against licensed real estate brokers or salespersons who committed certain wrongful acts. While detail accounts receivable records were maintained for the related claim payments made from the Real Estate Guaranty Fund, these records were not accurately maintained. Our test of 10 fiscal year 2009 and 2010 claim payments totaling $136,000 that were made from the Real Estate Guaranty Fund disclosed that, as of May 2010, 5 payments totaling $51,000, which were made from February 2009 to February 2010, were not recorded as amounts due in the Fund's detail accounts receivable records. According to DOPL records, as of June 8, 2010, unreimbursed Real Estate Guaranty Fund claim payments totaled approximately $429,000.

In addition, as of June 2010, DOPL had not established a cash balance control account for the Real Estate Guaranty Fund. Furthermore, DOPL did not record certain cash transactions (such as claim payments and related reimbursements received) applicable to the Home Improvement Guaranty Fund to that fund's cash balance control account. As a result, DOPL could not periodically reconcile the Funds' respective cash balances with the State's accounting records to ensure that all related transactions were properly accounted for and recorded. As of April 30, 2010, the cash balance of the Home Improvement Guaranty Fund, according to DOLP's records ($886,218), exceeded the corresponding balance reflected in the State's accounting records ($717,376) by $168,842.

The failure to maintain accounts receivable records for the Home Improvement Guaranty Fund and a cash control account for the Real Estate Guaranty Fund was commented on in our two preceding audit reports.

According to DOPL's records, during fiscal year 2010, claim payments and civil penalty assessments for the Home Improvement Guaranty Fund totaled approximately $1,846,000 and $77,000, respectively. During the same period, claim payments and civil penalty assessments for the Real Estate Guaranty Fund totaled approximately $154,000 and $257,000, respectively.

Recommendation 2
We recommend that DOPL

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

b. establish and accurately maintain the 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 take appropriate action regarding licensees who had not reimbursed the Home Improvement or Real Estate Guaranty Funds for claims paid on the licensees' behalf.

Analysis
DOPL did not always timely refer delinquent accounts to the State's Central Collection Unit (CCU) and timely suspend certain licenses, as required. Our test of 20 fiscal year 2009 and 2010 claim payments, totaling approximately $286,000, made from the Home Improvement and Real Estate Guaranty Funds (10 payments from each totaling $150,000 and $136,000, respectively) disclosed the following conditions:

- Amounts owed from eight licensees, related to claim payments totaling approximately $118,000 made from the Guaranty Funds, were not referred to CCU until 31 to 229 days after they should have been. A similar condition was commented upon in our preceding audit report.

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. 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.

- DOPL did not timely suspend the licenses of two licensees, as required by State law, for which DOPL had made claim payments from the Real Estate Guaranty Fund totaling approximately $33,000. Specifically, DOPL did not suspend these two licenses until 35 and 180 days after the applicable Final Orders (the legal decisions) had been issued.

  State law requires that DOPL immediately suspend a real estate agent's license upon issuance of a Final Order and that any such license shall remain suspended until the licensee has fully reimbursed the Real Estate Guaranty Fund.

According to DOPL's records, during fiscal year 2010, disbursements (claim payments and refunds) made from the Home Improvement and Real Estate Guaranty Funds totaled $1,846,000 and $154,000, respectively.

Recommendation 3
We recommend that DOPL

a. timely refer all delinquent accounts applicable to the Home Improvement and Real Estate Guaranty Funds to CCU as required (repeat); and
b. upon issuance of a Final Order, immediately suspend the license of any real estate agent that fails to reimburse the Real Estate Guaranty Fund.

Licensing

Finding 4
DOPL did not always conduct timely audits of continuing education required for certain renewal licenses, nor take appropriate follow-up actions to ensure that licensees complied with those requirements.

Analysis
DOPL did not always conduct timely audits of the continuing education required for certain renewal licenses, and did not always take appropriate follow-up actions to ensure that licensees complied with those requirements. Our review of three

boards, which had continuing education requirements for their licensees, disclosed that adequate written policies or guidance for continuing education audits had not been established for two of them. For example, there were no procedures specifying how often such audits should be performed, the number of licensees to be included in each audit, and the actions that should be taken when a licensee fails to comply with the applicable continuing education requirements. As of June 30, 2010, the most recent audits of continuing education completed by one board were for renewal licenses issued during calendar year 2008. Furthermore, these audits disclosed instances in which board actions (such as license suspension) were not timely taken against licensees who had not completed the minimum required number of continuing education hours. We also noted instances in which a board employee improperly granted licensees additional time after the expiration of their respective continuing education periods to comply with the related requirements without board authorization.

