

**OFFICE OF CONSUMER CREDIT COMMISSIONER**  
Austin, Texas

**ANNUAL INTERNAL AUDIT REPORT**

Fiscal Year 2016



OFFICE OF CONSUMER CREDIT COMMISSIONER  
Austin, Texas

Annual Internal Audit Report  
Fiscal Year 2016

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# Garza/Gonzalez & Associates

CERTIFIED PUBLIC ACCOUNTANTS

Finance Commission Members and  
Finance/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 Motor Vehicle Sales Finance (MVSF) Examinations area of the Office of Consumer Credit Commissioner (OCCC); and, its compliance with the Texas Finance Code, Texas Administrative Code, and OCCC's established policies and procedures, as applicable to the MVSF Examinations area, for the 7 months ended March 31, 2016.

The results of our tests disclosed that such controls were adequate and no material instances of noncompliance were noted; however, we noted certain matters that 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 State of Texas Internal Audit Annual Report requirements.

We have discussed the comments and recommendations from the MVSF Examinations 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.



May 13, 2016

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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 81<sup>st</sup> 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.

### **2016 Internal Audit Plan**

Following are the internal audits and other functions performed, as identified in OCCC's approved 2016 Internal Audit Plan:

- Motor Vehicle Sales Finance Examinations
- Follow-up of Prior Year Internal Audits
- Other Tasks

This report contains the results of our audit of the Motor Vehicle Sales Finance Examinations area, reflects the follow-up performed in the current year, and meets the State of Texas Internal Audit Annual Report requirements.

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### 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.

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## EXECUTIVE SUMMARY

### Motor Vehicle Sales Finance Examinations

#### Background

##### Organizational Structure

The Director of Consumer Protection, who reports to the Commissioner, is responsible for administering the Examination and Enforcement Division (Division), which is responsible for conducting Motor Vehicle Sales Finance (MVSF) examinations. The Division is comprised of 3 regional supervisory examiners, 3 assistant supervisors (1 position currently vacant), 5 review examiners, 1 out-of-state coordinator, 2 financial analysts, 3 administrative support positions and 39 examiners.

##### MVSF Licensees

MVSF licensees, licensed with OCCC, are both sellers and holders of retail installment contracts. Businesses that are required to be licensed with OCCC are retail motor vehicle sellers who provide financing, which includes sellers who originate and collect on installment sales and those who originate and sell retail installment contracts; and, finance companies who buy retail installment contracts (indirect lenders), and those who review applications from sellers and then buy the retail installment contract.

##### Examination Process

On-site examinations are performed to ensure MVSF licensees (licensees) are compliant with Chapter 348 of the Texas Finance Code (TFC), Chapter 84 of the Texas Administrative Code (TAC), and other federal requirements. As of March 31, 2016, there were 8,895 MVSF entities licensed with OCCC.

##### *Examination Scheduling*

Examination schedules are prepared by each of the 3 regional supervisory examiners on a monthly basis for their respective region using an add-on tool in the Application Licensing Examination Compliance System (ALECS) database. Licensees are selected for examination using various factors which include: (1) license date, (2) date of last examination, (3) examination ratings, (4) complaints, and (5) other risks and considerations.

##### *MVSF Examinations*

The Division has developed tailored examination work papers for MVSF examinations that are used by the examiners to denote compliance with and/or exceptions to TFC and TAC requirements. As part of the examination process, the examiner reviews a sample of contracts, applications, agreements, and other various documents, as applicable, to ensure compliance with various sections of the TFC and TAC. The examiners also ensure the licensee is properly displaying all the required consumer disclosures in a clearly visible area where sales are finalized; and, properly licensed with OCCC.

At the conclusion of the examination, the examiner assigns the exam a rating, using a scale of "1" to "5" based on the licensee's level of compliance, as follows:

<b>Rating</b>	<b>Basis</b>
1	No exceptions; no comment report.
2	Few exceptions; no significant examination issues.

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- 3 Several exceptions; few significant issues requiring remedy; possible minimal refunding required.
- 4 Several significant issues requiring urgent remedy; moderate refunding required; prior examination issues not addressed by licensee; moderate procedural or systemic error; follow-up examination is required.
- 5 Significant issues requiring immediate remedy; substantial refunding required; repeated examination issues on previous exams not addressed by licensee; serious procedural or systemic errors; follow-up examination is required; licensee will be monitored until unacceptable level of compliance is cleared or administrative action is taken.

