

# Arizona Department of Real Estate

Department met some of its statutory objectives and purposes but did not ensure it selected high-risk brokerages for audit, confirm the validity of license applicants' fingerprint clearance cards, and consistently investigate complaints in accordance with its policies and procedures

Performance Audit and  
Sunset Review

April 2021  
Report 21-102

A Report to the Arizona Legislature

Lindsey A. Perry  
Auditor General





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April 27, 2021

Members of the Arizona Legislature

The Honorable Doug Ducey, Governor

Ms. Judy Lowe, Commissioner  
Arizona Department of Real Estate

Transmitted herewith is the Auditor General's report, *A Performance Audit and Sunset Review of the Arizona Department of Real Estate*. This report is in response to a September 19, 2018, resolution of the Joint Legislative Audit Committee. The performance audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq. I am also transmitting within this report a copy of the Report Highlights to provide a quick summary for your convenience.

As outlined in its response, the Arizona Department of Real Estate agrees with all the findings and plans to implement all the recommendations.

My staff and I will be pleased to discuss or clarify items in the report.

Sincerely,

Lindsey A. Perry, CPA, CFE  
Auditor General

## Arizona Department of Real Estate

Department met some of its statutory objectives and purposes but did not ensure it selected high-risk brokerages for audit, confirm the validity of license applicants' fingerprint clearance cards, and consistently investigate complaints in accordance with its policies and procedures

### Audit purpose

To assess the Department's approach for selecting brokerages for audit; and determine whether it issued initial and renewal licenses to qualified applicants in a timely manner, appropriately charged a fee meant to cover travel costs for performing onsite subdivision inspections, and whether it adhered to its complaint investigation, resolution, and disciplinary processes and guidelines.

### Key findings

- The Department selects and conducts audits of brokerages in the State to assess and ensure their compliance with statute and rule but did not ensure that high-risk brokerages were selected for audit.
- Although the Department ensured that salesperson and broker license applicants for initial and renewal licensure met key statutory and rule requirements for the applications we reviewed, the Department did not have a process for nor did it confirm the validity of the 20 initial license applicants' fingerprint clearance cards we reviewed.
- The Department collected an estimated \$61,000 in fees meant to cover its travel and subsistence costs for performing 1,203 onsite inspections of subdivisions offered for sale in the State from 2017 until December 2019, but did not travel to conduct these inspections. Instead, during the audit, the Department implemented a new virtual inspection process and virtually conducted these inspections. Additionally, the Department developed a new policy indicating that it would charge a fee to cover its travel costs only if it traveled to conduct onsite inspections, and as of March 2021, reported it was in the process of determining what steps it should take to address the estimated \$61,000 in fees that it had collected to conduct onsite inspections that it instead had conducted virtually.
- The Department did not investigate complaints in accordance with its policies and procedures for a random sample of 26 of 45 complaints we reviewed.

### Key recommendations

The Department should:

- Use a risk-based approach to ensure that high-risk brokerages are selected for audit, and revise its policy and develop and implement a process for selecting brokerages for audit based on their assigned risk rating.
- Ensure that initial license applicants possess a valid fingerprint clearance card before it issues a license by confirming the validity of fingerprint clearance cards using the Arizona Department of Public Safety website.
- Work with its Assistant Attorney General to determine how it should address the estimated \$61,000 in fees that it previously collected although it did not travel to perform onsite inspections.
- Investigate and resolve complaints in accordance with its policies and procedures, and modify these policies and procedures to require supervisory review of all complaint investigations throughout the investigation process.



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The Office of the Auditor General has completed a performance audit and sunset review of the Arizona Department of Real Estate (Department). This report addresses whether the Department ensured that high-risk brokerages were selected for audit and provides responses to the statutory sunset factors, including information on the Department's licensing, complaint handling, and disciplinary actions.

## Mission and responsibilities

The Department's mission is to offer protection to Arizona consumers in real estate transactions. The Department's statutory responsibilities include:

- **Licensing and certification**—Issuing licenses for real estate, cemetery, and membership camping salespersons, brokers, and brokerages. Each license must be renewed every 2 years. According to Department data, there were approximately 67,108 licensed salespersons, 13,632 licensed brokers, and 8,357 licensed brokerages as of October 2020.

The Department is also responsible for certifying real estate schools, instructors, and courses. Each certification must be renewed every 4 years. According to the Department, there were approximately 254 schools, 801 instructors, and 2,658 courses certified by the Department to operate in Arizona as of October 2020.

- **Auditing brokerages**—Conducting brokerage audits to help ensure compliance with statute and rule requirements, such as maintaining complete employee records and real estate transaction documentation, as well as balancing and reconciling client trust fund accounts.<sup>1</sup> Client trust funds could include rent payments, security deposits, and other tenant deposits managed by the broker for its clients. The Department reported that brokerage audits also help to educate and provide constructive feedback to licensees to help ensure their compliance with statute, rule, or Department policy. According to the Department, it conducted 140 brokerage audits in fiscal year 2020 (see Finding 1, pages 5 through 7, for more information on the Department's selection of brokerages for audit).

### Key definitions

**Salesperson**—Engages in selling, negotiating offers to sell, and listing for sale real estate, cemetery, and membership camping properties.

**Broker**—Employs or supervises salespersons and can also engage in the same types of activities as salespersons.

**Brokerage**—Also known as an employing broker; a company for which salespersons and brokers act through and on behalf of.

**Real estate school**—Provides required pre-licensing real estate education and continuing education to prospective and licensed real estate professionals.

**Subdivision**—Improved or unimproved land divided or proposed to be divided into 6 or more lots, parcels, or fractional interests for the purpose of sale or lease.

**Public disclosure report**—Authorizes the sale of and provides consumers with vital details about subdivisions, unsubdivided land, campgrounds, cemeteries, or timeshares including available utilities, amenities, and unique land features.

Source: Auditor General staff analysis of Arizona Revised Statutes (A.R.S.) §§32-2101 and 32-2125.

<sup>1</sup> A.R.S. §32-2175.

- **Investigating complaints**—Investigating and adjudicating complaints against licensees and, when appropriate, taking disciplinary and nondisciplinary actions, including issuing advisory letters of concern, entering into accelerated settlement agreements, and issuing consent orders. According to the Department, it received 584 complaints and took disciplinary action in 114 cases in fiscal year 2020.
- **Issuing public disclosure reports**—Issuing statutorily required public disclosure reports for subdivisions, unsubdivided land, membership campgrounds, and timeshares (see textbox on page 1 for definition). As part of this process, the Department verifies that the public disclosure report applicant, such as a subdivision developer, owns the property and has proof of insurance and certificates from regulating entities authorizing the use of utilities, including water and sewer.
- **Homeowners association dispute resolution**—The Department acts as the administrative body for the Office of Administrative Hearings (OAH) in resolving homeowners association disputes.<sup>2</sup> Specifically, consumers submit dispute petitions and the associated fees to the Department; the Department then reviews the petitions for completeness and validity and forwards valid petitions to OAH for a hearing before an administrative law judge to issue a judgment on the petition. The Department uses the monies collected from petition fees to compensate OAH for hearing costs. A petition is considered valid if the applicant completed all components of the application and the claim involves eligible parties. For example, petitions must involve an owner and an association and cannot involve renters or other nonownership parties.
- **Administering Real Estate Recovery Fund (Recovery Fund)**—Statute requires the Real Estate Commissioner (Commissioner) to maintain the Recovery Fund to compensate those aggrieved by an act, representation, transaction, or conduct of a licensed real estate or cemetery broker or salesperson.<sup>3</sup> Statute establishes the Recovery Fund and related requirements including requiring that individuals obtain a judgment against licensed parties involved in the transaction and to pursue options to obtain the requested monies from the liable parties before Recovery Fund monies are provided. The Recovery Fund is primarily funded from salesperson and broker applications fees.<sup>4</sup> In fiscal year 2020, the Department received 4 applications and approved 1, resulting in a \$30,000 payout for a fraudulent residential property sale.<sup>5,6</sup> The Recovery Fund's balance was \$957,800 as of the beginning of fiscal year 2021.

## Organization and Staffing

As of November 2020, the Department reported having 26 filled full-time equivalent (FTE) positions and 11 vacancies. The Department's executive staff includes a commissioner, deputy commissioner, assistant commissioner of licensing services, and chief of staff. The Department is divided into the following divisions:

- **Licensing Services Division**—Issues licenses for real estate, cemetery, and membership camping salespersons and brokers.
- **Education Division**—Certifies real estate schools, instructors, and courses.
- **Auditing and Investigations Division**—Performs brokerage audits and investigates complaints.
- **Enforcement and Compliance Division**—Applies discipline in cases where statute or rule have been violated and monitors compliance with the terms of disciplinary orders and agreements.

