

# LEGISLATIVE AUDIT DIVISION

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## MEMORANDUM

**TO:** Legislative Audit Committee Members  
**FROM:** Nick Hill, Performance Auditor  
**CC:** Galen Hollenbaugh, Commissioner, Department of Labor and Industry  
Ric Smith, Chairman, Board of Realty Regulation  
**DATE:** November 2017  
**RE:** Performance Audit Follow-Up (17SP-23): *Licensing Real Estate Professionals*  
(orig. 15P-01)  
**ATTACHMENTS:** Original Performance Audit Summary

### Introduction

The *Licensing Real Estate Professionals* (15P-01) report was issued to the Committee in February 2016. The audit included 6 recommendations to the Department of Labor and Industry (DLI) and 11 to the Board of Realty Regulation (BRR). We conducted follow-up work to assess implementation of the report recommendations. This memorandum summarizes the results of our follow-up work.

### **Overview**

Montana's 5,000 real estate professionals have been affected by recent changes in how DLI and BRR operate. Audit work determined both DLI and BRR need to make improvements to address problems with license applications, continuing education requirements, fees and funding, data accuracy, and decision-making. Our performance audit contained 17 recommendations: 6 to DLI and 11 to BRR. Based on our follow-up work, we determined DLI has implemented three recommendations, one is being implemented, and two are not implemented. BRR has implemented one recommendation, seven are partially implemented, and three are not implemented.

### Background

Montana regulates the practice of various professions and occupations through licensing boards. All boards are administratively attached to DLI. BRR is responsible for regulating the state's real estate sales, rental industry, and licensing of real estate professionals doing business within the state of Montana. Licensees consist of nearly 5,000 active salespersons, brokers, property managers, and timeshare salespersons. Audit work found several concerns involving pre-licensure and continuing education, a lack of policies and procedures, unused and outdated forms and applications, licensee/supervisor relationships, BRR-related fees, and the Real Estate Recovery Account, all of which has led to a number of factors affecting BRR in recent years.

### Audit Follow-Up Results

The following sections summarize the progress toward implementation of the report recommendations. Audit staff met with DLI staff within the Business Standards Division, specifically the Board Licensing

Bureau and the Board Management Bureau; interviewed a BRR board member; and observed licensee data being entered into DLI's licensee database. The following summarizes information on completed follow-up work and the implementation status of recommendations.

### **RECOMMENDATION #1**

**We recommend the Board of Realty Regulation review the state real estate exam to ensure it is relevant and reflects additions and modifications to state laws and Administrative Rules.**

#### ***Implementation Status – Partially Implemented***

Interviews with both a BRR member and DLI staff found the salesperson exam was reviewed by the entire board in April 2016. According to the BRR, the board does not anticipate reviewing the exam as a whole annually. Instead, their Education sub-committee, which is made up of BRR members and industry professionals, will review the exam on an ongoing basis. The plan is to have the testing company give a final review of the exam once all the edits by BRR are complete. The broker exam has not yet been reviewed.

### **RECOMMENDATION #2**

**We recommend the Board of Realty Regulation:**

- A. Clearly define, in policy, criteria for treating an application as nonroutine, including classification of criminal convictions.**
- B. Clarify its position of nonroutine applicants appearing at board meetings in person versus over the phone.**
- C. Clearly define, in policy, how to renew applicants who received legal or disciplinary actions since their last renewal.**

