LA20-17

STATE OF NEVADA

Performance Audit

Department of Business and Industry
Real Estate Division

2020

Legislative Auditor
Carson City, Nevada

Audit Highlights

Highlights of performance audit report on the Real Estate Division issued on September 3, 2020.

Legislative Auditor report # LA20-17.

Background

The mission of the Real Estate Division (Division) is to protect the public and Nevada's real estate sectors by fairly and effectively regulating real estate professionals through licensure, registration, education, and enforcement. The Division shares authority with three Governor-appointed commissions. These commissions conduct disciplinary hearings, assess fines, adopt regulation changes, approve education courses, as well as hold other authorities to regulate the real estate marketplace.

The Division's main office is located in Las Vegas, with a secondary office located in Carson City. The Division administers five budget accounts, funded primarily through fees and a General Fund appropriation. In fiscal year 2019, the Division recorded over $14 million in revenues, and expenditures totaled over $7 million.

As of June 30, 2019, the Division had 51 filled positions.

Purpose of Audit

The purpose of this audit was to determine if controls over the collection of certain cash receipts and accounts receivable were adequate, and if the Division has adequate processes to ensure licensees comply with laws related to reporting requirements for broker trust accounts. This audit included a review of financial and administrative activities during fiscal year 2019, and accounts receivable information from prior years.

Audit Recommendations

This audit report contains six recommendations to improve oversight and controls over cash receipts, six recommendations to strengthen the Division's regulation of broker trust accounts, and two recommendations to improve collections of accounts receivable.

The Division accepted the 14 recommendations.

Recommendation Status

The Division's 60-day plan for corrective action is due on December 3, 2020. In addition, the 6-month report on the status of audit recommendations is due on June 3, 2021.

Real Estate Division

Department of Business and Industry

Summary

The Division's financial and administrative controls over revenues are inadequate. Specifically, there are limited system controls in the Division's database to prevent users from making changes to licensees' accounts to misappropriate cash, or to detect fraud once it has occurred. Furthermore, internal control procedures designed to compensate for the lack of system controls are not being adhered to by supervisors and staff. Additionally, the Division's procedures for processing refunds and reconciling revenues received and posted to real estate licensees' accounts and the state accounting system are inadequate. In fiscal year 2019, the Division collected over $8 million in licenses and fees, with 6% being cash collections. A lack of controls over revenues leaves the Division vulnerable to fraud and errors.

The Division has not provided effective oversight of broker trust fund accounts. Specifically, the Division only tracks submissions and assesses fines to a subset of the broker population, when all brokers are required to submit annual forms regarding their trust accounts or attest to the lack thereof. In addition, for the brokers who do submit trust account reconciliations, the Division's review of the documentation is inadequate and inconsistent. Inadequate records or failure to maintain control of trust funds can result in theft, commingling, or misuse of trust account funds.

The Division does not actively pursue collections of past due accounts and continues to have difficulty monitoring and submitting debt timely to the State Controller. Similar problems with collections were reported in our prior two audits in 2000 and 2009. Additionally, the Division's internal tracking spreadsheets are inaccurate, affecting collections on accounts and reporting of accounts receivable by the State Controller. In fiscal year 2019, the Division's three commissions levied nearly $3 million in fines, but only collected $130,000 of that amount (a 5% collection rate). If the Division does not actively pursue past due amounts early, the likelihood of collecting debt decreases with time.

Key Findings

Controls over voiding cash receipts and for making other adjustments to real estate licensees' accounts within the Division's database are inadequate. Specifically, there is no segregation of duties within the database; thereby, allowing employees to add or delete revenues from an account without any record of the edits to the account. In fiscal year 2019, 7% of all transactions processed in the Division's database were voided. (page 6)

The Division lacks controls to ensure refunds are posted timely to its database, and that only valid refunds are posted and issued. In fiscal year 2019, the average number of days between a refund check being issued from the state accounting system and the refund being entered into the Division's database was 140 days. The longest refund examined took 2,661 days to post in the Division's database, or nearly 7 years after the check was already issued. Without adequate controls over refunds, there is a higher risk of refunds being duplicated, or that credits in the system could be used to conceal theft. (page 9)

The Division's current practice only holds brokers that manage properties accountable for submitting trust account information annually. However, regulation requires all brokers to report trust account information, or attest that they do not manage trust accounts. Brokers that are property managers are less than half of the population within the State, but are the only ones held accountable for reporting by the Division. Brokers that are property managers and do not comply with reporting requirements may be fined thousands of dollars, while brokers that are not property managers are not fined nor requested to report. (page 11)

The Division's procedures for monitoring trust accounts are inadequate and ineffective. For 13 of 19 (68%) broker trust account reconciliations tested, we observed the information reported to the Division was incomplete or contained unallowed accounting entries. In addition, the Division does not have an effective process to track and verify all trust accounts are reported, and to help ensure brokers do not hide fraudulent activities. Without proper monitoring of trust accounts, individuals may be at risk from broker misconduct. (page 13)

Over the last 5 fiscal years (2015–2019), the Division submitted debt for collections with the State Controller, on average, 1.9 years after the debt became 60 days past due, with the longest in our testing taking 6.7 years. In addition, the Division has not maintained accurate accounts receivable information for reporting outstanding amounts to the State Controller. (page 18)

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This report contains the findings, conclusions, and recommendations from our performance audit of the Department of Business and Industry, Real Estate Division. 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 oversight and controls over cash receipts, six recommendations to strengthen the Division's regulation of broker trust accounts, and two recommendations to improve collections of accounts receivable. 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,

Daniel L. Crossman, CPA
Legislative Auditor

June 30, 2020
Carson City, Nevada

Real Estate Division
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Introduction

Background

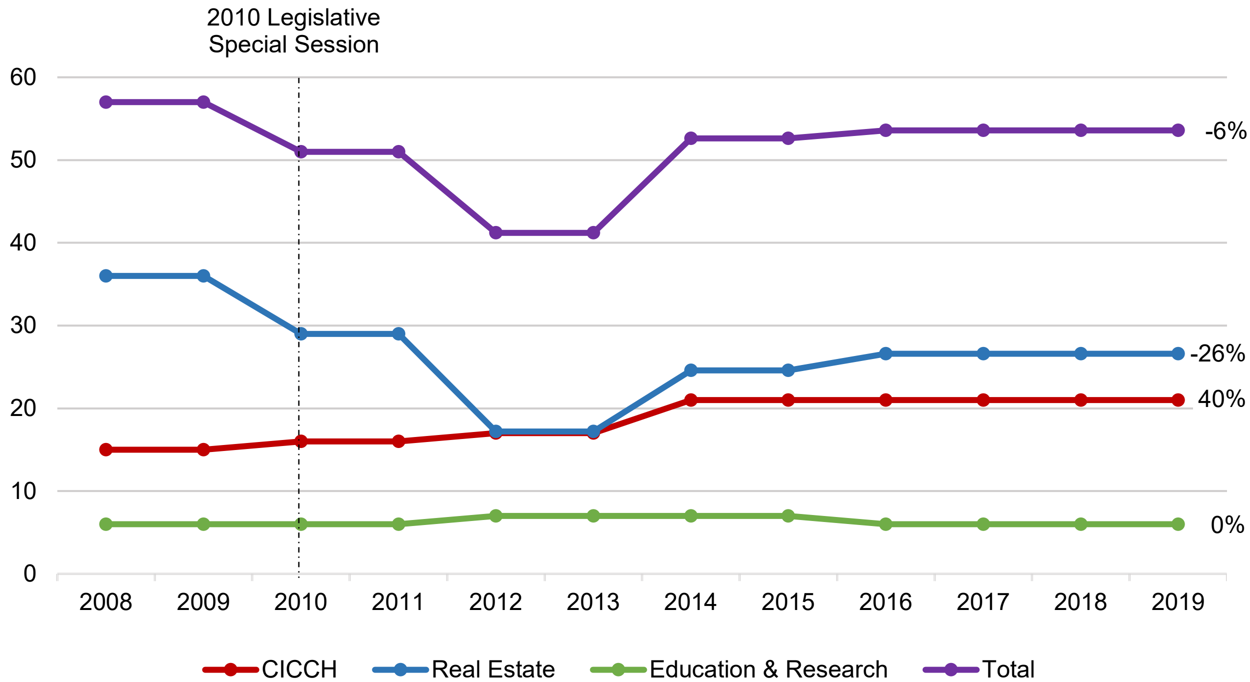
The mission of the Real Estate Division (Division) is to protect the public and Nevada's real estate sectors by fairly and effectively regulating real estate professionals through licensure, registration, education, and enforcement. The Division is responsible for regulating real estate licensees, appraisers of real estate, timeshare agents and representatives, property managers, community association managers, energy auditors, and inspectors of structures. In addition, the Division regulates the subdivision of land, timeshare development and sales, campground sales, reserve study specialists, and common-interest community associations.

