AUDITOR GENERAL

WILLIAM O. MONROE, CPA

OFFICE OF FINANCIAL REGULATION
REGULATION OF MONEY TRANSMITTERS AND MORTGAGE BROKERS AND LENDERS

Operational Audit

SUMMARY

This operational audit, for the period March 2004 through February 2006, with selected actions through June 30, 2006, focused on Office of Financial Regulation (Office) procedures and practices for the regulation of money transmitters and mortgage brokers and lenders. While we found the Office has made noteworthy efforts in regulation despite a large growth of activity for these industries, the following additional opportunities for improvements were noted in various aspects of the programs:

Finding No. 1: The Office should continue to identify opportunities for educating entities of Federal requirements associated with money transmitter licenses.

Finding No. 2: The Money Transmitter Unit (Unit) is drafting a comprehensive risk analysis matrix to be used as part of a future integrated regulatory enforcement and licensing system, scheduled for implementation by 2009. In the interim, the Unit should develop and document a workable, comprehensive risk assessment process.

Finding No. 3: Written policies and procedures related to money transmitter regulatory activities should be updated to reflect current practices.

Finding No. 4: The Office did not appropriately verify and reconcile remittances received and invoices paid for the deferred presentment provider database and call center.

Finding No. 5: The Office did not timely update the Department Licensing System to reflect the denial of applications remaining incomplete following the 90-day application period.

Finding No. 6: The Office could enhance its current practice to identify potential conflicts of interest of its regulatory staff and management by annually requiring a statement regarding any known conflicts of interest.

Finding No. 7: To supplement its efforts to identify unlicensed activity during the course of examinations, the Office should enhance its written procedures requiring the proactive searches for unlicensed activity.

BACKGROUND

The Financial Services Commission was created in 2002 by Section 20.121(3), Florida Statutes, as an entity within the Department of Financial Services (Department). The Office of Financial Regulation (Office) is responsible for activities of the Financial Services Commission relating to the regulation of financial institutions, securities, and finance. Within the Office, the Division of Securities and Finance (Division) regulates the securities industry and finance companies, including, among others, money transmitters, and mortgage brokers and lenders. Within the Division, multiple bureaus and units are involved in regulating money transmitters, and mortgage brokers and lenders, including the Bureau of Financial Investigations, the Bureau of Finance

Regulation, the Bureau of Regulatory Review, and the Money Transmitter Unit.

While the Office operates independently from the Department, the Department provides administrative and information systems support in accordance with Section 20.121(3)(e), Florida Statutes. Included among the administrative support services provided by the Department are collections processing through the Receipts Section, and payment processing through the Accounting Section.

FINDINGS AND RECOMMENDATIONS

Money Transmitters

Money transmitters include a variety of financial services entities such as wire transfer businesses, money order sellers, check cashers, and foreign currency exchangers. The authority for Federal and State regulation is as follows:

- The U.S. Department of the Treasury (Treasury) regulates money transmitters under Title 31, Section 103, Code of Federal Regulations (31 CFR 103), the implementing regulations of the Bank Secrecy Act (BSA). The Treasury's Financial Crimes Enforcement Network (FinCEN) administers the BSA, which requires money transmitters to register with FinCEN as a Money Service Business, maintain an anti-money laundering compliance program, file reports, and keep records on certain types of transactions.
- The State of Florida regulates money transmitters under Chapter 560, Florida Statutes. Money transmitters are registered under two license categories: wire transfer businesses and money order sellers are licensed under one category, while check cashers and foreign currency exchangers are licensed under another. Entities may also register as deferred presentment providers and issue payday loans as part of either license category.

While money transmitter licensees comprise only nine percent of all licensees regulated by the Division, these entities are of particular concern to State and Federal regulators due to the potential for fraud, money laundering, or terrorist financing and due to the growth in the number of these entities. As shown in Table 1 below, the number of active licensees has grown significantly over the last five years. Licenses for main offices, which require more regulatory attention, have increased 104 percent since the 2001-02 fiscal year.

Table 1
Growth in Active Licensees

License Type	FY 2001-02	FY 2005-06	Percentage Change
Main Offices	597	1,220	104%
Branches	1,119	1,660	48%
Other Locations	24,763	32,190	30%

In recognition of the growth in money transmitter entities in Florida and the increased Federal regulation of such entities with the passage of the USA Patriot Act, the Office created the Money Transmitter Regulatory Unit (Unit) in October 2004. This Unit is responsible for the coordination of money transmitter regulatory efforts including examinations, coordination of legal cases, policy and training support, legislative and rule changes, and unregistered activity referrals.

