

TEXAS REAL ESTATE COMMISSION

Austin, Texas

ANNUAL INTERNAL AUDIT REPORT

Fiscal Year 2001

To the Audit Committee of the
Texas Real Estate Commission
Austin, Texas

We performed tests of management's assertion about the effectiveness of the internal control structure and compliance with the Texas Public Funds Investment Act, the effectiveness of the internal control structure and compliance with its policies over the Examination, Investigation and Complaint Resolution processes for the year ending August 31, 2001. The results of our tests disclosed that such controls were generally adequate and no material instances of noncompliance were noted; however we noted certain matters that are opportunities for strengthening internal controls and compliance with contractual requirements. The report that accompanies this letter satisfies the annual compliance audit requirements established by the Public Funds Investment Act and summarizes our comments and suggestions regarding the various processes reviewed.

We have discussed these comments and suggestions with Texas Real Estate Commission personnel, and we will be pleased to discuss it in detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

Garza/Gonzalez & Associates

May 25, 2001

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INTRODUCTION

The Texas Real Estate Commission (the Commission), was created in 1939 under the Texas Real Estate Dealer's License Act and became an independent state agency in 1949. The Real Estate License Act (the Act) is the legislative authorization for the Agency to license and regulate real estate brokers and salespersons and provides for the licensing and regulation of real estate inspectors. The Commission also regulates residential service companies and easement or right-of-way agents. The Agency is responsible for administering and enforcing the provisions contained in the Act. Chapter 201, Texas Property Code, confers authority to the Agency to register by application and regulate timeshare entities offering timeshares in Texas.

The Texas Real Estate Commission is composed of nine Commissioners who are appointed by the Governor, with concurrence by the Senate, for six-year overlapping terms. Six members must be licensed real estate brokers who have been engaged in the real estate brokerage business as their major occupations for at least five years preceding their appointments. Three members must be members of the general public who are not licensed under the Act and do not have, other than as consumers, a financial interest in the practice of a real estate broker or salesman.

The Commissioners appoint an Administrator who serves as the Agency's chief administrative officer. The Agency's operating budget is prepared and approved by the Commission on an annual basis, whereas the State legislative appropriations are determined every two years. Appropriations are approved by the State Legislature. The Agency is divided into five divisions. The four operating divisions are the enforcement division, licensing and education division, information services division, and staff services division, all of which report directly to the Assistant Administrator. The Administration Division is headed by the Administrator and includes the Agency's general counsel.

The Agency is appropriated funds by the State for its operations. Revenues are primarily real estate license applications and renewals, education fees, and other charges derived from Agency operations. Funds collected by the Agency are not directly utilized in operations, but instead are passed on to the State.

Based on the internal audit plan we performed the following internal audits:

- Compliance with the Public Funds Investment Act
- Examination process
- Investigation process
- Complaint resolution process

This report contains the results of our review in the above areas.

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In accordance with the **Standards for the Professional Practice of Internal Auditing**, the internal audits will encompass the examination and evaluation of the adequacy and effectiveness of the Commission's system of internal control and the quality of performance in carrying out assigned responsibilities. The audits will determine the following:

- **Reliability and Integrity of Information**
Internal auditors should 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, Plan, Procedures, Laws, and Regulations**
Internal auditors should review the systems established to ensure compliance with those policies, plans, procedures, laws, and regulations, which could have a significant impact on operations and reports and determine whether the organization is in compliance.
- **Safeguarding of Assets**
Internal auditors should review the means of safeguarding assets and, as appropriate, verify the existence of such assets.
- **Economical and Efficient Use of Resources**
Internal auditors should appraise the economy and efficiency with which resources are employed.
- **Accomplishment of Established Objectives and Goals for Operations or Programs**
Internal auditors should 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

Background

Compliance with Texas Public Funds Investment Act

Effective May 19, 1975 the Real Estate Recovery fund was established by an amendment to the Real Estate License Act. The Commission was directed to use the fund for reimbursing aggrieved persons who suffer monetary damages by reason of certain acts committed by a duly licensed real estate broker or salesperson, or by an unlicensed employee or agent of a broker or salesperson.

