OPERATIONAL AUDIT

Oklahoma Department of Consumer Credit

For the period January 1, 2008 through June 30, 2010

Oklahoma State
Auditor & Inspector
Gary Jones, CPA, CFE

Audit Report of the Department of Consumer Credit

For the period January 1, 2008 through June 30, 2010

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Oklahoma State Auditor & Inspector

2300 N. Lincoln Blvd. • State Capitol, Room 100 • Oklahoma City, OK 73105 • Phone: 405.521.3495 • Fax: 405.521.3426

April 12, 2011

TO THE COMMISSION ON CONSUMER CREDIT

This is the audit report of the Department of Consumer Credit for the period January 1, 2008 through June 30, 2010. The Office of the State Auditor and Inspector is committed to serving the public interest by providing independent oversight and by issuing reports that serve as a management tool to the State. Our goal is to ensure a government that is accountable to the people of the State of Oklahoma.

We wish to take this opportunity to express our appreciation to the agency's staff for the assistance and cooperation extended to our office during the course of our engagement.

Sincerely,

Gary A. Jones

Gary A. Jones, CPA, CFE
Oklahoma State Auditor and Inspector

Background

The Department of Consumer Credit (the Department) was established in 1969 by enactment of the Uniform Consumer Credit Code. The Department enforces the code in all consumer credit transactions within the state, including licensing and regulation of consumer finance companies. They also enforce the Oklahoma Pawnbrokers Act, the Precious Metal and Gem Dealers Act, the Credit Services Organization Act, the Rental-Purchase Act, register health spas offering contracts, license mortgage brokers, and license and regulate deferred deposit lenders. Their mission is to serve consumers and creditors through education, protection, and regulation.

Beginning in July 2008, the agency contracted with the Office of State Finance – Shared Services to perform some accounting functions such as purchasing, claims processing, deposit posting, and transfer procedures.

Oversight is provided by a ten-member commission (the Commission). The voting members of the Commission include five at-large members appointed by the governor and four members recommended respectively by the Oklahoma Consumer Finance Association, the Independent Finance Institute, Inc., the Oklahoma Pawn Brokers Association, and the Oklahoma Association of Mortgage Professionals. The state banking commissioner acts as an ex officio non-voting tenth member of the Commission. Members serve five-year, alternating terms.

Commissioners are:

Spencer Stanley .... Chairman
Bob Moses .... Vice-Chairman
Joey Root .... Commissioner
James Lee .... Commissioner
Odell Roland .... Commissioner
Armando Rosell .... Commissioner
Trisha Garrett Thompson .... Commissioner
Cass Fahler .... Commissioner
Joe Wilbanks .... Commissioner
Mick Thompson .... State Banking Commissioner

Table 1 below summarizes the Department's sources and uses of funds for state fiscal years 2009 and 2010 (July 1, 2008 through June 30, 2010).

Table 1 - Sources and Uses of Funds for SFY 2009 and SFY 2010[1]

	2009	2010
Sources:		
Licenses, Fees & Other Charges	$359,901	$875,028
Refunded Money Previously Disbursed	0	647
Appropriations	543,246	576,352
Total Sources	$903,147	$1,452,027
Uses:		
Personnel Services	$1,034,571	$1,050,805
Professional Services	202,327	91,707
Miscellaneous Administrative Expenses	183,723	36,015
Program Reimbursement/Litigation Costs	18,000	104,580
Travel	84,522	38,009
Rent Expense	55,460	58,163
Office Furniture and Equipment	47,325	450
Other Expenses	22,337	27,721
Total Uses	$1,648,265	$1,407,450

Source: Oklahoma CORE Accounting System (unaudited, for informational purposes only)

[1] As discussed in this report, the Department was not transferring funds from its clearing account to its revolving funds on a monthly basis throughout the audit period. As a result, some funds deposited into the clearing account during 2009 are reported in the table under 2010, causing the discrepancy between 2009 and 2010 sources reported.

