An Audit Report on

The Department of Savings and Mortgage Lending: A Self-directed, Semi-independent Agency

May 2017

Report No. 17-034

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Overall Conclusion

The Department of Savings and Mortgage Lending (Department) had controls to accurately report financial and performance data and appropriately set fees and penalties.

The Department also had an adequate budgeting process to help ensure that it collected sufficient revenue to cover operating expenditures. The Department's fiscal year 2016 ending fund balance was $11,447,639, which represented an increase of $5,603,780 (96 percent) from its fiscal year 2012 ending fund balance. That increase was partially due to the Department increasing its cash reserve for the purchase of a new building.

In addition, the Department had a process for setting fees that was based on its budgetary needs. The Department also complied with requirements for the calculation of licensing and regulatory fees for the mortgage industry and the thrift industry, respectively, in fiscal years 2015 and 2016.

Background Information

The Department of Savings and Mortgage Lending (Department) operates under the oversight of the Finance Commission of Texas and is charged with supervising and regulating the state's savings institutions, residential mortgage loan originators, mortgage companies, and mortgage bankers.

The 81st Legislature granted the Department self-directed and semi-independent (SDSI) status effective September 1, 2009.

As of December 2016, the Department reported that it regulated:

- State-chartered savings banks with combined assets of more than $18.5 billion.
- More than 24,500 residential mortgage loan originators.
- More than 1,750 mortgage related entities.

Sources: The Department and Texas Finance Code, Chapter 16.

However, the Department did not have a schedule of penalties to help ensure transparency and to aid in imposing consistent penalty amounts. The Department's support for the enforcement actions tested did not always include an explanation regarding how the Department determined the amount of the penalty recommended in its investigative report or the amount of the penalty it actually imposed. The Department also did not always document its reasons for issuing a formal advisory letter instead of a formal enforcement order.

Additionally, the Department did not have current, written policies and procedures to document its processes for budgeting, fee-setting, and imposing penalties.

The Department reported accurate results for the two performance measures tested: (1) Number of (State Chartered Savings Bank, or Thrift) Examinations Performed and (2) Number of (Mortgage) Licensees Examined.

This audit was conducted in accordance with Texas Finance Code, Section 16.004; Texas Government Code, Section 472.103; and Texas Occupations Code, Section 1105.004.

For more information regarding this report, please contact Michael Simon, Audit Manager, or Lisa Collier, First Assistant State Auditor, at (512) 936-9500.

Auditors also identified weaknesses related to data reliability, user access, and information technology policies and procedures that the Department should address.

Auditors communicated other, less significant issues to Department management separately in writing.

Table 1 presents a summary of the findings in this report and the related issue ratings. (See Appendix 2 for more information about the issue rating classifications and descriptions.)

Table 1

Summary of Chapters and Related Issue Ratings		
Chapter	Title	Issue Rating [a]
1	The Department Had Effective Controls to Help Ensure the Accuracy and Completeness of Its Financial Data; However, It Should Strengthen Its Processes for Financial Reporting and Financial Reconciliations	Low
2	The Department Had a Budgeting Process and Complied With Requirements for Setting Fees and Imposing Penalties; However, It Should Formalize Several Key Processes in Written Policies and Procedures to Ensure Consistency and Transparency	Medium
3	The Department Reported Accurate Results for the Two Performance Measures Tested	Low
4	The Department Should Improve Certain Controls to Help Ensure the Reliability of Its Enforcement, Complaint, and Examination Data; It Also Should Strengthen Its Information Technology Policies and Procedures	Medium

[a] A chapter is rated Priority if the issues identified present risks or effects that if not addressed could critically affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern and reduce risks to the audited entity.

A chapter is rated High if the issues identified present risks or effects that if not addressed could substantially affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern and reduce risks to the audited entity.

A chapter is rated Medium if the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

A chapter is rated Low if the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

Summary of Management's Response

At the end of each chapter in this report, auditors made recommendations to address the issues identified during this audit. The Department agreed with the recommendations in this report.

Audit Objectives and Scope

The objectives of this audit were to:

- Determine whether the Department has processes and related controls to help ensure the accuracy and completeness of financial and performance data.

- Evaluate the Department's processes for setting fees and penalties.

The scope of this audit covered financial and performance information, applicable processes, and other supporting documentation for fiscal year 2015 (September 1, 2014, through August 31, 2015) and fiscal year 2016 (September 1, 2015, through August 31, 2016).