As described below, our audit has disclosed the need for enhanced controls as well as opportunities to improve the effectiveness of the Office's regulation of money transmitters.

Finding No. 1: Information Provided Regarding Federal Requirements

Section 560.103(21), Florida Statutes, was amended in 2004 to include in the definition of "unsafe and unsound practices," the failure to adhere to a number of BSA provisions.[1] Unit management has acknowledged that an increased percentage of examinations with findings in 2005 was partly due to a lack of industry knowledge and understanding regarding the BSA requirement to have an anti-money laundering program.

[1] Chapter 2004-85, Laws of Florida, added to the definition of "unsafe and unsound practice" contained in Section 560.103(21), Florida Statutes, the following Title 31, CFR sections: 103.20, 103.22, 103.27, 103.28, 103.29, 103.33, 103.37, 103.41, and 103.125.

While the Unit does participate in industry-sponsored conferences, we noted the following additional opportunities to educate potential and active registrants regarding Federal regulatory requirements included in Florida law:

- State application materials included no reference to Federal registration or reporting requirements. Other states such as Arizona, Colorado, Georgia, Maryland, and Texas either require proof of Federal registration as part of the state application or include a checklist as part of the application to inform applicants of Federal registration and reporting requirements.
- Certification notices mailed to new registrants referred to State quarterly reports but did not reference Federal requirements.
- Office Web site pages, including the main money transmitter page, provided no information regarding the BSA requirements. Other states such as California, Delaware, Georgia, and Illinois have a link to FinCEN and other Federal reporting information clearly visible on their main money transmitter licensing pages.
- Quarterly reports, as designed, did not require any Federal registration and other BSA compliance information. Requiring entities to report information pertaining to certain BSA provisions (such as their Federal Money Service Business registration number and name of their Anti-Money Laundering Compliance Officer) on quarterly reports could provide a means to further educate registrants as to those requirements, as well as identify which entities may not be in compliance.

Unit management has indicated that additional education and outreach efforts are planned in the future. Those plans include adding to the registration application a checklist addressing Federal requirements, adding a requirement on the quarterly report that the Anti-Money Laundering Compliance Officer be disclosed, sending a guidance letter to all check cashers, and initiating a telephone contact program in which examiners will contact new money transmitter registrants.

Recommendation: We recommend that the Office update its application and reporting forms, certification notices, and Web site, and continue to identify opportunities for educating entities regarding the Federal requirements incorporated by reference in Section 560.103(21), Florida Statutes.

Finding No. 2: Risk Assessment of Money Transmitters

As a regulator, the Office has a responsibility to utilize its finite resources in a manner which provides the greatest assurance that regulated entities operate in accordance with governing laws and rules designed to protect consumers and the general public. A means to help achieve that assurance is to identify and measure the risk that regulated entities may violate material governing provisions of law or rule and that consumers or the public may be harmed as a result of the violations. Comprehensive risk assessments provide a process to measure this risk and provide a basis for its control through increased regulatory monitoring.

While entities may be referred for examination for missing quarterly reporting deadlines, failing to meet financial requirements, or being the subject of a complaint or suspicious activity report, no written procedures requiring a documented, comprehensive industry-wide risk assessment process were in place. The implementation of such procedures could help ensure that entities that pose risks on a cumulative level are not overlooked and go unexamined. The Unit is drafting a comprehensive risk analysis matrix to be used as part of a future integrated Regulatory Enforcement and Licensing System (REAL System); however, the REAL System, now in the procurement stage, may not be fully implemented until 2009.

Recommendation: Given the timeframe for completing the risk analysis matrix as part of the integrated system, we recommend that in the interim, the Unit develop and document a workable, comprehensive risk assessment process that includes, among other risk factors, the length of time an entity has operated without examination.

Finding No. 3: Policies and Procedures

Documenting processes through written policies and procedures facilitates communication of management direction and control, provides a reasonable basis for training new employees, and promotes consistent performance of those processes. Our audit disclosed that written policies and procedures were insufficient to reasonably ensure the accomplishment of certain regulatory processes:

- **Money transmitter registrant monitoring**: During the audit period, procedures in place did not address substantial portions of the report review process involving identification of characteristics that may indicate potential abnormalities or "red flags" identified in quarterly reports and annual financial statements. Absent such procedures, red flags may not consistently receive appropriate attention.
- **Scheduling of follow-up examinations:** The Bureau of Finance Regulation's Examination Policies and Procedures Manual (Examination Manual) discusses in general terms the scheduling of examinations to follow up on previous findings. According to the Examination Manual, regional office Area Financial Managers are responsible for tracking and scheduling examinations.