A \$10.00 Recovery Fund fee is collected from each new applicant for a license in addition to the regular License filing fee. If on December 31 of any year the balance remaining in the Real Estate Recovery Fund is less than \$1 million, each broker and salesperson will be required to pay an additional fee of \$10.00 or a pro rata share of the amount necessary to bring the Recovery Fund to \$1.7 million dollars, whichever is less.

As set forth in the Real Estate License Act, as amended, the deposits to the Recovery Fund may be invested and reinvested in the same manner as funds of the Employee Retirement System of Texas. All investment transactions are conducted through the State Treasury.

Examination Process

The Education Section of the Licensing and Education Division is responsible for reviewing school, course, and instructor applications for education providers and conducting audits of these providers. This section is also responsible for the approval and regulation of 120 continuing education providers and 33 accredited schools offering real estate and inspection courses. To the extent permitted by current law, the Education section approves course content and determines the competency of instructors.

Experior, the Commission's private sector examination vendor, administers examinations for the Commission. The contract with Experior, formally, ACSI, Inc. d/b/a National Assessment Institute was signed on March 22, 1996. Since that time the contract has been extended on two occasions, the latest being June 30, 2000, which extended the contract through the period of September 1, 2000 to August 31, 2002.

Experior is contracted to perform the services related to the Examination process as follows:

- Develop examination for applicants for real estate salesmen, real estate broker, real estate inspector and professional inspector.
- Develop study guides satisfying the minimum requirements for real estate license applicants and inspector license applicants.

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- Administer all examinations at testing centers as described in the RFP, with the frequency required.
- Develop new examination items or substantial replacements for existing items at least annually and within 90 days after a request from the Commission based on changes in statutes or rules affecting persons licensed by the Commission.
- Provide services to applicants including providing information about examination schedules and procedures, collecting examination fees, notifying applicants of examination results and providing examination analyses to applicants.

Investigation and Complaint Resolution Processes

The Enforcement Division provides firm, fair, and consistent enforcement of the Real Estate License Act, the Texas Timeshare Act, and the Residential Service Company Act (the Acts). The Division Director supervises five attorneys, three legal assistants, a case manager, a staff of investigators and a support staff. The division is charged with the detection and prevention of violations of the laws enforced by the Commission to include investigation of complaints and initiating appropriate administrative action against firms or individuals. The Enforcement Division investigates allegations of individuals involved in unlicensed real estate activities and refers cases as necessary to the applicable legal authority. Investigations are conducted to determine the honesty, trustworthiness and integrity of licensing applicants and those renewing licenses when referred for investigation by the Licensing and Education Division.

The Commission requires signed written complaints to accompany alleged violations of laws enforced by the division. Many complaints are closed because of a lack of jurisdiction or evidence regarding the alleged violation, in these cases the complainants are informed of the status of the investigation and requests for additional information is made, as necessary. Licensees are informed of complaints (provided a copy of the complaint) that require investigation and both complainants and licensees are informed of the progress on at least a quarterly basis throughout the investigation. Disciplinary action must be approved by the Director of Enforcement. Upon the Directors approval settlement discussions between the licensee and the staff attorney may proceed and may result in an agreed order. If an agreed order cannot be reached then a formal hearing will be set in the county where the licensee conducts business. The presiding official of the Commission adjudicates the hearings; as such the official is independent of the investigation process.

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I. Audit Scope

Compliance with Public Funds Investment Act

This report satisfies the compliance audit requirements of the Public Funds Investment Act. The Texas Real Estate Commission (the Commission) has performed the compliance audit of management controls on investments and adherence to its established investment policies.