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Detailed Results

Chapter 1

The Department Had Effective Controls to Help Ensure the Accuracy and Completeness of Its Financial Data; However, It Should Strengthen Its Processes for Financial Reporting and Financial Reconciliations

Chapter 1 Rating:

Low [1]

The Department of Savings and Mortgage Lending (Department) had effective controls that helped to ensure that the financial data tested was accurate. However, the Department should improve controls over its financial reporting process to ensure that its annual financial reports are mathematically accurate, include totals for all applicable data, and are appropriately supported by the Uniform Statewide Accounting System (USAS). In addition, the Department should strengthen its process for performing reconciliations of cash, revenue, and expenditures.

Fiscal Year 2016 Annual Financial Report

The fiscal year 2016 beginning balances were accurate and tied to fiscal year 2015 ending balances. In addition, the notes to the fiscal year 2016 annual financial report were complete, complied with reporting requirements, and were substantially accurate and supported.

However, the Department did not have a process to review and approve its annual financial report prior to issuance. As a result, auditors identified certain overstatements and understatements in the Department's fiscal year 2016 annual financial report. Specifically, the Department:

- Overstated Net Assets, Restated as of September 1, 2015 (beginning of year) by $113,684 for the Governmental Fund.[2] That occurred because the Department did not calculate a total for that line item.
- Overstated by $572 the Cash in State Treasury (asset) and Funds Held for Others (liability) line items for the Child Support Fund (the Department's agency fund), when compared to the amount in USAS.

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[1] Chapter 1 is rated Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

[2] Although that amount was overstated, the Department accurately reported Total Net Assets in its fiscal year 2016 annual financial report.

- Understated by $3,511 the total for the Payables from Accounts (liability) line item. That occurred because the total calculated for the Payables from Accounts (liability) line item did not include the balance for the Agency Funds.

- Understated by $2,234 the Total Assets for the Governmental Fund. That occurred because the Department did not calculate totals for Capital Assets and Non-Current Assets.

The overstatements and understatements discussed above did not result in a change to the fiscal year 2016 fund balances or net asset amounts. However, implementing a formal review process would help the Department identify and correct such overstatements and understatements before it issues its annual financial report.

Auditors also tested the accuracy of selected Department revenue and expenditures transactions from fiscal years 2015 and 2016 and determined the following:

- Licenses, Fees, and Permits. The Department accurately collected, recorded, and sufficiently supported all fee and penalty revenue transactions tested, and related controls were operating effectively.

- Travel. The Department accurately recorded and sufficiently supported all travel expenditures tested, and related controls were operating effectively.

- Other Expenditures. The Department accurately recorded and sufficiently supported all other expenditures tested, and related controls were operating effectively. Other expenditures included miscellaneous expenditures for items such as temporary employee services, freight and delivery services, and cleaning services.

Financial Reconciliations

The Department's accounting policy and procedures requires monthly cash reconciliations and semi-annual revenue and expenditure reconciliations (see text box for additional details). Auditors tested a sample of 21 reconciliations (13 cash reconciliations, 4 revenue reconciliations, and 4 expenditure reconciliations) from fiscal years 2015 and 2016 and determined that the Department had performed those reconciliations, as required. However, auditors identified certain issues in the Department's documentation for the 21 reconciliations tested. Specifically:

> **Financial Reconciliations**
>
> The Department's accounting policy and procedures require (1) semi-annual reconciliations of revenue, (2) semi-annual reconciliations of expenditures, (3) monthly reconciliations of cash in Sage Micro Information Products (MIP) and cash in the Uniform Statewide Accounting System (USAS), and (4) monthly reconciliations of cash in Sage MIP and the cash held at the Texas Treasury Safekeeping Trust Company (Trust Company).
>
> Each monthly reconciliation of cash in Sage MIP and USAS may include the comparison of two to four separate Department funds. Each monthly reconciliation of cash in Sage MIP and the cash held in the Trust Company includes the comparison of three separate Department funds.
>
> Source: The Department.

- For 4 (19 percent) of the 21 reconciliations tested, the Department did not note or explain unreconciled differences in the reconciliation documentation. Auditors determined that:
  - The unreconciled differences associated with two of those four reconciliations were the result of the Department using incorrect or incomplete data for its reconciliations; therefore, they were not actual discrepancies.
  - The unreconciled differences associated with two of those four reconciliations were actual discrepancies that the Department should have explained in its documentation. Auditors verified that the Department identified and corrected in its accounting systems each of the unreconciled differences in a timely manner prior to auditors' review.
- The Department's accounting policy and procedures did not require the reconciliations to be signed or dated; therefore, none of the 21 reconciliations tested was signed or dated. Requiring that reconciliations be signed and dated is an important control in the financial reconciliation process. Having a preparer and reviewer document that reconciliations were performed and reviewed in a timely manner enhances accountability.

