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An Audit Report on
**The Office of Consumer Credit
Commissioner**

September 2008
Report No. 09-003



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Office of Consumer Credit Commissioner

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Overall Conclusion

The Office of Consumer Credit Commissioner (Office) provides reasonable assurance that lenders comply with state and federal statutes and rules when providing loans and services to Texans by examining financial transactions, resolving complaints, and conducting investigations.

The Office's examination process ensures the regulatory compliance of licensees. The Office has well documented policies and uses a risk-based process to schedule examinations. However, the Office could strengthen its procedures for the submission and processing of examination reports, and it could take steps to ensure that all examination reports receive a supervisory review in a timely manner.

The Office's complaint resolution process complies with its policies and procedures and most regulatory best practices. This includes complaints that are escalated to investigations. However, the Office could improve its process by allowing consumers to call in complaints after business hours. In addition, the Office could improve its review of complaint information and its process for addressing complaints that are open for more than 90 days.

Since fiscal year 2003, the Office has licensed motor vehicle sales finance dealers (dealers) that issue credit. The Office adequately regulates these dealers by accepting and resolving complaints, performing examinations, and conducting investigations. In addition, the Office actively seeks out non-licensed dealers to bring them into compliance with state and federal regulations.

The Office adequately gathers most of the required documentation to process dealer applications. However, the Office licensed some license applicants without receiving criminal history check results from the Federal Bureau of Investigation (FBI), as required by the Texas Administrative Code. The Office does not

Background Information

The Office of Consumer Credit Commissioner (Office) was established in 1963. The Office is responsible for regulating pawnshops, motor vehicle sales finance dealers, and non-depository consumer lenders for the following transactions:

- Home equity loans.
- Secondary mortgages.
- Home improvement loans.
- Motor vehicle sales financing.
- Pawnshop transactions.
- Signature loans.
- Payday loans.
- Consumer installment loans.
- Retail credit accounts.

The consumer credit commissioner is appointed by the Finance Commission of Texas and serves at the will of the commission.

As of February 2008, the Office regulated 3,853 non-depository consumer lenders; 5,916 motor vehicle sales finance dealer locations; and 1,513 pawnshops, including 6,825 pawnshop employees. The Office was appropriated \$4,203,499 for fiscal year 2007 and \$5,191,352 for fiscal year 2008. It had budgeted 80 full-time equivalent employees in fiscal year 2008.

consistently receive this information because the FBI or the Department of Public Safety (DPS) rejects submitted fingerprint cards due to the poor quality of the fingerprints submitted by the license applicants. The Office also is not receiving continuous background check information on licensees for whom submitted fingerprint cards have been rejected. DPS estimates that there is a 25 percent rejection rate for traditional ink cards.

Summary of Management's Response

The Office generally agrees with the findings and recommendations in this report.

Summary of Information Technology Review

Auditors reviewed the general information technology controls and application controls over the Office's document imaging system (system). That system stores electronic versions of examinations and criminal history check information on license applicants. The Office has adequate controls in place to ensure the reliability, validity, and accuracy of the system's data.

Auditors also followed up on information technology-related recommendations in *An Audit Report on Performance Measures at the Office of Consumer Credit Commissioner* (State Auditor's Office Report No. 07-039, July 2007). The Office has substantially implemented controls to address three of six recommendations. It has not implemented the other recommendations because of cost considerations and other factors.

Summary of Objectives, Scope, and Methodology

The objectives of this audit were to:

- Determine whether the Office's examination process provides reasonable assurance that licensed and registered lenders comply with state and federal statutes and rules when providing loans and services to Texans.
- Determine whether the Office addresses complaints in accordance with its policy and best practices, including reclassifying complaints as investigations when appropriate.
- Monitor the Office's progress in regulating motor vehicle sales finance dealers.

The scope of this audit included examinations, complaints, and investigations that occurred from September 1, 2006, to February 29, 2008. The scope of this audit also included the Office's processes for licensing motor vehicle sales finance dealers.

The audit methodology included collecting and reviewing documentation, conducting interviews with Office staff, reviewing and assessing policies and procedures, analyzing and evaluating the results of testing, and observing processes. Auditors evaluated controls and data related to examinations completed, complaints received and closed, and motor vehicles sales finance dealers licensed to assess for compliance with statutes and the Office's policies and procedures.

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Detailed Results

Chapter 1

The Office's Examination Process Reasonably Ensures That Lenders Comply with State and Federal Statutes and Rules

The Office of Consumer Credit Commissioner's (Office) examination process reasonably ensures that licensed lenders comply with state and federal statutes and rules. However, it could strengthen its procedures for examination report submission and processing. The Office could also take steps to ensure that all examination reports receive a supervisory review in a timely manner.

Examination Process

The steps in the Office's examination process include:

- The field supervisor creates a monthly schedule of examinations to be conducted using a risk-based formula.
- An examiner conducts an examination and gives the report to the licensee.
- An examiner scans the report into the Office's imaging system.
- An administrative technician processes the report by (1) verifying the licensee information in the hard-copy report against the information in the Office's licensing database and (2) entering exam results into the Office's examination database.
- A review examiner reviews the report for substantive issues.
- The licensee responds to special instructions from the report, if any.
- The Office closes the examination.

