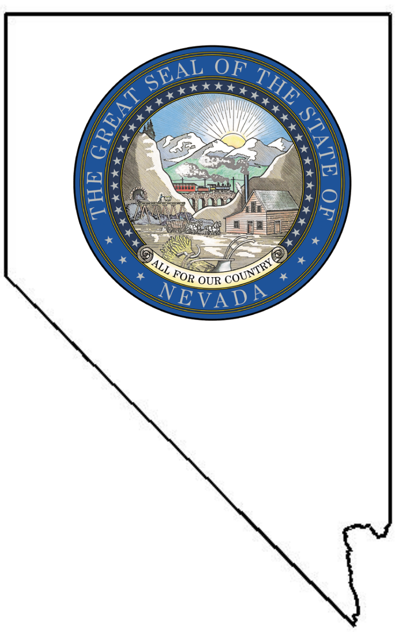
LA16-06

# STATE OF NEVADA

## Performance Audit

### Office of the Attorney General

2015




Legislative Auditor
Carson City, Nevada

# Audit Highlights

Highlights of performance audit report on the Office of the Attorney General issued on November 19, 2015. Legislative Auditor report # LA16-06.

## Background

The Office of the Attorney General (Office) is directed by the Attorney General, an elected officer of the State of Nevada. In fiscal year 2014, the Office had 350 authorized positions and personnel expenditures totaled about $33 million. One of the duties performed by the Office is to enforce consumer protection statutes, including those involving deceptive trade practices.

In fiscal year 2012, the Office participated in multimillion-dollar settlements against financial institutions that conducted deceptive mortgage lending practices. The largest settlement involved 49 states that sued major banks because of their mortgage lending practices.

In August 2012, the Office approached the Interim Finance Committee (IFC) to propose using about $33 million of the settlement funds to establish the program known as the Home Again Program. Under this Program, nonprofit organizations provide consumers free access to financial guidance services and legal counsel, as well as to specialized information about available state and federal housing assistance. The Program was approved by the IFC and again by the Legislature in the 2013 and 2015 Sessions. In addition, the Office pursued litigation against other financial institutions involved with mortgage lending in Nevada and reached settlements in fiscal years 2011 to 2014.

## Purpose of Audit

The purpose of the audit was to evaluate the Office of the Attorney General's process for collecting and disbursing restitution funds resulting from the litigation of deceptive trade practices. Our audit focused on activities related to deceptive trade practice litigation during fiscal years 2011 through 2014, but also 2015 for some activities.

## Audit Recommendations

This audit report contains six recommendations to improve the Office's controls over the disbursement of restitution funds from deceptive trade practice cases.

The Office of the Attorney General accepted the six recommendations.

## Recommendation Status

The Office's 60-day plan for corrective action is due on February 19, 2016. In addition, the six-month report on the status of audit recommendations is due on August 19, 2016.

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# Office of the Attorney General


## Summary

Between fiscal years 2011 and 2014, the Office pursued and obtained over $164 million in settlement funds from financial institutions for deceptive mortgage lending practices. These funds were to be used to help mitigate the effects of the foreclosure crisis on Nevada citizens. Although most of these funds were appropriately disbursed to victims and other entities, the Office's monitoring needs to be strengthened in some areas. For example, about $33 million of these funds were set aside to administer the Home Again Program. The Program provides a foreclosure hotline, and legal and credit counseling services through nonprofit organizations acting as grantees. We found the Office's review of grantee reimbursement requests for expenses was not adequate, annual fiscal audits of grantees were not performed, and performance data reported to the Legislature was not always accurate. As of July 2015, about $22 million remains to be disbursed under the Home Again Program. In addition to the Home Again Program, other settlement funds received were to be paid to homeowners that were affected by deceptive mortgage lending practices. We found that over $11 million in funds for victims that could not be located were not returned timely to the Office. Adequate monitoring of mortgage settlement funds in these areas is important to help ensure they are properly safeguarded and disbursed timely for the intended purposes.

The Office can also improve its controls over the disbursement of restitution funds for cases other than deceptive mortgage lending practices. Restitution funds are collected by the Office through court orders or agreements, and are payments to help make victims of deceptive trade practices whole. For example, the owner of an auto repair facility was ordered by the courts to pay restitution to customers that were charged for parts and services not provided. Although most restitution funds tested were disbursed after being collected, payments to victims for several cases were delayed from about 1 year to 3 years. Finally, the Office does not have adequate controls over the disbursement of restitution funds in its court settlement account. In fiscal year 2015, over $20 million was held in the account. Although we did not identify inappropriate disbursements, procedures are needed to help ensure funds are disbursed timely and adequately safeguarded.


## Key Findings

Since inception of the Home Again Program through fiscal year 2015, the Office reimbursed program grantees about $8 million. Although most payments we tested were appropriate, almost 15% of the amounts paid did not agree to supporting documentation originally provided to the Office. Even though additional supporting documentation was later provided upon our request for most of the amount tested, grantees could not provide documentation to support $21,000 in expenses tested. After our audit inquiries, a total of $56,195 in overpayments to grantees have been identified and repaid to the Office. (page 6)

The Legislature requested the Office submit quarterly reports to the IFC on the activities of the Home Again Program. We found that the reported number of services provided by grantees were not always accurate. Specifically, the information for one of four quarters tested in calendar year 2014 was significantly overstated. For example, the number of persons assisted through the credit restoration program was reported to be 1,970. However, supporting documentation showed only 696 persons received assistance. (page 9)

The Office did not perform annual fiscal audits of its three grantees for the Home Again Program. In the 2.5 years since the Program began, the Office performed one partial audit. Office procedures require annual fiscal audits of grantees. Audits help the Office ensure grantee expenses billed to the Program are appropriate. (page 10)

For 10 cases tested where the Office received restitution payments, we observed that funds collected were disbursed accurately. In addition, the majority of the funds were disbursed timely. However, funds for four cases were not disbursed timely. The funds were disbursed from about 1 year to 3 years after being received. The amount of restitution funds associated with the four cases totaled $213,079. Delaying restitution funds may cause financial hardship to victims. (page 15)

The Office does not have adequate controls over the disbursement of restitution funds in its court settlement account, which had disbursements ranging from $5 million to $46 million in the past 5 years. Disbursements were authorized through memorandums issued by attorneys and did not include supporting documentation or evidence of supervisory review and approval. (page 17)

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This report contains the findings, conclusions, and recommendations from our performance audit of the Office of the Attorney General. This audit was conducted pursuant to the ongoing program of the Legislative Auditor as authorized by the Legislative Commission. The purpose of legislative audits is to improve state government by providing the Legislature, state officials, and Nevada citizens with independent and reliable information about the operations of state agencies, programs, activities, and functions.