While the Department corrected each of the actual discrepancies that auditors identified, not documenting the detection and resolution of unreconciled differences in the reconciliation documentation reduces the effectiveness of the reconciliation process.

Recommendations

The Department should:

- Develop, document, and implement a formal process to ensure that two separate individuals prepare and review its annual financial report prior to releasing that report.
- Update its accounting policies and procedures to (1) require financial reconciliations to be complete and to include explanations and/or resolutions of all unreconciled differences, (2) require an individual other than the preparer to review the reconciliations, and (3) require the preparer and reviewer to sign and date the reconciliations.

Management's Response

Recommendation:

Develop, document, and implement a formal process to ensure that two separate individuals prepare and review its annual financial report prior to releasing that report.

Response:

The Department agrees with the recommendation. The Director of Administration and Finance has developed and documented a formal secondary review process of the Annual Financial Report. The new process will be implemented with the preparation of the next Annual Financial Report in September 2017.

Recommendation:

Update its accounting policies and procedures to (1) require financial reconciliations to be complete and to include explanations and/or resolutions of all unreconciled differences, (2) require an individual other than the preparer to review the reconciliations, and (3) require the preparer and reviewer to sign and date the reconciliations.

Response:

The Department agrees with the recommendation. The Director of Administration and Finance updated the policies and procedures described above to include the recommendations. New processes are in place, effective April 2017.

Chapter 2

The Department Had a Budgeting Process and Complied With Requirements for Setting Fees and Imposing Penalties; However, It Should Formalize Several Key Processes in Written Policies and Procedures to Ensure Consistency and Transparency

Chapter 2 Rating: Medium [3]

The Department had a process for setting fees that was based on its budgetary needs. The Department also complied with requirements for the calculation of licensing and regulatory fees for the mortgage industry and the thrift industry, respectively, in fiscal years 2015 and 2016. In addition, the Department followed a process guided by factors in the Texas Finance Code for imposing penalties on mortgage companies, mortgage bankers, mortgage loan servicers, and residential mortgage loan originators when they did not comply with requirements.

However, the Department did not have a schedule of penalties to help ensure transparency and to aid in imposing consistent penalty amounts. The Department's support for the enforcement actions tested did not always include an explanation regarding how the Department determined the amount of the penalty recommended in its investigative report or the amount of the penalty it actually imposed. The Department also did not always document its reasons for issuing a formal advisory letter instead of a formal enforcement order.

Additionally, the Department did not have current, written policies and procedures to document its processes for budgeting, fee-setting, and imposing penalties.

Budgeting

The Department had a process for settings fees that was based on its budgetary needs. Specifically, for fiscal years 2015 and 2016, the Department:

- Considered several factors to help it formulate its proposed budgets, including historical budget-to-actual comparisons, year-to-date actuals, and other available industry data.
- Used the proposed budgets and projected fees to determine whether it needed to adjust its fee structure. The Department determined that no

[3] Chapter 2 is rated Medium because the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

adjustments to the fee structure were necessary during fiscal years 2015 and 2016.

- Ensured that the Finance Commission of Texas formally approved the budgets for fiscal years 2015 and 2016.

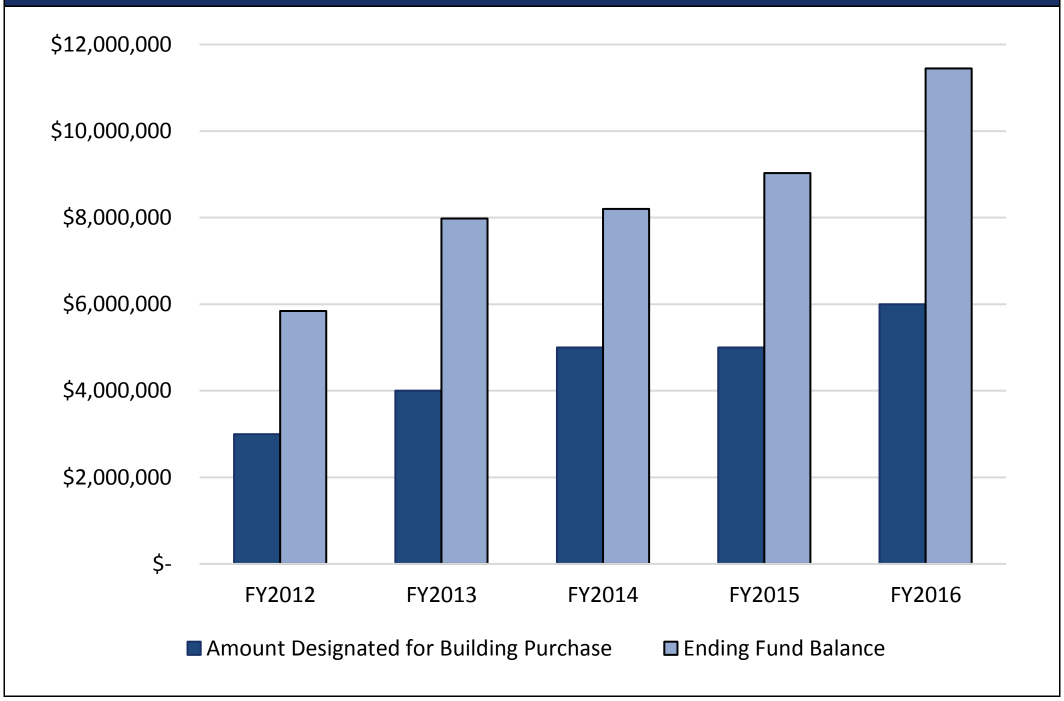
- Waived the fourth quarter assessment fees for all state-chartered savings banks in fiscal years 2015 and 2016 to ensure that its revenue aligned with its actual operational costs.