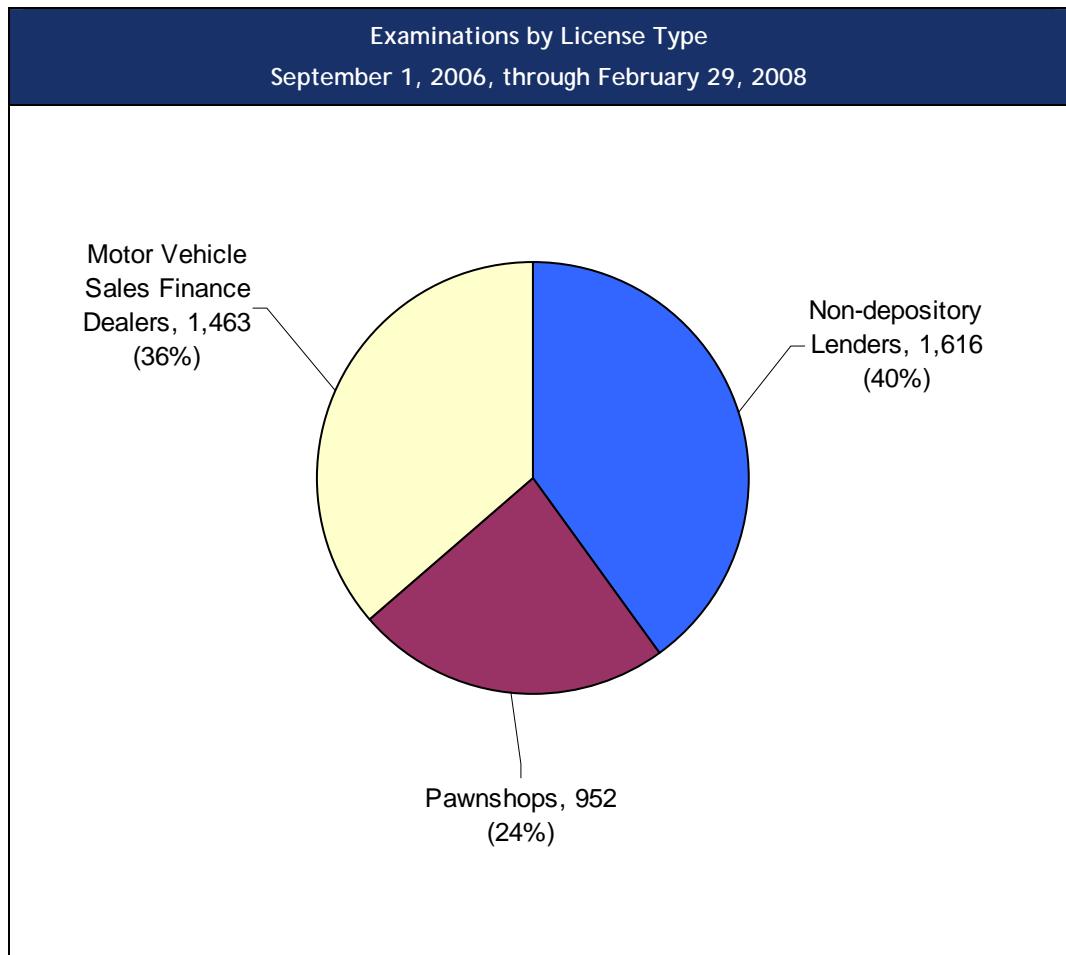
The Office's examination process ensures the regulatory compliance of licensees.

The Office has well documented procedures that guide its examination process of licensees. To schedule examinations, the Office uses a risk-based process that includes but is not limited to a licensee's geographical location, previous examination rating, and length of time since previous examination or licensure. The Office gives priority to examining motor vehicle sales finance dealers (dealers) because of the large number of new dealer businesses licensed through the Office since fiscal year 2003, when the Office began licensing dealers (see Chapter 3 for more information).

The Office conducted 4,031 examinations from September 1, 2006, through February 29, 2008; 92 percent of these examinations gave the licensee an acceptable rating. Of the

total examinations performed during that period, 40 percent were of non-depository lenders, 36 percent were examinations of dealers, and 24 percent were of pawnshops (see Figure 1 on the next page). Accounting for some licensees that were examined more than once, the Office conducted an examination of 3,630, or 31 percent of active licensees, during the same time period.

Figure 1



Source: Office of Consumer Credit Commissioner.

Each examination is guided by a template that identifies the specific areas that must be assessed for compliance, along with the supporting state statute and federal code citations. This template was created by the Office to add consistency to the examination and report writing process. All 55 examination reports that auditors tested were correctly completed in the field by the examiner.

The Office did not ensure that examinations were consistently processed or reviewed in a timely manner.

According to Office procedures, examiners in the field should transmit their reports on a weekly basis to the Austin headquarters. The Office took an average of 12 calendar days to process the examinations conducted between September 2006 and February 2008. However, 13 of 55 (24 percent) examination reports tested took longer than 100 days to be processed because examiners did not submit their reports in a timely manner. Eight of the 13 (62 percent) examinations took longer than average to process because of errors

made by a new examiner. The other five reports were part of larger consolidated examinations of multiple licensees, which require more time to complete than examinations of individual licensees.