<sup>2</sup> In 2016, the Legislature passed legislation moving the Homeowners Association (HOA) dispute process to the Department from the Arizona Department of Fire, Building and Life Safety.

<sup>3</sup> A.R.S. §32-2186.

<sup>4</sup> If the fund balance for the Recovery Fund drops below \$600,000, the Department will impose and collect a fee from broker and salespersons renewal licensing applicants in the subsequent licensing year, as authorized by A.R.S. §32-2187.

<sup>5</sup> Claims made against the fund are limited to \$30,000 per transaction and \$90,000 per licensee.

<sup>6</sup> For the 3 applications that did not result in payouts, 1 application was withdrawn by the applicant and 2 applications were denied because the alleged grievances did not involve acts that require a real estate license, as required by A.R.S. §32-2186.

- **Business Services Division**—Is responsible for customer service, information technology, and other administrative services.
- **Development Services Division**—Oversees the sale of subdivided and unsubdivided land, membership campgrounds, and timeshares.

The Department also works with the Arizona Real Estate Advisory Board (Advisory Board) comprising 10 governor-appointed members. All Advisory Board member positions were filled as of October 2020. Although not a decision-making body, the Advisory Board provides recommendations on specific questions or proposals as requested by the Commissioner.

## Revenues and expenditures

As shown in Table 1 (see page 4), the Department receives State General Fund appropriations and collects revenue from license, examination, filing, and inspection fees; and penalties. In fiscal year 2020, the Department received over \$2.4 million in State General Fund appropriations and collected over \$3.1 million in licensing and related fees. Statute requires the Department to remit all licensing and related fees to the State General Fund. Additionally, statute requires the Department to revise its fees each year so that the revenue from its fees equals at least 95 percent but not more than 110 percent of its anticipated appropriated budget for the succeeding fiscal year (see Sunset Factors, pages 10 through 11, for more information). The majority of the Department's expenditures are for payroll and related benefits, but also include expenditures for professional and outside services, travel, other operating costs, equipment, and transfers to other agencies.

**Table 1**  
**Schedule of revenues, expenditures, and changes in fund balances**  
**Fiscal years 2018 through 2020**  
(Unaudited)

	2018	2019	2020
<b>Revenues</b>			
State General Fund appropriations	\$2,614,607	\$2,499,621	\$2,466,948
Licensing and related fees	3,210,740	3,161,740	3,101,355
Charges for services			
Filing fees	244,700	253,600	256,760
Examination fees	260,560	337,029	254,050
Inspection fees	24,750	22,435	17,920
Publications and reproductions	7,030	15,766	10,654
Fines, forfeits, and penalties	243,145	403,870	277,326
Real Estate Recovery Fund <sup>1</sup>	74,740	90,490	67,894
Condominium and Planned Community Hearing Office Fund <sup>2</sup>	29,500	33,000	32,500
Other	678	3,959	1,150
<b>Total gross revenues</b>	<b>6,710,450</b>	<b>6,821,510</b>	<b>6,486,557</b>
Credit card transaction fees	(67,156)	(49,602)	(63,842)
Remittances to the State General Fund <sup>3</sup>	(3,907,957)	(4,133,163)	(3,845,385)
<b>Total net revenues</b>	<b>2,735,337</b>	<b>2,638,745</b>	<b>2,577,330</b>
<b>Expenditures and transfers</b>			
Payroll and related benefits	1,929,505	1,922,848	1,918,401
Professional and outside services	104,858	99,424	87,031
Travel	25,386	15,561	16,368
Other operating <sup>4</sup>	485,699	391,938	368,253
Furniture, equipment, and software	90,878	75,800	109,324
Transfers to the other agencies <sup>5</sup>	144,913	41,380	36,615
<b>Total expenditures and transfers</b>	<b>2,781,239</b>	<b>2,546,951</b>	<b>2,535,992</b>
Net change in fund balances	(45,902)	91,794	41,338
Fund balances, beginning of year	913,556	867,654	959,448
<b>Fund balances, end of year<sup>6</sup></b>	<b>\$867,654</b>	<b>\$959,448</b>	<b>\$1,000,786</b>

- <sup>1</sup> Real Estate Recovery Fund revenues were primarily paid by individuals applying for a real estate or cemetery broker or salespersons license in accordance with A.R.S. §32-2187(A). As previously discussed, the Real Estate Recovery Fund pays for losses to individuals aggrieved by acts, representations, transactions, or conduct of licensed real estate or cemetery broker or real estate cemetery salesperson that violate laws (see page 2). It also includes any reimbursements paid by real estate or cemetery brokers and salespersons to reimburse the Real Estate Recovery Fund for losses paid plus interest as established by A.R.S. §32-2188.01.
- <sup>2</sup> Condominium and Planned Community Hearing Office Fund revenues primarily comprise filing fees paid by owners, condominium associations, or planned community associations that are used to reimburse the Department for Office of Administrative Hearings costs incurred to resolve a dispute in accordance with A.R.S. §§32-2199.05(B) and 32-2199.01. It also includes civil penalties assessed in compliance with A.R.S. §32-2199.02.
- <sup>3</sup> A.R.S. §32-2103 requires the Department to remit all monies collected except those prescribed by laws. Consequently, all Department monies are remitted to the State General Fund except Condominium and Planned Community Hearing Office Fund monies in accordance with A.R.S. §§32-2199.01 and 32-2199.02, sale of educational products and grants of monies, if any, for the production of the products in accordance with A.R.S. §32-2107(C)(E), and Real Estate Recovery Fund revenues in accordance with A.R.S. §32-2187. These remitted revenues are required to be between 95 and 110 percent of the Department's General Fund appropriation (see Sunset Factor 2, pages 10 through 11, for more information on this requirement).
- <sup>4</sup> Other operating expenditures include building rent, telephone costs, data processing services, and software support and maintenance costs. Fiscal year 2018 and 2020 other operating expenditures also included approximately \$128,100 and \$30,000, respectively, paid from the Real Estate Recovery Fund for losses (see footnote 1 for additional information).
- <sup>5</sup> Transfers to other agencies were primarily for transfers to the Arizona Office of Administrative Hearings for hearing costs related to the Condominium and Planned Community Hearing Office Fund and to the Department of Administration for relocation costs and tenant improvements.
- <sup>6</sup> Ending fund balance primarily comprises Real Estate Recovery Fund monies that are reserved to pay for losses (see footnote 1 for additional information). For example, the Real Estate Recovery Fund comprised approximately \$957,800 of the fiscal year 2020 ending fund balance.

Source: Auditor General staff analysis of the Arizona Financial Information System (AFIS) *Accounting Event Transaction File* for fiscal years 2018 through 2020, and the State of Arizona *Annual Financial Report* for fiscal years 2018 and 2019.



## Department did not ensure high-risk brokerages were audited

### Department audits brokerages to assess and help ensure compliance with statute and rule requirements that protect consumers

As part of its regulatory responsibilities, the Department conducts audits of brokerages to assess and help ensure their compliance with statute and rule requirements that protect consumers (see textbox for key items reviewed during audits). The Department has identified violations of varying severity when conducting brokerage audits, ranging from basic compliance issues, such as missing signage, to more serious violations that put client funds at risk. For example, in calendar year 2019, the Department identified a brokerage that failed to properly reconcile a client trust account that resulted in severe underfunding. Specifically, the brokerage did not ensure that client trust account funds were being used only for their designated purpose, thus placing these funds at risk.

#### Key requirements reviewed during brokerage audits

- Maintaining sales transactions for 5 years and immediately placing client funds in an escrow depository.
- Reconciling trust accounts monthly.
- Managing client trust funds properly, including not commingling funds.
- Completing property management agreements with appropriate provisions, such as a reasonable cancellation provision.

Source: Auditor General staff analysis of the Department's audit report template.

However, because the number of brokerages in the State exceeds the number the Department can audit on an annual or regular basis, the Department annually selects which brokerages it will audit. Specifically, the Department reported it has the staffing resources to audit only a small percentage of the brokerages in the State every year and in calendar year 2019, audited 214 of the 7,227 active brokerages (3 percent) in the State.<sup>7</sup>

### Department's selection process did not ensure high-risk brokerages were audited

Best practices indicate that implementing a risk-based approach to regulation helps regulators prioritize their limited resources to focus on high-risk entities to identify and address instances of noncompliance.<sup>8</sup> In using a risk-based approach, regulators should identify, document, and use risk characteristics specific to the regulated entity; and develop and implement written policies and procedures for using these risk characteristics. Further, regulators should monitor entities that are determined to be low risk, such as by conducting inspections of a random sample of lower-risk entities to help ensure that all entities are subject to review. Lastly, regulators should

<sup>7</sup> Of the 214 audits the Department conducted, 44 resulted in a letter of concern and 63 resulted in disciplinary action.