The Department's fiscal year 2016 ending fund balance was $11,447,639, which represented an increase of $5,603,780 (96 percent) from its fiscal year 2012 ending fund balance. That increase was partially due to the Department increasing its cash reserve for the purchase of a new building.

Figure 1 shows the Department's ending fund balances for fiscal years 2012 through 2016.

Figure 1

The Department's Ending Fund Balances and the Amounts Designated for the Purchase of a New Building Fiscal Years 2012 through 2016



Source: The Department.

Setting Fees

The Department complied with Texas Administrative Code requirements for the calculation of licensing fees and regulatory fees for the mortgage industry and the thrift industry, respectively, in fiscal years 2015 and 2016. Auditors tested 14 licensing fee transactions and 6 regulatory fee transactions and determined that the Department accurately calculated and appropriately assessed and collected licensing and regulatory fees.

Imposing Penalties

Schedule of Penalties. The Department did not have a schedule of penalties to help ensure transparency and to aid in imposing consistent penalty amounts. In addition, the Department's documentation for the formal enforcement orders and formal advisory letters tested did not always include an explanation regarding how the Department determined the amount of the penalty recommended in its investigative report or the amount of the penalty the Department actually imposed. For example, for 4 (16 percent) of the 25 enforcement actions tested, the Department did not document its justification for assessing a penalty amount that was less than the amount recommended in the associated investigation report. Developing a schedule of penalties would increase consistency and transparency in the Department's process for assessing penalties.

Auditors reviewed 25 enforcement actions issued to mortgage companies, mortgage bankers, mortgage loan servicers, and residential mortgage loan originators in fiscal years 2015 and 2016, including 11 formal enforcement orders and 14 formal advisory letters.

Formal Enforcement Orders. For the 11 formal enforcement orders tested, the Department accurately calculated and appropriately imposed penalties, guided by its consideration of the factors specified in the Texas Finance Code. Those 11 formal enforcement orders totaled $60,600. Each of those enforcement orders also identified the final penalty amount and was signed and dated by the Department's commissioner.

Formal Advisory Letters. The Department used formal advisory letters as an alternative to formal enforcement orders. Specifically, in some cases, the Department issued a formal advisory letter that imposed fees (which are punitive in nature[4]) to reprimand a company for certain violations, rather than issuing a formal enforcement order. However, unlike a formal enforcement order, a formal advisory letter is not defined in the Texas Finance Code and is not approved and signed by the Department's

[4] The fees the Department imposed when issuing a formal advisory letter were intended to be punitive in nature; therefore, auditors categorized those fees as penalties for the purposes of this report.

commissioner. In addition, the Department does not post the details of a formal advisory letter on its Web site or record information from formal advisory letters in the Nationwide Multistate Licensing System and Registry.[5]

For the 14 formal advisory letters tested, the Department accurately calculated the fees that it imposed. The fees the Department imposed through those 14 formal advisory letters totaled $1,229,650.

However, for 6 (43 percent) of the 14 formal advisory letters tested, the Department (1) did not document its reasons for issuing a formal advisory letter instead of a formal enforcement order or (2) did not document its reasons for issuing a formal advisory letter for the purpose of providing the respondent an opportunity to have a prior formal enforcement order rescinded.

Policies and Procedures for Budgeting, Fee-setting, and Imposing Penalties

The Department did not have formal, written policies and procedures to document its budgeting and fee-setting processes.