Office management stated they have an informal policy requiring a supervisory review to be conducted for every examination report. New examiners must have their reports reviewed by a review examiner prior to the reports being given to the licensee. However, of the 55 examination files auditors tested, only 33 (60 percent) had received a supervisory review. As of February 29, 2008, the Office had a backlog of 2,093 examinations that needed to be reviewed, some of which dated back to 2005. The Office currently has only one employee who reviews examinations on a full-time basis. In addition, the Office lacks a formal written policy stating that all examinations must receive a supervisory review and written procedures to guide the examination review process.

Recommendations

The Office should:

- Ensure that examiners in the field submit examination reports to the Office's Austin headquarters on a timely basis.
- Continue to work toward providing a supervisory review of examinations in a timely manner while also working to reduce its backlog of examination reviews.
- Draft formal policies and procedures to guide the examination review process.

Management's Response

The agency generally agrees with the finding and recommendations; the Director of Enforcement will be responsible for the required modifications and implementation. The amended policies and procedures will be in place by October, 2008.

- Some examination reports may not be submitted in the week following the actual field work under legitimate expected situations. These situations relate to out of state examinations, centralized records examinations of multi-license organizations, or other complex examination situations.

The agency has amended its processing procedure to include additional steps to assure that all completed examination reports are submitted on a timely basis.

- *The agency will devise a methodology for selecting examinations for review that will substantially reduce its backlog in Fiscal Year 2009. Specific goals have been established for each of the examiners conducting examination reviews and the 3 supervising examiners will be assigned the additional duty of accomplishing the examination report reviews.*
- *The agency will draft a policy and procedural document to guide the review of examination reports. Further, the agency will formalize and document the review process of new examiners.*

The Office Addresses Complaints in Accordance with Its Policies and Procedures

The Office's complaint resolution process complies with its policies and procedures and most regulatory best practices. This includes complaints that are escalated to investigations. However, the Office could improve its process by allowing consumers to call in complaints after hours. In addition, the Office could improve its adherence to policy and procedures regarding the review of complaint information entered into its database and improve its process for addressing complaints that are open for more than 90 days.

The Office's policies and procedures are aligned with most regulatory best practices.

The Office's detailed written policies and procedures for its complaint process substantially align with the National State Auditors Association's (NSAA) best practices for a regulatory agency. The Office has established:

- Methods for receiving complaints that include providing information on its Web site, allowing complaints to be submitted formally or informally, collecting complaint information, taking anonymous complaints, and screening complaints.
- Appropriate policies and procedures for maintaining the confidentiality of complaints and pending investigations.
- Requirements to determine which complaints need action.
- A process for investigating complaints, as needed.
- A process of providing timely feedback to complainants.
- A process for tracking and overseeing complaints.
- A process for maintaining complaint records.

However, the Office has not established a process that allows a consumer to call in complaint information outside regular business hours. When a consumer calls the Office after business hours to file a complaint, a recording directs the consumer to call back during regular business hours. According to NSAA best practices, regulatory agencies should establish a complaint-handling process that allows complaints to be filed outside regular business hours.

The Office could strengthen its consistency in adhering to certain complaint procedures.

Between September 2006 and February 2008, the Office received 3,730 written complaints; the Office took an average of 27 days to close these complaints. The Office ensured that the receipt of a complaint is consistently logged; however, it did not sufficiently ensure that complaint information is accurately entered into its database and reviewed. Specifically:

- Of the 60 complaints tested, all 35 that were required to be logged were logged in upon receipt at the Office.¹
- Eight of 30 (27 percent) complaints tested for accuracy were not correctly entered into the Office's database.
- Of the 23 complaints tested that required data entry review, 8 (35 percent) lacked evidence of a data entry review.²

The Office's policy states that information entered into the complaint database must be reviewed by another employee and that this review should be documented.

In addition, the Office did not consistently document the reasons a complaint took longer than 90 days to close. Office procedures state that if a complaint is open for more than 90 days, complaint technicians must document the reason for the delay in the complaint database. Of the 30 complaints that auditors tested, 9 (30 percent) were open for longer than 90 days. Five of these nine complaints (56 percent) did not have a reason for the delay documented in the database. From September 2006 through February 2008, the Office had 95 complaints that took longer than 90 days to close. The 90-day benchmark is a performance measure for which the Office calculates the number of written complaints closed within 90 days.

Complaints that were escalated into investigations were addressed in accordance with the Office's policies and procedures. Five of the 30 complaints tested were escalated into investigations. All five contained documentation of the reason that the complaint was escalated into an investigation, as well as the disposition of the investigation.

¹ The Office began logging in complaints in September 2007. The initial sample of 30 contained only 5 complaints received after September 2007. Therefore, auditors expanded their testing sample for this attribute to 60 complaints.

² The Office began requiring data entry review of complaints in October 2007.

Recommendations

The Office should:

- Provide a way for consumers to call in a complaint after regular business hours.
- Ensure that all data entered into the complaint database is accurate and is reviewed for accuracy and completeness.
- Ensure that complaint technicians document the reason for delay in its database for all complaints that are not closed within 90 days.

Management's Response

The agency generally agrees with the finding and recommendations; the Director of Enforcement will be responsible for the required modifications and implementation.