This report includes six recommendations to improve the Office's controls over the disbursement of restitution funds from deceptive trade practice cases. We are available to discuss these recommendations or any other items in the report with any legislative committees, individual legislators, or other state officials.

Respectfully submitted,

Paul V. Townsend, CPA
Legislative Auditor

October 6, 2015
Carson City, Nevada

# Office of the Attorney General
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# Introduction

## Background

The Office of the Attorney General (Office) is directed by the Attorney General, an elected officer of the State of Nevada. Its mission is to serve Nevada by advising and defending its institutions, enforcing laws for the protection and benefit of its citizens, ensuring open government, and empowering through educational outreach. The Office's organization consists of five bureaus and an administration unit. Each of the five bureaus is explained below:

1. Bureau of Business and State Services – The Bureau provides legal counsel and litigation services to the Departments of Business and Industry, Health and Human Services, Taxation, and Transportation.

2. Bureau of Consumer Protection – Enforces various consumer protection statutes. In particular, it enforces deceptive trade and antitrust laws through the filing of lawsuits on behalf of the State of Nevada and the public good.

3. Bureau of Criminal Justice – Consists of four fraud units: Insurance, Medicaid, Mortgage, and Workers' Compensation. It also contains the Special Prosecutions Division that exercises the Office's general jurisdiction to conduct any prosecution in any court of this State for violation of any law of the State.

4. Bureau of Gaming and Government Affairs – Consists of three divisions: Boards and Licensing, Gaming, and Government and Natural Resources. The Bureau serves client agencies and officials responsible for providing core government infrastructure.

5. Bureau of Litigation – Consists of three divisions: Appellate, Personnel, and Public Safety. The Bureau oversees appeals before the Nevada Supreme Court, Ninth Circuit Court of Appeals, and U.S. Supreme Court; prepares Attorney General legal opinions; advises executive branch departments, divisions, and agencies on all aspects of employment law; and coordinates with other state agencies that perform activities related to public safety.

**Budget and Staffing**

The Office is primarily funded from General Fund appropriations, fees for services, transfers from other agencies, and regulatory assessments. Total fiscal year 2014 revenues were about $148 million and included over $84 million in National Mortgage Settlement (NMS) funds explained below. Fiscal year 2014 expenditures were about $146 million and included about $51 million in NMS funds transferred to the Department of Business and Industry and about $46 million from its court settlement account.

In fiscal year 2014, the Office had 350 authorized positions and personnel expenditures totaled about $33 million. The Office of the Attorney General includes offices in Carson City, Las Vegas, and Reno.

**Settlements Related to Deceptive Mortgage Lending**

In fiscal year 2012, the Office participated in multimillion-dollar settlements against financial institutions that conducted deceptive mortgage lending practices. The largest settlement involved 49 states that sued major banks because of their mortgage lending practices. The settlement required these banks to change their conduct related to mortgage lending activities.

From this settlement, Nevada received a cash payment of over $57 million. As part of the settlement, banks also agreed to provide the following relief to Nevada homeowners:

- Loss Mitigation – $1.3 billion to homeowners through principal reduction, facilitation of short sales, unemployment payment forbearance or forgiveness, relocation assistance, deficiency waivers, funding for remediation of blighted properties, and service-member short sale programs.

- Refinance Program – About $57 million in Nevada for a refinance program for those individuals who owed more than the value of their home, but were still making payments.
- Borrower Payments – Homeowners that were foreclosed upon could apply for a cash payment of up to $2,000.

To help ensure compliance with the provisions listed above, an independent monitor was included to oversee the settlement and provide periodic reports. In addition, a monitoring committee was established, which the Office participated in, to monitor whether the banks were complying with the settlement provisions.

Although the Bank of America was part of the multi-state settlement, the Office had already taken legal action against the Bank of America. As a result, Nevada received a cash payment of over $32 million from the Bank of America in a separate settlement. In addition, the Bank of America was to provide principal reductions to loans and undertake at least $750 million in loan modifications and other assistance in Nevada. The Bank of America provided quarterly reports to the Office, which monitored compliance with the provisions of the settlement.

The combination of funds from these two settlements is referred to as the National Mortgage Settlement (NMS), and resulted in cash payments to the State totaling about $90 million. Of this amount, about $52 million was transferred in fiscal years 2014 and 2015 to the Department of Business and Industry to support programs approved by the Office to mitigate the effects of the mortgage and foreclosure crisis in Nevada. The remaining $38 million remained under the control of the Office.[1]

In August 2012, the Office approached the Interim Finance Committee (IFC) to ask for input and support concerning the use of funding received by the State because of the NMS. The Office proposed a 3-year program to use approximately $33 million of the

[1] See Appendix A for additional information about NMS receipts and disbursements.

settlement funds to establish a call center and a program that is a partnership between the Office and nonprofit organizations. The program is known as the Home Again Program and provides free access to financial guidance services and legal counsel, as well as to specialized information about available state and federal housing assistance. The Program was approved by the IFC and again by the Legislature in the 2013 and 2015 Sessions.

In addition to the NMS, the Office pursued litigation against other financial institutions involved with mortgage lending in Nevada, and reached settlements with these entities. The settlements brought an additional $75 million in funding to the State and Nevada citizens. Exhibit 1 shows the amounts received by the Office from all deceptive mortgage lending settlements between fiscal years 2011 and 2014.

**Deceptive Mortgage Lending Settlements Fiscal Years 2011 to 2014** **Exhibit 1**

| Bank/Settlement | Fiscal Year | Amounts Received |
|---|---|---|
| National Mortgage Settlement | 2012 | $ 89,510,122 |
| Royal Bank of Scotland | 2013 | 42,500,000 |
| Morgan Stanley | 2012 | 12,973,454 |
| Deutsche Bank | 2014 | 11,500,000 |
| Lender Processing Services | 2014 | 6,064,258 |
| Wells Fargo | 2011 | 1,494,211 |
| Pulte Mortgage | 2011 | 475,000 |
| **Total** | | $164,517,045 |

Source: State accounting records and settlement agreements.