The Department also had not updated its existing enforcement policies and procedures since April 2014. Those policies and procedures did not reflect the enforcement processes in place during fiscal years 2015 and 2016, and they did not address the Department's use of formal advisory letters. Not having up-to-date and complete policies and procedures increases the risk that the Department could issue formal advisory letters in an inconsistent manner.

Recommendations

The Department should:

- Develop a schedule of penalties for use in assessing penalties.
- Document formal, written policies and procedures for its budgeting process.
- Document formal, written policies and procedures for its fee-setting process.

[5] The Nationwide Multistate Licensing System and Registry is a secure online mortgage licensing database that provides a centralized system where companies and individuals may transition, apply for, sponsor, amend, renew, or surrender licenses in jurisdictions where they conduct business.

- Update its enforcement policies and procedures to document and formalize its current enforcement processes, including its use of formal advisory letters.

Management's Response

Recommendation:

Develop a schedule of penalties for use in assessing penalties.

Response:

The Department agrees with the recommendation. The Director of Mortgage Examinations, General Counsel, and Commissioner are in the process of developing a schedule for use in assessing penalties. The anticipated date of completion is August 31, 2017.

Recommendation:

Document formal, written policies and procedures for its budgeting process.

Response:

The Department agrees with the recommendation. The Director of Administration and Finance has begun documenting and formalizing the existing budget process. The recommendation will be completed during the upcoming budget cycle in July 2017.

Recommendation:

Document formal, written policies and procedures for its fee-setting process.

Response:

The Department agrees with the recommendation. The Director of Mortgage Licensing & Information Resources, Director of Administration and Finance and Commissioner will document written policies and procedures and formalize the existing fee setting processes. The anticipated date of completion is August 31, 2017.

Recommendation:

Update its enforcement policies and procedures to document and formalize its current enforcement processes, including its use of formal advisory letters.

Response:

The Department agrees with the recommendation. The enforcement policies and procedures have been revised to reflect current enforcement processes and to address the use of formal advisory letters. The General Counsel and Commissioner have reviewed and approved the updated policies and procedures in April 2017.

The Department Reported Accurate Results for the Two Performance Measures Tested

Chapter 3 Rating:

Low [6]

In its reports to the Finance Commission of Texas for fiscal years 2015 and 2016, the Department reported accurate results for the two performance measures tested. The two performance measures tested were:

- Number of (State Chartered Savings Bank, or Thrift) Examinations Performed.
- Number of (Mortgage) Licensees Examined.

Number of (State Chartered Savings Bank, or Thrift) Examinations Performed

The Department had an adequate process to collect and accurately calculate and report the Number of (State Chartered Savings Bank, or Thrift) Examinations Performed. For fiscal year 2015, based on auditors' recalculation of the Department's source documentation, the Department accurately reported that the Number of (State Chartered Savings Bank, or Thrift) Examinations Performed was 25, which was less than its fiscal year 2015 target of 38. For fiscal year 2016, the Department accurately reported that the Number of (State Chartered Savings Bank, or Thrift) Examinations Performed was 16, which was less than its fiscal year 2016 target of 22.

Number of (Mortgage) Licensees Examined

The Department had an adequate process to collect and accurately calculate and report the Number of (Mortgage) Licensees Examined. For fiscal year 2015, based on auditors' recalculation using data in the Department's Semarca system, the Department accurately reported that the Number of (Mortgage) Licensees Examined was 8,239, which exceeded its fiscal year 2015 target of 3,600. For fiscal year 2016, based on auditors' recalculation using data in the Department's Semarca system, the Department accurately reported that the Number of (Mortgage) Licensees Examined was 5,511, which exceeded its fiscal year 2016 target of 3,600.

[6] Chapter 3 is rated Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

Sponsorship

An individual applying for a residential mortgage loan originator license must have an application approved and be properly sponsored by a licensed mortgage banker or mortgage company before conducting regulated activities. In providing its sponsorship, the mortgage bank or mortgage company asserts that the individual's financial-related activities are and will continue to be appropriately supervised by the company.

Compliance Examinations

The Department conducts compliance examinations of mortgage companies, mortgage bankers, and their sponsored residential mortgage loan originators (mortgage licensees) to ensure compliance with the requirements and guidelines of consumer protection laws and regulations.

Source: The Department.