Purpose, Scope, and Sample Methodology

This audit was conducted in response to 74 O.S. § 212, which requires the State Auditor and Inspector's Office to audit the books and accounts of state officers whose duty it is to collect, disburse or manage funds of the state.

The audit period covered was January 1, 2008 through June 30, 2010.

We selected our samples in such a way that whenever possible, the samples are representative of the populations and provide sufficient evidential matter. Sample methodologies can vary and are selected based on the audit objective and whether the total population of data was available. Random sampling is the preferred method; however, we may also use haphazard sampling (a methodology that produces a representative selection for non-statistical sampling), or judgmental selection when data limitation prevents the use of the other two methods. We identified specific attributes for testing each of the samples. When appropriate, we projected our results to that population.

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. This report is a public document pursuant to the Oklahoma Open Records Act (51 O.S. § 24A.1 et seq.), and shall be open to any person for inspection and copying.

Objective 1 - Determine whether the Department's internal controls provide reasonable assurance that revenues, expenditures, and inventory were accurately reported in the accounting records, and financial operations complied with 14A O.S. § 3-503, 14A O.S. § 6-106A, 14A O.S. § 6-301, 14A O.S. § 6-512, 59 O.S. § 1505-1506, 59 O.S. § 1525-1526, 59 O.S. § 2011, 59 O.S. § 2091.A, 59 O.S. § 2095.20, 59 O.S. § 3118, and 62 O.S. § 7.1.E.1.

Conclusion

Internal Controls

January 1, 2008 through December 31, 2009

Due to a large amount of turnover in key positions at the Department during the first two years of our audit period, and a lack of suitable documentation retained during that period regarding procedures performed and staff members responsible for those procedures, we were unable to adequately document the processes and controls used by the Department for this period. Therefore, we were unable to conclude on the ability of internal controls to provide reasonable assurance revenues, expenditures, or inventory were accurately reported in the accounting records from January 1, 2008 through December 31, 2009.

January 1, 2010 through June 30, 2010

The Department's internal controls provide reasonable assurance that expenditures were accurately reported in the accounting records. However, they do not provide reasonable assurance that revenues or inventory were accurately reported in the accounting records.

Compliance with Laws

January 1, 2008 through June 30, 2010

Financial operations generally complied with the following statues. However, the transfer process should be strengthened:

- 62 O.S. § 7.1.E.1 - monthly transfers from the Department's clearing account;
- 14A O.S. § 6-106A – transfers to the Consumer Credit Investigation Fund;
- 59 O.S. § 2011 – transfers to the Health Spa Revolving Fund;
- 59 O.S. § 2091.A – transfers to the Mortgage Brokers Recovery Fund;

- 59 O.S. § 3118 – transfers to the Deferred Deposit Lending Regulatory Revolving Fund;
- 14A O.S. § 3-503, 14A O.S. § 6-301, 59 O.S. § 1505 and 1506, and 59 O.S. § 1525 and 1526 – transfers to the Consumer Credit Administrative Expenses Revolving Fund;
- 59 O.S. § 2095.20 – transfers to the Mortgage Broker and Mortgage Loan Originator Recovery Fund;
- 14A O.S. § 6-512 – transfers to the State's general revenue fund.

Methodology

To accomplish our objective, we performed the following:

- Documented internal controls related to the revenue, expenditure, and inventory processes, which included discussions with Department personnel, observation, and review of documents;
- Tested controls for the period of January 1, 2010 through June 30, 2010 (as discussed previously), which included:
  - Discussing with personnel to determine whether the Department's duties were properly segregated;
  - Reviewing a random sample of 25 expenditure claims from the period (totaling $24,348.52) to ensure the invoice was properly approved;
  - Reviewing payroll documentation and timesheets from three randomly selected months to determine whether the timesheets and payroll documents were properly approved;
  - Reviewing payroll change forms for all payroll changes which took place to ensure the forms were properly approved;
- Verified funds are properly safeguarded prior to deposit;
- Verified a physical inventory count is conducted periodically;
- Reconciled the Department's deposit records to the Office of State Finance and tested to ensure the funds were transferred to the appropriate revolving funds as well as the State's general revenue fund as required by various statutes, and in a timely manner as required by 62 O.S. § 7.1.E.1.