The Division shares authority with three Governor-appointed commissions. These commissions conduct disciplinary hearings, assess fines, adopt regulation changes, approve education courses, as well as hold other authorities to regulate the real estate marketplace. The commissions consist of the Real Estate Commission, the Commission for Common-Interest Communities and Condominium Hotels (CICCH), and the Commission of Appraisers of Real Estate.

Staffing and Budget

In the 2010 Legislative Special Session, the Division experienced staffing cuts due to the Legislature's budget reduction measures as a result of the recession. While other units within the Division are now staffed at or above prerecession levels, the Real Estate unit continues to operate with 26% less authorized positions than before the recession. Exhibit 1 shows the number of authorized positions for the Division, including prerecession and postrecession authorized positions for fiscal years 2008 through 2019.

Authorized Position Count by Fiscal Year with Percent Change[(1)] **Exhibit 1**
Fiscal Years 2008 to 2019



Source: Budget Analysis System of Nevada and Real Estate Division records.
[(1)] Percent change is between 2008 and 2019.

As of June 30, 2019, the Division had 51 filled positions.

The Division's main office is located in Las Vegas with a secondary office located in Carson City. The Division administers five budget accounts, funded primarily through fees and a General Fund appropriation. The Division recorded over $14 million in revenues during fiscal year 2019, and expenditures totaled over $7 million. Most of the Division's operating activities are recorded in the Real Estate Administration budget account, which accounted for approximately $4 million in expenditures. Exhibit 2 shows the Division's revenues and expenditures related to the five budget accounts for fiscal year 2019.

Revenues and Expenditures by Budget Accounts Fiscal Year 2019

Exhibit 2

Revenues	**Administration**	**CICCH**	**Education and Research**	**Recovery Account**	**Real Estate Division[2]**	**Totals**
Beginning Cash	$ 1,550	$1,977,158	$ 561,686	$300,000	$ -	$ 2,840,394
State Appropriations	822,262	-	-	-	-	822,262
Licenses and Fees	2,947,184	2,524,127	-	626,629	3,417,825	9,515,765
Other Revenues[1]	150	49,901	5,422	14,360	-	69,833
Transfers	256,877	-	520,563	-	587,174	1,364,614
Total Revenues	**$4,028,023**	**$4,551,186**	**$1,087,671**	**$940,989**	**$4,004,999**	**$14,612,868**
Expenditures						
Personnel	$1,800,146	$1,368,696	$ 349,632	$ -	$ -	$ 3,518,474
Operating	357,928	210,094	53,917	-	-	621,939
Program Costs	652,256	42,738	13,601	120,426	-	829,021
Information Services	146,140	26,054	8,503	-	-	180,697
Other State Agency and Interagency Transfers	237,193	336,118	138,095	520,563	-	1,231,969
State Cost Allocations and Assessments	777,963	225,409	5,657	-	-	1,009,029
Total Expenditures	**$3,971,626**	**$2,209,109**	**$ 569,405**	**$640,989**	**$ -**	**$ 7,391,129**
Differences	$ 56,397	$2,342,077	$ 518,266	$300,000	$4,004,999	$ 7,221,739
Less: Reversions to General Fund	(55,887)	-	-	-	(4,004,999)	(4,060,886)
Balance Forward to 2020	**$ 510**	**$2,342,077**	**$ 518,266**	**$300,000**	**$ -**	**$ 3,160,853**

Source: Real Estate Division records and state accounting system.

(1) Other revenues include handbook sales, interest, and other miscellaneous revenue.

(2) All receipts are deposited into the General Fund, no expenditures are allowed in this budget account.

Scope and Objectives

The scope of our audit included a review of financial and administrative activities during fiscal year 2019, and accounts receivable information from prior years. Our audit objectives were to:

- Determine whether the Division's financial and administrative controls over the collection of certain cash receipts and accounts receivable are adequate.
- Determine if the Division has adequate processes to ensure licensees comply with laws related to reporting requirements for broker trust accounts.

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 Nevada Revised Statutes (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.

Limitations

We conducted this audit in accordance with government auditing standards. Standards require we report constraints imposed on the audit approach and limitations on access to information. We do not believe these limitations impacted our audit objectives or affected our conclusions on internal controls over certain cash receipts, because of other procedures performed, such as auditor observations and reconciliations. Readers are encouraged to review our findings regarding voided receipts and fund transfers beginning on page 6 of the report, and the methodology section of this report provides further detail regarding evidence obtained to support our audit conclusions. The following are items for consideration regarding the limitations:

- During the audit, it was discovered that if a transaction was voided it does not appear on a licensee's account in the Division's database, and unless the receipt is printed out prior to being voided, the receipt information is lost. Early in our testing of voided transactions, we found that voided receipts were not being printed out by staff. Thus, we could not perform data reliability testing on the system's void report to confirm it was accurate. Therefore, the total quantity and amount of voided receipts reported may not be accurate.

- We requested a report from the database showing all transfers of funds between licensees' accounts; however, the database vendor could not create an accurate report from the system. Without valid transfer data, we could not identify the population of transferred funds and select a sample to test if amounts transferred between licensees' accounts were legitimate.

Controls Over Revenues May Not Prevent or Detect Fraud

The Division's financial and administrative controls over revenues are inadequate. Specifically, there are limited system controls in the Division's database to prevent users from making changes to licensees' accounts to misappropriate cash, or to detect fraud once it has occurred. Furthermore, internal control procedures designed to compensate for the lack of system controls are not being adhered to by supervisors and staff. Additionally, the Division's procedures for processing refunds and reconciling revenues received and posted to real estate licensees' accounts and the state accounting system are inadequate. In fiscal year 2019, the Division collected over $8 million in licenses and fees, which does not include over $1 million in testing fees collected by a third party vendor, with 6% being cash collections. A lack of controls over revenues leaves the Division vulnerable to fraud and errors.