Of these settlement funds, over $27 million was distributed to victims of deceptive mortgage lending practices and about $19.7 million was transferred to the state's General Fund to help offset shortfalls in statutorily required reserves. Appendix B provides additional information regarding the receipts and disbursements from the mortgage settlements other than the NMS.

## Scope and Objective

The scope of our audit focused on activities related to deceptive trade practice litigation during fiscal years 2011 through 2014, but also 2015 for some activities. Our audit objective was to:

- Evaluate the Office of the Attorney General's process for collecting and disbursing restitution funds resulting from the litigation of deceptive trade practices.

This audit is part of the ongoing program of the Legislative Auditor as authorized by the Legislative Commission, and was made pursuant to the provisions of NRS 218G.010 to 218G.350. The Legislative Auditor conducts audits as part of the Legislature's oversight responsibility for public programs. The purpose of legislative audits is to improve state government by providing the Legislature, state officials, and Nevada citizens with independent and reliable information about the operations of state agencies, programs, activities, and functions.

# Monitoring of Mortgage Settlement Funds Needs To Be Strengthened In Some Areas

Between fiscal years 2011 and 2014, the Office pursued and obtained over $164 million in settlement funds from financial institutions for deceptive mortgage lending practices.  These funds were to be used to help mitigate the effects of the foreclosure crisis on Nevada citizens.  Although most of these funds were appropriately disbursed to victims and other entities, the Office's monitoring needs to be strengthened in some areas.  For example, about $33 million of these funds were set aside to administer the Home Again Program.  The Program provides a foreclosure hotline, and legal and credit counseling services through nonprofit organizations acting as grantees.  We found the Office's review of grantee reimbursement requests for expenses was not adequate, annual fiscal audits of grantees were not performed, and performance data reported to the Legislature was not always accurate.  As of July 2015, about $22 million remains to be disbursed under the Home Again Program.  In addition to the Home Again Program, other settlement funds received were to be paid to homeowners that were affected by deceptive mortgage lending practices.  We found that over $11 million in funds for victims that could not be located were not returned timely to the Office.  Adequate monitoring of mortgage settlement funds in these areas is important to help ensure they are properly safeguarded and disbursed timely for the intended purposes.

## Review of Expenditure Reimbursement Requests From Grantees Could Be Improved

Since inception of the Home Again Program through fiscal year 2015, the Office reimbursed three program grantees about $8 million.  During our audit work, we tested reimbursement payments to Home Again Program grantees totaling over

$745,000. While most payments were appropriate, our testing found that almost 15% of the reimbursement amounts paid in our sample did not agree to supporting documentation originally provided to the Office. Although additional supporting documentation was later provided upon our request for most of the amount tested, grantees could not provide documentation to support $21,000 in expenses tested. Because of our audit inquiries, a total of $56,195 in overpayments to grantees have been identified and repaid to the Office. Adequate review of expenditure reimbursements is important to help ensure the Office pays only appropriate expenses related to the Home Again Program, and to conserve program funds for future needs.

The Office oversees the Home Again Program, which uses funds from the National Mortgage Settlement to pay grantees that provide free financial guidance and legal counsel to Nevada residents. The Office approves grantees' annual budgets for program expenses. Grantees then submit monthly reimbursement requests for program related expenses.

We reviewed 15 reimbursement payments randomly selected and found that 8 of 15 (53%) did not have adequate documentation to support all amounts claimed. A total of 73 payments were made to grantees during the audit scope. The Office reimbursed grantees for the amounts requested despite lacking adequate supporting documentation. Examples of insufficient documentation found during our testing included:

- Grantee billed $20,498 for "Dues/Outreach/Ins.," but did not provide any documentation to support the amount.
- Grantee billed $11,417 for payroll expenses, but did not provide copies of check or pay stubs to verify amounts, as required by the Office's procedures.
- Grantee billed $4,298 for energy expenses, but only provided documentation to support $683 in expenses.

From our sample, grantees received reimbursements from the Office without providing documentation to support about $104,400 in expenses used to claim $745,609 in reimbursements.

Despite initially lacking adequate documentation, grantees provided adequate supporting documentation for most exceptions upon our request.  However, the grantees were unable to provide supporting documentation for approximately 3% of the reimbursement dollars tested.  As a result, we found $21,006 was overpaid to grantees by the Office.  Examples of overpayments included:

- Over several months, one grantee billed $10,380 for two employees' insurance premiums.  However, the grantee was not billed an insurance premium for one employee. For the other employee, the insurance premiums billed the grantee were significantly less than the amount requested for reimbursement by the grantee.
- A grantee overcharged the Office $5,702 for employees' benefit costs.  The employees' benefit costs were double-billed for two consecutive months.
- Another grantee did not use the correct percentage to bill lease expenses to the Office, resulting in an overpayment to the grantee of $3,157.  This grantee administers several programs and allocates its expenses, like the lease, between programs.

Because of our audit inquiries, a total of $56,195 in overpayments to grantees have been identified and repaid to the Office.  When we discussed some of our findings with agency personnel, they worked with grantees and received refunds for the overpayments we identified and additional overpayments identified by the grantees.

The Office developed general policies and procedures for the Home Again Program that required grantees to provide copies of supporting documentation for each expenditure reported. However, these policies and procedures were not always followed because agency personnel believed their primary focus was to ensure grantees were not paid in excess of amounts budgeted in their grant agreements.  Therefore, all supporting documentation for reimbursement requests was not always provided and adequate reviews were not performed.

## Home Again Program Reports Were Not Always Accurate

Through a 2013 Letter of Intent, the Legislature requested quarterly reports on the activities of the Home Again Program. Although the Office provided the reports to the IFC, we found that the reported number of services provided by grantees were not always accurate. Specifically, information for one of the four quarters tested in calendar year 2014 was significantly overstated. For example, the number of persons assisted through the credit restoration program was reported to be 1,970. However, supporting documentation showed only 696 persons received assistance. The information for two other quarters also had inaccuracies, although the differences were less significant. The Office provided six quarterly reports to the IFC during the audit scope. Decision makers need accurate information to help ensure programs meet their intended purposes and program funding levels are appropriate.