Observation

No Process in Place to Ensure All Receipts Are Deposited

An effective internal control system provides for accountability of funds.

Although receipting duties appear to be adequately segregated, there is no control in place to ensure all revenues received for licenses issued are ultimately deposited. The employee responsible for opening the mail and the employee preparing the deposit have the opportunity to misappropriate a payment and then distribute the licensing documentation to a licensing employee so that the license would still be issued without the funds being deposited.

This process could allow for funds to be received and not deposited without being detected in a timely manner. Management was unaware of the risk involved in its revenue process.

Recommendation

Management should develop a process to compare licenses issued to income received and deposited, thus verifying that payments were received for all licenses issued.

Views of Responsible Officials

Management concurs with the recommendation. The deposit process is now divided between three different employees and the checks for deposit are in the possession of two employees at all times, beginning with the first step of opening the mail, all the way though to the final step of taking the deposit to the bank. Each check received is stamped with a doc stamp, as are the corresponding documents, which allows for the verification of payment prior to issuance of a license. A computer consultant has been retained to automate the process of ensuring that each license application has a corresponding payment.

Observation

Inadequate Segregation of Duties in the Inventory Process

The United States Government Accountability Office (GAO) *Standards for Internal Control in the Federal Government*[2] states in part, "Key duties and responsibilities need to be… segregated among different people to reduce the risk of error or fraud…. No one individual should control all key aspects of a transaction."

The administrative assistant and administrative technician are responsible for:

- Maintaining inventory records;
- Deleting items from those records;
- Initiating surplus transactions.

In addition, all of the employees have the ability to edit the Department's inventory records because they are accessible on a shared computer drive.

Management was not aware of the risks created by not ensuring adequate segregation of duties, and by allowing all employees access to the inventory records. Misappropriation of assets could occur and not be detected in a timely manner.

Recommendation

Access to the inventory records should be restricted to only the employee responsible for recordkeeping. If needed, additional employees could have "read only" access. An employee without the ability to update inventory records should be responsible for initiating surplus transactions, and any deletions from the records should be approved by management.

Views of Responsible Officials

Management concurs with the recommendation. The inventory spreadsheet is now password protected, with access only available to the administrative assistant. The task of the actual physical count is assigned to an administrative technician, who has read-only access to the spreadsheet; the executive secretary is responsible for the surplus of items, and management approval is required prior to pick-up of all items.

Revenue Transfers Background

The following observations are related to revenue transfers performed by the Department. A list of various transfers required by statute is presented below for the reader's convenience. Please note that the lack of controls to ensure all funds received are deposited, as discussed in a previous observation, may impact the funds transfer process: if all funds received were not deposited, they also would not have been transferred. However, the administrator does review the transfer totals on a monthly basis and we performed a review of each month in the audit period to ensure that all funds deposited were transferred appropriately.

State statutes require the Department to transfer its revenues from its clearing account in the following manner:

- Funds received from licensees needing the Department to review their records outside of Oklahoma were transferred to the Consumer Credit Investigation Fund (Fund 200), according to 14A O.S. § 6-106A;

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[2] Even though this publication addresses controls in the federal government, this criterion can be treated as best practices. The theory of controls applies uniformly to federal or state government.