<sup>8</sup> Department of Finance, Services, & Innovation. (2016). *Guidance for regulators to implement outcomes and risk-based regulation*. State of New South Wales: Sydney, Australia. Retrieved on 6/30/20 from [http://productivity.nsw.gov.au/sites/default/files/2018-05/Guidance\\_for\\_regulators\\_to\\_implement\\_outcomes\\_and\\_risk-based\\_regulation-October\\_2016.pdf](http://productivity.nsw.gov.au/sites/default/files/2018-05/Guidance_for_regulators_to_implement_outcomes_and_risk-based_regulation-October_2016.pdf).

periodically evaluate and make revisions to their risk assessment characteristics based on trends in the regulated industry.

Although Department staff reported considering various risk characteristics for selecting brokerages to audit, such as brokerages with prior disciplinary history and/or brokerages that had a high volume of managed properties and real estate sales, our review of 30 of the 214 brokerages the Department audited in calendar year 2019 found that many did not meet the risk characteristics. Specifically, only 9 brokerages conducted both real estate sales and property management, whereas 18 conducted either real estate sales or property management but not both, and 3 brokerages did not conduct real estate sales or property management and did not have prior disciplinary history that would warrant further scrutiny.<sup>9</sup> By not selecting and auditing brokerages that met its selection criteria, the Department undermined its efforts to effectively and efficiently identify and address brokerage noncompliance.

In addition, the Department's selection process did not require selecting a random sample of brokerages for audit that did not meet its risk characteristics to help ensure that all brokerages were subject to review. By not doing so, the Department failed to provide a key deterrence mechanism to brokerages that may have been violating statute and/or rule by conveying the likelihood that violations will not be discovered through an audit.

Department staff may have been choosing brokerages for audit that did not meet the risk characteristics because the Department had not documented them in written policies and procedures nor explained how they would be used when selecting brokerages for audit. For example, the Department did not establish or document whether a brokerage would be selected for audit if it met a single risk characteristic or only if it met multiple risk characteristics. Similarly, the Department had not defined what constituted a high volume of managed properties and real estate sales.

## Department formalized new audit selection process during audit

In December 2020, the Department developed a new policy for selecting brokerages for audit based on various risk factors, such as the number of properties managed by a brokerage, whether a brokerage has been previously audited, and the results of the last audit.<sup>10</sup> For example, brokers who conduct property management services for 100 or fewer residential properties and have not been previously audited are assigned the highest risk rating. According to the Department's policy, after each brokerage has been assigned a risk rating the Department will then select the brokerages to be audited from each rating category on a monthly basis. However, the policy does not indicate whether the Department will focus its audit resources on higher-risk brokerages or specify the number of brokerages it will annually select for audit from each rating category. The policy also indicates that the Department will review the effectiveness of the rating system on an ongoing basis and adjust the rating system as needed.

### Recommendations

The Department should:

1. Use a risk-based approach to ensure that high-risk brokerages are selected for audit.
2. Revise its policy and develop and implement a process for selecting brokerages for audit based on their assigned risk rating.
3. Consistent with its policy, review the effectiveness of its new approach for selecting brokerages for audit, including:
  - a. Assessing its risk factors and audit results to determine if high-risk brokerages are being selected for audit.

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<sup>9</sup> One brokerage had disciplinary history from 2006, but it was unrelated to the items evaluated during a brokerage audit.

<sup>10</sup> Because the Department developed the policy at the end of our audit work in December 2020, we did not have an opportunity to evaluate the extent to which the Department had implemented it, but we will do so during our 6-month followup.

- b. Determining if additional risk factors relevant to the real estate brokerage industry are needed to ensure high-risk brokerages are selected for audit.
  - c. Monitoring trends of noncompliance in the real estate industry and making changes to its risk assessment process accordingly.
4. Randomly select lower-risk brokerages for audit.

**Department response:** As outlined in its [response](#), the Department agrees with the finding and will implement the recommendations.



Pursuant to A.R.S. §41-2954(D), the legislative committees of reference shall consider but not be limited to the following factors in determining the need for continuation or termination of the Department. This sunset factor analysis includes additional findings and recommendations not discussed earlier in the report.

**Sunset factor 1: The objective and purpose in establishing the Department and the extent to which the objective and purpose are met by private enterprises in other states.**

The Department’s mission is to offer protection to Arizona consumers in real estate transactions. The Department regulates the real estate industry by licensing real estate brokers, salespersons, cemeteries, and membership campgrounds; approving real estate pre-licensing instruction, testing, continuing education courses, and schools; investigating and adjudicating complaints against licensees; and auditing brokerages to protect consumers against improper representation and mismanagement of monies. The Department also regulates the sale of subdivisions, unsubdivided lands, timeshares, condominiums, membership campgrounds, and cemeteries through the issuance of public disclosure reports, which provide vital details about land features and available amenities. Further, the Department provides information to the public regarding licensees’ license status and disciplinary history.

We did not identify any states that met the Department’s objective and purpose through private enterprises. Specifically, we reviewed the Association of Real Estate License Law Officials Digest for 2019 containing regulatory information for approximately 30 states and contacted 5 western states—California, Nevada, New Mexico, Oregon, and Utah—and reviewed their statutes and websites and found that none used private enterprises to regulate the real estate industry (see Appendix A, pages a-1 through a-2, for more information on how we selected these 5 states).<sup>11</sup>

**Sunset factor 2: The extent to which the Department has met its statutory objective and purpose and the efficiency with which it has operated.**

The Department has met some of its statutory objective and purpose by issuing salesperson and broker licenses to applicants that met key statutory licensing requirements in a timely manner. The Department also has established internal controls for the areas we reviewed to help safeguard its information technology (IT) systems. Specifically, the Department:

- **Issued salesperson and broker licenses we reviewed to applicants that met key statutory licensing requirements in a timely manner**—Our review of a stratified random sample of 40 initial and renewal licensing applications for salespersons and brokers that the Department approved in fiscal year 2019 found that the Department ensured that all 40 applicants met the respective licensing requirements specified in statute and rule (see textbox for key licensing requirements).<sup>12</sup> The Department also

**Key broker and salesperson licensing requirements**

- Complete 90 hours of pre-licensing education.
- Pass the State examination.
- Submit a valid Arizona Department of Public Safety (DPS) fingerprint clearance card.
- Submit the criminal history disclosure form.
- Pay licensing fee.

Source: Auditor General staff analysis of A.R.S. §§32-2123, 32-2124, and 32-2132.

<sup>11</sup> Association of Real Estate License Law Officials. (2019). *Digest of real estate license laws and current issues*. Fishers, IN.

<sup>12</sup> The random sample consisted of 10 of 9,793 initial salesperson, 10 of 687 initial broker, 10 of 25,325 renewal salesperson, and 10 of 3,195 renewal broker licensing applications the Department approved in fiscal year 2019.

issued the licenses we reviewed within the time frame established in rule. Specifically, rule requires salesperson and broker licenses to be issued within 60 days and the Department issued all the licenses we reviewed the same day the applications were received.

- **Established controls to help safeguard its IT systems and data for areas reviewed**—The Department works with the Arizona Department of Administration’s Arizona Strategic Enterprise Technology Office (ASET) to help ensure its IT systems and data are adequately protected. Specifically, the Department’s IT systems are primarily managed by ASET, which provides some security and monitoring services for the Department, such as vulnerability management. However, the Department is responsible for also managing some of its own IT services, including authorizing and removing account access, web application development, and security awareness training. Our review of the Department’s accounts used to access some of its primary web applications did not identify any former employees with access and found that administrator access was appropriately limited. In addition, our scans of 3 Department web applications found that the applications had minimal security risks. Finally, the Department requires all of its staff to take security awareness training annually, and as of April 2020, all staff had taken the training within the last year.

However, the Department has not fully met its objective and purpose in some areas and may need to make additional changes in 1 area. Specifically:

- **Department did not confirm the validity of license applicants’ fingerprint clearance cards**—According to statute, initial licensure applicants must submit a valid fingerprint clearance card to be licensed (see textbox on page 8). According to DPS, fingerprint clearance card validity can be confirmed by checking the DPS website or contacting DPS directly. Doing so is important because a fingerprint clearance card may become suspended if a cardholder is arrested for a precluding offense. Once submitted, Department staff review the fingerprint clearance cards, including checking the issuance and expiration dates, and the Department reported that it will check the DPS website if the fingerprint clearance card submitted with an initial application was issued 1 year or longer prior to receiving the initial application. However, as of March 2021, the Department had not established a process for confirming the validity of all fingerprint clearance cards it receives when approving initial applications for licensure and did not do so for all 20 initial licensing applications for salespersons and brokers we reviewed. We used the DPS website to confirm that all 20 initial salesperson and broker licensing applicants had a valid fingerprint clearance card as of February 2021.
- **Department did not receive and/or retain documentation indicating that 7 of 30 education licensing applications we reviewed met all statutory and rule licensing requirements**—Our review of a stratified random sample of 30 school, course, and instructor initial and renewal applications that the Department approved in fiscal year 2019 found that 7 of these applications did not include documentation demonstrating that the applicants were qualified for licensure (see textbox for key licensing requirements).<sup>13</sup> These included requirements for providing complete disclosure statements related to any criminal and civil judgments, authorized signatures, and corporation/LLC documentation, such as the business’ articles of incorporation and certificate of good standing. For 3 of the 7 applications, the Department received the necessary documentation for the applicant’s initial licensing application but either did not receive

**Key school, course, and instructor licensing requirements**

**Schools**

- Corporation/limited liability company (LLC) documentation.
- Contact information for administrators, directors, and instructors.