- The agency currently allows consumers to submit complaints outside regular business hours. Complaints can be submitted via the fax or e-mail. In an attempt to provide better customer service, the agency will amend its 800 line phone message to advise consumers that complaints can be submitted by fax or email at any time of the day or week. This advisory notice will be completed by November, 2008. The agency notes that its call volume outpaces its complaint volume by approximately 25 times and thus after hours access raises concerns about cost and effectiveness.

The agency will implement a pilot project allowing consumers to leave messages on the agency's consumer hotline during non-business hours. We will evaluate the effectiveness, staff resource issues, and ultimate feasibility related to the increased consumer access. If a cost-effective, workable process can be achieved, the agency will implement it by September, 2009.

- The agency recently amended its procedures, relating to the accuracy of complaint information in the agency's database, in response to the State Auditor's Office audit of the agency's Performance Measure in fiscal year 2007. The accuracy exceptions found during the current audit occurred primarily during implementation of the procedural changes. The agency has reviewed and amended the procedure to assure accuracy and appropriate review of complaint information in the agency's database.

- The agency will amend its policy and procedures regarding written complaints not closed within 90 days. This amendment will require that an appropriate explanation be placed in the database record indicating why a complaint extended past 90 days before being closed.

The Office Adequately Regulates Motor Vehicle Sales Finance Dealers

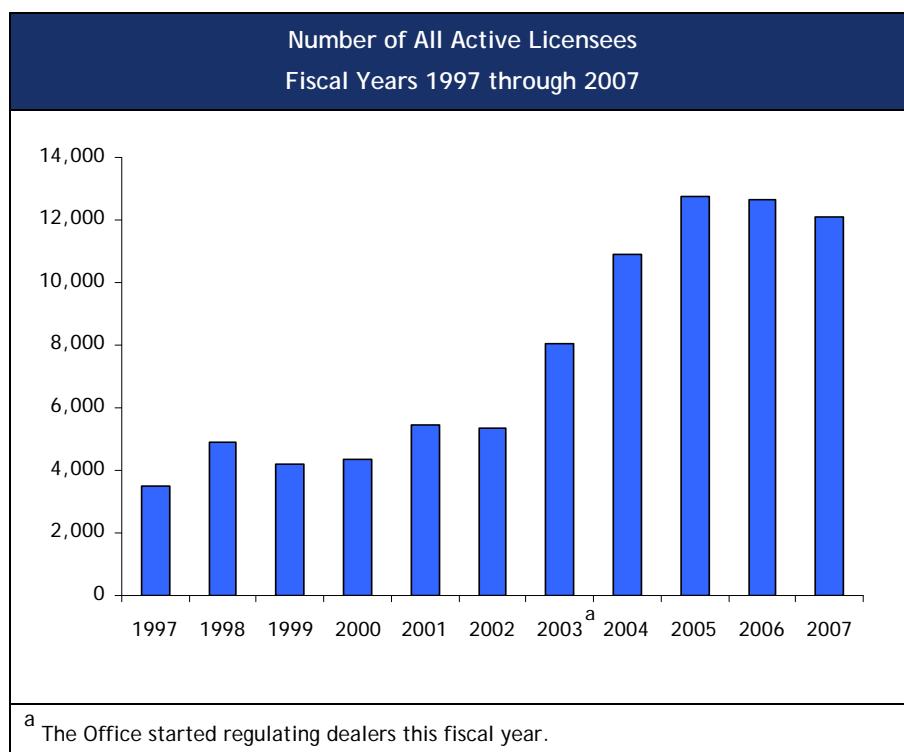
The Office has made progress in regulating motor vehicle sales finance dealers (dealers) since fiscal year 2003, when the Legislature mandated that the Office start licensing these dealers. The Office adequately regulates dealers by accepting and resolving complaints, performing examinations, and conducting investigations. In addition, the Office actively seeks out non-licensed dealers to bring them into compliance with state and federal regulations.

The Office adequately gathers most of the required documentation to process dealers' license applications. However, as discussed in Chapter 4, it could strengthen its licensing process by obtaining complete criminal history checks for its applicants.

The Office regulates dealers through licensing and compliance functions.

The Office performed 1,463 examinations of dealers from September 2006 through February 2008, representing 36 percent of all the examinations the Office performed during that time period. As of February 2008, the Office has added 7,292 active dealer licensees to its oversight. Figure 2 shows the increase in the number of total active licensees from fiscal year 1997 through fiscal year 2007.

Figure 2



Source: The Office of Consumer Credit Commissioner Strategic Plan 2009-2013.

From September 2006 through February 2008, the Office addressed and closed 1,617 complaints against dealers, representing 43 percent of all complaints the Office received during that period. The Office also investigated 57 dealers during this time period, which represented 52 percent of all investigations the Office performed. As discussed in Chapter 1 and Chapter 2, the Office adequately monitored its licensees through its examination process and addressed complaints in accordance with its policies and procedures.

The Office actively seeks out non-licensed dealers to bring them into compliance with state and federal regulations.

The Office actively seeks out non-licensed dealers operating in the state of Texas to bring them into compliance with state and federal regulations. The Office identifies these non-licensed dealers in several ways. These include:

Dealer Sweeps

The Office, Texas Department of Transportation, and the Office of the Comptroller of Public Accounts coordinate to select a location that contains multiple dealers to "sweep." Staff from each of these agencies participates in the sweeps, which start at one end of the street and proceed to the other end, verifying dealers business activities. If any business is found to be in violation of governing statutes, the appropriate oversight agency will instruct the business on how to come into compliance.