As part of our engagement, we performed procedures to:

- Determine if the Commission's policies and procedures comply with the Public Funds Investment Act (Government Code 2256, 1999) and that such policies and procedures are appropriate and reasonable for the Commission's investment types, goals, and strategies.
- Ascertain whether the Commission's policies and procedures establish internal controls sufficient to safeguard the funds assets, ensure proper conduct by participants in the investment process, and eliminate conflicts of interest over the investments of the Agency.
- Determine if such policies and procedures limit political and personal interference in the investment decision-making process, and
- Consider the appropriateness of the Commission's investments as reflected in the policies, strategies, and plans.

The compliance testing was performed in accordance with the Standards for the Professional Practice of Internal Auditing, generally accepted governmental auditing standards, the Certified Internal Auditor Code of Professional Ethics, the Statement of Responsibilities of Internal Auditing of the Institute of Internal Auditors, and the Texas Public Funds Investment Act and included other tests, as we considered necessary. Our tests of the policies, procedures, administrative and accounting systems and controls used to administer compliance with the Public Funds Investment Act disclosed no material instances of noncompliance with the requirements listed above.

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Examination Process

The scope of the audit of the Examination process consisted of the various audit procedures as follows:

- a. Determine that the Commission has established written policies, procedures, and practices that meet the requirements for administering the examinations;
- b. Obtain an understanding of the various policies, procedures and contractual requirements related to the examination process through staff interviews and review of the process related to administering the examination;
- c. Interview Commission staff responsible for the examination process.
- d. Review the contract and the related provisions and determine whether the contractor has complied with those requirements;
- e. Interview Commission staff responsible for processing the collection of examination fees.
- f. Determine whether the Commission's internal controls and procedures for collecting and processing examination fees are proper.

Investigation and Complaint Resolution

The scope of the audit of the Investigation and the Complaint Resolution processes included the following audit procedures:

- a. Determine that the Commission has established policies, procedures and current practices that ensure internal control over the detection and prevention of violations of the laws enforced by the Commission.
- b. Obtain an understanding of the internal controls and the related policies and procedures of the Investigation and Complaint Resolution processes.
- c. Review the report process and the types of reports provided by the Commission's information system and determine the key reports used in managing the caseloads and providing data to assist management in performing the required functions on a timely basis.
- d. Determine if the Commission has properly applied those policies and procedures for complaints received and to the resulting investigations by reviewing case files and related support.
- e. Determine whether the Commission is properly reporting the Key Performance Measures based on interviews of staff and review of the reports and related data used to determine the performance.
- f. Perform an analysis of investigation and complaint statistics for the current and prior year to determine whether the statistical data appears reasonable.

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II. Peer Review Report

The internal audit function received a peer review in August 25, 2000. The peer review resulted in an unqualified opinion.

III. Key Audit Findings/Recommendations

Report No.	Report Date	Name of Report	Findings/Recommendations	Status (Implemented, Partially Implemented, Action Delayed, No Action Taken)	Fiscal Impact/Other Impact
1	5/25/01	Annual Audit Report	<p>Examination Process</p> <p>1. The contract for administering examinations with the outside contractor "Experior" requires that the contractor ensure performance continuity by making replacements to staff only with persons having the requisite skills and experience. In addition the contractor is required to notify the Commission in writing no later than seven days after the replacement becomes effective and provide the details of skills experience and other qualifications of the replacements. The Commission did not provide documentation establishing that the contractor complied with the requirements.</p> <p>Recommendation We recommend that the Commission monitor the contract requirements to ensure that the contractor possesses the managerial ability to perform services under the contract.</p> <p>Management's Response We concur with the recommendation. The commission will monitor contract requirements. We have scheduled a meeting with Experior, the contractor, on August 20, 2001 to review contract requirements to ensure complete compliance including all documentation.</p>	Implemented	Internal Control over the Examination Process.