#### ***Implementation Status – Partially Implemented***

- A. When a potential BRR licensee fills out an application, they must answer a series of disciplinary questions. Based on how they answer these questions, the application may be considered nonroutine and is forwarded to BRR members for review during an upcoming board meeting. In response to the audit, a new ARM rule package (Montana Administrative Register Notice 24-210-43) was confirmed in June 2017. As part of this package, BRR defined their nonroutine application policy and a review of the rules finds the criteria is now more clearly defined. Some examples of this new criterion that defines a nonroutine applicant include anyone with a felony conviction within the last ten years, and have three or more misdemeanor convictions.
- B. According to BRR's written response to the audit in February 2016, "The Board members are on record as stating that the presence or absence of an individual has no bearing on their decision, except that if there are clarification issues, having an applicant in person or on the phone allows response to any question." However, an interview with a BRR board member found some think it is still a good idea for nonroutine applicants to appear in front of the board in person because it adds value to have them physically there to answer questions. It appears the board is still not in agreement on whether nonroutine applicants should attend board meetings or discuss issues over the phone.
- C. DLI staff stated they are in the process of defining a policy on how to renew licensees with disciplinary actions. According to staff, DLI is trying to make as many board processes as uniform as possible to reduce both staff time and money associated with accomplishing board duties. Making processes consistent across boards means staff do not have to be trained on multiple, unique processes and can instead focus only a few. Creating this policy is part of a larger renewal change DLI's Business Standards Division is making across all DLI boards.

### **RECOMMENDATION #3**

**We recommend the Board of Realty Regulation:**

- A. Establish and consistently follow criteria for the approval and denial of waiver applications, and**
- B. Review the potential for establishing reciprocity agreements with other jurisdictions that meet Montana licensing standards.**

#### ***Implementation Status – Not Implemented***

- A. Initial audit fieldwork found BRR was not consistently following guidelines when reviewing waiver applications. BRR stated they have since implemented a new method for considering waiver applications. However, documents provided by DLI found the same set of guidelines established in March 2009 were still in use. Interviews with a BRR board member found some members are still not quite sure which motions are in place and rely on board staff to notify them of motions they need to follow. Further review of minutes for 2016 and 2017 BRR board meetings found there is still confusion about how to process waiver applications. The motion currently used specifically states that all waiver applicants are required to take, at a minimum, the state's licensing exam. However, a review of board minutes found that BRR board members told DLI staff they have the ability to allow potential licensees to forgo the state exam. In addition, there is also confusion about what circumstances applicants are required to take the Rookie course. A recent decision during an August 2017 board meeting concluded that all out-of-state salesperson waiver applicants would be required to take both the state exam and the Rookie course.
- B. BRR did not concur with part B of this recommendation because they believed it would be too costly to review the real estate requirements found in other states. We continue to stand by this recommendation as stated.

### **RECOMMENDATION #4**

**We recommend the Board of Realty Regulation eliminate both the predetermination application and the equivalency application.**

#### ***Implementation Status – Partially Implemented***

As part of Montana Administrative Register 24-210-43, the board eliminated ARM 24.210.615, which implemented the equivalency application form. In addition, we verified the equivalency application is no longer available on the website and no longer in use. However, although BRR originally concurred with our recommendation to eliminate their predetermination application, the board decided to keep this application as they think it is beneficial for potential applicants and does not take a lot of staff time to process.

### **RECOMMENDATION #5**

**We recommend the Department of Labor and Industry provide an online method for the changing of supervising brokers.**

#### ***Implementation Status – Implemented***

In Montana, a salesperson must be assigned to a supervising broker. It is not uncommon for a salesperson to switch supervising brokers multiple times during their career. During audit work, we learned the professional real estate associations voiced concerns over the time it took DLI staff to process the forms used to change supervising brokers because salespersons are not allowed to work while they are not under the direction of a supervising broker. That process, which was done through paper forms, took more than

two weeks for 11 percent of those who filed for a change. According to DLI officials, the ability to change supervising brokers is now available online, which should make this process much more efficient.

### **RECOMMENDATION #6**

**We recommend the Board of Realty Regulation:**

- A. Establish a limit for the number of salespersons a broker with a supervising broker endorsement may supervise.**
- B. Work with DLI staff to improve communications with supervising brokers regarding their responsibilities and duties.**

### ***Implementation Status – Partially Implemented***

- A. Although BRR concurred with this recommendation in its written response to the audit report, it ultimately decided to not implement this part of the recommendation. Instead, BRR has changed ARM 24.210.641(5) dealing with professional conduct. This new rule defines unprofessional conduct as consisting of “failing as a supervising broker to adequately supervise his or her salespeople. A supervising broker endorsement may be limited or revoked as a consequence of violating this subsection.” BRR stated this would hold supervising brokers more accountable for salesperson actions through the complaint process. However, “adequately” is not defined and an interview with a BRR board member found they could not define what “adequately” means.
- B. BRR is working with their executive officer (a DLI employee) to publish a quarterly newsletter that will be emailed to all active licensees and available on BRR’s website. This newsletter will incorporate a supervising broker section. A review of BRR newsletters, which were published in April and July 2017, included a section on supervising broker best practices. Interviews with staff found they intend to put this section in every newsletter.