State law specifies the continuing education requirements that must be met by applicants of the aforementioned boards prior to receiving a renewal license. The lack of a formal written policy regarding audits of continuing education requirements was commented on in our two preceding audit reports.

Recommendation 4

We recommend that DOPL establish, and comply with, a formal written policy specifying the frequency (for example, annually) with which audits of continuing education requirements are to be conducted, the number of licensees to be audited and the actions to be taken when licensees fail to comply with applicable continuing education requirements (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 September 1, 2007 and ending March 28, 2010. 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, guaranty funds, and special funds. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of DOPL's operations. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives. Data provided in this report for background or informational purposes were deemed reasonable, but were not independently verified.

Our audit did not include certain support services provided by the Department of Labor, Licensing and Regulation – Office of the Secretary. These support services (such as payroll, purchasing, data processing, maintenance of accounting records, and related fiscal functions) 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 Department of Labor, Licensing and Regulation – 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

STATE OF MARYLAND
DLLR
DEPARTMENT OF LABOR, LICENSING AND REGULATION

OFFICE OF THE SECRETARY
500 N. Calvert Street, 4th Floor
Baltimore, MD 21202

October 22, 2010

Mr. Bruce A. Myers, CPA
Legislative Auditor
Office of Legislative Audits
State Office Building
301 West Preston Street, Room1202
Baltimore, MD 21201

Dear Mr. Myers:

We are providing this letter as the official agency response to the final audit report comments and recommendations for the Department of Labor, Licensing and Regulation - Division of Occupational and Professional Licensing for the period beginning September 1, 2007 and ending March 28, 2010.

The preliminary audit activity to examine the Division's financial transactions, records and internal controls, and evaluating its compliance with applicable State laws, rules and regulations, was conducted professionally by staff from the Office of Legislative Audits in both onsite activities and during the exit conference with the Office of the Commissioner. The Agency and Division will work toward compliance with the report's recommendations in a manner outlined in the final responses and will be available to respond further to questions or comments from the Joint Audit Committee.

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 at (410) 230-6020.

Sincerely,

Leonard J. Howie, III
Deputy Secretary

cc: Stanley J. Botts, Commissioner, Division of Occupational and Professional Licensing
Daniel Savery, Director of Performance Management & Consumer Protection

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

Agency Response to Audit Report
September 1, 2007 to March 28, 2010

Finding 1
Adequate accountability and control had not been established over certain collections.

Recommendation 1
We recommend that

a. collections be recorded immediately upon receipt and that employees involved with cash receipts processing be independent of the license application processing function (repeat),
b. employees independent of the cash receipts function verify that all recorded collections were subsequently forwarded to the Office of the Secretary for further processing and deposit (repeat), and
c. employees who have access to cash receipts not also have access to the related accounts receivable records.

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

DOPL RESPONSE:

The Division accepts this finding and recognizes the vulnerabilities that are attendant to each of the specific items that has been outlined

Recommendation a- The Division has over 20 different sources of daily cash deposits. It is the policy of DOPL to assure that such deposits are made according to the pertinent guidelines for timely deposit and immediate recordation. Employees have been again counseled on these issues and each unit manager made directly accountable for performance in this regard. Performance criteria are being amended as necessary to make employees clearly accountable for timeliness and immediate recordation where these activities are part of job responsibilities. The identified problem regarding separation of duties (cash receipts versus license processing) has been caused by staff reductions and vacancy control related to cost containment, which leaves the central licensing process without a sufficient staffing level to accomplish the required separation of duties. Subsequent to the preceding audit, when this finding was made, DOPL had implemented separation as recommended. However that change was reversed by the reduction of staff. DOPL has requested the filling of a position that would allow the separation to again be put in place (although with no alternate or back-up capacity) and is making every effort

to additionally monitor operations in the absence of sufficient staffing to fully separate duties.

Recommendation b.-With respect to independent verifications of deposits, the Board of Public Accountancy (CPA) was found fully compliant with the recommended verification protocol. Accordingly, all programs have been directed to utilize the recording methodology developed by the CPA Board. That Executive Director conducts training for all Division managers with respect to proper documentation and verification of daily deposits. Each program manger will be required to certify compliance on a quarterly basis The Deputy Commissioner of DOPL or the Division's Budgetary Officer will periodically spot check to verify compliance. It is noted for the record that the deposit process now in place no longer involves the physical delivery of checks to the Office of the Secretary or the preparation of the traditional "deposit slip." Check scanners are now in place within the Division and deposits remotely accomplished without the physical delivery of checks to the depository institution. The deposit verification protocol is adjusted to reflect this change of process.