  However, the Unit has made a policy decision to perform alternative procedures to address common examination findings, such as the failure to maintain books and records and the failure to implement an effective anti-money laundering program. This change had not been documented and communicated in written, Unit-specific policies and procedures.

Recommendation: We recommend the Office review and update its written policies and procedures related to money transmitter regulatory activities.

Finding No. 4: Deferred Presentment Provider Database Vendor Payments

Chapter 560, Florida Statutes, was amended in 2001 to require the establishment of an Internet-accessible deferred presentment provider (DPP) database in order to better regulate DPP loans (commonly referred to as payday loans).[2] Veritec Solutions was subsequently engaged by the Office[3] to manage the new DPP database and related call center that provides customer service to DPP licensees and consumers. In accordance with the contract, Veritec was to remit to the Receipts Section a one dollar per transaction fee the company received from each DPP licensee. The Accounting Section then paid Veritec for managing the database. This payment was based on the number of transactions reported in the weekly Veritec invoices submitted to the Office.

According to Office records, since the inception of the contract in 2001, through June 30, 2006, payments to Veritec totaled approximately $7.6 million. During the audit period, Veritec was paid approximately $3.4 million.

Our testing of Office procedures disclosed that the Office did not appropriately verify the accuracy and completeness of Veritec's remittances and invoices. Specifically:

- There were no written procedures requiring verification that all weekly remittances due had been made by Veritec prior to authorization and payment of Veritec invoices, and no such verifications were performed.-
- Veritec maintained a dedicated bank account for the deposit of deferred presentment transaction fees, and DPP licensees were to directly transmit into this bank account the one dollar deferred presentment transaction fee. Our audit disclosed that there were no written procedures requiring reconciliation of the number of transactions shown by Veritec invoices to corroborating data, such as bank statements, to verify that DPP fees received by Veritec corresponded to amounts remitted to the Department. While reviews of bank statements were performed in the past, no

[2] Among the many changes to Chapter 560, Florida Statutes, Chapter 2001-119, Laws of Florida, created Part IV, the Deferred Presentment Act. A key provision of the Act precludes the existence of more than the deferred presentment transaction per individual and prohibits an individual from opening a deferred presentment transaction within 24 hours of closing another. The database was established to facilitate compliance with that provision.

[3] The original contract was signed in 2001 by the former Department of Banking and Finance, Division of Securities and Finance. The Division of Securities and Finance became part of the Office of Financial Regulation after the creation of the Office in 2002.

reviews had been conducted after the period ending March 31, 2004. Veritec was paid approximately $4 million from April 1, 2004, through May 30, 2006.

In response to this audit, the Office indicated that it has instituted weekly and monthly written procedures, effective June 1, 2006, that include verifying receipt of Veritec's remittance before authorizing invoice payments, reviewing bank statements to reconcile fees received by Veritec to remittances received by the Department, and analyzing Veritec's Weekly Reports for accuracy.

Recommendation: We recommend that the Office monitor the implementation of the newly instituted procedures to ensure that: the receipt, accuracy, and completeness of Veritec's remittances to the Department are verified before payment of the vendor's invoices; and Veritec's invoices are reconciled to corroborating data including, but not limited to, the vendor's bank statements.

Mortgage Brokers and Lenders

As of June 30, 2006, there were more than 89,000 mortgage brokers and businesses, lenders, and branches subject to Office regulation. Primary Office regulatory activities included licensure, examination, and complaint resolution. During the 2004-05 fiscal year, the Office approved more than 5,000 new licenses and over 13,000 renewals and reactivations, conducted approximately 164 "for cause" examinations, and received over 2,000 complaints related to licensees.

Finding No. 5: Application Denial and Department Licensing System Status

Rule 69V-40.031, Florida Administrative Code, requires the Office to issue deficiency notices to mortgage broker applicants within 30 days of the receipt of an incomplete application package. Upon the issuance of the deficiency notice, the Office establishes, in the Department Licensing System (DLS), a 90-day application period during which the applicant must resolve all deficiencies, or in accordance with rule, the application will be denied.

For 30 mortgage broker license applications tested, seven had not resolved all deficiencies before the expiration of the 90-day application period. Our audit disclosed that the Office had not denied these applications nor updated the application status in DLS.