Exhibit 2 shows the information reported for each quarter in 2014 compared to supporting documentation.

**Home Again Program Data Reported to IFC Compared to Supporting Documentation** **Exhibit 2**

| Date/Description | Counseling Sessions[1] | Class Participants | Credit Restoration Programs[2] |
|---|---|---|---|
| **Jan. – Mar. 2014** | | | |
| Supporting Documentation | 299 | 903 | 693 |
| Reported to IFC | 299 | 903 | 693 |
| **Difference Over/(Under)** | **0** | **0** | **0** |
| **Apr. – Jun. 2014** | | | |
| Supporting Documentation | 345 | 962 | 596 |
| Reported to IFC | 304 | 947 | 540 |
| **Difference Over/(Under)** | **(41)** | **(15)** | **(56)** |
| **Jul. – Sep. 2014** | | | |
| Supporting Documentation | 218 | 708 | 696 |
| Reported to IFC | 900 | 2,884 | 1,970 |
| **Difference Over/(Under)** | **682** | **2,176** | **1,274** |
| **Oct. – Dec. 2014** | | | |
| Supporting Documentation | 217 | 635 | 676 |
| Reported to IFC | 217 | 637 | 552 |
| **Difference Over/(Under)** | **0** | **2** | **(124)** |

Source: Auditor review of Office records.
[1] Number of participants in one-on-one counseling sessions.
[2] Number of participants provided credit restoration services.

As shown above, most of the differences between what was reported to the IFC and what was shown on supporting documentation occurred in the quarter ending September 2014.

The Office relies on a grantee to collect and compile reported information. According to the Office, some numbers reported were incorrect because the IFC report was due before all information was collected by the grantee preparing the report. For the significant discrepancy in the third quarter numbers, agency personnel were unable to determine how the errors occurred.

Internal control standards require management evaluate both internal and external sources of data for reliability. In addition, these standards require reported information be complete and accurate. The Legislature and management need accurate information to help ensure programs meet their intended purposes and program funding levels are appropriate.

## Annual Fiscal Audits of Grantees Were Not Performed

The Office did not perform annual fiscal audits of its three grantees for the Home Again Program. In the 2.5 years since the Program began, the Office performed one partial fiscal audit of one grantee. Since inception of the Program through fiscal year 2015, the Office reimbursed grantees about $8 million. According to its policies and procedures, the Office is supposed to perform annual fiscal audits of grantees. Performing annual fiscal audits would help the Office ensure grantee reimbursement claims are accurate and expenses billed to the Program are appropriate.

When the Office started the Home Again Program, it created a document outlining general policies and procedures for the Program. These included performing an annual fiscal audit of grantees. The audits were to include the following:

- random test of transactions selected from reimbursement reports,
- procedural fiscal interviews with selected staff, and
- review of financial records to ensure no comingling of revenues or expenses related to the Home Again Program.

Despite this policy, only one partial audit was performed in the 2.5 years since the Program began. Since the Home Again Program began, the Legislature authorized four positions to oversee program activities, which would include fiscal audits of grantees.

For the partial audit, we found documentation showing staff performed a random test of transactions for one grantee. This random test of transactions was dated November 2014, after we began asking questions about the Program. However, the audit was not performed on-site and did not include procedural fiscal interviews or a review of financial records to ensure no comingling of revenues or expenses related to the Home Again Program.

Although the Office indicated it works closely with grantees and requires grantees submit reimbursement requests for payment, these do not replace on-site fiscal audits where supporting documentation is examined thoroughly, and grantee procedures and activities can be observed. As previously discussed in our report, problems with supporting documentation and overpayments for some grantee expenses occurred despite the Office's monitoring activities mentioned above, and were only found after our audit was performed.

Performing annual fiscal on-site audits would help the Office ensure grantee reimbursement claims are accurate and expenses billed to the Program are appropriate. Since we discussed this issue with the Office, staff indicated they have performed on-site audits of all three grantees as of April 2015.

## Undisbursed Mortgage Settlement Funds Were Not Returned Timely

For two mortgage settlements, the Office obtained settlement funds totaling $38 million to be disbursed among victims of deceptive mortgage lending practices. These funds were disbursed using a third party administrator (TPA), as required by the settlement agreements. Although the majority of the funds were disbursed, the Office did not adequately monitor the TPA to ensure $11 million in undisbursed funds were returned timely to the Office. When funds for which the Office has oversight are not properly monitored and returned timely, there is a greater risk payments to victims will be delayed and funds will become susceptible to misappropriation or theft.

Besides the National Mortgage Settlement, the Office settled deceptive trade practice cases with other mortgage related entities. As of September 2014, these settlements totaled $75 million. Over $38 million of these funds was provided to a TPA that handled the disbursement of funds to homeowners harmed by the deceptive mortgage lending practices. The TPA has not been able to locate some victims and over $11 million remains undisbursed. According to the Office, undisbursed funds will be collected from the TPA and deposited with the State Treasurer's Unclaimed Property Program; thereby, providing the opportunity for victims to claim the funds.

The two settlements that involved the use of the TPA were the Royal Bank of Scotland and Morgan Stanley settlements. The Royal Bank of Scotland settlement included $36 million for disbursement to victims. According to documentation provided by the Office, almost 1.5 years have passed since most funds were disbursed. Specifically, our review of agency documentation found the following regarding the disbursement of Royal Bank of Scotland funds:

- December 2013 – Office transferred $36 million to TPA, who began disbursing funds to homeowners.
- February 2014 – TPA updated Office on status of disbursed checks indicating it obtained new addresses and reissued some checks ($21.4 million of $36 million disbursed).
- August 2014 – TPA provided another update on the status of disbursed checks and requested instruction on what to do with about $10.6 million in undisbursed funds.
- December 2014 – We inquired of Office personnel regarding the status of undisbursed funds, and the Office directed TPA to perform one last attempt to locate homeowners with uncashed checks so remaining funds could be sent to the state's Unclaimed Property Program.
- January 2015 – TPA issued letters to try and identify current contact information for homeowners that have not

received restitution funds ($10.5 million in undisbursed funds remained).