In addition, auditors tested source documentation for a sample of 25 compliance examinations the Department performed during fiscal years 2015 and 2016 to determine whether the information in Semarca was accurate and supported (see Chapter 4 for other more information on the Semarca system). The source documentation included company rosters that listed all residential mortgage loan originators sponsored by the mortgage companies and mortgage bankers (see text box for more information). The Department did not retain the finalized company rosters for 3 (12 percent) of those 25 compliance examinations; therefore, auditors could not verify the accuracy of the number of licensees that was recorded in the Semarca system for those 3 examinations. The Department's records retention schedule requires the Department to retain all workpapers associated with a mortgage licensee compliance examination for five years after the date it issues the associated examination report.

Recommendation

The Department should develop, document, and implement a process to ensure that it retains all workpapers associated with mortgage licensee compliance examinations, as required by its records retention schedule.

Management's Response

Recommendation:

The Department should develop, document, and implement a process to ensure that it retains all workpapers associated with mortgage licensee compliance examinations, as required by its records retention schedule.

Response:

The Department agrees with the recommendation. The examination policies and procedures have been updated to require that all workpapers are retained; specifically, the final company roster report. Additionally, verification that a final company roster report is contained in the workpapers has been added to the post examination procedures. The Director of Mortgage Examinations approved the updated policies and procedures in April 2017.

Chapter 4

The Department Should Improve Certain Controls to Help Ensure the Reliability of Its Enforcement, Complaint, and Examination Data; It Also Should Strengthen Its Information Technology Policies and Procedures

Chapter 4 Rating: Medium [7]

The Department should improve certain controls to ensure the reliability of enforcement, complaint, and examination data related to the supervision and regulation of the mortgage industry. In addition, the Department should strengthen its information technology policies and procedures to ensure that they address certain critical processes.

Semarca

The Department uses the Semarca application as its system of record for activities related to the supervision and regulation of the mortgage industry, including licensee examinations, consumer complaints, and enforcement actions. The Semarca application did not have adequate application controls to ensure that only valid data was entered into that application. As a result, auditors identified numerous issues in the validity, accuracy, and completeness of the data reviewed. For example, auditors identified:

- Complaint files/cases with a closed date that preceded the order issued date.
- Complaint files/cases with an open date that preceded the received date.
- Complaint files/cases with a resolved date that preceded the open date.
- Complaint files/cases with a closed date but a status of “open.”
- Examination files/cases with a completed date that preceded the scheduled date.
- Enforcement files/cases without a respondent name.
- Enforcement files/cases without a received date.

[7] Chapter 4 is rated Medium because the issues identified present risks or effects that if not addressed could moderately affect the audited entity’s ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

In addition, 3 (10 percent) of the 30 Semarca user accounts had inappropriate access based on the users' current job responsibilities. Specifically:

- One administrative assistant had the ability to delete information related to mortgage examinations.
- Two accountants had the ability to edit information related to enforcement activities.

Unnecessary or inappropriate access increases the risk of unintended or unauthorized changes to the data.

Because of the issues discussed above, auditors concluded that the data in the Semarca application was not reliable. Having unreliable data could impair the Department's decision making.

Information Technology Policies and Procedures

The Department had documented information technology policies and procedures that generally defined employees' responsibilities for securing the Department's information technology resources and data from unauthorized or accidental modification or disclosure. For example, those policies and procedures addressed the responsibility to safeguard laptop computers and defined the minimum requirements for establishing a password.

However, the Department's information technology policies and procedures did not address certain critical processes, including:

- Adding, modifying, or removing user access to applications, servers, and databases.
- Reviewing user access on a periodic basis.
- Backing up and restoring applications and data.
- Safeguarding critical information technology infrastructure in the server room from unauthorized access or damage.
- Requesting, testing, approving, and implementing changes to applications.

The Department outsourced certain information technology functions in March 2016. However, the Department is still responsible for the security of its data. As a result, it is critical for the Department to (1) document detailed, comprehensive information technology policies and procedures for all critical information technology operations and security processes and (2) ensure that its third-party vendor adheres to those policies and procedures.

Recommendations

The Department should:

- Define, document, and implement processes and controls to help ensure the validity and integrity of its examination, complaint, and enforcement data.
- Perform and document a periodic review of all access to its Semarca application to verify that access is appropriate based on users' job responsibilities.
- Document detailed, comprehensive policies and procedures for all critical information technology operations and security processes, and ensure that its third-party vendor adheres to those policies and procedures.

Management's Response

Recommendation:

Define, document, and implement processes and controls to help ensure the validity and integrity of its examination, complaint, and enforcement data.

Response:

The Department agrees with the recommendation. The Director of Mortgage Examinations and the General Counsel will develop and implement processes and controls to verify data entry is valid. The anticipated date of completion is August 31, 2017.

Recommendation:

Perform and document a periodic review of all access to its Semarca application to verify that access is appropriate based on users' job responsibilities.