Further analysis of DLS entries for mortgage broker and lender applications showing unresolved deficiencies and a pending status as of March 24, 2006, showed that 58 percent (over 10,000 applications) had exceeded the 90-day application period, yet remained pending. While staff had been directed to review incomplete application files that exceeded the 90-day period, such files had not been reviewed or processed for denial.

The usefulness of DLS as a management tool to track, monitor, and report application status is diminished, absent timely denial of applications and timely update of the DLS application status.

Recommendation: For incomplete applications that have exceeded the 90-day application period, we recommend the Office timely deny applications and timely update DLS to reflect application status.

Shared Findings

Finding No. 6: Annual Statements of Conflicts of Interest

Office policy requires that personnel must sign a Prohibited Activities Statement (Statement) upon employment. This Statement provides the standards of conduct for State employees as detailed in Section 112.313(7), Florida Statutes, and prohibits employees from holding employment, contractual, or financial relationships with regulated entities. The policy followed by the Office also requires that employees must report any such relationships within five working days of the employment or contractual application or offer, or within five working days of the acquisition of a financial interest.

Ensuring that examinations, investigations, and other regulatory activities are conducted free of conflicts of

interest is a critical element of successful regulation as it provides assurance regarding the objectivity of regulatory personnel and activities. An undisclosed conflict of interest can have a detrimental effect on both the integrity of a particular investigation or examination, as well as the integrity of the Office's regulatory efforts as a whole. Assurance of the objectivity of personnel could be enhanced by supplementing the current exception-based reporting with an annual statement identifying any known conflicts of interest.

Recommendation: We recommend the Office require from all Office regulatory personnel and management annual statements identifying any known conflicts of interest. This information should be used by management when making work assignments.

Finding No. 7: Unlicensed Activity

Unlicensed activity increases the risk of the public's exposure to fraud and other illegal activity, such as money laundering, the assessment of unreasonable late fees and prepayment penalties, higher-than-market interest rates, hidden fees, "bait and switch" tactics, and possible terrorist financing.

The Office attempts to deter unscrupulous activity through various educational outreach and compliance monitoring measures. Public awareness campaign activities are conducted for certain regulated industries and Office policies provide for the performance of examinations. These policies require examiners to notify supervisors of unlicensed activity discovered during the course of examinations. Such examinations may be "for cause" in response to information received indicating a potential violation, or routine for ensuring statutory compliance. Additionally, the Office conducted a one-time investigative "sweep" in 2003 to search for unlicensed and noncompliant money transmitters. During this sweep, investigators visited 315 unlicensed firms, identified $1.75 million in customer losses, took regulatory action against 29 unlicensed money transmitter firms, and levied $136,750 in fines.

Despite such efforts, the Office had only limited written procedures requiring proactive searches for unlicensed activity. By enhancing policies and procedures to require proactive searches for unlicensed activity, the Office can further promote compliance through licensing and better protect the State's citizens.

Recommendation: We recommend the Office establish written procedures to require proactive searches for unlicensed activity, in addition to searches made during the conduct of routine regulatory activities.

OBJECTIVES, SCOPE, AND METHODOLOGY

This operational audit focused on the procedures and practices of the Office of Financial Regulation, Division of Securities and Finance, related to the State's regulation of money transmitters and mortgage brokers and lenders.

Our audit objectives related to money transmitter regulation were to:

- Obtain an understanding of the industry and industry current events and issues.
- Determine the adequacy of the Office's controls for registering, monitoring, and examining money transmitters.
- Obtain an understanding of the procedures used by the Office to detect instances of money laundering under the "Florida Control of Money Laundering in Money Transmitters Act," Section 560.123, Florida Statutes.
- Review of the selection of the deferred presentment database vendor, determine whether payments made to the vendor were adequately supported, and determine whether the vendor's performance has been appropriately monitored.
- Obtain an understanding of the activities performed by the Office to detect and prevent money transmitter fraud in Florida.

Our audit objectives related to the regulation of mortgage brokers and lenders were to:

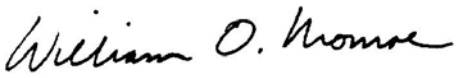
- Evaluate controls related to licensing mortgage brokers and lenders.

- Obtain an understanding of procedures related to selecting licenses and complaints for examination, including appropriate risk assessments.
- Evaluate regulatory processes used by the Office to detect and prevent mortgage fraud in Florida, including, but not limited to, reviews for unlicensed or out-of-state activity, fostering of relationships with relevant mortgage industry groups, and educating the public and licensees.