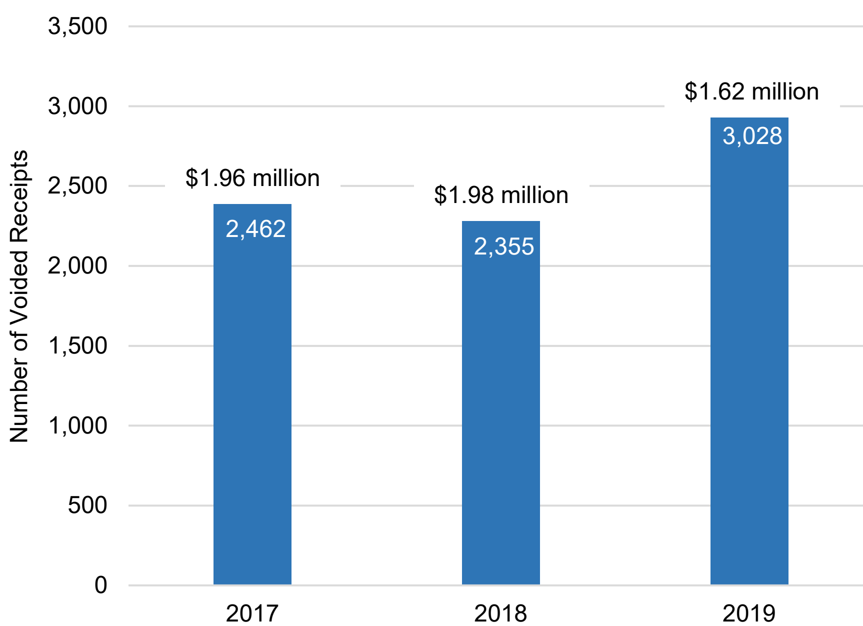
Inadequate System Controls Over Revenues

Controls over voiding cash receipts and for making other adjustments to real estate licensees' accounts within the Division's database are inadequate. Specifically, there is no segregation of duties within the database; thereby, allowing employees to add or delete revenues from an account without any record of the edits to the account. This is concerning, especially for front desk staff who handle cash. In addition, the system allows users to void receipts days, months, and even years after the original transaction occurred. These weaknesses leave the Division susceptible to fraud and other errors. In fiscal year 2019, there were over 3,000 voided transactions, totaling over $1.62 million. Although our testing did not identify any instances of fraud, the limitations discussed on page 4 may have prevented us from being able to identify potential fraudulent transactions.

The lack of system controls and managerial oversight is an issue because fraud or errors can occur and go undetected. Due to poor database controls, we simulated different situations in the database's test environment for fraud to occur and go undetected. For example, a front counter staff accepts a cash payment, voids the receipt in the database, steals the cash, and makes other database adjustments to cover up the theft. Under current processes, nothing would flag the theft and the fee would show as paid.

In fiscal year 2019, five employees accounted for 87% of the voids and the number of voided transactions was 7% of the total processed transactions in the Division's database. Exhibit 3 shows the total number of voided transactions over the last 3 fiscal years and the total dollar amount voided.

Number and Value of Voided Receipts (Unaudited) Exhibit 3
Fiscal Years 2017 to 2019



Source: Real Estate Division records.
Note: The data presented on voids is from the Division's database, which we could not confirm as being either accurate or complete due to poor record maintenance.

Our testing of the Division's voided receipts revealed that users are voiding receipts days, months, and even years after the original transaction occurred. In fiscal year 2019, the average number of days between the original transaction date and the void date was 38 days, with the longest being 2,884 days, or nearly 8 years later. Voiding a receipt should be the last option to correct a transaction as changes to an account number, amount, payment method, etc., can be edited before posting it. Transactions would only need to be voided if the receipt amount should be zero.

We reviewed preventative controls, such as user roles within the Division's database, and found that front desk staff who handle cash had system access that allowed them to void receipts, transfer funds, adjust amounts due, and to create and delete accounts as well. User permissions in the database are not appropriately configured so there is a segregation of duties between authority, custody, and accounting for payments.

Furthermore, we observed the Division's written procedure that includes a control to help detect fraudulently voided transactions is not followed. Voided receipts must be printed out with a reason for the void documented on the receipt, which should be reviewed by a supervisor. However, only 1 of 25 voided transactions tested was documented, but the supervisor's signature was not included. Early in our testing, we found that voided receipts do not show on a licensee's account in the Division's database, and unless a receipt is printed out before being voided, the receipt information is lost.

The Division confirmed that no supervisors are reviewing daily voids and ensuring that supporting documentation for voided receipts is retained. Similarly, the Division confirmed that no one reviews transfers or credit adjustments posted in the database. A transfer occurs when a payment has been posted to an incorrect account and is subsequently moved or transferred to the correct account. A credit adjustment occurs when the amount due is altered to reflect the correct amount due.

Refunds Are Not Processed Accurately or Timely

The Division lacks controls to ensure refunds are posted timely to its database, and that only valid refunds are posted and issued. Amounts shown as refunded in the database were not processed in the state accounting system. In addition, refunded amounts that had been issued in the state accounting system were not posted timely in the Division's database, sometimes taking years for the refunded amount to be posted in the database. Without adequate controls over refunds, there is a higher risk of refunds being duplicated, or that credits in the system could be used to conceal theft.

In fiscal year 2019, the Division posted 200 refunds in its database totaling $41,500. The average number of days between a refund check being issued from the state accounting system and the refund being entered into the Division's database was 140 days. The longest refund examined took 2,661 days to post in the Division's database, or nearly 7 years after the check was already issued.

After our analysis of the fiscal year 2019 refunds, we expanded our audit procedures to test 30 refunds posted in the Division's database between fiscal years 2017 and 2019. Our testing found six refunds (20%) posted in the database were invalid, as the amounts were never refunded in the state accounting system. Additionally, one refund was entered in the database 11 days prior to a credit showing on the account. We confirmed with the Division that the database allows amounts to be refunded without having an available credit on the account.

Ineffective Reconciliations of Revenues

The Division does not perform an effective reconciliation of revenues received, deposited, and recorded in its database. A reconciliation is only performed at the time of the deposit. Thus, any voids or transfers between budget accounts in the database after the deposit are not reconciled to what is in the state accounting system. With poor database controls, performing monthly reconciliations is a good compensating control to help discover potential fraud or errors.

In fiscal year 2019, the amount of revenue posted in the Division's database was $89,000 more than the revenue posted in the state accounting system. During the audit, it was determined that a majority of this difference was due to collections by the State Controller. Another $28,000 of the difference was due to a money wire transfer posted in the state accounting system in fiscal year 2018, but not posted in the Division's database until fiscal year 2019.

Similarly, during our testing of 25 deposits, we discovered that funds for a voucher from the Department of Health and Human Services were never transferred to the Division. We brought the missing funds to their attention, and it was corrected in fiscal year 2020. An effective reconciliation would have captured these differences timely and corrective action could be taken during the appropriate fiscal year.