As of June 2015, $10.5 million in undisbursed funds from the Royal Bank of Scotland settlement remained with the TPA, over 18 months after disbursements were initially made to victims.

For the Morgan Stanley settlement, $2 million was provided as restitution to victims of deceptive mortgage lending practices. According to documentation provided by the Office, over 3 years have passed since most funds were disbursed. Specifically, our review of agency documentation found the following regarding the disbursement of Morgan Stanley funds:

- February 2012 – TPA began disbursing $2 million in restitution funds to homeowners.
- June 2012 – Documentation showed $1.3 million of the $2 million in restitution funds disbursed.
- September 2013 – TPA informed Office about status of undisbursed funds totaling about $780,000.
- September 2014 – TPA provided Office with another update of undisbursed funds, totaling $600,000.

As of June 2015, $580,000 in undisbursed funds from the Morgan Stanley settlement remained with the TPA. The settlement required the return of undistributed funds to the Office within 6 months after the effective date of the settlement (September 9, 2011), but this did not occur.

According to management, the attorney that oversaw the two settlements was also monitoring the TPA. However, during this time, the attorney's main focus was on other multi-million dollar mortgage lending settlements completed by the Office. Management agreed that the responsibility for overseeing the TPA should have been assigned primarily to fiscal personnel.

When restitution funds for which the State has stewardship are not properly monitored to ensure timely disbursement, this delays funds getting to victims of deceptive trade practices. In addition, the State missed the opportunity to earn interest on these funds as most of the funds were deposited in non-interest bearing accounts.

## Recommendations

1. Ensure adequate documentation is provided for Home Again Program reimbursement requests, and perform thorough reviews of these requests to help ensure charged expenses are appropriate under the grant agreement.
2. Develop procedures to help ensure Home Again Program information reported to the Legislature and management is reliable.
3. Ensure annual on-site audits of Home Again Program grantees are completed as outlined in the Office's policies for the Program, and develop procedures for performing these audits.
4. Develop procedures to help ensure settlement funds not tracked within the state accounting system are properly monitored, and returned timely to the State for proper safeguarding.

# Controls Over Disbursement of Restitution Funds Are Needed

The Office can also improve its controls over the disbursement of restitution funds for cases other than deceptive mortgage lending practices. Restitution funds are collected by the Office through court orders or agreements, and are payments to help make victims of deceptive trade practices whole. For example, the owner of an auto repair facility was ordered by the courts to pay restitution to customers that were charged for parts and services not provided. Although most restitution funds tested were disbursed after being collected, payments to victims for several cases were delayed from about 1 year to 3 years. Finally, the Office does not have adequate controls over the disbursement of restitution funds in its court settlement account. In fiscal year 2015, over $20 million was held in the account. Although we did not identify inappropriate disbursements, procedures are needed to help ensure funds are disbursed timely and adequately safeguarded.

## Process to Disburse Restitution Funds Can Be Improved

For 10 cases tested where the Office received restitution payments, we observed that funds collected were disbursed accurately. In addition, the majority of the funds were disbursed timely. However, restitution funds for four cases were not disbursed timely. The time required to disburse funds to victims ranged from about 1 year to 3 years after funding was available for disbursement. We considered funding available for disbursement after a court judgment or agreement was obtained. The amount of restitution funds associated with the four cases totaled $213,079. Delaying restitution funds may cause financial hardship to victims. Furthermore, when payment of restitution funds is not timely, there is greater risk the Office will not be able to locate victims.

The following examples provide more detail on two of the cases with untimely payment of restitution funds to victims:

- Case 1 – As of May 2010, the Office received $13,200 of the $33,806 in restitution owed. However, the Office waited until August 2012, over 2 years, before making payments to the two victims. Office personnel indicated they wanted to wait until all the restitution money was collected before paying the victims.
- Case 2 – The Office collected restitution funds in two installments. For the first installment, $17,549 was collected in December 2009. The second installment of $31,766 was received in May of 2013. Once the second installment was received, three victims were promptly paid. However, the remaining 34 victims were not paid for over 1 year. The amount owed these victims totaled $44,315. Amounts due victims ranged from $346 to $3,519.

The Office has not developed centralized policies and procedures for disbursing restitution funds. Each unit tracks its own cases and it is left up to the attorney assigned the case to notify the accounting unit regarding payments to victims. This has resulted in different methods of disbursing restitution funds, including some attorneys waiting until all funds are collected and some making periodic disbursements as funds are available.

The Division of Parole and Probation also collects restitution funds and has indicated those funds are allocated among the victims and paid immediately upon receipt, even if the total restitution amount was not received. This is a good practice that the Office could adopt. However, any process adopted by the Office should ensure it is cost effective for the State.

Delays in disbursing restitution funds to victims may cause financial hardship for some victims. For some of the cases tested, restitution payments to individual victims ranged from $22,000 to $50,000. In addition, when payment of funds is not timely, there is greater risk the Office will not be able to locate victims.

## Controls Over Court Settlement Funds Are Not Adequate

The Office does not have adequate controls over the disbursement of restitution funds in its court settlement account. Money deposited in this account is for restitution ordered as the result of descriptive trade practices. In fiscal year 2015, over $20 million was held in this account. Despite the large amount of money that is sometimes in this account, the Office does not have written policies and procedures over the disbursement of these funds, including reconciliation of the account. Disbursements were authorized through memos from attorneys and did not include evidence of supervisory review and approval. Although our testing did not identify inappropriate disbursements, adequate controls are important to help ensure funds are properly safeguarded.

We tested the appropriateness of all payments for the 10 cases with the largest amounts of restitution ordered, which included 139 payments. Although we found only one instance of an incorrect payment for the transactions we tested, inadequate controls increase the risk that fraud or errors could occur and go undetected. For example, we observed one instance where the Office paid $1,500 more to victims than was due to them. The Office did not detect this overpayment because the account is not periodically reconciled.

The court settlement account is used to disburse restitution funds to victims. In the past 5 years, disbursements from the account have ranged from about $5 million to $46 million.