In conducting our audit, we obtained an understanding of governing laws and rules. We also reviewed Office written and electronic guidance, interviewed Office personnel, performed tests of pertinent Office records, and conducted tests of effectiveness of relevant Office controls. Our audit included examinations of transactions occurring during the period March 2004, through February 2006 and selected actions through June 30, 2006.

AUTHORITY

Pursuant to the provisions of Section 11.45, Florida Statutes, I have directed that this report be prepared to present the results of our operational audit.



William O. Monroe, CPA
Auditor General

MANAGEMENT RESPONSE

In a letter dated January 19, 2007, the Commissioner provided responses to our findings. The letter is included in its entirety at the end of this report as Appendix A.

To promote accountability in government and improvement in government operations, the Auditor General makes operational audits of selected programs, activities, and functions of State agencies. This operational audit was conducted in accordance with applicable Generally Accepted Government Auditing Standards. This audit was conducted by Robin Ralston, CPA, and Marcia Bremer, CPA. Please address inquiries regarding this report to Kathryn D. Walker, CPA, Audit Manager, via e-mail at kathrynwalker@aud.state.fl.us or by telephone at (850) 487-9085.

This report, as well as other audit reports prepared by the Auditor General, can be obtained on our Web site (http://www.state.fl.us/audgen); by telephone at (850) 487-9024; or by mail at G74 Claude Pepper Building, 111 West Madison Street, Tallahassee, Florida 32399-1450.

APPENDIX A
MANAGEMENT RESPONSE

FINANCIAL SERVICE COMMISSION

CHARLIE CRIST
GOVERNOR

BILL MCCOLLUM
ATTORNEY GENERAL

ALEX SINK
CHIEF FINANCIAL OFFICER

CHARLES BRONSON
COMMISSIONER OF AGRICULTURE

OFFICE OF FINANCIAL REGULATION

DON B. SAXON
COMMISSIONER

January 19, 2007

Mr. William O. Monroe
Auditor General
G74 Claude Pepper Building
111 West Madison Street
Tallahassee, Florida 32399-1450

Dear Mr. Monroe:

Enclosed is the Office's response to the preliminary and tentative audit findings for the operational audit of the Office of Financial Regulation's Regulation of Money Transmitters and Mortgage Brokers and Lenders.

If you have any questions, please contact Inspector General Bob Dyar at 410-9712.

Sincerely,

Don Saxon

Don B. Saxon

DBS/rd

Enclosure

DON B. SAXON • COMMISSIONER • OFFICE OF FINANCIAL REGULATION
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APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)

Office of Financial Regulation

Response to the Preliminary and Tentative Audit Findings
Regulation of Money Transmitters and
Mortgage Brokers and Lenders

Finding No. 1: Information Provided Regarding Federal Requirements

Section 560.103(21), Florida Statutes, was amended in 2004 to include in the definition of "unsafe and unsound practices," the failure to adhere to a number of BSA provisions. Unit management has acknowledged that an increased percentage of examinations with findings in 2005 was partly due to a lack of industry knowledge and understanding regarding the BSA requirement to have an anti-money laundering program.

While the Unit does participate in industry-sponsored conferences, we noted the following additional opportunities to educate potential and active registrants regarding Federal regulatory requirements included in Florida law:

- State application materials included no reference to Federal registration or reporting requirements. Other states…either require proof of Federal registration as part of the state application, or include a checklist as part of the application to inform applicants of Federal registration and reporting requirements.

- Certification notices mailed to new registrants referred to State quarterly reports, but did not reference Federal requirements.

- Office Web site pages, including the main money transmitter page, provided no information regarding the BSA requirements. Other states…have a link to FinCEN and other Federal reporting information clearly visible on their main money transmitter licensing pages.

- Quarterly reports, as designed, did not require any Federal registration and other BSA compliance information. Requiring entities to report information pertaining to certain BSA provisions…on quarterly reports could provide a means to further educate registrants as to those requirements, as well as identify which entities may not be in compliance.