### **RECOMMENDATION #7**

**We recommend the Board of Realty Regulation:**

- A. Revise Administrative Rules to allow first-year salespersons 12 months following their initial license date to complete the Rookie course, or**
- B. Provide an online version of the Rookie course.**

### ***Implementation Status – Partially Implemented***

- A. A change to ARM 24.210.661(1) now allows a new salesperson 120 days from their original licensure date to complete the Rookie course. If no course were offered within that time frame, the salesperson would be required to complete the next offered course unless, at BRR’s discretion, it is extended for good cause. The board also has an agreement with the local Realtors Associations to hold a course every 120 days for course availability. Ultimately, BRR plans on moving the Rookie course education into the pre-licensure education and testing. Although BRR now allows new licensees four months to complete their Rookie course, it still falls short of the recommended 12 months, so this portion of the recommendation has been partially implemented.
- B. BRR did not concur with this recommendation because the board believed that an in-person course is more valuable. Interviews with a BRR board member found they still agree with this decision. However, we continue to stand by this recommendation because of the efficiencies an online version of the Rookie course would provide.

### **RECOMMENDATION #8**

#### **We recommend the Board of Realty Regulation:**

- A. Revise the continuing education self-certification question on renewal applications,**
- B. Define a continuing education audit protocol, and**
- C. Eliminate the requirement for course providers to upload course roster information.**

#### **Implementation Status – *Partially Implemented***

- A. This portion of the recommendation has been implemented as a review of both the salesperson and broker renewal applications found the licensee no longer has to state whether or not they have completed all continuing education requirements.
- B. During follow-up audit work, we found DLI staff and BRR have conflicting answers to this recommendation. Based on a motion from a January 2016 board meeting, BRR moved that only those licensees who are known to have not met the continuing education requirements, based on DLI data, will be sent a continuing education letter. Once responses are received, licensees that do not have their continuing education will have their licenses administratively suspended by DLI until the licensee's continuing education is caught up. However, interviews with DLI staff found that all BRR licensees will be audited, exactly how it was done during audit fieldwork. An interview with a BRR board member found their understanding of the annual audits did not match with what DLI actually did last year; they could not specify the actual percentage of licensees audited. As a result, there is still a disconnect between what BRR board members think the continuing education audit consists of, versus what is actually occurring. Finally, during a May 2017 board meeting, the board decided to complete a 100 percent compliance check of all licensees annually.
- C. BRR did not concur with this recommendation. We continue to stand by this recommendation, as we believe its implementation would decrease DLI's and BRR's potential for liability issues.

### **RECOMMENDATION #9**

#### **We recommend the Board of Realty Regulation:**

- A. Include an assessment of the relationship between regulatory activity and administrative costs when reviewing revenues and expenditures in the last five licensing renewal years, and**
- B. Comply with Administrative Rules relating to fees for changing license status from inactive to active.**

#### **Implementation Status – *Not Implemented***

- A. BRR's executive officer gives a financial report to the board at every meeting. According to DLI staff, at the beginning of the fiscal year the executive officers look at past board expenditures and revenues and determine a projection of what the costs will be for the upcoming fiscal year. A review of BRR agendas found fees are not an agenda item. As a result, it does not appear the board actually reviews all their revenues and expenditures for the purpose of adjusting their fees. An interview with a BRR board member found they did not think the fees were reviewed since the audit was released.
- B. During audit work, we found ARM 24.210.401(13) requires BRR licensees pay a fee of \$80 to change their license status from inactive to active for salespersons and brokers. However, under ARM 24.101.403(1)(h) "inactive to active status change fee during the licensure period is the difference between the cost of an inactive license and an active license renewal fee" As such,

BRR licensees should not be assessed a fee to change their license from inactive to active status (\$150 for an active salesperson license minus \$150 for inactive salesperson license is \$0). A review of ARM 24.210.401(13) found that the \$80 is still in place. According to DLI staff, the department has not addressed this issue because it is looking into inactive licenses across all boards in order to develop a more consistent way to define them. The deadline for this change was October 1; however, this has not occurred as of the date of printing this document.