**Courses**

- A detailed outline of course content.
- The category of course approval requested.

**Instructors**

- Résumé proving subject matter experience/expertise.
- Disclosure statements related to any criminal and civil judgments.

Source: Auditor General staff analysis of AAC R4-28-404.

<sup>13</sup> The random sample consisted of 10 of 81 school, 10 of 715 course, and 10 of 558 instructor initial and renewal licensing applications the Department approved in fiscal year 2019.

or did not retain the required documentation as part of the renewal application, as required by statute.<sup>14</sup> Although the Department has policies and procedures for obtaining and maintaining license application documentation, it has not established a supervisory review process to ensure staff adhere to them.

- **Department revised process to inspect subdivisions virtually, but still collected fee meant to cover travel and subsistence costs for onsite inspections**—Statute requires the Department to conduct inspections of subdivisions offered for sale in the State.<sup>15</sup> These inspections allow the Department to verify representations made by developers to the public and potential buyers about the subdivision’s utilities and amenities in their public disclosure report. However, the Department reported it stopped conducting these inspections from 2017 until December 2019 because it did not have sufficient staff to do so. Despite not conducting the inspections during this time period, the Department collected the fee when the developer applied for a public disclosure report that was intended to cover the Department’s travel and subsistence costs for conducting onsite inspections.<sup>16</sup> The fee ranged from \$10 to \$160 depending on how far the Department would have needed to travel to perform an onsite inspection.

During the audit in December 2019, the Department developed and implemented a new process to virtually conduct the required inspections using Google Earth, Google Maps, and other online resources. Similar to an onsite inspection, this virtual process allows the Department to review subdivision utilities, such as sewer lines, streetlights, and paved roads, as well as amenities, such as barbecues and community pools.<sup>17</sup> As of March 2021, the Department reported that it had conducted virtual inspections for 1,203 of the 1,224 subdivisions that had not been previously inspected and conducted onsite inspections for the remaining 21 subdivisions because of limited information available online. However, according to the Department, from 2017 until December 2019, it collected an estimated \$61,000 in fees intended to cover the travel costs for the 1,203 inspections that it instead inspected virtually.

Additionally, in March 2020, the Department developed a new policy indicating that it would charge a fee to cover its travel costs only if Department staff had to travel onsite to conduct an inspection. As of March 2021, the Department reported it was in the process of determining what steps it should take to address the estimated \$61,000 in fees that it had previously collected for traveling to conduct onsite inspections that it instead had conducted virtually.

- **Department has reduced some fees to comply with statute, but further fee reductions may be necessary**—Statute requires the Department to revise its fees each year so that the total fee revenue it receives equals at least 95 percent but not more than 110 percent of its anticipated appropriated budget for the succeeding fiscal year.<sup>18</sup> If the revenue exceeds 110 percent, statute requires the Department to lower its fees by a proportional amount. This threshold helps ensure that the Department is not overcharging applicants and licensees for the regulatory services it provides. All Department fees are deposited in the State General Fund.

To help ensure compliance with this statutory requirement, the Department tracks its fee revenues and updates its annual fee revenue forecasts on a monthly basis and then compares this information to its anticipated appropriated budget for the succeeding fiscal year. The Department then determines if it needs to make changes to its fee amounts to comply with statute. For example, based on its projections where it determined that its revenues would exceed its anticipated appropriated budget for the succeeding fiscal year, the Department reduced its fee to renew a salesperson’s license online from \$65 to \$60 in September 2019 and its fee to renew a broker’s license from \$150 to \$125 in January 2021 in an effort to reduce its fee

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<sup>14</sup> A.R.S. §32-2130(C).

<sup>15</sup> A.R.S. §32-2182.

<sup>16</sup> A.R.S. §32-2182 does not prescribe a required time frame for the completion of subdivision inspections.

<sup>17</sup> In some cases, the Department indicated it would need to perform an onsite inspection if the online resources did not provide enough information to satisfy the inspection requirements, such as out of date or unclear satellite images.

<sup>18</sup> A.R.S. §32-2103.

revenues to comply with the statutory threshold requirement. However, the Department has not included the revenue from its development fees in its analysis, such as the fees for processing and approving public reports, which totaled more than \$255,000 in fiscal year 2020. The Department reported that it has historically been its practice to not include the development fees in its analysis, but was unable to provide a basis for this decision. If the Department were to include the revenue from its development fees in its analysis, further fee reductions would likely be necessary to comply with statute.

## Recommendations

The Department should:

5. Ensure that initial license applicants possess a valid fingerprint clearance card before it issues a license by developing and implementing policies and procedures requiring Department staff to confirm the validity of fingerprint clearance cards using the DPS website.
6. Ensure that applicants for school, course, and instructor licenses submit and it retains all required documentation demonstrating compliance with statutory and rule licensing requirements prior to approving applicants for licensure.
7. Train all relevant staff on the Department's policies and procedures for obtaining, reviewing, and maintaining licensing documentation for school, course, and instructor applications.
8. Develop and implement a supervisory review process to ensure that staff adhere to the Department's policies and procedures for maintaining licensing documentation.
9. Continue to perform the required subdivision inspections and only charge an inspection fee when it must travel to perform an onsite inspection as authorized by statute.
10. Work with its Assistant Attorney General to determine how it should address the estimated \$61,000 in fees that it previously collected although it did not travel to perform onsite inspections.
11. Work with its Assistant Attorney General to determine whether the revenue it receives from development fees should be included in its fee revenue calculation and analysis.

**Department response:** As outlined in its [response](#), the Department agrees with the findings and will implement the recommendations.

### Sunset factor 3: The extent to which the Department serves the entire State rather than specific interests.

The Department serves the entire State by licensing qualified real estate, cemetery, and membership campground salespersons and brokers, investigating consumer complaints, and issuing public disclosure reports to land developers throughout the State. The Department also serves consumers throughout the entire State by administering the Real Estate Recovery Fund, which provides relief to consumers aggrieved by real estate licensees in Arizona.

However, the Department had not complied with some conflict-of-interest requirements. Statute requires public officers and employees of public agencies, including Advisory Board members, to avoid conflicts of interest that might influence or affect their official conduct.<sup>19</sup> These laws require certain interests to be disclosed in a public agency's official records, either through a signed document or the agency's official minutes. Public officers and employees must then refrain from participating in matters related to disclosed interests. In addition, although not required by statute, best practices indicate that conflict-of-interest disclosure statements should be signed annually, which reminds public officers/employees of the importance of complying with conflict-of-interest laws and helps ensure that potential conflicts are disclosed if their circumstances change. Finally, public agencies are required to maintain a special file of all documents necessary to memorialize such disclosures and make this file available for public inspection. As of October 2019, the Department's conflict-of-interest policy required staff to

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<sup>19</sup> A.R.S. §38-501 et seq.

complete annual disclosures and its policy outlined a process to address conflicts should they occur. However, the policy did not require that all conflict-of-interest disclosures be kept in a special file or that Advisory Board members disclose both financial and decision-making interests (see page 3 of the Introduction for information about the Advisory Board). In addition, our review of 2019 conflict-of-interest documentation for all 30 Department staff members identified the following:

- 1 staff member’s conflict-of-interest disclosure form was not completed—only signed and dated.
- 2 staff members’ secondary employment forms, which the Department requires its employees to complete if they have other employment, were not approved by a supervisor, as required by Department policy.
- 2 staff members who indicated they had secondary employment on their disclosure forms did not have corresponding approved secondary employment forms.

To address these deficiencies, the Department required all staff to complete new conflict-of-interest disclosure forms in January 2020. Our review of these conflict-of-interest disclosure forms found that all staff had completed the forms and that applicable staff also had completed and approved secondary employment disclosure forms. Additionally, the Department created a hard copy and electronic special file to house these documents and updated its policy to reflect these changes. Further, in November 2020, the Department updated its conflict-of-interest policy to require Advisory Board members to annually complete a conflict-of-interest disclosure form, and its Advisory Board members completed forms in November 2020 and January 2021.