Recommendations

1. Evaluate all user roles in the database to ensure staff access is appropriate for their duties and responsibilities, in addition to ensuring proper segregation of duties.
2. Establish monitoring controls to ensure supervisors and staff are following the Division's internal control procedures for documenting and approving voids.
3. Develop procedures for documenting transferred payments between accounts and credit adjustments.
4. Update internal control policies and procedures to include an independent verification that a refund issued by the State Controller was accurately posted in the database and perform a monthly reconciliation, agreeing refunded amounts to the state accounting system.
5. Post refunds timely in the database once a check has been issued by the State Controller.
6. Perform a revenue reconciliation between the database and the state accounting system routinely, addressing any differences timely.

Monitoring of Broker Trust Accounts Is Ineffective

The Division has not provided effective oversight of broker trust fund accounts. Specifically, the Division only tracks submissions and assesses fines to a subset of the broker population, when all brokers are required to submit annual forms regarding their trust accounts or attest to the lack thereof. In addition, for the brokers who do submit trust account reconciliations, the Division's review of the documentation is inadequate and inconsistent. Inadequate records or failure to maintain control of trust funds can result in theft, commingling, or misuse of trust account funds.

Trust funds are money or things of value that are received by the broker on behalf of a client or other person, such as earnest money deposits or rents collected by the broker for a property owner. A broker's fiduciary responsibility makes the maintenance of adequate trust account records necessary, and regulations require brokers to submit records of their trust accounts annually.

Enforcement of Trust Account Reporting Requirements Is Not Equitable

The Division's current practice only holds brokers that manage properties accountable for submitting trust account information annually. However, regulation requires all brokers to report trust account information, or attest that they do not manage trust accounts. Brokers that are property managers are less than half of the population within the State, but are the only ones held accountable for reporting by the Division. Brokers that are property managers and do not comply with reporting requirements may be fined thousands of dollars, while brokers that are not property managers are not fined nor requested to report.

Nevada brokers are personally responsible for the supervision and maintenance of their trust accounts and records. To ensure brokers comply with this requirement and to help safeguard individual's money, Nevada Administrative Code 645.806 requires every real estate broker to file annually either a completed trust account reconciliation or an affidavit declaring they do not manage trust accounts, or be fined for failure to submit.

As of June 30, 2019, there were 1,235 active real estate brokers with property manager permits, and 1,322 without permits. Even though all brokers are required to file trust account information annually, the Division only tracks and fines brokers who are property managers for not submitting the required information, which is less than half of the total broker population.

We sent a questionnaire on broker trust accounts to 50 randomly selected brokers without property manager permits and we received 35 responses back. Of the 35 responses, 25 (71%) of the brokers did not file anything with the Division for fiscal year 2019 and none of the 25 brokers were fined by the Division for noncompliance. In contrast, we tested 25 brokers with active property manager permits in fiscal year 2019 and observed 7 were fined because they did not file the appropriate report. Four fines were eventually waived, but three brokers were fined between $250 and $1,000 each. We found little or no documentation explaining why the fines were waived. The Division does not have policies and procedures regarding when administrative sanctions will be waived and how that will be documented and approved.

Our testing also revealed three brokers who were managing properties, but did not have an active property manager permit. The minimum fine for engaging in property management activities without a valid permit is $5,000, but no fines were issued to these three brokers.

According to the Division, it focuses on monitoring brokers that are property managers because they are the most likely to have trust accounts, but our survey found there are other brokers with trust accounts that are not being monitored or held accountable. Ensuring all brokers report trust account information would be equitable and help lower the risk of abuse.

Inadequate Reviews of Reported Trust Account Information

The Division's procedures for monitoring trust accounts are inadequate and ineffective. For 13 of 19 (68%) broker trust account reconciliations tested, we observed the information reported to the Division was incomplete or contained unallowed accounting entries. For example, one broker submitted a trust account reconciliation that contained over $175,000 in account balances that were labeled as unknown. There was no follow-up by the Division. In addition, the Division does not have an effective process to track and verify all trust accounts are reported, and to help ensure brokers do not hide fraudulent activities. Without proper monitoring of trust accounts, individuals may be at risk from broker misconduct.

Risk of Embezzlement or Commingling of Funds

Individuals who deposit money with a broker may have those funds lost accidentally or intentionally through commingling or embezzlement of trust account funds. Commingling can occur when multiple sources of funding are deposited in the same account but accurate records are not kept, making the ownership of funds unknown. Embezzlement could occur if brokers transfer money from a trust account for their personal use.

In an attempt to discover any commingling or embezzlement by brokers, the Division is supposed to review trust account documents for several requirements, such as negative property balances and nondescript journal entries. A nondescript journal entry will just say 'journal entry' as the description in the general ledger for a transaction, and can be used in accounting software to post a withdrawal from a trust account without flagging any theft.

Inadequate Reviews Performed by Staff

When the Division reviews trust account information submitted by brokers, these reviews are not effective. In our review of 19 brokers' trust account submittals, we found:

- 2 had questionable items that were charged by brokers to their trust accounts, such as gift card purchases that were not addressed by the Division;

- 3 had nondescript journal entries;
- 4 brokers did not submit complete bank statements with their reconciliations and only one was contacted and requested to provide all documentation;
- 7 did not have their trust accounts properly named with the financial institution, but the Division only took action with three of these brokers; and
- 1 broker's trust account reconciliation contained over $175,000 in "Unknown" account holder balances.

Despite these practices being unallowed per the Division's policies, we found little or no evidence the Division took action to ensure unallowed or potentially fraudulent activities were corrected or investigated.

In addition, we observed the Division does not have an effective process to follow up when unallowed trust account activities are identified. The Division does not utilize its database to enter outstanding trust account reconciliation items under broker account notes. Instead, the Division tracks outstanding reconciliation items through staffs' private email calendars. Therefore, other staff accepting items through the mail and at the front desk are unaware of the Division's requested reconciliation items, because there are no notes in the database under the broker's account.

Without effective oversight by the Division, the individual's money is at risk of mismanagement or theft by licensed brokers in the State. In a November 2019 Real Estate Commission hearing, a broker was ordered to pay $14,000, because his bookkeeper embezzled over $300,000 from client trust accounts by using nondescript journal entries. The Division's desk reviews of the trust account reconciliations submitted by this broker did not catch the bookkeeper's fraud.

Ineffective Process to Track Broker Trust Accounts

Although the Division has a form for brokers to report trust account information, the Division does not require all brokers to regularly update it, or use it to ensure brokers report all trust accounts they manage. Per NRS 645.310(6), a broker must notify the Division of the names of the banks and accounts for their trust accounts on a form provided by the Division.

For 50 brokers tested, selected from Division records, we observed the following problems with trust account information on file with the Division:

- 14 brokers tested did not report bank account information in fiscal year 2019 that agreed with the trust account information on file with the Division;

- 6 brokers did not have trust account information on file with the Division; and

- 2 brokers' records on file with the Division indicated they have trust accounts; however, they did not report trust account information in fiscal year 2019.

Similarly, in a broker trust account questionnaire that we mailed to randomly selected brokers with property manager permits, we observed 8 of 41 (19%) reported trust bank account information to us that did not agree with the Division's records.

Different factors contribute to the Division's ability to effectively track broker trust accounts. First, the Division relies on brokers to self-report trust account information, and this information is not compared from year to year. Second, the Division does not effectively use the capabilities of its database to track those brokers with trust accounts. The functionality of the database allows the Division to search the database for brokers that have not reported the required trust account information for the current year and assess a fine for noncompliance. However, the Division only uses this function for brokers who are property managers.