Recommendation: We recommend that the Office update its application and reporting forms, certification notices, and Web site, and continue to identify opportunities for educating entities regarding the Federal requirements incorporated by reference in Section 560.103(21), Florida Statutes**.**

APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)

Auditee Response: The Office agrees that "self regulation" is an important component in ensuring compliance by the industries we regulate. As such, the Office routinely conducts industry outreach programs with regulated industries and maintains various links to the statutes governing money transmitters on our website. However, it is the responsibility of money transmitter applicants and registrants to be familiar with and comply with all applicable State and Federal regulations when conducting money transmitter activities. Neither the state statutes, nor the administrative code rules, require the Office to proactively notify money transmitter applicants or registrants of changes in State or Federal regulations. Moreover, money transmitter businesses in all states, including Florida, were already subject to Federal BSA regulations before they were enacted into Florida law in 2004. Prior to Florida's enactment, Federal authorities enforced BSA regulations against money transmitters. Since Florida's enactment, both OFR and Federal agencies have authority to enforce BSA regulations.

The Office will continue to review various methods to enhance its industry outreach activities to provide additional information to educate potential and active money transmitter registrants regarding the Federal requirements incorporated by reference in Section 560.103(21), Florida Statutes.

Finding No. 2: Risk Assessment of Money Transmitters

As a regulator, the Office has a responsibility to utilize its finite resources in a manner which provides the greatest assurance that regulated entities operate in accordance with governing laws and rules designed to protect consumers and the general public. A means to help achieve that assurance is to identify and measure the risk that regulated entities may violate material governing provisions of law or rule, and that consumers or the public may be harmed as a result of the violations. Comprehensive risk assessments provide a process to measure this risk and provide a basis for its control through increased regulatory monitoring.

While entities may be referred for examination for missing quarterly reporting deadlines, failing to meet financial requirements, or being the subject of a complaint or suspicious activity report, no written procedures requiring a documented, comprehensive industry-wide risk assessment process were in place. The implementation of such procedures could help ensure that entities that pose risks on a cumulative level are not overlooked and go unexamined. The Unit is drafting a comprehensive risk analysis matrix to be used as part of a future integrated Regulatory Enforcement and Licensing System (REAL System); however, the REAL System, now in the procurement stage, may not be fully implemented until 2009.

Recommendation: Given the timeframe for completing the risk analysis matrix as part of the integrated system, we recommend that in the interim, the Unit develop and document a workable, comprehensive risk assessment process that includes, among other risk factors, the length of time an entity has operated without examination.

Auditee Response: We concur with the finding and recommendation.

Since its inception, the staff of MTRU has utilized risk-based criteria to determine which regulated entities should be examined. The staff has continued to refine these criteria as additional data becomes available.

APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)

Prior to the implementation of the REAL system, which will include risk-based targeting capabilities, the MTRU will continue the development of a comprehensive risk assessment process for selecting registrants to be examined. As recommended, the risk assessment process currently in use will be documented in written procedures.

Finding No. 3: Policies and Procedures

Documenting processes through written policies and procedures facilitates communication of management direction and control, provides a reasonable basis for training new employees, and promotes consistent performance of those processes. Our audit disclosed that written policies and procedures should be enhanced to reasonably ensure the accomplishment of certain regulatory processes:

- **Money transmitter registrant monitoring**: During the audit period, procedures in place did not address substantial portions of the report review process involving identification of characteristics that may indicate potential abnormalities or "red flags" in quarterly reports and annual financial statements. Absent such procedures, red flags may not consistently receive appropriate attention.

- **Scheduling of follow-up examinations**: The Bureau of Finance Regulation's Examination Policies and Procedures Manual (Examination Manual) discusses in general terms the scheduling of examinations to follow up on previous findings. According to the Examination Manual, regional office Area Financial Managers are responsible for tracking and scheduling examinations.

  However, the Unit has made a policy decision to perform alternative procedures to address common examination findings, such as the failure to maintain books and records and the failure to implement an effective anti-money laundering program. This change had not been documented and communicated in written, Unit-specific policies and procedures.

Recommendation: We recommend the Office review and update its written policies and procedures related to money transmitter regulatory activities to reflect current practice.

Auditee Response: We concur with the finding and recommendation.

Money transmitter registrant monitoring: Office policies and procedures for the Bureau of Regulatory Review are primarily intended to document the methods used to perform a task in the registration process. In the case of quarterly reports, the Regulatory Review staff is responsible for ensuring that the registrants file the required reports. The analysis of the data contained in the quarterly reports is conducted by the MTRU as part of its risk assessment of money transmitters (see discussion in finding 2 above). The Regulatory Review procedures will be amended to identify potential statutory and/or rule violations in financial statements and follow-up as needed.

APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)

Scheduling of follow-up examinations: When the Office's MTRU was created in 2004, it lacked its own Procedures Manual. Consequently, the MTRU used, to the extent practicable, the Bureau of Finance Regulation's examination manual as a baseline, while simultaneously commencing the development of its own procedures to meet its own particular needs. The Unit's examination procedures have been continually supplemented and refined and were finalized in October 2006. The MTRU will revise all of the Unit's operating policies and procedures, making them Unit-specific.

Finding No. 4: Deferred Presentment Provider Database Vendor Payments

Chapter 560, Florida Statutes, was amended in 2001 to require the establishment of an Internet-accessible deferred presentment provider (DPP) database in order to better regulate DPP loans (commonly referred to as payday loans). Veritec Solutions was subsequently engaged by the Office to manage the new DPP database and related call center that provides customer service to DPP licensees and consumers. In accordance with the contract, Veritec remitted to the Receipts Section a one dollar per transaction fee the company received from each DPP licensee. The Accounting Section then paid Veritec for managing the database. This payment was based on the number of transactions reported in the weekly Veritec invoices submitted to the Office.

According to Office records, since the inception of the contract in 2001, through June 30, 2006, payments to Veritec totaled approximately $7.6 million. During the audit period, Veritec was paid approximately $3.4 million.

Our testing of Office procedures disclosed that the Office did not appropriately verify the accuracy and completeness of Veritec's remittances and invoices. Specifically:

- There were no written procedures requiring verification that all weekly remittances due had been made by Veritec prior to authorization and payment of Veritec invoices, and no such verifications were performed.

- Veritec maintained a dedicated bank account for the deposit of deferred presentment transaction fees, and DPP licensees were to directly transmit into this bank account the one dollar deferred presentment transaction fee. Our audit disclosed that there were no written procedures requiring reconciliation of the number of transactions shown by Veritec invoices to corroborating data, such as bank statements, to verify that DPP fees received by Veritec corresponded to amounts remitted to the Department. While reviews of bank statements were performed in the past, no reviews had been conducted after the period ending March 31, 2004. Veritec was paid approximately $4 million from April 1, 2004, through May 30, 2006.

In response to this audit, the Office indicated that it has instituted weekly and monthly written procedures, effective June 1, 2006, that include verifying receipt of Veritec's remittance before authorizing invoice payments, reviewing bank statements to reconcile fees received by Veritec to remittances received by the Department, and analyzing Veritec's Weekly Reports for accuracy.

APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)

Recommendation: We recommend that the Office monitor the implementation of the newly instituted procedures to ensure that: the receipt, accuracy, and completeness of Veritec's remittances to the Department are verified before payment of the vendor's invoices; and Veritec's invoices are reconciled to corroborating data including, but not limited to, the vendor's bank statements.

Auditee Response: We concur with the finding and recommendation.

There are several factors that should be considered in a review of the Office's oversight of Veritec's activities related to billing and payment. First, Veritec is audited by an independent third party on a yearly basis with regard to its invoicing and remittance procedures. This audit report is submitted to and reviewed by the Office. Second, Veritec maintains a $1 million dollar performance bond in favor of the Office for any failure on its part to perform its duties under the contract, including any failure to remit monies which it collects as agent for the State of Florida. Finally, to date, no Deferred Presentment Provider has brought forward a complaint regarding any billing irregularities.

As stated above, effective June 1, 2006, OFR implemented written procedures as discussed in the audit findings. As recommended, the Office will continue to monitor the implementation of these newly instituted procedures.

Finding No. 5: Application Denial and Department Licensing System Status

Rule 69V-40.031, Florida Administrative Code, requires the Office to issue deficiency notices to mortgage broker applicants within 30 days of the receipt of an incomplete application package. Upon the issuance of the deficiency notice, the Office establishes in the Department Licensing System (DLS) a 90-day application period during which the applicant must resolve all deficiencies, or in accordance with rule, the application will be denied.

For 30 Mortgage broker license applications tested, seven had not resolved all deficiencies before the expiration of the 90-day application period. Our audit disclosed that the Office had not denied these applications nor updated the application status in DLS.

Further analysis of DLS entries for mortgage broker and lender applications showing unresolved deficiencies and a pending status as of March 24, 2006, showed that 58 percent (over 10,000 applications) had exceeded the 90-day application period, yet remained pending. While staff had been directed to review incomplete application files that exceeded the 90-day period, such files had not been reviewed or processed for denial.