### **Recommendation**

12. The Department should ensure that Advisory Board members continue to annually disclose both financial and decision-making interests as required by its updated policy.

**Department response:** As outlined in its [response](#), the Department agrees with the finding and will implement the recommendation.

### **Sunset factor 4: The extent to which rules adopted by the Department are consistent with the legislative mandate.**

Our review of the Department’s statutes and rules found that A.R.S. §32-2107(F) provides the Department with general rulemaking authority, allowing it to adopt necessary rules; however, no specific rules are required by statute. According to the Department, it has established the rules it deems necessary to meet its legislative mandate.

### **Sunset factor 5: The extent to which the Department has encouraged input from the public before adopting its rules and the extent to which it has informed the public as to its actions and their expected impact on the public.**

As of May 2020, the Department had not initiated any rulemaking since 2015, and therefore has not needed to encourage input from the public before adopting rules. However, the Department provides the public with information on its actions and expected impact on its website, which includes the Advisory Board meeting agendas and minutes, annual reports, and the ability to search for real estate licensee information.

Additionally, Department staff provided appropriate information about licensees when we placed 2 anonymous calls in June 2020. Specifically, statute requires the Department to provide public records, including information on dismissed complaints and complaints that resulted in nondisciplinary action to the public during business hours.<sup>20</sup> For both phone calls, Department staff appropriately disclosed information about 2 licensees’ status and

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<sup>20</sup> A.R.S. §39-121.

whether the Department had taken disciplinary or nondisciplinary action against them. The Department's website also contained accurate disciplinary information for 5 licensees we reviewed.<sup>21</sup>

Finally, we assessed the Advisory Board's compliance with various provisions of the State's open meeting law for its October 2019, January 2020, and June 2020 meetings, and found that it complied with the requirements we reviewed. For example, it posted meeting notices and agendas at least 24 hours in advance and provided written meeting minutes or recordings within 3 working days after the meetings.

**Sunset factor 6: The extent to which the Department has been able to investigate and resolve complaints that are within its jurisdiction.**

Statute requires the Department to investigate complaints against anyone engaged in the business or acting in the capacity of a broker, salesperson, or developer. In addition, the Department conducts audits of brokerages to help ensure their compliance with statutory requirements. However, the Department has various deficiencies in its complaint investigation and resolution process, including inconsistencies in administering discipline. Specifically, the Department:

- **Did not always investigate complaints in accordance with its policies and procedures**—The Department has established policies and procedures for investigating and adjudicating complaints. If followed, these policies and procedures help to ensure that the Department performs investigations in a timely and appropriate manner and that involved parties are kept apprised of a complaint's status. However, our review of a random sample of 45 complaints that the Department received in calendar year 2019 identified 1 or more instances where the Department did not adhere to its complaint investigation policies for 26 of the complaints:<sup>22</sup>
  - **13 complaints were not initially reviewed within the Department's required time frame**—Department policy requires investigators to initially review complaints within 5 calendar days of their receipt. However, the Department did not meet this requirement for 13 of the 45 complaints we reviewed, with the initial reviews of these complaints ranging from 6 to 42 calendar days.<sup>23</sup>
  - **4 complaints did not have their initial review documented**—Department policy requires investigators to document their initial review of complaints. However, Department staff did not document this review in 4 of the complaints we reviewed.
  - **7 complaints did not have acknowledgement/closure letters sent**—Department policy requires that complaint acknowledgement and closure letters be sent to the appropriate parties. However, for 7 of the complaints we reviewed, 1 or both of these required letters were not sent.
  - **8 complaints did not have supervisory review**—The Department requires a supervisor to review all complaint investigations prior to resolution. However, 8 of the complaints we reviewed did not undergo a supervisory review prior to adjudication.<sup>24</sup>

Untimely and undocumented initial review, as well as missing acknowledgement letters, can be partially attributed to the Department not requiring supervisory review of complaints until the end of the investigation to ensure that its staff are following complaint-handling policies and procedures. The Department also reported that some of these problems could be attributed to a new staff member and the associated learning curve

<sup>21</sup> We randomly selected the 5 licensees for comparison to information in the Department's website from the 15 complaints that resulted in disciplinary action that we reviewed and are referenced in Sunset Factor 6 and noted below in footnote 22.

<sup>22</sup> The Department received a total of 422 complaints in 2019. Our random sample included 15 of 237 dismissed complaints, 15 of 97 complaints that resulted in nondisciplinary action, and 15 of 88 complaints that resulted in disciplinary action.

<sup>23</sup> Although not required by Department policy, the Department resolved 44 of the 45 complaints we reviewed within 180 days. We have determined that Arizona regulatory agencies should resolve complaints within 180 days of receiving them. For the 1 complaint that took longer than 180 days to resolve, the complaint investigation was delayed because the licensee did not cooperate with the Department's investigation.

<sup>24</sup> For 2 of 8 complaint investigations where supervisory review did not occur, the Department's Auditing and Investigations Manager conducted the investigation, and Department policy does not require that a supervisor review her work.

with its complaint-handling processes. During the audit, the Department reported that it enhanced its new staff training to address some of the concerns we identified, such as providing hands-on instruction regarding the online database used to record complaint investigations and training new staff on the Department's investigation processes. The Department also reported it took steps to enhance its supervisory review of staff through weekly check-ins to better track complaint-investigation progress.

- **Department did not consistently administer discipline in response to identified statutory and rule violations**—According to best practices for implementing a regulatory program, regulatory agencies should develop a systematic, fair, and progressively stringent enforcement process to help ensure that the public is adequately protected.<sup>25</sup> The Department has the authority to administer discipline when adjudicating complaints and when it identifies violations as part of conducting audits of brokerages, such as suspending or revoking a license and levying civil penalties (see textbox), and has developed a disciplinary actions matrix that outlines the actions it should take based on certain factors related to the violation, including progressively stringent enforcement. In prescribing the disciplinary action the Department should take, the matrix considers the type of violation, the number of violations, and whether the licensee had prior disciplinary action. However, our review of a random sample of 30 complaints and audits that resulted in disciplinary action identified instances where the Department did not follow its disciplinary matrix or consistently administer discipline.<sup>26</sup> The Department's inconsistency in disciplining licensees for complaint and audit violations has resulted in licensees being treated improperly or inequitably. Specifically, the Department:

### Examples of the Department's disciplinary and nondisciplinary options to address violations

Nondisciplinary actions:

- Advisory letter of concern

Disciplinary actions:

- Civil penalty
- Continuing education hours
- Provisional license
- License suspension
- License revocation
- Cease and desist order

Source: Auditor General staff analysis of the Department's policies and procedures and A.R.S. §§32-2153, 32-2154, and 2160.01.

- **Did not follow its disciplinary matrix for 6 of 15 complaints we reviewed that resulted in disciplinary action**—Table 2 on page 15 shows the discipline prescribed by the Department's disciplinary actions matrix and the discipline that was imposed for the 6 complaints. For example, the Department's matrix specifies that subdivision violations are subject to a \$1,000 civil penalty but makes no mention of also requiring continuing education. However, for 1 of the 6 complaints, an individual who listed parcels for sale without having first obtained a public disclosure report received 12 hours of continuing education in addition to the prescribed \$1,000 civil penalty. Additionally, the matrix prescribes a \$400 civil penalty for a single advertising violation but makes no mention of any continuing education. However, for another complaint we reviewed, a licensee was issued a \$500 civil penalty and 6 hours of continuing education for failing to disclose his owner/agent status while advertising a property.
- **Inconsistently administered discipline for 2 of 15 audits that resulted in disciplinary action**—For 2 separate brokerage audits that identified similar violations, including failing to reconcile and maintain balance of client trust accounts, the Department issued 1 brokerage a \$2,000 civil penalty for 5 violations, but issued a \$6,000 civil penalty to another brokerage for 6 similar violations.

Although the Department has a disciplinary actions matrix, Department staff reported that they do not use the matrix when administering discipline and instead rely on their experience to do so. Department staff also

<sup>25</sup> Department of Finance, Services, & Innovation. (2016). *Guidance for regulators to implement outcomes and risk-based regulation*. State of New South Wales: Sydney, Australia. Retrieved on 6/30/20 from [http://productivity.nsw.gov.au/sites/default/files/2018-05/Guidance\\_for\\_regulators\\_to\\_implement\\_outcomes\\_and\\_risk-based\\_regulation-October\\_2016.pdf](http://productivity.nsw.gov.au/sites/default/files/2018-05/Guidance_for_regulators_to_implement_outcomes_and_risk-based_regulation-October_2016.pdf).

<sup>26</sup> We randomly selected 15 of 88 complaints that resulted in disciplinary action and 15 of 56 audits that identified violations resulting in discipline in calendar year 2019.