- Complaints initiated by consumers and/or other dealers.
- Examinations of finance companies that have activity with a non-licensed dealer.
- Partnerships with other state agencies. According to the Office, it partners with the Texas Department of Transportation³ and the Office of the Comptroller of Public Accounts⁴ to conduct "sweeps" to identify non-licensed dealers (see text box).

In addition, the Office began comparing its licensing database to the Texas Department of Transportation's licensing database. As a result of this comparison, the Office recently implemented a process of sending out requests for information regarding possible non-licensed dealers. The Office sent 150 letters to a sample of dealers identified in the San Antonio area. Office management estimated that of the 150 letters sent to possible non-licensed dealers, 20 resulted in a dealer applying for a license since April 2008.

If a dealer is discovered to be operating without a license, the Office will request that the dealer:

- Pay a late filing fee of \$10,000,
- Pay an administrative penalty of less than \$10,000, if an agreed order is negotiated between the dealer and the Office, or

³ The Texas Department of Transportation issues licenses to dealers to buy, sell, or exchange motor vehicles; however, the Department of Transportation's licensing authority does not extend to retail installment agreements.

⁴ The Office of the Comptroller of Public Accounts issues sales tax permits to businesses.

- Refund to the consumer any finance charges collected by the dealer while the dealer was not licensed.

The Office could strengthen its process for licensing dealers.

The Office licenses dealers to ensure their compliance with state statutes and rules and federal regulations. From September 2006 through February 2008, the Office licensed 1,473 dealers. Auditors tested 30 dealer licensing files and found that:

- All files tested had the required documentation to complete an application, such as the license application, employment history, personal affidavit, and a Department of Public Safety (DPS) criminal history check. However, as discussed in Chapter 4, the Office did not consistently receive FBI criminal history checks due to the poor quality of the fingerprints cards submitted by the license applicants.
- All files contained evidence of an initial review and a supervisory review by the Commissioner.

Recommendations

The Office should:

- Continue its efforts to identify non-licensed dealers and bring them into compliance with state and federal regulations.
- Collect all required documentation for licensing dealers.

Management's Response

The agency generally agrees with the finding and recommendations; the Director of Administration will be responsible for any required modifications and implementation.

- The agency will continue its efforts to identify unlicensed dealers. Identifying and bringing unlicensed entities into compliance, is one of the agency's key priorities and will be a continual on-going process.

- The agency will seek to strengthen its process for licensing dealers, as appropriate. The agency will continue its process to collect all required documentation for license applications.

The Office Could Strengthen Its Licensing Process for Receiving Criminal History Background Information

Texas Administrative Code

Section 84.613: Upon submission of an application for a license, a principal party of an applicant for a license is investigated by the commissioner. In submitting an application for a license, a principal party of an applicant for a license is required to provide fingerprint information to the commissioner. Fingerprint information is forwarded to the Texas Department of Public Safety and to the Federal Bureau of Investigation to obtain criminal history record information. The commissioner will continue to receive information on new criminal activity reported after the fingerprints have been processed.

Section 84.602 (2) (A) (i): For all persons meeting the definition of "principal party" as defined in Section 84.601 of this title, a complete set of legible fingerprints must be provided. All fingerprints should be submitted in a format prescribed by the OCCC and approved by the Texas Department of Public Safety and the Federal Bureau of Investigation.

Principal Parties

A **principal party** is an individual with a substantial relationship to the proposed business of the applicant. The following individuals are considered to be principal parties:

- Proprietors, including spouses with community property interest.
- General partners.
- Officers of privately-held corporations, including the chief executive officer or president, the chief operating officer or vice president of operations, and those with substantial responsibility for operations or compliance with Texas Finance Code, Chapter 348.
- Directors of privately held corporations.
- Individuals associated with publicly held corporations.

Source: Title 7, Texas Administrative Code, Section 84.601.

The Office licensed some license applicants without receiving criminal history check results from the Federal Bureau of Investigation (FBI), as required by the Texas Administrative Code (TAC) (see text box). The Office did not consistently receive this information because the FBI or DPS rejected submitted fingerprint cards due to the poor quality of the fingerprints submitted by the license applicants. In addition, the Office is not receiving continuous background check information on licensees for which submitted fingerprint cards were rejected. DPS estimates that there is a 25 percent rejection rate for traditional ink fingerprint cards

Applicants did not always submit legible fingerprint cards.

The Office requires all applicants for licenses to submit fingerprint cards as part of their application documentation. The Office submits these cards to DPS for a statewide background check, then DPS forwards the cards to the FBI for a national criminal history check. The Office receives the results of both checks electronically, Office staff reviews these results, and the Commissioner approves or rejects the applicant's request for a license.

In 11 of 30 (37 percent) dealer licensing files tested, the FBI did not conduct criminal history checks for at least one of the principal parties listed on the application because fingerprint cards submitted by the applicants were illegible. Additionally, 7 of the 11 fingerprint cards rejected by the FBI also were rejected by DPS (see Appendix 3 for examples of these rejections). The Office did perform name-based checks on these applicants using the DPS criminal history check secure Web site. As a result, the Office received criminal history checks for all 30 applicants tested. However, these criminal history checks do not contain national criminal history information. In all 30 files that auditors tested, the Office approved licenses for the applicants.

