

OFFICE OF CONSUMER CREDIT COMMISSIONER
Austin, Texas

ANNUAL INTERNAL AUDIT REPORT

Fiscal Year 2014



Garza/Gonzalez & Associates
CERTIFIED PUBLIC ACCOUNTANTS

OFFICE OF CONSUMER CREDIT COMMISSIONER
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Annual Internal Audit Report
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CERTIFIED PUBLIC ACCOUNTANTS

Finance Commission Members and
Audit Committee Members
Office of Consumer Credit Commissioner
Austin, Texas

We performed tests of management's assertion about the effectiveness and efficiency of the internal control structure over the Professional Licensing Area of the Office of Consumer Credit Commissioner (OCCC); and, its compliance with the Texas Finance Code, the Texas Administrative Code, and OCCC's established policies and procedures, as applicable to the Professional Licensing Area, for the period ending January 31, 2014.

The results of our tests disclosed that such controls were adequate and no material instances of noncompliance were noted; however, we noted certain matters, which are included in this report, that are opportunities for strengthening internal controls and ensuring compliance with state requirements and OCCC's established policies and procedures. We also performed a follow-up of the findings that were presented in the prior year annual internal audit report and this report reflects the implementation status of those matters; and, includes all information required for the Annual Internal Audit Report.

We have discussed the comments and recommendations from the Professional Licensing Area audit; and, the implementation status from the follow-up performed, with various OCCC personnel, and we will be pleased to discuss them in further detail; to perform an additional study of these matters; or, to assist you in implementing the recommendations.

*Garza/Gonzalez
& Associates*

June 24, 2014

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INTRODUCTION

The Office of Consumer Credit Commissioner (OCCC) operates pursuant to Texas Finance Code, §14.001, and under the oversight of the Texas Finance Commission, who appoints the consumer credit commissioner. OCCC has authority to regulate consumer credit transactions and interest rates in Texas, offers protection to consumers, coordinates educational efforts aimed at consumers and industry alike, and advises lenders on compliance issues.

OCCC's primary task is to license and examine finance companies, home equity and junior lien mortgage lenders, residential mortgage loan originators, payday lenders, signature loan companies, motor vehicle sales finance companies, property tax lien lenders, and pawnshops. Pawnshop employees must also be licensed.

OCCC was granted Self-Directed, Semi Independent (SDSI) status in the 81st Legislative Session. As an SDSI agency, OCCC is not required to have their budget approved by the Legislature; however, the Finance Commission is responsible for setting OCCC's spending authority or limits. OCCC's entire operating funds are generated from fees assessed to the businesses it supervises and are used to fund both direct and indirect costs. General revenue funds are not used to support OCCC's operations.

2014 Internal Audit Plan

Following are the internal audits and other functions performed, as identified in OCCC's approved 2014 Internal Audit Plan:

- Professional Licensing Area
- Follow-up of Prior Year Internal Audits
- Other Tasks

This report contains the results of our audit of the Professional Licensing Area, reflects the follow-up performed in the current year, and meets the Annual Internal Audit Report requirements.

INTERNAL AUDIT OBJECTIVES

In accordance with the **International Standards for the Professional Practice of Internal Auditing**, the audit scope encompassed the examination and evaluation of the adequacy and effectiveness of OCCC's system of internal control and the quality of performance in carrying out assigned responsibilities. The audit scope included the following objectives:

- **Reliability and Integrity of Financial and Operational Information** – Review the reliability and integrity of financial and operating information and the means used to identify, measure, classify, and report such information.
- **Compliance with Policies, Procedures, Laws, Regulations and Contracts** – Review the systems established to ensure compliance with those policies, procedures, laws, regulations, and contracts which could have a significant impact on operations and reports, and determine whether the organization is in compliance.
- **Safeguarding of Assets** – Review the means of safeguarding assets and, as appropriate, verify the existence of such assets.
- **Effectiveness and Efficiency of Operations and Programs** – Appraise the effectiveness and efficiency with which resources are employed.
- **Achievement of the Organization's Strategic Objectives** – Review operations or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned.