Response:

The Department agrees with the recommendation. Under the direction of the Director of Licensing & Information Resources, a review of all users' access levels in the Semarca application was conducted and all appropriate changes made in April 2017. The review process was documented and will be conducted on an annual basis going forward.

Recommendation:

Document detailed, comprehensive policies and procedures for all critical information technology operations and security processes, and ensure that its third-party vendor adheres to those policies and procedures.

Response:

The Department agrees with the recommendation. Under the direction of the Director of Licensing & Information Resources, existing policies and procedures, regarding all critical information technology operations and security processes in place, will be updated to be more detailed and comprehensive. The Department will confirm and document that the third party vendor adheres to these policies and procedures. The anticipated date of completion is August 31, 2017.

Appendices

Appendix 1

Objectives, Scope, and Methodology

Objectives

The objectives of this audit were to:

- Determine whether the Department of Savings and Mortgage Lending (Department) has processes and related controls to help ensure the accuracy and completeness of financial and performance data.
- Evaluate the Department's processes for setting fees and penalties.

Scope

The scope of this audit covered financial and performance information, applicable processes, and other supporting documentation for fiscal year 2015 (September 1, 2014, through August 31, 2015) and fiscal year 2016 (September 1, 2015, through August 31, 2016).

Methodology

The audit methodology included collecting information and documentation, performing selected tests and other procedures on the information obtained, analyzing and evaluating the results of tests, and conducting interviews with Department management and staff. In addition, the methodology included performing a limited review of the general and application controls over the information technology systems that the Department used to manage and report financial data and performance measure data.

Data Reliability and Completeness

Auditors used revenue and expenditure information from the Uniform Statewide Accounting System (USAS) and Sage Micro Information Products (MIP). To determine the reliability of financial information in USAS and Sage MIP, auditors reviewed the validity and completeness of the information by (1) reviewing user access, (2) performing a high-level review of data fields and their contents for appropriateness, and (3) comparing that information to other sources. In addition, auditors reviewed the Department's reconciliation process for the financial information in Sage MIP and USAS. Auditors determined that the data in both systems was sufficiently reliable for the purposes of this audit.

Auditors used enforcement, consumer complaints, and licensee examination data from the Department's Semarca system to review the Department's process for imposing penalties and to verify the accuracy of a performance measure. To determine the reliability of that data, auditors (1) reviewed the parameters used to extract the data from that system, (2) tested access to that system, (3) reviewed record completeness, (4) reviewed data fields and their contents for accuracy and validity, and (5) tested certain application controls.

The Semarca system did not have adequate application controls to prevent invalid or inaccurate data from being entered into key fields. As discussed in Chapter 4, auditors identified numerous issues in the validity, accuracy, and completeness of the data reviewed.

In addition, auditors identified users with inappropriate access based on their current job responsibilities. Because of the issues discussed above, auditors determined that the data in the Semarca system was not reliable. Having unreliable data is significant because it could lead to the Department's reporting inaccurate performance measures and impair the Department's decision making. While auditors determined the data was not reliable, that data was the most complete population available; therefore, auditors used that data for the purposes of this audit.

Sampling Methodology

To assess the Department's financial processes related to calculating, collecting, and recording revenue, auditors used professional judgement to select a risk-based sample of transactions related to licensing and regulatory fees and penalties imposed through disciplinary actions. The sample items were not necessarily representative of the population; therefore, it would not be appropriate to project the test results to the population.

To assess the Department's financial processes related to expenditures, auditors used professional judgement to select a risk-based sample of transactions related to travel and other expenditures. The sample items were not necessarily representative of the population; therefore, it would not be appropriate to project the test results to the population.

To assess the Department's cash reconciliation processes, auditors selected a nonstatistical sample through random selection designed to be representative of the population of monthly cash reconciliations of Sage MIP with USAS and Sage MIP with the Texas Treasury Safekeeping Trust Company. Auditors also used professional judgement to select one additional monthly cash reconciliation based on an identified risk. The test results as reported did not identify which items were randomly selected or selected using professional judgment; therefore, it would not be appropriate to project the test results to the population.

Auditors also used professional judgement to select risk-based samples of Department enforcement actions, consumer complaints, and two performance measures. The sample items were not necessarily representative of the population; therefore, it would not be appropriate to project the test results to the population.