The TAC requires that a complete set of legible fingerprints must be provided by all persons meeting the definition of principal party (see text box for definition). In addition, all fingerprints should be submitted in a format prescribed by the Office and approved by DPS and the FBI.

The Office is not receiving continuous DPS background check information on licensees for which submitted fingerprint cards have been rejected.

The TAC also requires the Office to receive new criminal history information after fingerprints have been processed. DPS flags principal parties for continuous checks when it processes fingerprint cards. These continuous checks ensure that the Office is notified about any new reported criminal activity committed by the principal parties that occurs in Texas. However, if the fingerprint cards are rejected, then these licensees are not flagged for continuous monitoring and the Office does not receive continuous criminal history checks. In 7 of 30 (23 percent) files tested, the Office was not receiving continuous background check information for at least one principal party.

Recommendations

The Office should ensure that:

- All licensees receive a complete criminal history check upon applying for a license.
- It does not issue a license to any applicant or principal party unless the Office has a completed criminal history check on file.
- Continuous criminal history checks are performed on applicants whose fingerprints are rejected.

Management's Response

The agency generally agrees with the finding and recommendations; the Director of Administration will be responsible for the required modifications and implementation.

- The agency has not approved an application without receiving some type of criminal background check on the principal parties of the applicant. Sometimes the criminal background check is a “Name Check” from the Department of Public Safety. “Name Checks” are conducted when the fingerprints provided to the agency, from the applicant, are rejected twice by both the Department of Public Safety and the Federal Bureau of Investigations. The agency has been instructed by both the Department of Public Safety and the Federal Bureau of Investigations to only submit fingerprints twice for an individual. Upon rejection of the second set of fingerprints the agency conducts a “Name Check” through the Department of Public Safety, on the rejected individual.

The agency, in an attempt to reduce the low number of fingerprint rejections, will contact the Department of Public Safety and begin discussions to determine the feasibility and requirements of implementing electronic

fingerprint submissions to reduce the number of rejected fingerprint submissions. If feasible the agency will implement the electronic submission by September, 2009.

The Office's Document Imaging System has Adequate Controls and the Office has Implemented Some Prior State Auditor's Office Recommendations

The Office's document imaging system (system) has adequate controls to ensure the reliability, validity, and accuracy of the system's data. The Office's system stores electronic versions of examinations and criminal history check information on license applicants.

In addition, the Office has substantially implemented controls to address three of six information technology-related recommendations made in *An Audit Report on Performance Measures at the Office of Consumer Credit Commissioner* (State Auditor's Office Report No. 07-039, July 2007). As a result, the Office has improved (1) its process for assigning and deleting user access and (2) its ability to protect backed up data and to conduct a successful system recovery in the event of an emergency. The Office has not implemented the other remaining recommendations because of increased costs or a lack of functionality within the databases reviewed during that audit (see Table 1 on the next page).

Table 1

Status of Implementation of State Auditor's Office Prior Audit Recommendations			
Recommendation	Summary of Office's Original Response to Recommendation	Substantially Implemented (Y or N)	Auditors' Assessment
Strengthen user access controls to the Complaint, Licensing and Examination, and Employee Pawnshop databases by developing written policies and procedures for passwords.	The Office will amend its policies and procedures to document the process of assigning passwords for its databases.	N	The process used to assign passwords <u>has not changed</u> since the prior audit. The Office continues to use an older legacy system that does not give individual users the right to change their own passwords.
Develop a process for assigning and deleting user access.	The Office will amend its procedures to better document the addition and deletion of users.	Y	The Office <u>has implemented changes</u> to document the addition and deletion of user database access by developing an employee access request form.
Expand the audit trail function of the databases to identify all edits made to data files. The audit trail should record a timestamp, user id, and a comment field listing the reason for the modification. The audit trail also should include a way to track corrections that currently cannot be made by end users, but must be made by Information Resources or the director of administration.	This functionality is not feasible due to the cost and capabilities of the Office's database.	N	The Office <u>has not made any changes</u> to its database that would allow for more comprehensive audit trail records. As stated in the Office's response to the finding, the cost of adding this functionality to its database is excessive.
Use heat or smoke detection systems in the server room to minimize the risk of fire damage to the Office's server room.	This additional detector is not feasible due to cost and the capability of the current system.	N	The Office <u>has not installed</u> a fire detection system or smoke detector in the server room: 1) The server room does not have a smoke detector. 2) The fire break wall does not extend to the actual ceiling. The Office asserts that this would require additional construction cost.
Store daily back-ups in a place that would protect them from fire or water damage.	The Office will implement a procedure for storage of the differential back-ups in the agency's fireproof safe.	Y	The Office <u>has installed</u> a small fireproof and waterproof safe in the server room, which contains daily back-up tapes.
Enhance its disaster recovery plan to include specific information about how to carry out the plan, as well as after hours contact information for Office personnel and information for contacts outside the Office.	The Office will enhance its disaster recovery plan.	Y	The Office <u>has addressed two of the three</u> recommendations. The Office has not provided after hours contact information for Office personnel.