EXECUTIVE SUMMARY

Professional Licensing

Background

Organizational Structure

The Professional Licensing Area is under the Licensing and Registration Division and is managed by the Licensing Manager, who reports directly to the Commissioner. The Division is comprised of the Licensing Manager, 1 License Analyst, 5 License and Permit Specialist II, and 1 clerk III.

The Professional Licensing Area is responsible for processing 2 types of licenses, which are residential mortgage loan originators and pawnshop employees. The following tables summarize the fees associated with the 2 license types:

Residential Mortgage Loan Originator (RMLO)	Fee Amount
License Fee	\$300
Recovery Fund Fee	\$ 25
Renewal Fee	\$250
Renewal Late Fee	\$ 50

Pawnshop Employees	Fee Amount
Investigation (License) Fee	\$ 25
Amendment Fee (Name Change)	\$ 10
Duplicate License Fee	\$ 10
Renewal Fee	\$ 15

RMLO

New Applications

Applicants complete applications through the NMLS (National Mortgage Licensing System) by setting up a user name and password and following the steps within the NMLS. The License Analyst, who is responsible for the review and approval of all applications, logs onto the NMLS on a weekly basis and generates a report that details all payments received for applications, since an application is processed only upon receipt of payment. The application fee for an RMLO is \$325, which includes the license fee of \$300 and the recovery fund fee of \$25.

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Once the application has been processed by the NMLS, the License Analyst begins the application review process by completing a checklist that details the following information:

1. Company Employment Verification—Verify the company name and address and that the company is licensed with OCCC.
2. Disclosure Questions—Prepare and send a deficiency letter to the applicant requesting additional information for any “yes” responses to disclosure questions.
3. Education—Verify the completion of 20 hours of education courses prior to the submission of the application.
4. Testing—Verify that the applicant has passed required examinations.
5. Criminal Background Check—Prepare and send an arrest letter to the applicant requesting additional information for any arrests disclosed in the application.
6. Credit Check—Prepare and send a deficiency letter to the applicant requesting additional information for any liens or judgments disclosed in the credit report.
7. License Status in Other States—Verify through the NMLS that the applicant’s license has not been denied or revoked in another state, which would automatically, and permanently, result in denial of a license by OCCC.

The License Analyst initials and dates the checklist upon completion and receipt of all required documentation. At this time, the License Analyst will make a determination on whether to approve or deny the application and change the application status in the NMLS accordingly. Upon making the status change, the NMLS will send the applicant an automated notification by email informing them that a determination has been made. The Licensing Manager reviews only those applications where an applicant is found to have a criminal record or fraud disclosed in their credit report.

In the event that an applicant does not meet the required license qualifications, or all required documentation is not received, the application for an RMLO license may be denied. Prior to making this determination; however, the License Analyst defers to the Licensing Manager, who will make the final determination after reviewing the application and accompanying documentation. OCCC is cautious in denying an application since once the license has been denied, the applicant can never be licensed in another state. Therefore, OCCC’s practice is to consider the application abandoned when all required documentation is not received; and, in other instances, the applicant may be asked to withdraw their application in lieu of it being denied. When an application is denied, a denial letter will be sent to the applicant via certified mail, which will inform them that they have 30 days to submit a written request for a hearing.

The following provides further detail on certain RMLO licensing requirements:

Education Requirements—In accordance with Texas Finance Code (TFC) Section 180.056, an applicant is required to complete 20 hours of NMLS-approved education, which consists of 3 hours of Federal law, 3 hours of ethics, 2 hours of non-traditional mortgage lending, and 12 hours of undefined education (referred to as electives).

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Testing—In accordance with TFC Section 180.057, an applicant must pass a qualified, written test that:

1. meets the standards and requirements established by the S.A.F.E. Mortgage Licensing Act;
2. is developed by the NMLS; and,
3. is administered by a test provider in accordance with the S.A.F.E. Mortgage Licensing Act.