The Office does not have written policies and procedures for disbursing funds from the account. The disbursements we observed were authorized through memorandums issued by attorneys and did not include evidence of supervisory review and approval, or supporting documentation. Additionally, the Office has not reconciled account activity per state accounting records to the Office’s internal records of restitution funds received and disbursed. However, the Office’s accounting unit has recently been working to reconcile the account.

## Recommendations

5. Develop centralized procedures for the payment of restitution funds, including supervisory review and approval of amounts payable to victims and supporting documentation for the disbursements.
6. Develop procedures to reconcile state accounting records to the Office's records of restitution funds received and disbursed in the court settlement account.

# Appendix A

## Receipts and Disbursements From National Mortgage Settlement
## Fiscal Years 2013 to 2015

| RECEIPTS | FY2013 | FY2014 | FY2015 (1) |
|---|---|---|---|
| Balance Carried Forward | – | $84,667,248 | $30,448,672 |
| Multi-state Mortgage Settlement | $57,368,430 | – | – |
| Bank of America Settlement | 32,081,897 | – | – |
| Interest Income | 340,860 | 151,845 | 117,345 |
| **Total Receipts** | $89,791,187 | $84,819,093 | $30,566,017 |
| **DISBURSEMENTS** | | | |
| **Attorney General Administration Expenses** | | | |
| Personnel Services | $ 197,445 | $ 338,148 | $ 354,657 |
| Mortgage Fraud Allocation | 16,731 | 14,453 | 11,909 |
| Administrative Costs | 25,492 | 26,487 | 23,733 |
| AG Cost Allocation | – | 36,359 | 37,214 |
| **Home Again Program Expenses** | | | |
| Call Center | 298,440 | 127,695 | 79,143 |
| Financial Guidance Center | 1,745,640 | 2,266,806 | 1,630,017 |
| Legal Services | 655,235 | 978,543 | 752,372 |
| **Transfers to Other Accounts** | | | |
| Department of Business and Industry | 103,059 | 50,581,930 | 1,399,165 |
| Attorney General Unfair Trade Practices Budget Account | 2,081,897 | – | – |
| **Total Disbursements** | $ 5,123,939 | $54,370,421 | $ 4,288,210 |
| Ending Balance | $84,667,248 | $30,448,672 | $26,277,807 |

Source: State accounting records.
(1) Fiscal year 2015 amounts are as of August 4, 2015.

# Appendix B

## Receipts and Disbursements From Other Mortgage Settlements Fiscal Years 2011 to 2015 (3)

| Entity | Amounts Received | Outside Legal Counsel Payments | General Fund Transfers | Victim Restitution Payments | Transfers to Other AG Units | Transfers to Other State Agencies | Balance Remaining |
|---|---|---|---|---|---|---|---|
| Royal Bank of Scotland | $42,500,000 | ($ 6,375,000) | ($ 125,000) | ($36,000,000)(1) | – | – | – |
| Deutsche Bank | 11,500,000 | (1,491,100) | (10,008,900) | – | – | – | – |
| Morgan Stanley | 12,973,454(2) | (3,611,591) | (4,280,363) | (2,089,454)(1) | ($2,087,550) | ($70,899) | $833,597 |
| Lender Processing Services | 6,064,258 | (892,384) | ( 5,171,874) | – | – | – | – |
| Wells Fargo | 1,494,211(2) | (300,000) | – | – | (1,194,211) | – | – |
| Pulte Mortgage | 475,000 | (175,000) | (300,000) | – | – | – | – |
| **Totals** | **$75,006,923** | **($12,845,075)** | **($19,886,137)** | **($38,089,454)** | **($3,281,761)** | **($70,899)** | **$883,597** |

Source: State accounting records and settlement agreements.

(1) The Office of the Attorney General anticipates return of over $10.5 million from a third-party administrator. These amounts are due to victims that cannot be located. The amounts identified for these victims will be transferred to the State Treasurer's Unclaimed Property Program.

(2) For these settlements, additional monetary benefits such as interest rate reductions were provided directly to Nevada citizens.

(3) Amounts are as of August 4, 2015.

# Appendix C
## Audit Methodology

To gain an understanding of the Office of the Attorney General (Office), we interviewed staff and reviewed statutes, regulations, and policies and procedures significant to the Office's operations. We also reviewed financial information, prior audit reports, budgets, legislative committee minutes, and other information describing Office activities. Furthermore, we documented and assessed internal controls over the payment of contractors, administration of tort claims, grant monitoring, and collection and disbursement of restitution funds.

To determine whether the Office of the Attorney General has an effective process for collecting and disbursing restitution funds resulting from the litigation of deceptive trade practices by mortgage lending entities, we reviewed Office and state accounting system records to identify cases settled between fiscal years 2011 to 2014. For each settlement with a mortgage lending entity, we reviewed accounting records to determine the amount of settlement funds collected and compared those amounts to the required amounts in the settlement agreement. Furthermore, we calculated the time between when the settlements were finalized and the funds were received and recorded in the state accounting system.

To determine if disbursements of National Mortgage Settlement (NMS) funds to grantees were appropriate, we randomly selected 15 reimbursements paid to Home Again Program grantees from fiscal years 2013 and 2014, including five from each of the three grantees that were greater than $10,000. We tested our sample items to ensure that supporting documentation for reimbursement requests was adequate, agreed to reimbursement amounts, and agreed to allowable costs per the grant documents. When documentation was not adequate, we requested additional documents to support the reimbursement request. We also discussed our findings with Office and grantee personnel as necessary.

To determine if Home Again Program information provided to the Legislature's Interim Finance Committee (IFC) was reliable, we requested supporting documentation from the Office for calendar year 2014 information reported to the IFC. Specifically, we requested supporting documentation for first time homeowners (FTH) counseling sessions, FTH class participants, and credit restoration programs. We compared the numbers shown in the supporting documentation to those reported to the IFC. In addition, we discussed with Office personnel discrepancies between the numbers calculated using supporting documentation and those reported to the IFC.

To evaluate if the Office performed annual fiscal audits of Home Again Program grantees, we reviewed policies and procedures related to the Program. In addition, we requested documentation from the Office showing audits of program grantees. We then compared the documentation provided by the Office to the audit procedures contained in the Home Again Program policies and procedures.