Source: Recommendations made in *An Audit Report on Performance Measures at the Office of Consumer Credit Commissioner* (State Auditor's Office Report No. 07-039, July 2007).

Recommendations

The Office should:

- Implement recommendations made in the July 2007 State Auditor's Office report, where feasible.

Management's Response

The agency generally agrees with the finding and recommendations; the Director of Administration will be responsible for the required modifications and implementation.

- Of the items outstanding from the prior audit, the agency has or is in the process of implementing two additional items, after-hours numbers for key personnel and smoke detector in the server room. The agency has added the after-hours contact numbers for key personnel to its disaster recovery plan. The fire detection system, in the Finance Commission building, recently was significantly upgraded. As a part of this upgrade the agency requested that a smoke detector be installed in its server room. The updated system is in the final stages of being replaced and should be completed by October, 2008.

The two remaining items from the prior audit relate to the agency's database, complex password requirement, and audit trail functionality. This functionality is still not feasible due to the cost and capabilities of the agency's database.

Appendices

Appendix 1

Objectives, Scope, and Methodology

Objectives

The objectives of this audit were to:

- Determine whether the Office of Consumer Credit Commissioner's (Office) examination process provides reasonable assurance that licensed and registered lenders comply with state and federal statutes and rules when providing loans and services to Texans.
- Determine whether the Office addresses complaints in accordance with its policy and best practices, including reclassifying complaints as investigations when appropriate.
- Monitor the Office's progress in regulating motor vehicle sales finance dealers.

Scope

The scope of this audit included examinations, complaints, and investigations that occurred from September 1, 2006, to February 29, 2008. The scope of this audit also included the Office's processes for licensing motor vehicle sales finance dealers.

Methodology

The audit methodology included collecting and reviewing documentation, conducting interviews with Office staff, reviewing and assessing policies and procedures, analyzing and evaluating the results of testing, and observing processes. Auditors evaluated controls and data related to examinations completed, complaints received and closed, and motor vehicle sales finance dealers licensed to assess compliance with statutes and the Office's policies and procedures.

Information collected and reviewed included the following:

- Policies and procedures for examinations of, complaints about, and licensing of lenders in Texas.
- Data on examinations completed, complaints received, and motor vehicle sales finance dealers licensed.
- Training curriculum for new examiners.

- Examination, complaint, and licensing files.

Procedures and tests conducted included the following:

- Analyzed examination data and compared across licensee types with regard to the ratings received and the length of time since previous examination.
- Analyzed complaint and investigation data and compared across licensee type with regard to number of complaints received and length of time for complaint resolution.
- Analyzed motor vehicle sales finance dealers licensee data to determine examination coverage.
- Tested examinations using judgmental sampling to ensure that the examinations were properly completed and processed.
- Tested complaint files using judgmental sampling to ensure that the complaints were addressed in accordance with the Office's policies.
- Tested motor vehicle sales finance dealers' license files using judgmental sampling to ensure that the licenses were processed correctly.
- Followed up on previous information systems findings in *An Audit Report on Performance Measures at the Office of Consumer Credit Commissioner* (State Auditor's Office Report No. 07-039, July 2007).
- Reviewed general and application controls for the Office's document imaging system used to store examinations.

Criteria used included the following:

- Texas Finance Code, Chapters 14, 342, 348, and 371.
- Title 7, Texas Administrative Code, Chapter 84.
- Title 1, Texas Administrative Code, Chapter 202.
- *Carrying Out a State Regulatory Program*, National State Auditors Association best practices document, 2004.
- The Office's policies and procedures.

Project Information

Audit fieldwork was conducted from May 2008 through July 2008. We conducted this performance audit 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.

The following members of the State Auditor's staff performed the audit:

- Michael A. Simon, MBA, CGAP (Project Manager)
- Michael F. Boehme, CIA, PHR (Assistant Project Manager)
- W. Chris Ferguson, MBA
- Brian K. Jones, CGAP
- Gary L. Leach, MBA, CISA, CQA (Information Systems Audit Team)
- J. Scott Killingsworth, CIA, CGFM, CGAP (Quality Control Reviewer)
- Lisa R. Collier, CPA (Assistant State Auditor)

Transactions Regulated by the Office

Home Equity Loans: Home equity loans allow borrowers to use the market value of a home as collateral for a loan. Loans secured by real estate generally are considered safer by lenders, resulting in lower interest rates than for other types of loans.

Secondary Mortgages: Also known as *second lien* or *junior lien* mortgages; secondary mortgages are secured by houses that already have at least one other mortgage or lien.

Home Improvement Loans: Home improvement loans can hold either first lien positions (the only or primary loan secured by a house) or second lien positions. Loan principal is devoted to home repairs and renovations.

Motor Vehicle Sales Financing: Companies that finance motor vehicle sales in Texas need be licensed by the Office. The requirement extends to dealers that provide financing themselves and to dealers that arrange financing with lenders for their customers, as well as the finance companies that provide financing to dealers' customers.

Pawnshop Transactions: Pawnshops make loans in exchange for keeping collateral onsite at the lending locations. When borrowers repay their loans, the pawnshop returns the items left as collateral to the borrower. If a borrower does not repay the loan, the pawnshop keeps the items for retail resale.