To comply with this requirement, OCCC adopted the Uniform State Test (UST) in October, 2013; however, a grace period was in effect, which allowed applicants to complete either of the following 2 testing options before October 1, 2013:

1. UST – applicants are required only to take the National Test Component with Uniform State Content.
2. Non-UST – applicants are required to take the National Test Component with Uniform State Content and the State Test Component for the state agency in which they are seeking licensure.

Applicants who tested after October 1, 2013, could only complete the UST.

Criminal Background Check—In accordance with TFC Section 180.054, the applicant shall, at a minimum, furnish in the form and manner prescribed by the regulatory official and acceptable to the NMLS, information concerning their identity, for submission to the Federal Bureau of Investigation and any governmental agency or entity authorized to receive the information, to conduct a state, national, and international criminal background check.

Credit Check—In accordance with TFC Section 180.054, OCCC has authorization to obtain an independent credit report from a consumer reporting agency described by Section 603(p), Fair Credit Reporting Act (15 U.S.C. Section 1681a(p)).

From September 1, 2013 through January 31, 2014, OCCC received 157 new RMLO applications. As of January 31, 2014, 86 of the applications were approved, 19 withdrawn, 7 abandoned, and the remaining 45 were either pending approval or considered terminated.

Renewals

Automatic renewal reminders are sent by the NMLS to each RMLO license holder informing them that the RMLO renewal fee is due by December 1. OCCC provides a grace period through December 31 before assessing the RMLO license holder the renewal late fee of \$50. If the RMLO license holder fails to meet the renewal deadline and grace period, they may still reinstate their license through February 28, but will be assessed the \$50 renewal late fee. The License Analyst is responsible for reviewing the NMLS to ensure that the RMLO license holder paid the renewal fee due and meets the continuing education requirements, as described in the next paragraph. When these 2 requirements are met, the license is automatically renewed. If an RMLO license holder does not reinstate their license by February 28, their license expires and the license holder is required to go through the new application process to obtain a license.

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An RMLO license holder must annually complete at least 8 hours of NMLS-approved continuing education, which consists of 3 hours of Federal law, 2 hours of ethics, 2 hours of non-traditional mortgage lending, and 1 hour of undefined education (referred to as an elective). Completion of these courses is entered by the RMLO license holder into the NMLS.

The OCCC-established RMLO renewal fee is \$250; however, a \$75 discount was provided for 2014 renewals, bringing the fee to \$175, which is compliant with TAC §2.104, that states RMLO annual renewal fees are not to exceed \$300.

From September 1, 2013 through January 31, 2014, all 310 RMLO license renewals received by OCCC were approved.

Pawnshop Employees

New Applications

Pawnshop employees are required to apply for a license within 75 days of being employed. Currently, all pawnshop employee applications (applications) are submitted to OCCC in paper format; however, OCCC is in the process of developing ALECS (Applications License Exam Compliance System), which is an online system that will allow applicants to complete applications in an electronic format.

Applications are received either in the mailroom or at the front desk. When received, the applications are opened and date stamped; and, any money received for the application fee is logged onto a daily cash sheet. Since the application fee is required to be submitted with the application, the entire application is routed to the Accounting Department. When applications are received by the Accounting Department, the cash receipt is recorded in the general ledger; the deposit is made; the amount received is documented at the top of the application, along with other deposit information; and, in most cases, a copy of the check is attached to the application. The application is then routed to the Licensing Department.

A License & Permit Specialist within the Licensing Department is responsible for the review and approval of all new applications. As part of the review process, the License & Permit Specialist ensures the application is complete and signed, and receipt of the \$25 application fee. The License & Permit Specialist uses the application to enter the following information into the Pawnshop Employee Access Database (Database).

1. Last, first, and middle names
2. Social security number
3. Date of hire
4. Application received date, as stamped on paper application
5. Application review completion date
6. Pawnshop license number, which populates all company fields; such as, name and address

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A coversheet generated by the Database is used by the License & Permit Specialist as a checklist to document an applicant's compliance with the license requirements. A background check is conducted on all pawnshop employee applicants, unless the applicant has previously been fingerprinted by OCCC, and the results are manually documented on the coversheet. The License and Permit Specialist reviews the background check results and will require an explanation, statement, and/or court documents for certain arrests that may be reported.