Examinations rated a “4” or “5” require verbal approval from the director or review examiner. The examiner is required to document the name of the approver and the approval date on the exam work papers, to denote approval of the exam rating.

The examiner then proceeds to prepare a report of examination (ROE), which is provided to the licensee while the examiner is still on-site, and includes the findings identified, if any, during the examination. Findings that require a response are included in the “Special Instructions” section of the ROE and the licensee is required to respond to these matters within 60 to 90 days from the ROE date. These reports also require the signature of the licensee or licensee representative, which signifies that they have read the report and agree to respond to the findings within the required number of days.

Licensees submit their responses to OCCC’s Austin office, for review by the review examiners. A reminder/notification letter is sent to licensees who fail to provide a response within the required time period to inform them that their response is overdue. Failure to correct the matter can result in a follow-up examination or administrative action.

As of March 30, 2016, the Division completed 1,238 MVSF examinations, with the following ratings:

	Ratings					Total
	1	2	3	4	5	
<b>MVSF Exams</b>	155	198	606	275	4	1,238

### *Examination Review*

ROEs with ratings of “4” and “5” require the review of the director, review examiner, or supervisory examiner (review staff). The Division’s goal is to review examination reports within 120 days of the ROE processing date, which is the Friday following the ROE date. An exam summary log is maintained and used to track receipt of all ROEs, and for the assignment of ROEs for review. Each individual of the review staff maintains a log of the ROEs that they have reviewed, and a summary of all the logs is prepared on a quarterly basis and submitted to the director for his review.

### Fees

TAC §84.706 authorizes OCCC to assess a fee at a rate of \$100 per hour to conduct a follow-up examination. Although the Division has performed follow-up examinations, OCCC has not determined a need to assess such fees.

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### **Audit Objective, Scope, and Methodology**

#### **Objective**

The objective of our audit was to gain an understanding of the processes and controls in place over the Motor Vehicle Sales Finance (MVSF) Examinations area to determine whether it is being managed in accordance with applicable rules and regulations and OCCC's established policies and procedures.

#### **Scope**

The scope of our audit covered the time period from September 1, 2015 through March 31, 2016, and included a review of the processes and the effectiveness of controls in place for performing MVSF examinations.

#### **Methodology**

The audit methodology included a review of policies and procedures, laws and regulations, and other internal and external documentation; an interview with OCCC employees, to include the Director of Consumer Protection; and, a review of sample examination work papers and reports.

We obtained and/or reviewed the following information:

- a. OCCC policies and procedures related to MVSF examinations.
- b. Examination and Enforcement Division organizational chart.
- c. A listing of examinations performed during the period from September 1, 2015 through March 30, 2016.
- d. A listing of active MVSF licensees as of March 31, 2016.
- e. Samples of various MVSF examination work papers and reports.
- f. Sample MVSF notification letters.
- g. ALECS overview report for examinations conducted during fiscal year 2016.
- h. Reports on the summary of exams reviewed for fiscal year 2016.
- i. Initial examiners training agenda.

We performed various procedures, to include the following:

1. Reviewed and obtained an understanding of the rules, laws and regulations of the Texas Finance Code (TFC), and Texas Administrative Code (TAC), as applicable to the MVSF Examinations area.



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2. Obtained and reviewed established policies and procedures, collected documentation, and conducted interviews to obtain an understanding of the processes and current practices in for conducting MVSF examinations.
3. Obtained a report of MVSF examinations performed from September 1, 2015 through March 30, 2016 and randomly selected 25 examinations to test for the following attributes:
  - a. Completion of the examination work papers;
  - b. Proper sample size of transactions selected for testing;
  - c. Reasonableness of assigned examination rating;
  - d. Approval from director or review examiner for examinations rated "4" or "5";
  - e. Exceptions cited in the ROE correspond to the exceptions include in the examination work papers;
  - f. Signature of licensee's owner or manager in the examination report, if applicable;
  - g. Examinations reviewed in accordance with the Division's goals; and,
  - h. Response and notification letter sent to the licensees, if applicable.
4. Reviewed examination work papers tailored for MVSF examinations to ensure inclusion of significant TFC and TAC compliance requirements.