### **RECOMMENDATION #10**

**We recommend the Board of Realty Regulation:**

- A. Align the current parameters for funding the Real Estate Recovery Account with resource needs,**
- B. Determine whether existing uses of the Real Estate Recovery Account funds should be expanded to increase protections for consumers, and**
- C. Increase the visibility of the Real Estate Recovery Account to both licensees and the general public through improved marketing.**

#### ***Implementation Status – Not Implemented***

- A. BRR initially partially concurred with all three parts of this recommendation. However, in July 2016 BRR decided not to make any changes to Real Estate Recovery Account (Account) laws. As a result, no changes in Account law from BRR were presented to the 2017 Legislature. According to its written response, BRR stated it will review the resource needs of the Account, which totaled nearly \$400,000 at the time of the audit, annually.
- B. BRR made a determination at a July 2016 board meeting that although they want to provide protections for consumers, they believe the marketing of the Account to consumers would be hard to determine (i.e., they don't know who their target audience is) and costly. Therefore, BRR plans to take no further action. In our opinion, this will continue to bring the level of consumer protections into question because this fund will likely not be used to enhance efforts to combat fraudulent or deceptive practices that could occur within the real estate industry.
- C. BRR is working with the executive officer to publish a quarterly newsletter that will be emailed to all active licensees and be available on BRR's website. The board indicated the first newsletter would include information on the Account. A review of the July 2017 newsletter did include a discussion on the Account. However, while this newsletter is on the website and is emailed to licensees, the general public would not know to look at the newsletter for Account information. According to BRR, based on the difficulty of finding the detailed information of those that would benefit from the Account, BRR believes it would be difficult to increase the visibility to the general public. We believe BRR could alleviate this concern simply by instructing the public that Account information is located in the newsletter and instructions on how to access the newsletter on the BRR website.

### **RECOMMENDATION #11**

**We recommend the Department of Labor and Industry comply with statute and only assess the Real Estate Recovery Account fee to license applicants that have their applications approved.**

#### ***Implementation Status – Implemented***

DLI supplied audit staff with a letter showing a \$35 RERA refund being given back to past applicants that did not ultimately get a board license. DLI staff stated the department identified prior applicants that were owed refunds during the 2006-2015 time period and also processed those refunds.

### **RECOMMENDATION #12**

**We recommend the Department Labor and Industry establish a two-way connection between the licensing database and eBiz to allow for licensee profile edits.**

#### ***Implementation Status – Implemented***

In the summer of 2012, DLI rolled out a new licensing database to all the boards. DLI staff use the licensing database to issue licenses to BRR salespersons, brokers, property managers, and timeshare salespersons. Licensees may not be familiar with the licensing database; however, they may use it throughout the year under the name “eBiz,” which is the portion of the licensing database that gives the user a limited portion of a licensee’s actual database record (also known as profile). This is what licensees see when they use the “Licensee Look-Up” system. Audit work found profile changes made within eBiz by licensees do not actually occur within the licensee database. Follow-up work found this recommendation was complete in May 2016 as part of an eBiz upgrade. If a licensee makes any changes to their demographic information within their eBiz profile, the change is now reflected in their profile within the licensing database.

### **RECOMMENDATION #13**

**We recommend the Department of Labor and Industry establish data entry controls within the licensing database to ensure licensing data is accurate, complete, and reliable for new applications and renewals going forward.**

#### ***Implementation Status – Not Implemented***

Working with DLI staff responsible for entering data into DLI’s licensee database, follow-up work found this recommendation is not yet implemented. Several tests were conducted and we found inaccurate data could still be entered into a licensee profile, which would ultimately lead to the same licensee profile problems identified during audit fieldwork. Examples include social security numbers being entered into name fields and incomplete social security numbers being entered into the licensing database.