Upon receipt of all required documents, the License & Permit Specialist will either approve or deny the application. When an application is approved, the status in the Database is changed by the License & Permit Specialist to indicate the applicant was approved for a pawnshop employee license. The pawnshop employee license is then mailed to the applicant. The Licensing Manager will review the determination made by the License & Permit Specialist for only those applications that have criminal history issues.

In accordance with TFC Section 371.104, OCCC has 60 days from the date an application is filed to determine if an applicant will be approved for or denied a pawnshop employee license. If OCCC finds that the applicant does not qualify for a pawnshop employee license, the applicant and the employing pawnbroker must be notified in writing that the application will be denied unless the applicant, in writing and not later than the 30th day after the date of the notice, requests a hearing on the application. At the conclusion of the hearing, the application will either be approved or denied. An application is denied on the 31st day after the date of the notice if the applicant does not request a hearing in the time allowed.

For the period from September 1, 2013 through January 31, 2014, OCCC approved 865 and denied 28 pawnshop employee applications.

Renewals

During the month of May, OCCC mails renewal forms to all pawnshop employee license holders informing them that a signed renewal form and fee are due June 1; however, OCCC provides a grace period through June 30. OCCC also mails a written notice of delinquency to all pawnshop license holders who have not renewed by June 15. Once the signed renewal form and fee is received, the license is renewed and mailed to the pawnshop employee license holder. If the signed renewal form and fee is not received, a pawnshop employee license will expire either on June 30 or the 16th day after the written notice of delinquency is given, whichever is later, and the license holder will have to go through the new application process to obtain a license.

A total of 6,161 renewals were received by OCCC as of June 30, 2013.

Performance Measures

Performance measures are tracked on a monthly basis and reported to the Finance Commission on a quarterly basis. The Professional Licensing Area is responsible for tracking and reporting one performance measure, which is the number of pawnshop employee applications processed. This measure captures data on the number of applications processed for the quarter and cumulative for the year for pawnshop employees; to include, those that are approved, withdrawn, and denied; and, is obtained from the Pawnshop Employee Access Database.

Fee Reconciliation

All fees collected by the Licensing Department are recorded in the Sage Accounting System, which is OCCC's general ledger. A monthly reconciliation, which involves the reconciliation of the general ledger to the bank statement is performed; however, a reconciliation from the NMLS or Pawnshop Employee Access Database to the general ledger is not performed. The general ledger has the capability of generating reports by category received; such as, deposits, lockbox, credit card, NMLS, and Tx Online; which, are used to reconcile to the bank statement.

Audit Scope/Objective

The scope of our audit was the Professional Licensing Area. The objective of our audit was to gain an understanding of the processes and controls in place within the Professional Licensing Area to determine whether RMLO and Pawnshop Employee licenses were approved and/or denied in accordance with applicable established policies and procedures and rules and regulations.

The procedures performed to achieve the objective of our audit were as follows:

1. Reviewed and obtained an understanding of the applicable laws and regulations provided in the Texas Finance Code (TFC) and Texas Administrative Code (TAC), as applicable to the Professional Licensing Area.
2. Obtained and reviewed the Professional Licensing Area's written policies and procedures, collected documentation, and conducted interviews to document the formal/informal processes and controls.
3. Obtained a listing of new and renewed RMLO and pawnshop employee applications that were processed from September 1, 2013 through January 31, 2014 and selected a sample of 25 from each license type. The sample was tested for compliance with selected policies, procedures, rules and regulations, and current practices in place to ensure they were properly approved, canceled, denied, abandoned, or withdrawn.

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4. Using the same selection in procedure 3, we ensured that the respective fee(s) was properly calculated, collected, and recorded.
5. Reviewed the performance measure related to the Professional Licensing Area for the 1st and 2nd second quarters of fiscal year 2014 and ensured it was properly computed and reported.

I. Compliance with Government Code 2102: Internal Audit

To comply with the provisions of Government Code, 2102.015 and the State Auditor's Office, within 30 days after approval by the Finance Commission, OCCC will post the following information on its website:

- An approved fiscal year 2015 audit plan, as provided by Texas Government Code, Section 2102.008.
- A fiscal year 2014 internal audit annual report, as required by Texas Government Code, Section 2102.009.