### **I. Compliance with Texas Government Code 2102: Required Posting of Internal Audit Information**

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

- An approved fiscal year 2017 audit plan, as provided by Texas Government Code, Section 2102.008.
- A fiscal year 2016 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 2016**

The Internal Audit Plan (Plan) included one audit to be performed during the 2016 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 2016.

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**Risk Assessment**

Utilizing information obtained through the inquiries and background information reviewed, 17 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.

Following are the results of the risk assessment performed for the 17 potential audit topics identified:

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

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

Fiscal Year 2015:

- Texas Financial Education Endowment Fund

Fiscal Year 2014:

- Professional Licensing

Fiscal Year 2013:

- Credit Access Business Examinations

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The areas recommended for internal audits and other tasks to be performed for fiscal year 2016 were as follows:

<u>Report No.</u>	<u>Audits/Report Titles</u>	<u>Report Date</u>
1.	Motor Vehicle Sales Finance Examinations	5/13/2016
1.	Annual Internal Audit Report – Follow-Up of Prior Year Internal Audits	5/13/2016
-	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 7, 2015, 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 (Implemented, Partially Implemented, Implementation Delayed, No Action Taken, Do Not Plan to Take Corrective Action, or Other)	Fiscal Impact/Other Impact
1	May 13, 2016	MVSF Examinations	<p>1. Notification Letter</p> <p>Section XII – Examination Process of the Examiner Manual states that a copy of the notice of the upcoming examination (notification letter), sent to the licensee, will be sent to the Austin office by uploading it into the imaging system, along with the examination work papers.</p> <p>Our review of the 25 examinations selected for testing disclosed 6 instances where the notification letter was not included in the examination work papers.</p> <p><b>Recommendation</b> We recommend that OCCC comply with Section XII – Examination Process of the Examiner Manual and ensure a copy of the notification letter is included in the examination work papers that are submitted to the Austin office to provide evidence that the notification letter was sent to the licensee, as required.</p> <p><b>Management's Response</b> The OCCC complies with the statutory requirement to give notice to a MVSF licensee prior to conducting an examination. The OCCC examination procedure purposefully creates confirmation of the notice in the examination process. The administrative and statistical portion of the examination workpapers has a section in which the examiner documents the date and method of notification. In the 6 examples cited above, the notations were contained in the records signifying that the licensee was provided notification. The examination procedure additionally directs the examiner to include a copy of the notification or an acknowledgement of the notification in the examination workpaper file. In these 6 examples, the examiners did not provide the additional copy. All examiners have been retrained on the procedure and have provided an acknowledgment of the policy.</p> <p>The examination process will be significantly improved with the new IT application development for an examination tool presently underway. The examination tool not only brings efficiencies and robust functionality, it also serves to strengthen internal controls and compliance with policies and procedures. Notification of a MVSF examination will be provided through the system to licensees with a system account and the audit history will maintain evidence of the notification.</p>		To ensure compliance with OCCC's policies and procedures.

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Report No.	Report Date	Name of Report	Observations/ Findings and Recommendations	Current Status (Implemented, Partially Implemented, Implementation Delayed, No Action Taken, Do Not Plan to Take Corrective Action, or Other)	Fiscal Impact/Other Impact
1	May 13, 2016	MVSF Examinations	<p>2. Examination Work Papers</p> <p>Our testing of 25 MVSF examinations for various attributes disclosed the following:</p> <ul style="list-style-type: none"> <li>• 2 instances where examination work papers were not entirely completed, as follows—           <ul style="list-style-type: none"> <li>○ 1 instance where 3 procedures on the examination check sheet were not annotated to denote whether there was or was not a violation, or whether it was not applicable; and,</li> <li>○ 1 instance where the <i>Motor Vehicle Examination Review</i> work paper lacked transaction volume information, which documents the total number of accounts the business has as of the examination date, and is the population used for selecting the minimum required transactions for testing.</li> </ul> </li> <li>• 1 instance where discrepancies reported in the ROE did not agree to the discrepancies reflected in the <i>Monetary Correction Worksheet</i>.</li> </ul> <p><b>Recommendation</b>            We recommend OCCC implement quality control procedures to ensure proper completion of examination work papers.</p> <p><b>Management's Response</b>            The examination process will be significantly improved with the new examination tool. The application will include edit checks to ensure completion and quality control. Any examination may not be finalized by an examiner until all applicable data fields and responses are completed. All three of the instances mentioned above would not have occurred if the examinations had been conducted after the implementation of the examination tool. In the interim, all examiners will receive refresher training, focusing on thorough and accurate report completion.</p>		To ensure completion of examination work papers.