The importance of identifying broker trust accounts is emphasized in a fiscal year 2018 Real Estate Commission case where the respondent was fined $10,000 for each trust account that was not reported to the Division. Because the Division does not adequately track all brokers' trust accounts, it is unaware of how many trust accounts each broker has, increasing the risk accounts will go unreported and unmonitored. Therefore, the Division is leaving the individual's money vulnerable to fraud.

Recommendations

7. Require all brokers to file trust account forms annually and assess administrative sanctions for noncompliance.
8. Develop policies and procedures for waiving sanctions, including sufficient documentation of reasoning for waiver.
9. Utilize the database to track trust account reconciliation submittal for all licensed real estate brokers.
10. Implement a monitoring process to include comparing bank account information submitted on the annual trust account reconciliations to what was submitted by each broker in their prior year filings, following up on any discrepancies.
11. Develop and implement controls to monitor outstanding trust account reconciliation items.
12. Develop a risk-based approach for monitoring and initiating inspections of broker trust accounts.

Efforts to Collect On Accounts Receivable Are Limited

The Division does not actively pursue collections of past due accounts and continues to have difficulty monitoring and submitting debt timely to the State Controller. Similar problems with collections were reported in our prior two audits in 2000 and 2009. The Division only sends an initial notification letter after the Commission orders a disciplinary fine, no other past due notices are sent until the debt is sent to collections with the State Controller. Additionally, the Division's internal tracking spreadsheets are inaccurate, affecting collections on accounts and reporting of accounts receivable by the State Controller. In fiscal year 2019, the Division's three commissions levied nearly $3 million in fines, but only collected $130,000 of that amount (a 5% collection rate). If the Division does not actively pursue past due amounts early, the likelihood of collecting debt decreases with time.

The Division Does Not Actively Pursue Past Due Amounts

We tested 76 commission fines selected from the Division's accounts receivable tracking spreadsheets, and found that none of the debt holders received a past due notice at 30, 60, or 90 days. The only notice sent after the initial communication from the Division, regarding the payment amount and due date, was the final pre-collection notice sent by the Department of Business and Industry (Department) after the debt is 120 days past due. Per our discussions with staff, the Division believed the Department was sending out past due notices. However, the Department only sends a pre-collection notice prior to turning the debt over for collection with the State Controller.

In addition, our testing of fines revealed that a pre-collection notice was sent an average of 374 days after the debt became past due and no notice was sent to 10 debt holders before being turned over to collections. The Division did not follow up with the

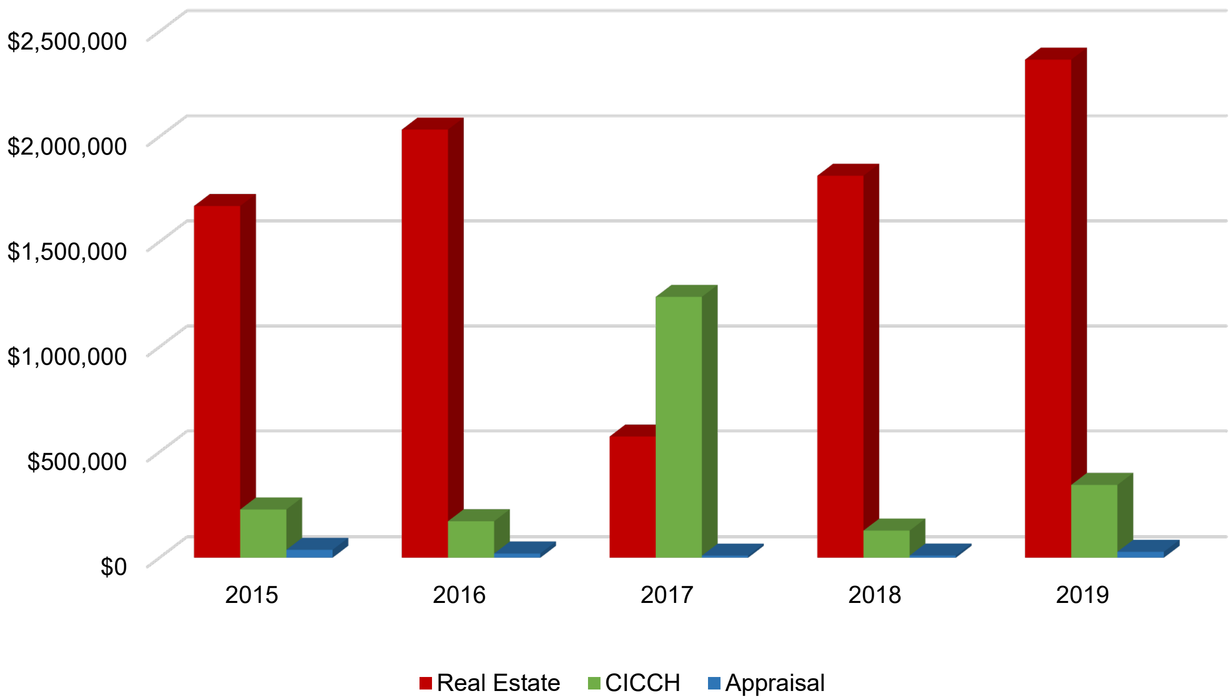
Department regarding whether or not pre-collection notices were sent. Procedures for notifying debt holders and for submitting amounts to the State Controller for collection efforts should align between Division staff and the Department's fiscal staff, who submit the Division's debts to the State Controller for collection.

Additional testing of accounts receivable found untimely reporting has been a problem for many years. We obtained a listing from the State Controller of debts reported by the Department on behalf of the Division. For the last 5 fiscal years, 122 commission fines were reported totaling $7.79 million. Our testing found the Division took an average of 695 days (1.9 years), once the debt became 60 days past due, to submit delinquent accounts to the State Controller for collection efforts. The longest in our sample took 2,452 days (6.7 years) for the Division to submit the debt to the State Controller. Although the Department has taken over reporting the Division's debt to the State Controller, the Division should ensure timely reporting of its past due accounts by the Department. According to NRS 353C.195, an agency must assign a debt to the State Controller for collection no later than 60 days after the debt becomes past due.

If the Division does not act quickly to collect on the $3 million in commission fines currently under its custody, a majority of these fines will be turned over to the State Controller after already being approximately 2 years old, and the likelihood of collecting on this debt is low. Exhibit 4 shows the amount of fines issued by each commission over 5 fiscal years (2015 through 2019). In 2019, there was a $1.3 million dollar fine issued in August 2018 by the Real Estate Commission, making up 56% of the total Real Estate Commission fines issued.