The internal audit annual report includes any weaknesses, deficiencies, wrongdoings, or other concerns raised by internal audits and other functions performed by the internal auditor as well as the summary of the action taken by OCCC to address such concerns.

II. Internal Audit Plan for Fiscal Year 2014

The Internal Audit Plan (Plan) included one audit to be performed during the 2014 fiscal year. The Plan also included a follow-up of the prior year audit recommendations, other tasks as may be assigned by the Finance Commission, and preparation of the Annual Internal Audit Report for fiscal year 2014.

Risk Assessment

Utilizing information obtained through the inquiries and background information reviewed, 18 audit areas were identified as the potential audit topics. A risk analysis utilizing our 8 risk factors was completed for each individual audit topic and then compiled to develop an overall risk assessment.

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Following are the results of the risk assessment performed for the 18 potential audit topics identified:

HIGH RISK	MODERATE RISK	LOW RISK
Texas Financial Education Endowment Fund	Fiscal Division	Records Management
Professional Licensing (Pawnshop Employees & MLO)	Regulated Examinations	Complaint Investigations
Property Tax Lender Examinations	Pawn Examinations	Human Resources
Billing and Collection of Fees	Credit Access Business Examinations	Performance Measures
Motor Vehicle Sales Finance Examinations	Fixed Assets	Business Licensing
	Management Information Systems	Registration
		Risk Management

In the prior 3 years, internal audits were performed in the following areas:

Fiscal Year 2013:

- Credit Access Business Examinations

Fiscal Year 2012:

- Complaint Investigations

Fiscal Year 2011:

- Management Information Systems
- Business Licensing

The areas recommended for internal audits and other tasks to be performed for fiscal year 2014 were as follows:

<u>Report No.</u>	<u>Audits/Report Titles</u>	<u>Report Date</u>
1.	Professional Licensing	6/24/2014
-	Annual Internal Audit Report – Follow-Up of Prior Year Internal Audits	6/24/2014
-	Other Tasks Assigned by the Finance Commission	None

III. Consulting and Nonaudit Services Completed

The internal auditor did not perform any consulting services, as defined in the Institute of Internal Audit Auditors' *International Standards for the Professional Practice of Internal Auditing* or any non-audit services, as defined in the *Government Auditing Standards, December 2011 Revision*, Sections 3.33-3.58.

IV. External Quality Assurance Review

The internal audit department's most recent *System Review Report*, dated October 26, 2012, indicates that its system of quality control has been suitably designed and conforms to applicable professional standards in all material respects.

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V. Observations/Findings and Recommendations

Report No.	Report Date	Name of Report	Observations/ Findings and Recommendations	Current Status (Fully Implemented, Substantially Implemented, Incomplete/ Ongoing, or Not Implemented) with brief description if not yet implemented	Fiscal Impact/Other Impact
1	6/24/2014	Professional Licensing	<p>1. Fee Reconciliation</p> <p>On a monthly basis, the Accounting Department performs a reconciliation, of license fees received, between the bank statement and the general ledger to ensure all fees are properly accounted for and recorded. However, a reconciliation from the Pawnshop Employee Database to the general ledger is not performed. Furthermore, the reconciliation between the bank statement and general ledger is prepared by the Accounting Manager with no other review or approval.</p> <p>Recommendation We recommend OCCC develop a reconciliation process between the Pawnshop Employee Database to the general ledger to ensure all fees are properly received for licenses approved and renewed. We also recommend that a review process be established for the reconciliations performed.</p> <p>Management Response The reconciliation process for Pawnshop Employee Database and the general ledger will be performed through the ALECS import of data on a monthly basis. Alternatives to conducting reconciliations for fees received outside of the Alecs system are being researched. In response to the comment regarding the lack of review on approval for reconciliations, journal vouchers do have oversight. However, the process for reconciliations will be modified to have one person prepare and another person review. Performing the additional reconciliations will require additional resources as the accounting staff is not able to absorb the additional workload with its current staffing. These findings and recommendations require an additional part-time FTE. Implementation date planned for December 2014.</p>		To ensure fees are received for all licenses approved and renewed.