**Table 2****Examples of Department-imposed discipline that did not match Department’s disciplinary actions matrix from calendar year 2019 complaints**

 <b>Violations of law</b>	 <b>Discipline prescribed by matrix</b>	 <b>Deviation by Department</b>
Listed parcels for sale without a public disclosure report	\$1,000 civil penalty	An additional 12 hours of continuing education
Failure to disclose owner/agent status while advertising a property	\$400 civil penalty	An additional \$100 civil penalty and 6 hours of continuing education
Teaching and advertising with an expired school license	\$1,000 civil penalty	An additional \$500 civil penalty and 12 hours of continuing education
Failure to disclose a civil judgment involving real estate	\$1,000 civil penalty and 12 hours of continuing education	3 fewer hours of continuing education
Failure to disclose relationship to the seller in writing to other parties in transaction	\$1,000 civil penalty and 12 hours of continuing education	3 fewer hours of continuing education
Paid compensation for real estate activity to an unlicensed and unregistered entity	\$1,000 civil penalty and 12 hours of continuing education	6 fewer hours of continuing education

Source: Auditor General staff analysis of Department’s disciplinary actions matrix and review of 15 calendar year 2019 complaints that resulted in disciplinary action.

reported that the matrix is out of date and does not reflect recent changes to the Department’s enforcement practices, such as requiring continuing education in addition to civil penalties to address some violations. Additionally, the matrix does not address all potential statutory and rule violations, including failure to disclose conflicts of interest, teaching with an expired school license, and common violations identified through brokerage audits, such as failure to reconcile trust accounts and maintain transaction records.

**Recommendations**

The Department should:

13. Investigate and resolve complaints in accordance with its policies and procedures.
14. Modify its policies and procedures to require supervisory review of all complaint investigations throughout the investigation process to help ensure investigation time frames and notification requirements are met.
15. Provide training to staff to ensure they are aware of the new policy changes, including key time frames and requirements. The Department should also continue to provide its enhanced training for new staff.
16. Review the disciplinary actions matrix to ensure the penalties reflect current practices and expand the matrix to address all potential statutory and rule violations.
17. Include in its policies and procedures a requirement to adhere to the disciplinary actions matrix when imposing discipline and include in the case report any aggravating or mitigating circumstances that would cause them to deviate from the disciplinary actions matrix guidance.

**Department response:** As outlined in its [response](#), the Department agrees with the findings and will implement the recommendations.

**Sunset factor 7: The extent to which the Attorney General or any other applicable agency of State government has the authority to prosecute actions under the enabling legislation.**

A.R.S. §§41-192(A)(1) and 32-2111 require the Attorney General to act as the Department's legal advisor and to provide all legal services that the Department requires. In addition, the Department's enabling statute, A.R.S. §32-2165, authorizes individuals who are practicing in the real estate industry without a license or who falsely advertise in a manner that indicates the person is licensed to be prosecuted for a felony.

**Sunset factor 8: The extent to which the Department has addressed deficiencies in its enabling statutes that prevent it from fulfilling its statutory mandate.**

A recent statutory change transferred an additional function to the Department. The Department also reported that it has addressed deficiencies in its enabling statutes by seeking statutory changes to better serve its consumers. Specifically:

- Laws 2016, Ch. 128, §131(A) transferred the HOA dispute process from the Department of Fire, Building and Life Safety to the Department along with all unspent and unencumbered monies remaining in the Condominium and Planned Community Hearing Office Fund. As a result of this change, the Department acts as the administrative body for the Office of Administrative Hearings (OAH) regarding HOA disputes. Specifically, consumers submit dispute petitions to the Department for review to ensure the petitions are complete and valid, and then the Department forwards the petitions to OAH (see page 2 of the Introduction for information about OAH and the HOA dispute process). The Department also collects the required fees for filing a dispute petition and deposits them into the Condominium and Planned Community Hearing Office Fund. At fiscal year end, the Department disburses monies from the Fund to OAH for reimbursement of hearing costs.
- Laws 2017, Ch. 123, §1(A)(9) exempts employees hired by a licensee, such as a broker or salesperson, to perform clerical, bookkeeping, accounting, and other administrative support duties from the licensing requirements if they are not engaged in activity requiring a license. Previously, it was unlawful for any person to engage in any activity of real estate, cemetery, or membership camping without first obtaining a license issued by the Department. This change allows individuals in administrative support positions to perform administrative duties without needing a license.
- Laws 2018, Ch. 327, §2(B) allows real estate salesperson and broker license applicants to take online courses in lieu of in-person classes offered by a school certified by the Commissioner if all exams are taken in person. This change provides greater access to real estate education for prospective licensees.

**Sunset factor 9: The extent to which changes are necessary in the laws of the Department to adequately comply with the factors listed in this sunset law.**

We did not identify any needed changes to the Department's statutes.

**Sunset factor 10: The extent to which the termination of the Department would significantly affect the public health, safety, or welfare.**

Terminating the Department would not significantly harm the general public health or safety; however, it would impact those individuals involved in real estate transactions. The Department plays a key role in regulating the real estate industry and in protecting the public in transactions that can significantly affect their financial welfare, particularly since buying a home is typically the largest purchase an individual or family makes in their lifetime. Eliminating the Department without transferring its responsibilities to another agency would result in real estate professionals no longer being licensed and thus reduce accountability and consumer protection.

**Sunset factor 11: The extent to which the level of regulation exercised by the Department compares to other states and is appropriate and whether less or more stringent levels of regulation would be appropriate.**

The level of regulation that the Department exercises in Arizona is generally similar to that of the 5 other western states that we reviewed and contacted—California, Nevada, New Mexico, Oregon, and Utah (see Appendix A,

pages a-1 through a-2, for more information on how we selected these 5 states). However, we identified some differences, such as the number of education hours required for salespersons to obtain a license. In addition, Arizona is the only one of these states that conducts routine inspections of subdivisions. We also identified the following:

- **Examination**—Arizona and the 5 states we reviewed require all licensing applicants to pass a state examination.
- **Fingerprint-based criminal history records checks**—Arizona requires licensing applicants to undergo a fingerprint-based criminal history records check in order to obtain a fingerprint clearance card. Similarly, the 5 states we reviewed also require licensing applicants to undergo a fingerprint-based criminal history records check prior to licensure.
- **Education**—The minimum level of education required to obtain a real estate salesperson license varies from state to state. Arizona, New Mexico, Utah, and Oregon all require pre-licensing education from a state-approved real estate school; however, the number of required hours varies. For example, Oregon requires 150 hours, Utah requires 120 hours, and Arizona and New Mexico require 90 hours. Instead of requiring education from a real estate school, California and Nevada require completion of college coursework in specific real estate courses—California requires the completion of 3 courses and Nevada requires completion of 2 courses.
- **Brokerage audits**—Arizona, Oregon, California, and New Mexico routinely audit brokerages, but Nevada and Utah do not. In addition, the scope of these brokerage audits varies from state to state. For example, Oregon and California focus their audits on the brokerages' management of client trust accounts and security deposit accounts. In comparison, Arizona and New Mexico perform broader compliance audits that assess transaction documentation, compliance with signage requirements, and brokerages' trust account management.
- **Public disclosure reports and inspections**—Statute requires subdivision developers in Arizona to submit an application and obtain a public disclosure report from the Department prior to offering subdivided land for sale.<sup>27</sup> These disclosure reports provide consumers with information about surrounding land features, utilities, and available amenities. In addition, the Department is required to conduct inspections of subdivisions to confirm representations made in the public disclosure reports (see Sunset Factor 2, page 10, for more information). Although California and Oregon issue public disclosure reports to developers, they do not routinely inspect subdivisions. The other states we contacted do not issue public disclosure reports or conduct subdivision inspections.

**Sunset factor 12: The extent to which the Department has used private contractors in the performance of its duties as compared to other states and how more effective use of private contractors could be accomplished.**

The Department's only use of a private contractor is to administer Arizona's statutorily required pre-licensure real estate examination. Similarly, Oregon, New Mexico, Nevada, and Utah use private contractors to administer their respective licensing examinations. In contrast, California reported that it administers its own examination.

We did not identify any additional areas where the Department should consider using private contractors.

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<sup>27</sup> A.R.S. §§32-2181 & 32-2183.