- Revenue from health spa licensees' fees were transferred to the Health Spa Revolving Fund (Fund 210), according to 59 O.S. § 2011;
- Revenue from mortgage brokers' and mortgage loan originators' fees were transferred to the Oklahoma Mortgage Brokers Recovery Fund (Fund 220), according to 59 O.S. § 2091.A;
- Revenue from deferred deposit lenders' fees were transferred to the Oklahoma Deferred Deposit Lending Regulatory Revolving Fund (Fund 230), according to 59 O.S. § 3118;
- Beginning July 1, 2009, the fee increase amounts for various industries were transferred to the Consumer Credit Administrative Expenses Revolving Fund (Fund 250), established at 14A O.S. § 6-301. The increases and amounts to be transferred to this fund and the State's general revenue fund were established by statutes at 14A O.S. § 3-503, 59 O.S. § 1505 and 1506, and 59 O.S. § 1525 and 1526;
- Beginning July 1, 2009, revenue from a fee charged to mortgage brokers and mortgage loan originators for recovery costs was transferred to the Oklahoma Mortgage Broker and Mortgage Loan Originator Recovery Fund (Fund 260), according to 59 O.S. § 2095.20;
- The remaining revenues were transferred to the State's general revenue fund (General Fund), according to 14A O.S. § 6-512.

Observation

<u>Errors in Transfer Totals Calculated by Department</u>

The Department calculates the transfer total for each fund using a monthly financial income report that lists revenues by industry and fee type. We reviewed the transfer totals calculated by Department staff for each month of the audit period and noted the following issues:

- For the period of November 2008 through June 2009, transfer totals per fund were not included on the Department's monthly financial income reports;
- In April and May 2008, a total of $200 in miscellaneous revenues that should have been included in the total for the General Fund was not included;
- In May 2008, the transfer to the General Fund should have included an additional $25;
- In May and October 2008, December 2009, and January, April and May 2010, refunds issued or voided by the Department were not considered in its calculation of transfer amounts. As a result, the totals to transfer to the mortgage industry funds (Funds 220 and 260) were $210 too high and the total to transfer to the General Fund was $1,200 too high;
- In September 2009 and January 2010, the totals to be transferred to Funds 220 and 260 were divided incorrectly. As a result, the total for Fund 220 was $150 too high and the total for Fund 260 was $150 too low.

We also noted the following issues related specifically to Fund 250:

- During fiscal year 2010, a total of $1,973.71 that should have been included in the totals to transfer to Fund 250 was instead included in the total to transfer to the General Fund;
- In four of the six fiscal year 2010 months with refunds, the refunds were not considered in figuring transfer amounts. In the two months where refunds were considered, they were only removed from the General Fund transfer, while it is

likely that a portion of the refunds should have been applied to the Fund 250 total.[3]

These issues appear to be attributable to lack of knowledge by staff, likely related to the turnover rate at the Department, and in many cases to clerical and electronic spreadsheet errors. As a result, the transfer totals calculated by Department staff were incorrect and inappropriate amounts of revenue were transferred to the Department's funds and to the General Fund, altering the amount of monies available for the Department to meet its obligations.

Recommendation

Management should develop a review process to ensure that transfer totals are calculated correctly and are in compliance with relevant fund-related statutory requirements. This includes reviewing the calculations performed in electronic spreadsheets for accuracy and completeness.

Views of Responsible Officials

Management concurs with the recommendation. The Department, along with the OSF staff, has a better awareness of the problems and has created a stronger review process of our reconciliations in addition to some other changes.

- Refunds will now be posted daily instead of monthly effective April 1, 2011 to eliminate mistakes when reconciling.
- In the past fees were split between numerous Department revolving funds and the general revenue fund, which created accounting issues for the Department staff. Effective July 1, 2010, the various Department revolving funds were consolidated into one fund, which reduces accounting issues for staff.
- To ensure the transfer totals are calculated correctly, the Department has turned the reconciliation function over to OSF as of November, 2010.

Observation

Clearing Account Transfers Not Occurring Monthly, and Not in Agreement with Department Records

62 O.S. § 34.57.E.1 requires that "at least once each month each state agency shall transfer monies deposited in agency clearing accounts to the various funds or accounts, subdivisions of the state, or functions as may be provided by statute."