Recommendation c.-This recommendation addresses a finding involving separation of duties in the Real Estate Commission. Job responsibilities have been adjusted to fully comply with the separation requirements.

Finding 2
DOPL did not maintain adequate accounts receivable records and cash balance control accounts for the Home Improvement and Real Estate Guaranty Funds.

Recommendation 2
We recommend that DOPL

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

b. establish and accurately maintain the 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).

Recommendation a.-DOPL has established the detail accounts receivable records and control accounts for amounts due for the two guaranty funds. These accounts are maintained by the DOPL budget officer. Accounting is in place for FY 11 receivables and the Division will establish records incrementally for receivables from the preceding fiscal year and earlier as feasible.. The history of successful collections with respect to guaranty fund payouts has been and continues to be very limited, especially for the MHIC Guaranty Fund. For FY 2010, the official record maintained by the DLLR Office

of Budget and Fiscal Services discloses claims paid in the amount of $1,832,553 and central collections receipts $114,627. Direct reimbursement recorded by the MHIC totaled $119,691 for FY 10.

Recommendation b.-DOPL has established the cash control accounts as recommended, using the Guaranty Fund Balances reported by the DLLR Office of Budget and Fiscal Services on June 30, 2010 as a baseline The DOPL budget officer will maintain the account and conduct the periodic reconciliation with State accounting records on a quarterly basis.

Finding 3
DOPL did not always take appropriate action regarding licensees who had not reimbursed the Home Improvement or Real Estate Guaranty Funds for claims paid on the licensees' behalf.

Recommendation 3
We recommend that DOPL

a. timely refer all delinquent accounts applicable to the Home Improvement and Real Estate Guaranty Funds to CCU as required (repeat); and
b. upon issuance of a Final Order, immediately suspend the license of any real estate agent that fails to reimburse the Real Estate Guaranty Fund.

The Executive Director's of both the Home Improvement and Real Estate Commissions now certify on a quarterly basis to the Commissioner that both the referrals to CCU of delinquent accounts and the suspension of licensees who have failed to reimburse the Funds have occurred within specified time frames. The Directors are counseling any employee with these responsibilities as to the critical nature of timely compliance. Employee performance criteria are being as altered as appropriate to reflect timeliness as a measure of performance.

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

Finding 4
DOPL did not always conduct timely audits of continuing education required for certain renewal licenses, nor take appropriate follow-up actions to ensure that licensees complied with those requirements.

Recommendation 4

We recommend that DOPL establish, and comply with, a formal written policy specifying the frequency (for example, annually) with which audits of continuing education requirements are to be conducted, the number of licensees to be audited and the actions to be taken when licensees fail to comply with applicable continuing education requirements (repeat).

Effective April 1, 2010, DOPL moved to a new process of automatic auditing of continuing education that is contemporaneous with the renewal process and is hard coded in the DLLR E-licensing system. The Executive Director of each licensing program that requires continuing education determines a sample size for renewing licensees in that profession. Consistent with that sample, the computer randomly selects renewing licensees after their affirmation and payment of the renewal fee, and notifies that they have been selected for audit. This notice is part of the confirmation screen that appears immediately after the licensee executes the transaction. The notice instructs the individual to forward the requisite documentation of course completion as specified.

This change eliminates timeliness or frequency issue as there is no lag time between renewal and audit. Claims of lost documentation have diminished. Audits are integrated into the normal flow of work rather than becoming a burdensome "special project" that is difficult to complete. Licensees often comply within twenty four hours of the electronic notice. The system allows each Director to track each selectee as they are determined compliant or moved into the particular Board's disciplinary process.

The Division has counseled the affected Boards and Commissions regarding their obligation to address the status of non-compliant licensees consistent with the provisions of their individual statutes and the range of sanctions available to them. Each has a policy in place and that policy is reflected in writing in the draft administrative/procedures manual currently being finalized for each operational unit of the Division.

AUDIT TEAM

Peter J. Klemans, CPA
Audit Manager

Robert A. Wells
Senior Auditor

Carey L. Harper
Staff Auditor