# SUMMARY OF RECOMMENDATIONS

## Auditor General makes 17 recommendations to the Department

The Department should:

1. Use a risk-based approach to ensure that high-risk brokerages are selected for audit (see Finding 1, pages 5 through 7, for more information).
2. Revise its policy and develop and implement a process for selecting brokerages for audit based on their assigned risk rating (see Finding 1, pages 5 through 7, for more information).
3. Consistent with its policy, review the effectiveness of its new approach for selecting brokerages for audit, including:
  - a. Assessing its risk factors and audit results to determine if high-risk brokerages are being selected for audit.
  - b. Determining if additional risk factors relevant to the real estate brokerage industry are needed to ensure high-risk brokerages are selected for audit.
  - c. Monitoring trends of noncompliance in the real estate industry and making changes to its risk assessment process accordingly (see Finding 1, pages 5 through 7, for more information).
4. Randomly select lower-risk brokerages for audit (see Finding 1, pages 5 through 7, for more information).
5. Ensure that initial license applicants possess a valid fingerprint clearance card before it issues a license by developing and implementing policies and procedures requiring Department staff to confirm the validity of fingerprint clearance cards using the DPS website (see Sunset Factor 2, pages 8 through 11, for more information).
6. Ensure that applicants for school, course, and instructor licenses submit and it retains all required documentation demonstrating compliance with statutory and rule licensing requirements prior to approving applicants for licensure (see Sunset Factor 2, pages 8 through 11, for more information).
7. Train all relevant staff on the Department's policies and procedures for obtaining, reviewing, and maintaining licensing documentation for school, course, and instructor applications (see Sunset Factor 2, pages 8 through 11, for more information).
8. Develop and implement a supervisory review process to ensure that staff adhere to the Department's policies and procedures for maintaining licensing documentation (see Sunset Factor 2, pages 8 through 11, for more information).
9. Continue to perform the required subdivision inspections and only charge an inspection fee when it must travel to perform an onsite inspection as authorized by statute (see Sunset Factor 2, pages 8 through 11, for more information).
10. Work with its Assistant Attorney General to determine how it should address the estimated \$61,000 in fees that it previously collected although it did not travel to perform onsite inspections (see Sunset Factor 2, pages 8 through 11, for more information).

11. Work with its Assistant Attorney General to determine whether the revenue it receives from development fees should be included in its fee revenue calculation and analysis (see Sunset Factor 2, pages 8 through 11, for more information).
12. Ensure that Advisory Board members continue to annually disclose both financial and decision-making interests as required by its updated policy (see Sunset Factor 3, pages 11 through 12, for more information).
13. Investigate and resolve complaints in accordance with its policies and procedures (see Sunset Factor 6, pages 13 through 15, for more information).
14. Modify its policies and procedures to require supervisory review of all complaint investigations throughout the investigation process to help ensure investigation time frames and notification requirements are met (see Sunset Factor 6, pages 13 through 15, for more information).
15. Provide training to staff to ensure they are aware of the new policy changes, including key time frames and requirements. The Department should also continue to provide its enhanced training for new staff (see Sunset Factor 6, pages 13 through 15, for more information).
16. Review the disciplinary actions matrix to ensure the penalties reflect current practices and expand the matrix to address all potential statutory and rule violations (see Sunset Factor 6, pages 13 through 15, for more information).
17. Include in its policies and procedures a requirement to adhere to the disciplinary actions matrix when imposing discipline and include in the case report any aggravating or mitigating circumstances that would cause them to deviate from the disciplinary actions matrix guidance (see Sunset Factor 6, pages 13 through 15, for more information).



## Objectives, scope, and methodology

The Office of the Auditor General has conducted a performance audit and sunset review of the Department pursuant to a September 19, 2018, resolution of the Joint Legislative Audit Committee. This audit was conducted as part of the sunset review process prescribed in A.R.S. §41-2951 et seq.

We used various methods to review the objectives and issues in this performance audit and sunset review. These methods included reviewing Department statutes, rules, and policies and procedures; interviewing Department staff; and reviewing Department documentation and information from the Department's website. We also used the following specific methods to meet the audit objectives:

- To assess the Department's approach for selecting brokerages for audit, we reviewed a random sample of 30 of 214 brokerage audits the Department conducted in calendar year 2019. Additionally, we reviewed best practices on regulation and the policies and procedures for selecting brokerages for audit that the Department developed during the audit.<sup>28</sup>
- To determine whether the Department issued initial and renewal licenses to qualified applicants in a timely manner, we selected and reviewed a stratified random sample of 40 salesperson and broker initial and renewal applications from a total of 39,000 licenses approved in fiscal year 2019.<sup>29</sup> Additionally, we selected and reviewed a stratified random sample of 30 school, course, and instructor applications from a total of 1,354 licenses approved in fiscal year 2019.<sup>30</sup>
- To assess the Department's complaint investigation and resolution processes, including the timeliness of complaint resolution, we reviewed a stratified random sample of 15 of 237 dismissed complaints, 15 of 97 complaints that resulted in nondisciplinary action, and 15 of 88 complaints that resulted in disciplinary action in calendar year 2019.
- To determine whether the Department consistently disciplined licensees, we randomly selected 15 of 88 complaints that resulted in discipline in 2019, and 15 of 56 audits that identified violations resulting in discipline in calendar year 2019.
- To determine the Department's compliance with the ASET IT security requirements and credible industry standards, we compared the Department's IT policies, procedures, and practices to ASET requirements and credible industry standards. We also conducted interviews with Department staff, assessed whether the Department was limiting access to its active directory and ensuring Department staff complied with IT security awareness training requirements, and performed external scans on 3 business critical customer-facing web applications.

<sup>28</sup> Department of Finance, Services, & Innovation. (2016). *Guidance for regulators to implement outcomes and risk-based regulation*. State of New South Wales: Sydney, Australia. Retrieved on 6/30/20 from [http://productivity.nsw.gov.au/sites/default/files/2018-05/Guidance\\_for\\_regulators\\_to\\_implement\\_outcomes\\_and\\_risk-based\\_regulation-October\\_2016.pdf](http://productivity.nsw.gov.au/sites/default/files/2018-05/Guidance_for_regulators_to_implement_outcomes_and_risk-based_regulation-October_2016.pdf).

<sup>29</sup> The sample consisted of 10 of 9,793 initial salesperson, 10 of 687 initial broker, 10 of 25,325 renewal salesperson, and 10 of 3,195 renewal broker licensing applications the Department approved in fiscal year 2019.

<sup>30</sup> The sample consisted of 10 of 81 school, 10 of 715 course, and 10 of 558 instructor initial and renewal licensing applications the Department approved in fiscal year 2019.

- To obtain additional information for the Sunset Factors, we assessed the Department’s compliance with various provisions of the State’s open meeting law for 3 Advisory Board meetings held in October 2019, January 2020, and June 2020. We also reviewed the amount of Department revenues derived from fees for fiscal years 2012 through 2020, the Department’s documented fee analysis, and applicable statutes that establish the Department’s fees. To assess the Department’s compliance with the State’s conflict-of-interest laws and best practices, we reviewed statute, the Department’s conflict-of-interest disclosure form, and the Department’s adherence to its conflict-of-interest policy. Additionally, to determine whether the Department provided appropriate information to the public, we judgmentally selected 2 licensees with complaints from our stratified random sample of 45 complaints and placed 2 anonymous phone calls to the Department in April and May 2020 requesting information about these licensees. We then compared the information that the Department provided to statutory requirements. Finally, we judgmentally selected and contacted 5 states—California, Nevada, New Mexico, Oregon, and Utah—and reviewed their regulation of the real estate industry, including their use of private contractors.
- To obtain information for the Introduction, we reviewed Department-provided information regarding Department staff and the number of active licensees as of October 2020. In addition, we compiled and analyzed unaudited financial information from the AFIS *Accounting Event Transaction File* for fiscal years 2018 through 2020 and the State of Arizona *Annual Financial Report* for fiscal years 2018 and 2019.
- Our work on internal controls included reviewing the Department’s policies and procedures for ensuring compliance with Department statutes and rules, and where applicable, testing its compliance with these policies and procedures. We reported our conclusions on these internal controls, and where applicable, Department efforts to improve its controls in Finding 1, as well as Sunset Factors 2 and 6 of the report. Our work included reviewing the following components and associated principles of internal controls:
  - Risk assessment—including identifying, analyzing, and responding to risks.
  - Control activities—including the design of control activities, design activities for information systems, and implementing control activities through policies.
  - Monitoring—including performing monitoring activities, elevating issues, and remediating deficiencies.

We selected our audit samples to provide sufficient evidence to support our findings, conclusions, and recommendations. Unless otherwise noted, the results of our testing using these samples were not intended to be projected to the entire population.

We conducted this performance audit and sunset review 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.

We express our appreciation to the Department Commissioner and her staff for their cooperation and assistance throughout the audit.