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Report No.	Report Date	Name of Report	Observations/ Findings and Recommendations	Current Status (Implemented, Partially Implemented, Implementation Delayed, No Action Taken, Do Not Plan to Take Corrective Action, or Other)	Fiscal Impact/Other Impact
1	May 13, 2016	MVSF Examinations	<p>3. ROE Review</p> <p>The Examination Review Completion Procedure indicates that it is OCCC's goal to review examination reports, with a compliance rating of 4 or 5, within 120 days of the ROE processing date.</p> <p>Our testing of 25 MVSF examinations disclosed 2 instances where reports assigned a rating of 4 were reviewed 4 and 24 days after the 120 days from the ROE processing date.</p> <p><b>Recommendation</b> We recommend that OCCC strengthen controls to comply with the established goal.</p> <p><b>Management's Response</b> Currently the review process is coordinated by a senior staff examiner and several additional senior staff members review examination reports as an additional duty. At this time the examination review coordinator is the only staff member with the primary duty of reviewing examination reports. A review of workload vs staffing will be conducted to ensure adequate resources are assigned. Additionally, staff will review the procedure to strengthen deadline compliance.</p> <p>The examination review process will also be significantly improved with the new examination tool. The workflow will include a review assignment queue that will allow better prioritization and work load distribution which should support timely review processing.</p> <p>4. Reminder Letters</p> <p>Findings included in the special instructions section of the ROE require the licensee to respond and/or provide verification of action taken, within 60 to 90 days from the ROE date. It is OCCC's practice for the examiner to send the licensee a reminder/notification letter if a response or verification of action taken is not received by the response due date, to inform them they are noncompliant and to make a 2<sup>nd</sup> request for the information. Failure to correct the matter can result in a follow-up examination or administrative action.</p>		<p>To comply with the established ROE review goal.</p> <p>To ensure compliance with OCCC's procedures and practices.</p>

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Report No.	Report Date	Name of Report	Observations/ Findings and Recommendations	Current Status (Implemented, Partially Implemented, Implementation Delayed, No Action Taken, Do Not Plan to Take Corrective Action, or Other)	Fiscal Impact/Other Impact
1	May 13, 2016	MVSF Examinations	<p>Our testing of 25 MVSF examinations disclosed 2 instances where the licensee did not respond by the response due date and the reminder/notification letters, which management indicated were sent on January 21, 2016 and April 29, 2016, were sent 1 month after the response due date and were not provided for our review. However, we did note that in 1 instance the licensee signed an Agreed Order dated February 1, 2016 and agreed to pay an administrative penalty fee; and, in the other instance, the licensee paid restitution to its customers, and OCCC is currently preparing the Agreed Order.</p> <p><b>Recommendation</b> We recommend that OCCC strengthen controls to ensure reminder/notification letters sent to the licensees are maintained with the examination work papers to provide evidence that licensees are informed of their delinquency and support the basis for performing a follow-up examination or issuing an administrative action.</p> <p><b>Management's Response</b> The examination process will be significantly improved with the new examination tool. The application will include a workflow process that will monitor response due dates and generate automatic communication and alerts to support the examination process and licensee responses. In the two instances mentioned above, if the examinations had been conducted after the implementation of the examination tool, the system would reflect notations that the examinations had been referred to legal for additional work. In the interim, examination staff with responsibility for examination responses will review current policy to improve examination processing and communication.</p>		





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### **VI. External Audit Services Procured in Fiscal Year 2016**

OCCC procured the internal audit services documented in the Internal Audit Plan for fiscal year 2016.

### **VII. 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.

### **VIII. Proposed Internal Audit Plan for Fiscal Year 2017**

The risk assessment performed during the 2016 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 2017. The Internal Audit Plan for Fiscal Year 2017 will be developed and presented to the Finance Commission at a meeting to be determined at a later date.

- Registration
- Follow-up of Prior Year Internal Audits
- Other Tasks Assigned by the Finance Commission

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**IX. Organizational Chart**