According to PeopleSoft records, transfers were not performed on a monthly basis. It should be noted that from July 1, 2008 through the end of the audit period, the Department contracted with OSF Shared Services to perform several accounting duties, including performing the revenue transfers. Due to various factors including turnover at the Department, problems with monthly reconciliations, refunds, and communications with the OSF Shared Services staff, transfers were not performed in July through November 2008 or April through June 2009. The transfers that should have taken place in July through November 2008 were ultimately made in December 2008, and the transfers that should have taken place in April through June 2009 were ultimately made in August 2009. However, 62 O.S. § 34.57.E.1 requires that funds be transferred from the clearing account "at least once each month," and the transfers were therefore out of compliance with this statute.

We compared the transfer totals according to the Department's monthly financial income reports[4] to OSF records of the transfers that were performed, and noted that there was a variance, outlined in the following table:

[3] The dollar amount of this error was not calculated due to the relatively low dollar value of the refunds (a total of $2,360 in refunds was issued during the audit period).

[4] As discussed in the previous observation, the Department did not calculate the total transfer amount for each fund on its financial reports for the months of November 2008 through June 2009. For these months, we calculated the totals based upon the relevant fee revenues listed in the financial reports.

Fund	Total Transfer per Department Records[5]	Transferred per OSF Records	Variance
General Fund	$ 2,350,212.60	$ 2,340,427.60	$ (9,785.00)
Fund 200	2,599.35	2,599.35	-
Fund 210	68,354.58	68,801.58	447.00
Fund 220	563,374.04	561,759.04	(1,615.00)
Fund 230	633,369.27	627,418.37	(5,950.90)
Fund 250	77,405.87	77,245.87	(160.00)
Fund 260	137,450.00	137,450.00	-
Total	$ 3,832,765.71	$ 3,815,701.81	$ (17,063.90)

The total variance of Department records from OSF records represented here is approximately 0.4%. Various errors found in the Department's monthly financial income reports (listed in the previous observation) were not taken into account in this comparison.

It appears that not all transfers, and therefore not all deposits, listed in the Department's reports were accurately transferred from the Department's clearing account to the General Fund or to one of the various Department funds.

Management's review of transfers performed may not have been effective. In addition, adjustments to transfer amounts occurred and documentation does not appear to exist. Revenues are not available to be expended until they have been transferred from the clearing account, and failure to promptly transfer as required by 62 O.S. § 34.57.E.1, and to transfer in the proper amounts as required by the fund-specific statutes, reduces the amount of cash available for the Department to fulfill its various obligations.

Recommendation

Management should implement necessary procedures to ensure the appropriate transfers are performed at least once per month. They should also implement a review process to ensure that transfers performed by OSF Shared Services agree to Department records. If adjustments are made to the transfers, documentation of the adjustments should be retained.

Views of Responsible Officials

Management concurs with the recommendations. The Department along with the OSF staff has strengthened our review process in regards to our monthly reconciliation.

- The reason monthly transfers did not occur was due to the fact that OSF could not conduct a monthly reconciliation with Department records. As of November 2010, the Department has turned the reconciliation function over to OSF. OSF performs a three-pronged reconciliation process between the records of the Department, PeopleSoft and the State Treasurer's Office, and transfers are made once all processes are in balance. As of April 1, 2011, we have procedures in place to ensure that refunds are posted to the income statement the same day, thereby providing a means for daily reconciliation as opposed to waiting until the end of the month.

[5] In March 2009, the agency discovered that some past refunds had not been accounted for in calculating transfer totals, and their clearing account total was therefore lower than expected. Over the following months (April through July 2009), management intentionally shorted transfers to funds 210, 220, and 230 to restore the clearing account to its correct balance and continue to transfer the appropriate amounts to the general revenue fund. The Department shorted funds 210, 220, and 230 by $3,200, $9,162.99, and $33,111.61 respectively. The Department Records totals for these funds in the table above have been adjusted to include these deductions.

- All adjustments to transfer amounts are now being fully documented. Documentation is being kept with the Form 11 and the reconciliations for each month. Copies of these documents are kept in the offices of the Department and OSF.

OFFICE OF THE STATE AUDITOR AND INSPECTOR
2300 N. LINCOLN BOULEVARD, ROOM 100
OKLAHOMA CITY, OK 73105-4896

WWW.SAI.OK.GOV