Signature Loans: Signature loans are unsecured loans, meaning that the borrower pledges no collateral but receives a loan after putting his or her signature to an agreement. Lenders generally grant up to \$500 for signature loans amounts.

Payday Loans: Payday loans are made for up to \$500 and usually require payment in two weeks or less. Generally, the consumer writes a check as security for the loan with the understanding that the lender will not present the check for deposit until a predetermined date (such as the borrower's next payday).

Consumer Installment Loans: These are secured loans that a borrower pays off in multiple installments. Loan amounts typically range from \$500 to \$12,000.

Retail Credit Accounts: Some retailers act as creditors, financing the sale of their goods and services and thus allowing their customers to make payments over time. These creditors include boat and manufactured home dealers, furniture and carpet retailers, home improvement and air conditioner sales and

service companies, some medical offices, and other retail and service companies.

Sample of Fingerprint Rejections

These are two examples of rejected fingerprint submissions.

ELECTRONIC RAP SHEET
 FBI TCN = [REDACTED]
 TOT = ERRT [REDACTED]
 NAME = [REDACTED]
 FBI = [REDACTED]
 TRN = [REDACTED]
 TCN = [REDACTED]
 SID = [REDACTED]
 ORI = [REDACTED]
 CRI = [REDACTED]
 DAT = [REDACTED]
 Search Result Findings =
 MSG = L0008 - The quality of the characteristics is too low to be used .

Fields from Database:
 NAME = [REDACTED] D
 SOC = [REDACTED]
 TCN = [REDACTED]

Rejection

Rejection

Texas Department of Public Safety
 Criminal Records Service
 City of Austin, Texas

NAME (LAST, FIRST, MIDDLE)		DATE OF BIRTH	SEX
SOCIAL SECURITY NO.		YEAR	ROCK
ALIAS (LAST, FIRST)			
DRIVING LICENSE NO.		STATE	LEAVING STATE
CITY		TYPE	ADDRESS
APPLICANT FOR		EXPIRATION DATE	APPLICANT ADDRESS
CONTINUATION OF FORM		APPLICANT SIGNATURE	APPLICANT SIGNATURE
TIN: 411-067-8411-005		0111405	TX
FINGERPRINTS TAKEN			
PRINTS TAKEN MULTITUDEDLY			
L. R. INDEX		R. R. INDEX	S. R. INDEX
L. MIDDLE		R. MIDDLE	S. MIDDLE
L. THUMB		R. THUMB	S. THUMB
R. INDEX		L. INDEX	R. MIDDLE
L. MIDDLE		R. MIDDLE	S. MIDDLE
L. THUMB		R. THUMB	S. THUMB
RIGHT FOUR FINGERS TAKEN MULTITUDEDLY			

The fingerprints submitted are not suitable for AFIS search or retention. Please resubmit another set of fingerprints for processing.

LEFT FOUR FINGERS TAKEN MULTITUDEDLY

R. INDEX

L. INDEX

R. MIDDLE

S. MIDDLE

L. THUMB

R. THUMB

S. THUMB

RIGHT FOUR FINGERS TAKEN MULTITUDEDLY

Examinations Rating Scale Used by the Office of Consumer Credit Commissioner

The Office of Consumer Credit Commissioner (Office) uses a 1-to-5 scale to rate examinations of license holders for compliance with state statutes and federal regulations. The Office considers ratings of 1, 2, or 3 acceptable and ratings of 4 or 5 unacceptable. According to the Commission's examination procedures:

- A rating of 1 indicates the examiner did not identify any exceptions and did not prepare a comment report.
- A rating of 2 indicates the examiner identified few exceptions and no significant examination issues.
- A rating of 3 indicates the examiner identified (1) several exceptions, (2) few significant issues requiring remedy, and/or (3) possible minimal refunding required by the licensee.
- A rating of 4 indicates the examiner identified (1) several significant issues requiring urgent remedy, (2) moderate refunding required by the licensee, (3) prior examination issues that were not addressed by the licensee, (4) moderate procedural or systemic errors, and/or (5) the need for a follow-up examination.
- A rating of 5 indicates the examiner identified (1) significant issues requiring immediate remedy, (2) substantial refunding required by the licensee, (3) repeated examination issues on previous exams that were not addressed by licensee, (4) serious procedural or systemic errors, (5) the need for a follow-up examination, and/or (6) the need for the licensee to be monitored until an acceptable level of compliance is achieved or administrative action is taken.

Recent State Auditor's Office Work

Recent SAO Work		
Number	Product Name	Release Date
07-039	An Audit Report on Performance Measures at the Office of Consumer Credit Commissioner	July 2007

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair
The Honorable Tom Craddick, Speaker of the House, Joint Chair
The Honorable Steve Ogden, Senate Finance Committee
The Honorable Thomas “Tommy” Williams, Member, Texas Senate
The Honorable Warren Chisum, House Appropriations Committee
The Honorable Jim Keffer, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Office of Consumer Credit Commissioner

Members of the Finance Commission

Mr. John L. Snider, Commission Chair
Mr. Mike Bradford
Mr. Vidal Gonzalez
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Ms. Cindy F. Lyons
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Mr. Paul Plunket
Mr. Stanley D. Rosenberg
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Ms. Leslie Pettijohn, Consumer Credit Commissioner



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