Fines Issued by Commission
Fiscal Years 2015 to 2019

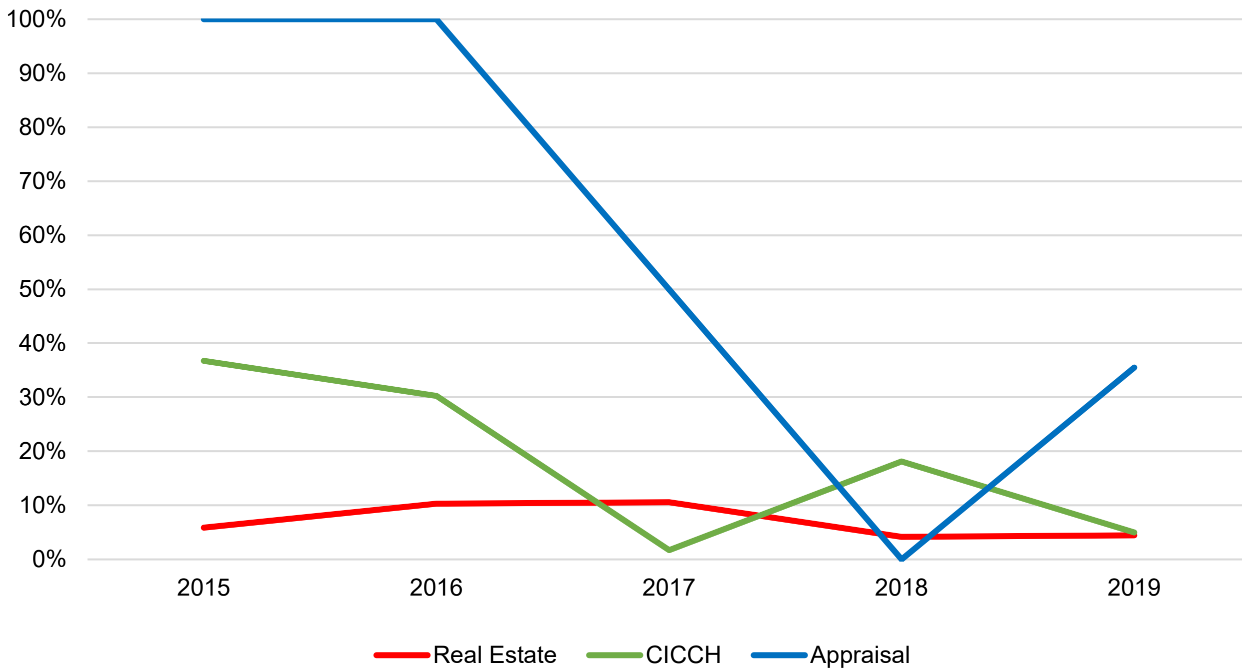
Exhibit 4



Source: Real Estate Division records.

The Real Estate Commission's fines are sometimes very large, depending on the severity of the violation, and can range from thousands to millions of dollars. The commission fines for the Common-Interest Communities and Condominium Hotels (CICCH) are not as numerous as the Real Estate Commission fines, but they can be very large as well. Exhibit 5 shows the Division's collection rate on these same fines issued by fiscal year (2015 to 2019).

Percentage of Fines Issued and Collected
Fiscal Years 2015 to 2019 **Exhibit 5**



Source: Real Estate Division records.

The Division's collection rate on Real Estate Commission fines has averaged below 10%, while collection rates for CICCH Commission fines dropped from almost 40% in fiscal year 2015 to just 5% in fiscal year 2019. The Appraisal Commission does not levy as many or as large of fines as the other two commissions; thus, the collection rates are usually much higher for these fines.

Reporting of Past Due Amounts to the State Controller Is Not Accurate

Account receivable amounts reported to the State Controller are not accurate. The Division relies on shared tracking spreadsheets for the Department to initiate sending a debt holder to collections with the State Controller. However, due to manual entry of data in the spreadsheets and the lack of an independent supervisory review, the shared tracking spreadsheets contain errors. In our review of the spreadsheets, we found unexplained differences between the Division's and the Department's sections for two commission tracking spreadsheets. The Real Estate Commission's tracking spreadsheet had a difference of $154,900 between the Division's and the Department's total balance due. Similarly, the CICCH Commission's tracking spreadsheet had a total difference of $9,500 between the Division's and the Department's total balance due.

Per the Division's accounts receivable internal control procedures, the data integrity between the Division's and Department's sections on the shared tracking spreadsheets should be reviewed on a monthly basis to ensure amounts agree. However, we observed the following errors:

- **Differences between tracking spreadsheets and commission orders -** 8 of 76 (11%) commission fines tested had errors when we compared amounts on the spreadsheets to the commission's order for the debt. Errors included incorrect fine amounts, due dates, and payment plan amounts. For one fine, the amount entered on the tracking spreadsheet was $30,000 when the commission's court order showed the fine was actually $300,000.

- **Differences between tracking spreadsheets and amounts submitted to State Controller -** 8 of 122 (7%) commission fines tested between fiscal years 2015 and 2019 had errors. Specifically, there were differences between what was entered on the tracking spreadsheets and what was turned over to the State Controller, with a net difference of $79,900.

- **Differences between amounts submitted to State Controller and amounts due in database -** 28 of 122 (23%) fine amounts tested had current amounts due in the Division's database that did not agree with the State Controller's records. For instance, one commission fine was reported to the State Controller as $7,719 when the database showed the amount was $70,719, which agreed to the commission order.

These errors are concerning, because if debt is not accurately tracked and correctly reported to the State Controller, the debt holder could end up paying the incorrect amount or dispute the debt all together.

Due to the manual nature of the Division's and Department's tracking of accounts receivable, the data in the spreadsheets is susceptible to errors. To ensure debts are properly tracked and reported accurately to the State Controller, policies and procedures should be enhanced to include an independent supervisory review of accounts, reconciling tracking spreadsheet amounts to the original commission order and confirming amounts collected by the State Controller are posted correctly in both the database and shared tracking spreadsheets.

Recommendations

13. Work with the Department of Business and Industry to develop clear policies and procedures for the debt collection process, documenting the Division's and the Department's respective duties.

14. Enhance existing internal control policies and procedures to ensure amounts entered in the commission fines shared tracking spreadsheets are accurate, verifying that amounts posted in the database and reported to the State Controller for collection are correct as well.

Appendix A
Audit Methodology

To gain an understanding of the Real Estate Division (Division), we interviewed staff, reviewed state laws, regulations, and policies and procedures significant to the Division's operations. We also reviewed financial information, prior audit reports, budgets, legislative committee minutes, and other information describing the Division's activities. Furthermore, we documented and assessed the Division's controls related to the collection of accounts receivable, certain cash receipts, and regulation of broker trust accounts. Our scope of work on internal controls included reviewing the Division's policies, procedures, and activities.

To determine if controls related to voids were performed, we obtained a voided transaction report for fiscal year 2019 from the Division's database. From this report, we judgmentally selected 25 voided receipts, in proportion to the total number of front desk voided receipts, from five staff who were responsible for 87% of the voids, selecting the largest cash or check payments. We then requested the supporting documentation for each item and noted if the voided receipt was printed and approved by a supervisor. We were unable to perform data reliability testing on the void report used to obtain the audit sample, which was disclosed as a limitation earlier in the report. Therefore, we do not know if the void report contained all of the voids performed by the Division in fiscal year 2019.

To determine if controls related to refunds were adequate, we obtained refund reports from the Division's database for fiscal years 2017–2019. We performed data reliability testing on the reports, and confirmed the data was reliable. Next, we analyzed all 200 refunds in the database report for fiscal year 2019, and expanded our audit testing to include two other fiscal years (2018 and 2017). For the prior years, we judgmentally selected refunds that had multiple amounts paid to the same person, which resulted in 26. We then selected four other refunds by selecting the highest dollar amounts refunded that were not multiples, for a total sample of 30 selected from a population of 683 refunds. We requested documentation for each refund, as well as data from the Division's database. We calculated the number of days between when the overpayment resulted in the Division's database and when the refund was issued from the state accounting system. We also determined the number of days between when the refund was issued from the state accounting system and when the refund was posted in the Division's database.