Usefulness of DLS as a management tool to track, monitor, and report application status is diminished, absent timely denial of applications and timely update of the DLS application status.

Recommendation: For incomplete applications that have exceeded the 90-day application period, we recommend the Office timely deny applications and timely update DLS to reflect application status.

APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)

Auditee Response: We concur with the finding and recommendation.

Although the Office's Rule 69V-40.031, F.A.C., may be construed to require the Office to deny an application when we request additional information relating to a license application, but have not received all requested information within 90 days, the rule does not stipulate when the denial has to be entered. The Office finds that in many cases it is preferable, and in the best interests of the applicant and State, to allow more time for the applicant to gather and provide the additional documentation required by the Office. The alternative would require the applicant to incur the burden of compiling an entirely new application and paying additional filing fees. This practice has enabled the Office to process the 300% increase in mortgage broker applications received over the last three years.

The Office has initiated steps to reduce the backlog of applications awaiting denial. These efforts have reduced the number of files by half. Management will continue to monitor this process to ensure that all technical denials are issued promptly.

Finding No. 6: Annual Statements of Conflicts of Interest

Office policy requires that personnel must sign a Prohibited Activities Statement (Statement) upon employment. This Statement provides the standards of conduct for State employees as detailed in Section 112.313(7), Florida Statutes, and prohibits employees from holding employment, contractual, or financial relationships with regulated entities. The policy followed by the Office also requires that employees must report any such relationships within five working days of the employment or contractual application or offer, or within five working days of the acquisition of a financial interest.

Ensuring that examinations, investigations, and other regulatory activities are conducted free of conflicts of interest is a critical element of successful regulation as it provides assurance regarding the objectivity of regulatory personnel and activities. An undisclosed conflict of interest can have a detrimental effect on both the integrity of a particular investigation or examination, as well as the integrity of the Office's regulatory efforts as a whole. Assurance of the objectivity of personnel could be enhanced by supplementing the current exception-based reporting with an annual statement identifying any known conflicts of interest.

Recommendation: We recommend the Office require from all Office regulatory personnel and management, annual statements identifying any known conflicts of interest. This information should be used by management when making work assignments.

Auditee Response: The statute referenced in this finding applies to all officers and employees of all state agencies. The Office has always taken proactive measures to ensure that its employees are aware of, and comply with, these requirements. The Office will implement the additional measures recommended by the Auditor General.

APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)

Finding No. 7: Unlicensed Activity

Unlicensed activity increases the risk of the public's exposure to fraud and other illegal activity, such as money laundering, the assessment of unreasonable late fees and prepayment penalties, higher-than-market interest rates, hidden fees, "bait and switch" tactics, and possible terrorist financing.

The Office attempts to deter unscrupulous activity through various educational outreach and compliance monitoring measures. Public awareness campaign activities are conducted for certain regulated industries, and Office policies provide for the performance of examinations. These policies require examiners to notify supervisors of unlicensed activity discovered during the course of examinations. Such examinations may be "for cause" in response to information received indicating a potential violation, or routine for ensuring statutory compliance. Additionally, the Office conducted a one-time investigative "sweep" in 2003 to search for unlicensed and noncompliant money transmitters. During this sweep, investigators visited 315 unlicensed firms, identified $1.75 million in customer losses, took regulatory action against 29 unlicensed money transmitter firms, and levied $136,750 in fines.

Despite such efforts, the Office had only limited written procedures requiring proactive searches for unlicensed activity. By enhancing policies and procedures to require proactive searches for unlicensed activity, the Office can further promote compliance through licensing and better protect the State's citizens.

Recommendation: We recommend the Office establish written procedures to require proactive searches for unlicensed activity, in addition to searches made during the conduct of routine regulatory activities.

Auditee Response: This finding appears to involve three areas within the Office: the Bureau of Finance Regulation, the MTRU, and the Bureau of Financial Investigations. The primary responsibility of the Bureau of Finance Regulation and the MTRU is to conduct examinations of licensed entities. The primary mission of the Bureau of Financial Investigations is to detect and investigate unlicensed or fraudulent activities. This Bureau works with various State and Federal investigative, law enforcement, and civil and criminal prosecutorial agencies to accomplish this goal.

As discussed in the finding, the Bureau of Finance Regulation, and the MTRU, currently have examination procedures containing specific steps for examiners to identify unlicensed activity during examinations. The Bureau of Financial Investigations will review its current procedures to determine what additional actions may be viable to enhance their ability to identify unlicensed activity and update their written procedures.

APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)

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