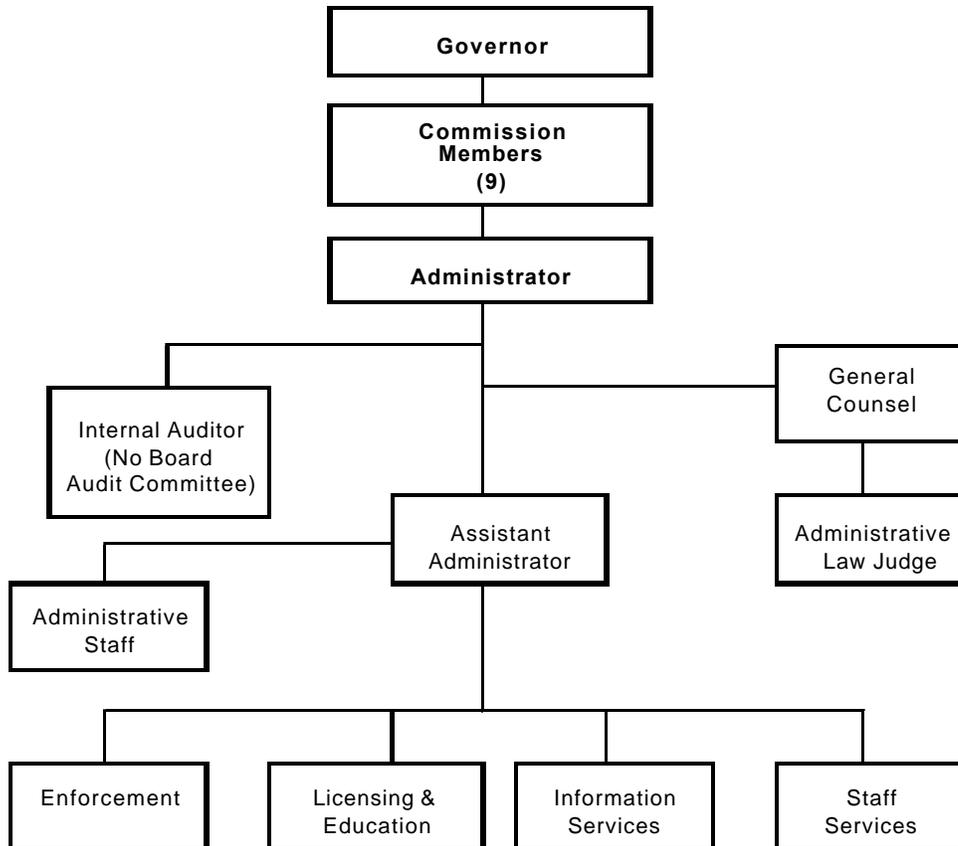
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IV. Organizational Chart



V. Proposed Internal Audit Plan for Fiscal Year 2002

- Compliance with the Public Funds Investment Act
- Cash receipts and fee process
- Program monitoring process
- Recovery fund process

TEXAS REAL ESTATE COMMISSION (TREC)

Portfolio Composition as of August 31, 2000

Investment Type	Book Value	Market Value
Savings Accounts(s) in Financial Institutions	\$ N/A	\$ N/A
Certificates of Deposit	N/A	N/A
Repurchase Agreements	N/A	N/A
No-Load Money Market Mutual Fund	N/A	N/A
No-Load Mutual Fund	N/A	N/A
Investment Pool(s)	N/A	N/A
U.S. Government Securities - Short-Term	500,781	502,313
U.S. Government Agencies - Long-Term	1,103,657	1,097,406
Mortgage-Backed Securities, Federal Home Loan Mortgage Notes	N/A	N/A
Collateralized Mortgage Obligations		
Interest-Only Strips	N/A	N/A
State Maturities Longer Than 10 Years	N/A	N/A
Municipal Debt	N/A	N/A
Guaranteed Investment Contract(s)	N/A	N/A
Corporate Bonds, Debentures, or Similar Debt Obligations	N/A	N/A
Equities	N/A	N/A
Other Investments		
Checking Accounts, interest-bearing, cash in investment accounts	1,226,862	1,226,862
TOTAL PORTFOLIO	\$ 2,831,300	\$ 2,826,581