To determine if mortgage settlement funds not related to the NMS were disbursed accurately and adequately safeguarded, we reviewed state accounting system records and documented disbursements of funds for all six settlements with restitution funds completed during our audit scope. In addition, we documented settlement terms related to the disbursement of funds and compared these terms to the Office's disbursement activities. When settlement funds were disbursed to a third party administrator (TPA), we reviewed Office and TPA documentation regarding the disbursement of funds, and documented the Office's actions to monitor the TPA. In addition, we discussed Office monitoring and TPA disbursement activities with Office personnel.

To evaluate if the Office had adequate controls over the collection and disbursement of restitution funds involving deceptive trade practices not related to the mortgage settlements, we judgmentally selected cases where restitution funds were awarded victims, excluding Medicaid, Workers' Compensation, and Insurance fraud where the victim is usually a government entity. Using agency accounting records and information reported from various units, we compiled a list of deceptive trade cases finalized between fiscal years 2011 and 2014. Our audit procedures identified 79 cases during the audit scope involving restitution amounts owed and collected by the Office.

To determine if restitution funds received by the Office on behalf of victims were collected and disbursed timely, we judgmentally selected 10 cases (out of 51) with the highest amount of restitution ordered. For these cases, we reviewed the Office's case documentation and state accounting records to identify restitution amounts, victims, and restitution payments. To verify restitution funds were collected, we reviewed court orders and compared the restitution amount ordered to the amount collected by the Office.

To determine if restitution funds were disbursed correctly, we reviewed court orders and state financial records regarding disbursement of funds. To evaluate the timeliness of payments, we calculated the time from when a court order or agreement was reached to the disbursement of funds recorded in the state accounting system. In addition, we discussed collection and disbursement of restitution funds with Office personnel.

To evaluate if restitution funds received by the Office without specific victims were collected and disbursed timely, we judgmentally selected five cases (out of 28) with the highest amount of restitution due. For these cases, we documented the settlement agreements, payment information, and information regarding the disbursement of the funds for the cases tested. We also calculated the time required to deposit the funds once the Office received them.

For our sample design, we used nonstatistical audit sampling, which was the most appropriate and cost effective method for concluding on our audit objective. Based on our professional judgment, review of authoritative sampling guidance, and consideration of underlying statistical concepts, we believe that nonstatistical sampling provided sufficient, appropriate audit evidence to support the conclusions in our report. We have not projected the errors noted in our samples to the population because our samples included randomly and judgmentally selected items. Judgmental selections were made based on an analytical review of data and known risk factors such as high dollar value items. Since a portion of our samples were based on these risk factors, we do not think a projection of the errors would be appropriate.

Our audit work was conducted from July 2014 to July 2015. 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 objective.

In accordance with NRS 218G.230, we furnished a copy of our preliminary report to the Attorney General. On September 23, 2015, we met with agency officials to discuss the results of the audit and requested a written response to the preliminary report. That response is contained in Appendix D, which begins on page 24.

Contributors to this report included:

Todd Peterson, MPA
Deputy Legislative Auditor

Rick Neil, CPA
Audit Supervisor

David Steele, CPA
Deputy Legislative Auditor

# Appendix D

## Response From the Office of the Attorney General

STATE OF NEVADA

OFFICE OF THE ATTORNEY GENERAL

100 North Carson Street
Carson City, Nevada 89701-4717

ADAM PAUL LAXALT
*Attorney General*

WESLEY K. DUNCAN
*Assistant Attorney General*

NICHOLAS A. TRUTANICH
*Chief of Staff*

October 5, 2015

Mr. Paul V. Townsend
Legislative Auditor
Legislative Counsel Bureau
401 South Carson Street
Carson City, Nevada 89701

Dear Mr. Townsend:

Enclosed please find the responses to the draft audit report we received on September 23, 2015. As you know, the audit focused on many activities that pre-date my term as the Nevada Attorney General. We are pleased that the audit did not identify any inappropriate disbursements. We accept all audit recommendations and have started to implement procedures and take immediate action to address audit findings, as they were identified during my tenure. Nonetheless, please see the attached written explanation to the audit report.

Please do not hesitate to call me if you have questions about the response.

Sincerely,

ADAM PAUL LAXALT
Attorney General

Recommendation #1:

**Ensure adequate documentation is provided for Home Again Program reimbursement requests, and perform thorough reviews of these requests to help ensure charged expenses are appropriate under the grant agreement.**

Agency Response:

Recommendation accepted.

We agree that it is important to ensure that charged expenses are appropriate, and that the review of reimbursement requests could be improved. Given that out of 8 million dollars reimbursed to the grantees over the 2.5 year period of the Audit, the Audit only identified $21,006 in overpayments to Home Again grantees. Because of these audit inquiries, the office performed additional reviews, and overpayments identified by the grantees brought the total to $56,195. All overpayments have been repaid, and we are appreciative that the audit process helped bring this to our attention. No other discrepancies have since been noted upon further review.

The findings from the LCB audit seem to have originated from the size of the supporting documents and the instructions previously relayed to the Grantees. Because of the voluminous size of the supporting documents provided on a monthly basis, the main Grantee was instructed to provide limited documentation for reimbursement purposes and to keep on file all other supporting documentation that could be made available upon request for on-site audit purposes. In theory it appeared that this policy was acceptable because the main Grantee also performed on site audits of the sub-grantees on a regular basis. Nonetheless, as a result of this Audit finding, the previous instructions given to the main grantee, despite the on-site audits of the sub-grantees was found to be inadequate. As a result, new grant agreements entered into by the Home Again Grantees in July of 2015, provide for additional supporting documentation required to support reimbursement requests. Further, these new grant agreements will ensure adequate documentation is provided to guarantee 100% of the reimbursement amounts paid conform with supporting documentation provided to the Office. The Office will continue to refine and develop appropriate procedures to monitor and perform thorough reviews of these requests.

Recommendation #2:

**Develop procedures to help ensure Home Again Program Information reported to the Legislature and management is reliable.**

Agency Response:

Recommendation accepted.

The office agrees that information provided about any program should be as accurate as possible when reporting to the IFC or any entity that requests such information about the Program. Under the previous administration, the office performed a random sample of services for the first quarter 2014 of the Program and found no discrepancies.