To evaluate controls over broker trust accounts, we obtained the Division's June 2019 active broker and property manager listings. We performed data reliability testing on each and determined both lists were accurate and complete. For our sample, we randomly selected 50 unique brokers from the lists; ensuring 25 were permitted to be property managers as well. We requested all communications sent by the Division to these brokers regarding noncompliance and any sanctions assessed. In addition, we reviewed both physical and electronic records for these brokers. Using this information, we determined whether each broker was compliant with the annual reporting requirements, reported bank account information agreed to agency records, and if fines had been issued and posted to the database accordingly.

Using the Division's desk review guidelines, we verified if the trust account reconciliations were accurate and complete, and if the Division followed up on reconciliations that were not in compliance. We repeated these same steps, comparing Division's records to responses received on a trust account questionnaire that we sent to 100 randomly selected brokers, of which 50 were brokers with property manager permits and 50 were brokers without property manager permits. Finally, we calculated the minimum amount of administrative sanctions not assessed by the Division in fiscal year 2019, based on our findings.

To evaluate collection efforts by the Division on their accounts receivable, we requested the Division's fine tracking spreadsheets for each commission, updated through July 8, 2019. We judgmentally selected 76 outstanding commission fines from the tracking spreadsheets, in proportion to the total number of outstanding fines, choosing the largest outstanding fines, ranging from oldest to newest, but not older than July 1, 2017, and not past due after June 1, 2019. Our audit sample resulted in 54 fines from the Real Estate Commission, 18 fines from the Commission for Common-Interest Communities and Condominium Hotels, and 4 fines from the Commission of Appraisers of Real Estate, out of 165 total fines. For each commission fine, we verified that the amount due, date due, and license status matched both the Division's database and the commission's order. For each sample, we collected all notices sent by both the Division and by the Department of Business and Industry's fiscal staff. We calculated the dates when past due notices should have been sent according to internal policies and procedures and state law, and compared our calculated dates to the actual dates notices were sent.

To determine the accuracy and completeness of the Division's accounts receivable that were turned over to the State Controller for collections over the last 5 fiscal years (FY 2015–FY 2019), we obtained a listing from the State Controller. We compared the fine amount on the State Controller's report to what was entered in the Division's database and on the tracking spreadsheets. We noted differences in the date sent to the State Controller, amount due, and any collections on the fine. We also calculated the date the Division was required to send the debt to the State Controller, per NRS 353C.195(3), and compared our auditor calculated date to the actual date the debt was submitted to the State Controller. We also compared the accounts receivable aging amounts that were reported to the State Controller for fiscal year-end 2019, to what should have been reported using information on the Division's commission fine tracking spreadsheets.

For our testing of voids, refunds, broker trust accounts, and accounts receivable, we used nonstatistical audit sampling, which was the most appropriate and cost-effective method for concluding on our audit objectives. Based on our professional judgment and review of authoritative sampling guidance, we believe that nonstatistical sampling provided sufficient, appropriate audit evidence to support the conclusions in our report. We did not project the results of our testing because the exceptions reported from our test samples were sufficient to identify the nature and magnitude of the problems, and some populations could not be verified.

Our audit work was conducted from January 2019 to March 2020. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In accordance with NRS 218G.230, we furnished a copy of our preliminary report to the Administrator of the Real Estate Division. On June 19, 2020, 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 B, which begins on page 27.

Contributors to this report included:

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Appendix B
Response From the Real Estate Division

STEVE SISOLAK
Governor

STATE OF NEVADA

TERRY REYNOLDS
Director

SHARATH CHANDRA
Administrator

DEPARTMENT OF BUSINESS AND INDUSTRY
REAL ESTATE DIVISION
www.red.nv.gov

June 29, 2020

Daniel L. Crossman, Legislative Auditor
Legislative Counsel Bureau - Audit Division
401 S. Carson Street
Carson City, Nevada 89701

Re: Nevada Real Estate Division Audit Report

Dear Mr. Crossman:

Thank you for the information provided in the Legislative Counsel Bureau preliminary Audit Report of the Department of Business and Industry, Real Estate Division (Division). We appreciate the professionalism of your team and their efforts in helping the Division assess, identify and improve agency operations and compliance with State guidelines and statutory requirments.

The Division agrees and accepts the Audit Recommendations. The Division respectifully submits our "Agency Response to Audit Recommendations" along with the audit recommendations checklist.

We are confident that these efforts will enhance and strenthen the Division as we move forward. If you have any comments or questions, please do not hesitiate to contact me or my staff.

Respectifully,

Sharath Chandra – Administrator
Nevada Real Estate Division
Department of Business and Industry

Enc: Agency Response to Audit Recommendations
Cc: Terry Reynolds, Director, Department of Business and Industry
Budd Milazzo, Deputy Director, Department of Business and Industry

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Agency Response to Audit Recommendations

1. **Evaluate all user roles in the database to ensure staff access is appropriate for their duties and responsibilities, in addition to ensuring proper segregation of duties.**

   The Division is in the process of mapping out and evaluating all staff who work with the database to ensure that their roles align with levels of access in the system. At the same time, we will be ensuring appropriate permissions associated with these roles so there is a segregation of duties.

2. **Establish monitoring controls to ensure supervisors and staff are following the Division's internal control procedures for documenting and approving voids.**

   The Division will review its current internal control procedures and ensure that procedures are updated for documenting and approval of voids. In addition, Division will work to ensure that procedures are followed by staff and supervisors.

3. **Develop procedures for documenting transferred payments between accounts and credit adjustments.**

   The Division will develop a process for documenting these transactions. This will dovetail and may be incorporated into #6 Audit Recommendation which recommends the Division perform a regular revenue reconciliation between the State system and the Division's database.

4. **Update internal control policies and procedures to include an independent verification that a refund issued by the State Controller was accurately posted in the database and perform a monthly reconciliation, agreeing all refunded amounts to the state accounting system.**
5. **Post refunds timely in the database once a check has been issued by the State Controller.**

   These two (2) recommendations encompass the entire refund process. Prior to commencement of the Audit, the Division had begun developing a comprehensive internal control policy that addressed refunds processed in the database including documentation, supervisory approval, in addition to verifying that the Controller's office issued the check and the final reconciliation. This detailed internal control policy was sent to the Audit team and we also received suggestions from the Audit team on accessing data from DAWN to confirm checks were issued.

6. **Perform a revenue reconciliation between the database and the state accounting system routinely, addressing any differences timely.**

   The Division will work with the Department of Business and Industry fiscal staff to develop a routine reconciliation process between the database and the state accounting system. The Division does not have dedicated fiscal staff since the consolidation of all fiscal and budgetary duties within the Department of Business and Industry. The Division reviews and processes day to day transactions however will require support of fiscal personnel to develop the reconciliation procedures and perform it.

2

8. Develop policies and procedures for waiving sanctions, including sufficient documentation of reasoning for waiver.

The waiving of fines for not submitting trust account reconciliations and form 546A was initially implemented as a way to encourage licensees to submit the forms every year. Currently waiving of sanctions are only approved by the Chief Investigator and on a case by case basis. Documentation for waiving of sanctions is included in the database. There may be isolated exceptions due to a significant life event a licensee may have experienced for a fine to be waived. The documentation for waiving of the fine is entered into the records database so that this information can be reviewed if the licensee ever receives the same sanction again. The Division will develop a procedure of ensuring notes and supporting documentation is included in waivers approved.