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Report No.	Report Date	Name of Report	Observations/ Findings and Recommendations	Current Status (Fully Implemented, Substantially Implemented, Incomplete/ Ongoing, or Not Implemented) with brief description if not yet implemented	Fiscal Impact/Other Impact
1	6/24/2014	Professional Licensing	<p>2. Review and Approval of Applications</p> <p>The Licensing Manager reviews and approves or denies only those applications where an applicant is found to have a criminal record or fraud is disclosed in their credit report. In all other instances, either the License Analyst (RMLO licenses) or the License & Permit Specialist (Pawnshop Employee licenses) is responsible for receiving and reviewing all application information; making a determination to approve or deny an application; and, changing the application status, accordingly, in the NMLS or Pawnshop Employee Access Database, with no other review and approval.</p> <p>Recommendation We recommend that OCCC consider implementing a quality control review process whereby the population of the RMLO and Pawnshop Employee applications received are sampled and reviewed on a periodic basis to provide added assurance that applicants are approved or denied in accordance with OCCC's established policies and procedures; and, applicable laws and regulations.</p> <p>Management Response OCCC recognizes the value in implementing a quality control mechanism whereby a second individual will review on a periodic basis a certain percentage of applications to provide added assurance that applicants are approved or denied in accordance with established policies and procedures; and applicable laws and regulations. This new quality control process will likely require additional resources to accommodate the new process given the current volume levels. However, OCCC is committed to continually improving the process in an expeditious and efficient manner.</p>		To provide added assurance that applications are properly approved or denied.

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Report No.	Report Date	Name of Report	Observations/ Findings and Recommendations	Current Status (Fully Implemented, Substantially Implemented, Incomplete, Ongoing, or Not Implemented) with brief description if not yet implemented	Fiscal Impact/Other Impact
	6/24/2014	2014 Follow-Up	<p>Follow-Up of Prior Year Audits</p> <p>Following is the status of the recommendations made during fiscal year 2013 that had not been fully implemented.</p> <p><u>Credit Access Business Examinations</u></p> <p>1. Examination Workpapers</p> <p>Ensure the applicable TFC and TAC requirements were considered in the examination workpapers.</p> <p>2. CAB Examination Policies and Procedures</p> <p>Consider developing examination process procedures specific to CABs.</p> <p>Following is the status of the recommendations made during fiscal year 2011 that had not been fully implemented.</p> <p><u>Business Licensing</u></p> <p>1. Annual Renewal and Assessment Fees</p> <p>Consider revising the TAC to clarify that the assessment for motor vehicle sales entities and pawnshop licenses is a "not to exceed" versus a "fixed" fee.</p>	<p>Fully Implemented</p> <p>Fully Implemented</p> <p>Fully Implemented</p>	<p>Ensure compliance with established procedures.</p> <p>Ensure policies and procedures are established.</p> <p>Ensure TAC reflects the current practice of computing the annual renewal and assessment fees.</p>

VI. Proposed Internal Audit Plan for Fiscal Year 2015

The risk assessment performed during the 2014 fiscal year was used to identify the following *proposed* area that is recommended for internal audit and other tasks to be performed for fiscal year 2015. The Internal Audit Plan for Fiscal Year 2015 will be developed and presented to the Finance Commission at a meeting to be determined at a later date.

- Texas Financial Education Endowment Fund
- Follow-up of Prior Year Internal Audits
- Other Tasks Assigned by the Finance Commission

VII. External Audit Services Procured in Fiscal Year 2014

OCCC procured the internal audit services documented in the Internal Audit Plan for fiscal year 2014.

VIII. Reporting Suspected Fraud and Abuse

OCCC has provided information on their home page on how to report suspected fraud, waste, and abuse to the State Auditor's Office (SAO) by posting a link to the SAO's fraud hotline. OCCC has also developed a Fraud Policy that provides information on how to report suspected fraud.

IX. Organizational Chart