However, the LCB auditors found that in two quarters (April – June of 2014 and October – December 2014) some figures were *underreported* to the IFC. This was generally due to the fact that in some instances numbers were reported early in order to complete IFC reports on time.

In addition, in the following quarter (July – September of 2014) figures were *over reported,* which in essence propagated this particular error in subsequent reports. Basically, one month in this quarter out of the 30-month period identified in the audit accounted for the majority of the discrepancy. Our own analysis noted that there was a staffing change with the main Grantee that may have contributed to this error and, despite lengthy review efforts, it was not possible to find the reason for the large discrepancy. Subsequent reports presented to the IFC have corrected the underlying propagated error and the office will continue to ensure any data or information is reliable. The office has refined and will continue to develop procedures to ensure Home Again information reported is reliable.

Recommendation #3

**Ensure annual on-site fiscal audits of Home Again Program grantees are completed as outlined in the Office's policies for the Program, and develop procedures for performing these audits.**

<u>Agency Response:</u>

<u>Recommendation accepted.</u>

We agree that onsite audits of the Home Again grantees should be completed annually. Although the Grant Analyst falls within the 1045 budget, the position is supervised by and reports to the CFO. A request was made by the Multistate Counsel for a fiscal audit of the Home Again Program in mid-2013, but the prior CFO responded that the request was premature. Additional requests were made for on-site fiscal audits to occur in 2014, but it is believed that the Grant Analyst did not receive travel approval from the prior CFO. A desk audit of the Financial Guidance Center was performed in November of 2014. An on -site physical audit of all grantees was performed in April 2015.

As a result of this audit, the office has revised monitoring procedures that continue to require annual on-site fiscal audits by the Grant Analyst and also adds semi-annual fiscal desk audits of the Home Again Grantees. The Grant Analyst has revised procedures for performing the fiscal audits. The office will develop and revise its procedures to ensure annual on-site fiscal audits of the Home Again Program grantees are completed as outlined in the Office's policies for the Program and develop procedures for performing these audits.

Recommendation #4

**Develop procedures to help ensure settlement funds not tracked within the state accounting system are properly monitored and returned timely to the State for proper safeguarding.**

Agency Response:

Recommendation accepted.

As noted in the performance audit, besides the National Mortgage Settlement, the Office commenced investigations and eventually settled with other mortgage-related entities regarding alleged violations of the Nevada Deceptive Trade Practices Act. And as of September 2014, these settlements totaled $75 million with approximately $38 million involving restitution to Nevada homeowners. Given that the office at the time did not have sufficient resources to administer payments to the victims in these cases, it was agreed to by the respective parties to the settlements that a third-party settlement administrator was to be retained by the financial institutions. The purpose to retain a third-party administrator was to ease the administrative burden to the office, to ensure payments to victims would not be delayed, and that the funds would be secure and not susceptible to misappropriation or theft. In both cases, the same third-party administrator (TPA) was utilized: a TPA with over 30 years of experience and one to have earned a SOC 2, Type 2 certification, given by the American Institute of CPAs, and one that had been utilized by US District Courts and the Securities Exchange Commission, among hundreds of representative clients. The Audit notes that all funds are accounted for and no inappropriate disbursements occurred.

Nonetheless, the Office agrees that in both cases, after the TPA began disbursing restitution payment to victims, a delay occurred due to the fact that that the remainder of the restitution pool in these two cases represented individuals that could not be easily located without additional skip-tracing efforts from the office. Furthermore, the Office agrees that the responsibility for overseeing TPA and other fiscal aspects should be assigned to primarily fiscal personnel.

Currently, the office is recalling or has recalled the remainder of the monies from the third-party administrator and is in the process of assessing (through assigning additional personnel) the status of the remaining individuals and whether they could be found for direct payment or, in the alternative, for restitution money to be eventually deposited with the State Treasurer's Unclaimed Property Program. Furthermore, the office will develop procedures to help ensure future settlement funds not tracked within the state accounting system are properly monitored and returned timely to the State for proper safeguarding.

Recommendation No. 5:
**Develop centralized procedures for the payment of restitution funds, including supervisory review and approval of amounts payable to victims and supporting documentation for the disbursements.**

Agency Response:

Recommendation Accepted.

As previously stated, the Office's current and future involvement in the collection and distribution of restitution is and will be quite limited. Nevertheless, the Office accepts the recommendation. The Chief Financial Officer will develop and implement policies to centralize and improve the collection and distribution of restitution owed victims. These policies will include development of standardized forms and other forms of supporting documentation for disbursements as well as a procedure for supervisory approval.

Recommendation No. 6:

**Develop procedures to reconcile state accounting records to the Office's records of restitution funds received and disbursed in the court settlement account.**

Agency Response:

Recommendation Accepted.

The Office accepts this recommendation. As previously discussed, in the vast majority of criminal cases, the Division of Parole and Probation is responsible for the collection and distribution of restitution owed to victims. Under existing protocols, the Division does not routinely share information about the status of restitution payments with the Office.

The Chief Financial Officer and chiefs of the criminal divisions will endeavor to work with their counterparts in the Division of Parole and Probation, Office of Controller and other relevant agencies to reconcile state accounting records regarding restitution funds.

## Attorney General's Response to Audit Recommendations

| | Recommendations | Accepted | Rejected |
|---|---|---|---|
| 1. | Ensure adequate documentation is provided for Home Again Program reimbursement requests, and perform thorough reviews of these requests to help ensure charged expenses are appropriate under the grant agreement | X | |
| 2. | Develop procedures to help ensure Home Again Program information reported to the Legislature and management is reliable | X | |
| 3. | Ensure annual on-site fiscal audits of Home Again Program grantees are completed as outlined in the Office's policies for the Program, and develop procedures for performing these audits. | X | |
| 4. | Develop procedures to help ensure settlement funds not tracked within the state accounting system are properly monitored, and returned timely to the State for proper safeguarding | X | |
| 5. | Develop centralized procedures for the payment of restitution funds, including supervisory review and approval of amounts payable to victims and supporting documentation for the disbursements | X | |
| 6. | Develop procedures to reconcile state accounting records to the Office's records of restitution funds received and disbursed in the court settlement account | X | |
| | TOTALS | 6 | |