7. Require all brokers to file trust account forms annually and assess administrative sanctions for noncompliance.

9. Utilize the database to track trust account reconciliation submittal for all licensed real estate brokers.

10. Implement a monitoring process to include comparing bank account information submitted on the annual trust account reconciliations to what was submitted by each broker in their prior year filings, following up on any discrepancies.

11. Develop and implement controls to monitor outstanding trust account reconciliation items.

12. Develop a risk-based approach for monitoring and initiating inspections of broker trust accounts.

We would like to address recommendations 7, 9, 10, 11 and 12 collectively as it involves trust accounts and the Division's ability to collect, monitor, track, review, inspection, and discipline licensees. As highlighted in the Audit report, during the 2010 legislative session the Division experienced severer budget reductions and staffing cuts. The Division currently has 26% fewer authorized positions than before the recession. Currently the Enforcement Section only targets brokers with property manager permits. Brokers holding property manager permits, are most likely to handle other people's monies. Approximately 50% of the licensed brokers also have a property manager permit. By selective targeting this population of licensees the Division is able to maximize its effectiveness. The Division currently has 1 (one) administrative position that combines trust account reviewer duties and administrative duties. In 2013 the Division's Enforcement Section began the enforcement of brokers to submit reconciliations and reviewing reconciliations. In 2016 the requirement for brokers to submit the form 546A became effective in regulation. In 2017 the Division's Enforcement Section began the enforcement of brokers to submit form 546A but only as part of the trust account reconciliation enforcement.

Current trust account reconciliation enforcement which includes report generation, contacting brokers, broker follow up, generation of violation letters, tracking of payments, and collections requires 1 full time position for approximately 10 working days each month. Currently the Division's Enforcement Section does not have the resources to enforce the requirement for all

brokers to report annually and keep up with the complaint investigation demands of the section.
Currently reconciliations are reviewed, and any identified errors or discrepancies are noted. The broker is contacted by the trust account reviewer staff member. In order to improve and develop risk-based approaches, sophisticated controls to monitor outstanding reconciliations, comparing bank information and accounts from prior years; the Division will require an auditor or similar position along with some technology enhancements.

13. Work with the Department of Business and Industry to develop clear policies and procedures for the debt collection process, documenting the Division's and the Department's respective duties.

The Division has had several conversations with the Department of Business and Industry on developing a better process for debt collection and coordinating with the Controller's office to reconcile collections received. The Department of Business and Industry has shared a copy of their revised policy and the Division will work to develop clear procedures for debt collection.

14. Enhance existing internal control policies and procedures to ensure amounts entered in the commission fines shared tracking spreadsheets are accurate, verifying that amounts posted in the database and reported to the State Controller for collection are correct as well.

The Division will work to augment the existing internal control policies to ensure there is additional verification of commission fines entered in the database and spreadsheets prior to being reported to the Department of Business and Industry and eventually reported to the State Controller for collection.

Real Estate Division's Response to Audit Recommendations

	Recommendations	Accepted	Rejected
1.	Evaluate all user roles in the database to ensure staff access is appropriate for their duties and responsibilities, in addition to ensuring proper segregation of duties.	X	
2.	Establish monitoring controls to ensure supervisors and staff are following the Division's internal control procedures for documenting and approving voids.	X	
3.	Develop procedures for documenting transferred payments between accounts and credit adjustments.	X	
4.	Update internal control policies and procedures to include an independent verification that a refund issued by the State Controller was accurately posted in the database and perform a monthly reconciliation, agreeing all refunded amounts to the state accounting system.	X	
5.	Post refunds timely in the database once a check has been issued by the State Controller.	X	
6.	Perform a revenue reconciliation between the database and the state accounting system routinely, addressing any differences timely.	X	
7.	Require all brokers to file trust account forms annually and assess administrative sanctions for noncompliance.	X	
8.	Develop policies and procedures for waiving sanctions, including sufficient documentation of reasoning for waiver.	X	
9.	Utilize the database to track trust account reconciliation submittal for all licensed real estate brokers.	X	
10.	Implement a monitoring process to include comparing bank account information submitted on the annual trust account reconciliations to what was submitted by each broker in their prior year filings, following up on any discrepancies.	X	
11.	Develop and implement controls to monitor outstanding trust account reconciliation items.	X	
12.	Develop a risk-based approach for monitoring and initiating inspections of broker trust accounts.	X	

Real Estate Division's Response to Audit Recommendations (continued)

	Recommendations	Accepted	Rejected
13.	Work with the Department of Business and Industry to develop clear policies and procedures for the debt collection process, documenting the Division's and the Department's respective duties.	X	
14.	Enhance existing internal control policies and procedures to ensure amounts entered in the commission fines shared tracking spreadsheets are accurate, verifying that amounts posted in the database and reported to the State Controller for collection are correct as well.	X	
	TOTALS	14	

Appendix C
Auditor's Comments on Agency Response

The Division in its response, starting on page 27, states it agrees and accepts all recommendations. However, when addressing recommendations 7, 9, 10, 11, and 12, the Division indicates resource limitations prevents a review of all brokers and that current processes identify errors, and related discrepancies are noted and resolved. Because these statements differ from information noted in our report, we have provided our comments to inform the reader of our position and demonstrate why we believe our findings, conclusions, and recommendations, as stated in the report, are accurate and appropriate.

In its response on pages 29 and 30, the Division states its current process targets brokers holding a property manager permit, as they are most likely to handle trust funds. As reported on pages 11 and 12, brokers that hold property manager permits represent less than half the broker population. However, during the audit, we identified brokers without property manager permits that managed trust accounts, but were not monitored or held accountable by the Division. Therefore, it is important the Division have ongoing procedures to identify all brokers who may be managing trust funds to adequately protect individuals' money. Nevada Administrative Code 645.806 requires every real estate broker to report trust account information annually, or attest that they do not manage trust accounts. A simple attestation form could be utilized and reviewed, which should not require significant Division resources.

The Division, in its response, also indicates trust accounts are reviewed and errors or discrepancies noted. However, on pages 13 to 15 of our report, we describe how the Division's process for reviewing and ensuring correction of trust account errors or discrepancies is severely deficient. For 13 of 19 (68%) broker trust accounts tested, information reported to the Division was incomplete or contained unallowed, potentially fraudulent, accounting entries that the Division did not properly identify and resolve. For example, as noted on page 14, we observed $175,000 in unallowed trust account entries on one reconciliation that went unchallenged by the Division.

To improve its regulatory oversight of trust accounts, the Division indicates additional staffing and sophisticated controls and technology would be required. Adequately designed internal control systems help agencies perform vital functions in an efficient manner. Since the Division has not fully developed its internal control system over broker trust account reporting and review, we cannot opine on whether additional resources would be necessary. However, the issues discussed above can be corrected by developing basic internal controls, properly training and cross-training existing staff, and utilizing current resources like spreadsheets and databases. As discussed on pages 14 and 15, the Division does not effectively use the capabilities of its existing database to manage broker trust account information.

The Division has been given the responsibility to help safeguard citizens' money by regulating broker trust accounts. Therefore, it is the responsibility of the agency to use its resources effectively and develop processes and procedures that help ensure all broker trust accounts are identified and properly monitored.