### **RECOMMENDATION #14**

**We recommend the Department of Labor and Industry:**

- A. Implement internal controls to link the salesperson/supervising broker relationship within the department’s licensing database, and**
- B. Establish uniform standards to define relationships and supervision status in the department’s licensing database**

#### ***Implementation Status – Not Implemented***

- A. In order for a licensed salesperson to practice real estate in Montana, they must be under the direction of an active broker with a supervising broker endorsement. It is not uncommon for salespersons to switch from one supervising broker to another within a firm or when they change brokerage firms. Audit work found data integrity issues relating to how these relationships are input and updated in the licensing database records for both the salesperson and their supervising broker. Although DLI stated this recommendation was implemented as part of an update to the license database in February 2017, a review of this process found that staff had to still physically go into three licensee profiles to update a single supervising broker relationship: the salesperson, the former supervising broker, and the new supervising broker.
- B. Interviews with DLI staff and observations during follow-up work found uniform standards have not been established. Observations found when changing the relationships between salespersons

and their supervising brokers, the dropdown box displaying the relationship type still includes 13 options, when only 2 should be present. Staff stated there is not a policy DLI staff follow when changing relationships for BRR licensees in the database. Instead, relationship types are assigned by memory.

**RECOMMENDATION #15**

**We recommend the Board of Realty Regulation and its executive officer review the board’s website for content and accuracy on a regular basis.**

***Implementation Status – Implemented***

Audit work found a number of website issues, such as outdated administrative rules, broken links, and outdated FAQs. DLI staff stated the executive officers are now responsible for editing their boards’ website. The executive officers were given training on how to make basic edits to the websites. The BRR executive officer stated changes are made to the website on a regular basis and reminders on board member electronic calendars have been created to review certain components of the website on certain dates. The executive officer also stated the website is reviewed with the entire board on an annual basis. A review of a recent board meeting found this was the case. An interview with a BRR board member found they believe the website is improved and easier to navigate. Follow-up work verified the website’s contents and the usefulness of the website has improved.

**RECOMMENDATION #16**

**We recommend the Department of Labor and Industry improve the efficiency and effectiveness of administrative services provided to the Board of Realty Regulation by:**

- A. Identifying measures and performance standards for key administrative processes and regularly reporting results at board meetings, and**
- B. Establishing priorities for the Board of Realty Regulation executive officer position to ensure the board is provided with consistent and updated information.**

***Implementation Status – Being Implemented***

- A. DLI staff stated the department has an immense amount of licensee data, but does not currently have expertise on staff to analyze it. They are hoping to have the necessary skill sets in place by the end of 2017 to meet the conditions of this recommendation. At that time, they can begin reviewing licensee data to help identify and improve performance measures and standards related to its administrative services.
- B. According to DLI, they are using protocols and procedures found in the newly established annual board review policy to direct key administrative processes and document review. The executive officer, in conjunction with this new policy, has an ongoing “next meeting agenda list” and has annual and ongoing review items on each meeting agenda.

**RECOMMENDATION #17**

**We recommend the Board of Realty Regulation develop and implement a biennial work plan that includes regular and cyclical review of all significant areas of board regulatory activity affecting real estate industry professionals.**

***Implementation Status – Partially Implemented***

Interviews with DLI and board staff found that there is not a biennial work plan in place for BRR as recommended. However, in its place DLI has established an annual review board policy. Using ideas

listed in our audit report, this policy is to be used with all boards on an annual basis. DLI is still in the process of fine-tuning this policy. DLI staff said some items in the policy would be reviewed more frequently than others, some possibly every two years. Items to be reviewed on a regular basis are as follows:

- a. Department and board statutes and any others that impact the board
- b. Department and board administrative rules
- c. Board's revenues and expenditures
- d. Annual audit percentages – get percentage from board and relay to audit unit
- e. Exams – question review
- f. Exams – process for testing
- g. Board motions delegating authority to department staff
- h. Website contact review
- i. Legislation – process and needs
- j. Processes and policies – i.e. application, board meetings, board minutes, complaints
- k. Board-approved continuing education courses, schools, lists
- l. Board goals – future planning
- m. Board member training