Information collected and reviewed included the following:

- The Department's policies and procedures.
- The Department's fiscal year 2016 annual financial report.
- All fiscal year 2016 year-end adjusting accounting entries.
- Purchase orders, invoices, and supporting documentation for Department purchases.
- Travel vouchers, invoices, and supporting documentation for Department travel reimbursements.
- Expenditure data from USAS and revenue data from Sage MIP.
- Department reconciliations for cash, revenue, and expenditures.
- Texas Finance Commission meeting packets, budget information, and supporting documentation for the Department's budget process.
- The Department's formal enforcement orders, formal advisory letters, and other supporting documentation for penalties imposed on mortgage companies, mortgage bankers, mortgage loan servicers, and individual residential mortgage loan originators.
- Data and supporting documents for selected performance measures.
- The Department's strategic plan for fiscal years 2015 through 2019.

Procedures and tests conducted included the following:

- Interviewed Department staff to identify the Department's financial and operational processes, including financial and administrative controls.
- Tested internal controls and selected significant accounts, including testing of detailed supporting documentation, to determine the accuracy of selected financial data in the Department's annual financial report for fiscal year 2016.

- Evaluated the Department's annual fee-setting process.
- Tested selected licensing and regulatory fee transactions and selected administrative penalty transactions to determine whether the Department accurately calculated and appropriately assessed and collected those fees and penalties.
- Tested selected performance measure data that the Department reported to the Texas Finance Commission.
- Reviewed supporting documentation related to the general controls and application controls over the Department's network, the Semarca system, and Sage MIP.

Criteria used included the following:

- Texas Finance Code, Chapters 11, 13, 16, 31, 61, 91, 156, 157, 158, and 180.
- Texas Government Code, Chapter 660.
- Title 7, Texas Administrative Code, Chapters 76, 79, 80, and 81.
- Title 1, Texas Administrative Code, Chapter 202.
- The Office of the Comptroller of Public Accounts' travel policies and procedures.
- Governmental Accounting Standards Board (GASB) Statements No. 16, 31, 34, and 56.
- The Office of the Comptroller of Public Accounts' financial reporting requirements.
- The Department's policies and procedures.
- The Department's strategic plan for fiscal years 2015 through 2019.

Project Information

Audit fieldwork was conducted from November 2016 through March 2017. 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:

- Justin H. Griffin, CISA (Project Manager)
- Jamie Kelly, MBA (Assistant Project Manager)
- Charlotte Carpenter, MBA
- Kelley Ngaide, CIA, CFE
- Dennis Ray Bushnell, CPA (Quality Control Reviewer)
- Michael Simon, MBA, CGAP (Audit Manager)

Issue Rating Classifications and Descriptions

Auditors used professional judgement and rated the audit findings identified in this report. Those issue ratings are summarized in the report chapters/sub-chapters. The issue ratings were determined based on the degree of risk or effect of the findings in relation to the audit objective(s).

In determining the ratings of audit findings, auditors considered factors such as financial impact; potential failure to meet program/function objectives; noncompliance with state statute(s), rules, regulations, and other requirements or criteria; and the inadequacy of the design and/or operating effectiveness of internal controls. In addition, evidence of potential fraud, waste, or abuse; significant control environment issues; and little to no corrective action for issues previously identified could increase the ratings for audit findings. Auditors also identified and considered other factors when appropriate.

Table 2 provides a description of the issue ratings presented in this report.

Table 2

Summary of Issue Ratings	
Issue Rating	**Description of Rating**
Low	The audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited <u>or</u> the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.
Medium	Issues identified present risks or effects that if not addressed could <u>moderately affect</u> the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern(s) and reduce risks to a more desirable level.
High	Issues identified present risks or effects that if not addressed could <u>substantially affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern(s) and reduce risks to the audited entity.
Priority	Issues identified present risks or effects that if not addressed could <u>critically affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern(s) and reduce risks to the audited entity.

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable Dan Patrick, Lieutenant Governor, Joint Chair
The Honorable Joe Straus III, Speaker of the House, Joint Chair
The Honorable Jane Nelson, Senate Finance Committee
The Honorable Robert Nichols, Member, Texas Senate
The Honorable John Zerwas, House Appropriations Committee
The Honorable Dennis Bonnen, House Ways and Means Committee

Office of the Governor

The Honorable Greg Abbott, Governor

Members of the Finance Commission of Texas

Ms. Stacy G. London, Chair
Mr. Hilliard Shands III, Vice Chair
Mr. Robert Borochoff
Mr. Hector J. Cerna
Ms. Margaret Curl
Mr. Phillip A. Holt
Mr. William M. Lucas
Ms. Lori B. McCool
Mr. Matthew Moore
Mr. Vince E. Puente Sr.
Mr. Paul Plunket

Department of Savings and Mortgage Lending

Ms. Caroline C. Jones, Commissioner