# DEPARTMENT RESPONSE



**STATE OF ARIZONA**  
**DEPARTMENT OF REAL ESTATE**

**DOUGLAS A. DUCEY**  
GOVERNOR

**JUDY LOWE**  
COMMISSIONER

100 NORTH 15<sup>TH</sup> AVE., SUITE 201, PHOENIX, ARIZONA 85007  
PHONE: 602.771-7760 FAX: 602.771-7023

April 21, 2021

Ms. Lindsey Perry, Auditor General  
Arizona Office of the Auditor General  
2910 N. 44<sup>th</sup> Street, Suite 410  
Phoenix, Arizona 85018

**Re: Arizona Department of Real Estate – Performance Audit and Sunset Review**

Dear Ms. Perry,

The Arizona Department of Real Estate (ADRE) would like to thank you for the work you and your office performed to evaluate how well the Department is fulfilling its mission, and for providing us the opportunity to respond to the recommendations in your preliminary report draft of the performance audit and sunset review dated April 14, 2021.

The Department would like to highlight a few key successes:

- ADRE remains committed to the continuous improvement of Department processes, and services delivered to our customers.
- ADRE has fully implemented or started the implementation process for all of the recommendations during the audit period.
- The Department now licenses over 90,000 Arizona real estate salespersons, brokers, and entities.

We have carefully reviewed the opportunities, recommendations, feedback, and research provided during this process, and remain committed to using this report to continue to improve the Arizona Department of Real Estate to best serve Arizonans.

Sincerely,

Judy Lowe  
Commissioner

**Finding 1:** Department did not ensure high-risk brokerages were audited

**Recommendation 1:** The Department should use a risk-based approach to ensure that high-risk brokerages are selected for audit.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department has actively enhanced its policies and procedures during the audit process to conduct audits through a risk-based approach. The Department has already begun to implement this recommendation during the audit process by determining the potential risk to the public related to the real estate activities conducted, and will continue to review and implement the updated process, best practices, and identify other similar states' audit selection process. The Department will continue to interact with other state real estate agencies through its affiliation with the Association of Real Estate License Law Officials (ARELLO), an international trade association of real estate regulators to continuously improve its audit selection process.

**Recommendation 2:** The Department should revise its policy and develop and implement a process for selecting brokerages for audit based on their assigned risk rating.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department has already begun implementing this recommendation. The Department proposes to implement this recommendation as stated in recommendation one.

**Recommendation 3:** The Department should, consistent with its policy, review the effectiveness of its new approach for selecting brokerages for audit, including:

**Recommendation 3a:** Assessing its risk factors and audit results to determine if high-risk brokerages are being selected for audit.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department has already begun implementing this recommendation, and will continue to identify how best to perform this activity on an ongoing basis.

**Recommendation 3b:** Determining if additional risk factors relevant to the real estate brokerage industry are needed to ensure high-risk brokerages are selected for audit.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department has already begun implementing this recommendation as stated in recommendation one, and will continue to identify if additional risk factors are needed to be considered during the audit selection process.

**Recommendation 3c:** Monitoring trends of noncompliance in the real estate industry and making changes to its risk assessment process accordingly.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department has already begun implementing this recommendation as stated in recommendation one, and will continue to develop a method to periodically review the risk assessment process.

**Recommendation 4:** The Department should randomly select lower-risk brokerages for audit.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department has already begun implementing this recommendation as stated in recommendation one, and will continue to develop a method to periodically review the risk assessment process.

**Sunset Factor 2:** The extent to which the Department has met its statutory objective and purpose and the efficiency with which it has operated.

**Recommendation 5:** The Department should ensure that initial license applicants possess a valid fingerprint clearance card before it issues a license by developing and implementing policies and procedures requiring Department staff to confirm the validity of fingerprint clearance cards using the DPS website.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department is working to develop as part of its policies and procedures a process to require staff to check the validity of each fingerprint clearance cards on the DPS website. The Department relies on the Arizona Department of Public Safety to review criminal history records of applicants to determine their suitability to receive a fingerprint clearance card, and provide notification of changes in the status of current fingerprint clearance cards. The Department of Real Estate ensures initial license applicants possess a valid fingerprint clearance card by requiring and confirming that all license applicants submit required documents with their applications, including a copy of the front and back of the fingerprint clearance card. Arizona real estate licensees are required by statute to disclose convictions and adverse decisions issued by the courts at the time of license application, and within 10 days of a conviction action. Additionally, the Department receives notices from DPS when an action has been taken on a fingerprint clearance card, and actively tracks these notices weekly, acting as required by statute. This process allows the Department to actively track licensees fingerprint clearance card compliance when a status update is received during their license period.

**Recommendation 6:** The Department should ensure that applicants for school, course, and instructor licenses submit and it retains all required documentation demonstrating compliance with statutory and rule licensing requirements prior to approving applicants for licensure.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department remains committed to continuously improving processes and services delivered to our customers, and has already begun to implement process improvement and enhanced staff training in this area.

**Recommendation 7:** The Department should train all relevant staff on the Department's policies and procedures for obtaining, reviewing, and maintaining licensing documentation for school, course, and instructor applications.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department remains committed to continuously improving processes and services delivered to our customers, and has implemented training to problem solve and manage workflow.

**Recommendation 8:** The Department should develop and implement a supervisory review process to ensure that staff adhere to the Department's policies and procedures for maintaining licensing documentation.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department has already begun to implement this recommendation as stated in recommendation six.

**Recommendation 9:** The Department should continue to perform the required subdivision inspections and only charge an inspection fee when it must travel to perform an onsite inspection as authorized by statute.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department has successfully implemented recommendation nine as further provided in recommendation 10. By way of background, the Department conducts subdivision inspections to verify that elements of an approved public report are complete, such as roads, utilities, community or recreational facilities and other improvements included in the offering. These subdivision inspections completed by the Department are preceded by multiple inspections completed by local jurisdictions, such as cities or counties, that ensure construction meets local building codes and regulations before granting a Certificate of Completion or Certificate of Occupancy. In lieu of, and per statute, the developer may select and pay the inspector, and have the inspector approved by the Department.

**Recommendation 10:** The Department should work with its Assistant Attorney General to determine how it should address the estimated \$61,000 in fees that it previously collected although it did not travel to perform onsite inspections.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department will review this recommendation with its Assistant Attorney General. The Department evaluated its process for completing subdivision inspections, and successfully implemented an updated process in February 2020 during the challenges of the COVID-19 pandemic to complete subdivision inspections virtually using established technology tools that identify elements of a public report approval. The subdivision inspection fee was eliminated in March 2020 for inspections that are completed not requiring travel. Upon receipt, all inspection fees are deposited into the state's General Fund.

**Recommendation 11:** The Department should work with its Assistant Attorney General to determine whether the revenue it receives from development fees should be included in its fee revenue calculation and analysis.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department will review this recommendation with its Assistant Attorney General.

**Sunset Factor 3:** The extent to which the Department serves the entire State rather than specific interests.

**Recommendation 12:** The Department should ensure that Advisory Board members continue to annually disclose both financial and decision-making interests as required by its updated policy.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department initially implemented this recommendation in November 2020, with final implementation completed in January 2021, during the audit process.

**Sunset Factor 6:** The extent to which the Department has been able to investigate and resolve complaints that are within its jurisdiction.

**Recommendation 13:** The Department should investigate and resolve complaints in accordance with its policies and procedures.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department remains committed to continuously improving processes and services delivered to our customers, and has already begun implementing this recommendation as stated in recommendations 14 and 15. The Department will continue its established focus on thorough investigations and timely resolution of complaints, while ensuring that policies and procedures accurately reflect our target goals.

**Recommendation 14:** The Department should modify its policies and procedures to require supervisory review of all complaint investigations throughout the investigation process to help ensure investigation time frames and notification requirements are met.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department will implement a supervisory review process for investigations conducted by the division manager, and update the current processes and procedures accordingly.

**Recommendation 15:** The Department should provide training to staff to ensure they are aware of the new policy changes, including key time frames and requirements. The Department should also continue to provide its enhanced training for new staff.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department implemented enhanced ongoing staff training and modified process and procedures accordingly during the audit process. The Auditing & Investigations Division continues to hold individual and division wide staff trainings, and weekly ongoing case review meetings.

**Recommendation 16:** The Department should review the disciplinary actions matrix to ensure the penalties reflect current practices and expand the matrix to address all potential statutory and rule violations.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department thoroughly reviews and deliberates all disciplinary action decisions resulting from a public or consumer complaint, brokerage audit, agency initiated investigation, or licensing disclosure to determine the fair and lawful decisions taken. The Department is committed to conduct a thorough review of its disciplinary actions matrix and update it to ensure it reflects current practices and expand the matrix to address all potential statutory and rule violations, including consideration for “aggravating or mitigating circumstances”. This will ensure that disciplinary actions and penalties are issued fairly and consistently.

**Recommendation 17:** The Department should include in the policies and procedures a requirement to adhere to the disciplinary actions matrix when imposing discipline and include in the case report any aggravating or mitigating circumstances that would cause them to deviate from the disciplinary actions matrix guidance.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department will implement this recommendation as stated in recommendation 16.

