

Board for Licensing Contractors

September 1997

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The Honorable John S. Wilder
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Speaker of the House of Representatives
The Honorable Kenneth N. (Pete) Springer, Chair
Senate Committee on Government Operations
The Honorable Mike Kernell, Chair
House Committee on Government Operations
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the performance audit of the Board for Licensing Contractors. This audit was conducted pursuant to the requirements of Section 4-29-111, *Tennessee Code Annotated*, the Tennessee Governmental Entity Review Law.

This report is intended to aid the Joint Government Operations Committee in its review to determine whether the board should be continued, abolished, or restructured.

Very truly yours,

W. R. Snodgrass
Comptroller of the Treasury

WRS/tp
96/024

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Performance Audit
Board for Licensing Contractors
September 1997

AUDIT OBJECTIVES

The objectives of this audit were to review the board's legislative mandates; to assess the efficiency and effectiveness of management's organization and use of resources to accomplish the board's mission; and to make recommendations that might result in more efficient and effective operation of the board.

FINDINGS

Not All Recommendations from an Investigative Report Implemented

A December 1993 Division of State Audit report noted significant internal control weaknesses in the board's issuance of licenses, resulting in 19 licenses issued inappropriately. The report recommended several actions to improve internal controls. Some recommendations were implemented, and some are no longer relevant because of procedural changes. However, the following recommended improvements have not been made: (1) security of contractor and investigative files should be reviewed and improved; (2) checks should be restrictively endorsed; and (3) board-member approvals of licenses should be included in minutes of the board meetings (page 7).

Communication Between Board Staff and Information Systems' Staff Needs to Be Improved

Because of insufficient communication between board staff and Information Systems' staff, board staff are not fully aware of all the regulatory boards' computer system's capabilities, and Information Systems' staff are not aware of all the board's information needs. Improved communication and additional training of board staff appear necessary to ensure that the board obtains the reports and information it needs and that board staff are able to use the system to access the available information in the desired format (page 9).

OBSERVATIONS AND COMMENTS

The audit also discusses the following issues that affect the operations of the Board for Licensing Contractors: improvements in the collection of civil penalties and the complaint-handling process; unlicensed contractors; and the board's interviews of licensure applicants (page 5).

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

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Performance Audit Board for Licensing Contractors

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Performance Audit Board for Licensing Contractors

INTRODUCTION

PURPOSE AND AUTHORITY FOR THE AUDIT

The performance audit of the Board for Licensing Contractors was conducted in accordance with the Tennessee Governmental Entity Review Law, *Tennessee Code Annotated*, Title 4, Chapter 29. Under Section 4-29-219 of that statute, the Board for Licensing Contractors is scheduled to terminate June 30, 1998. The Comptroller of the Treasury is authorized under Section 4-29-111 to conduct a limited program review audit of the board and to report to the Joint Government Operations Committee of the General Assembly. This audit is intended to aid the committee in determining whether the Board for Licensing Contractors should be abolished, continued, or restructured.

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to determine the authority and responsibility mandated to the board by the legislature;
2. to assess the efficiency and effectiveness of management's organization and use of resources to accomplish the board's mission;
3. to develop recommendations, as needed, for board or legislative action that might result in more efficient and/or more effective operation of the board.

SCOPE AND METHODOLOGY OF THE AUDIT

The board's activities and procedures were reviewed, focusing on procedures and conditions in effect during fiscal year 1996. The audit was conducted in accordance with generally accepted government auditing standards and included

1. review of applicable statutes, regulations, and rules;
2. examination of board files, data, and reports; and

3. interviews with board members, staff of the board, staff of the Department of Commerce and Insurance, and representatives of the Better Business Bureau and the Tennessee Homebuilders Association.

The activities of the Home Improvement Commission, administratively a part of the board, but separated by statute, were not reviewed. The commission had a sunset public hearing on July 12, 1995, and was given a sunset termination date of June 30, 2002.

ORGANIZATION AND RESPONSIBILITIES

The General Assembly created the first State Board for Licensing Contractors by Chapter 70 of the Public Acts of 1931. The purpose of the board is to regulate the contracting industry and to safeguard life, health, and property by licensing properly qualified contractors. As of December 1995, approximately 13,000 contractors held licenses issued by the board.

The board is administratively attached to the Department of Commerce and Insurance, Division of Regulatory Boards, and is composed of nine members who serve staggered seven-year terms. Eight of the nine members are to be actively engaged as licensed contractors in the following classifications:

- At least three residential contractors
- At least two commercial building contractors
- At least one mechanical contractor
- At least one electrical contractor
- At least one highway, railroad, or airport contractor

At least one member shall not be engaged as a contractor in any county of this state. All contractor members shall have been engaged in the contracting business for at least ten years before their appointment to the board. There may be no more than one member per classification per grand division of the state and no more than three members from any one grand division. There should be at least one member 60 years old or older and at least one member of a racial minority. The board meets at least once every other month and rotates its location among each of the three grand divisions.

The board appoints an executive director to provide all administrative functions. The executive director keeps a register of license applicants and a printed roster of all licensed contractors. At the end of fiscal year 1996, the board had 22 staff positions, including the executive director and nine inspectors. A Department of Commerce and Insurance attorney assists the board in legal matters.

Board revenue for fiscal year 1996, consisting of fines, fees, and penalties, was \$1,430,837. Expenditures for the same period were \$1,025,132, leaving a surplus of \$405,705.

The board's revenues have routinely exceeded expenditures. By statute, all money collected by the board is to be deposited in the general fund and credited to a separate account. Disbursements from this account are to be "solely for the purpose of defraying expenses incurred in the implementation and enforcement of the board's areas of regulation." At the end of fiscal year 1994, the board's account had a balance of \$1,031,198. During fiscal year 1995, this balance was reduced to \$184,597, as the result of a statutory change which allowed the balances (as of June 30, 1994) in the accounts of the state's professional and health regulatory boards to be transferred to the general fund. As of June 30, 1996, the Board for Licensing Contractors' account had a balance of \$1,069,015.

LICENSING CLASSIFICATIONS AND APPLICATION PROCESS

The board determines the classification and monetary limitation of each license. Nine major licensing classifications are defined by statute:

1. Commercial building construction
2. Industrial construction
3. Heavy construction
4. Highway, railroad, and airport construction
5. Municipal and utility construction
6. Mechanical construction
7. Electrical construction
8. Environmental and special construction
9. Residential construction

The board has defined numerous subcategories under each major classification.

To obtain a license, applicants complete the application form, submit other documentation required, and pay the application fee of \$150. If the application is satisfactory, the applicant must take one or more written examinations, depending on the number of classifications desired, and be interviewed by a board member. If the results of all examinations are satisfactory, the board issues a license to operate as a contractor in the state. A license is good for one year and may be renewed after submission of current financial statements and the renewal fee of \$100.

The board has the power to revoke or suspend a license or assess a civil penalty of up to \$5,000 per offense. Persons operating without a license may be cited by the executive director, ordered to stop work, and assessed a fine of between \$50 and \$1,000.

EXEMPTIONS FROM LICENSING REQUIREMENTS

Statute exempts the following from contractor licensing requirements:

- Contractors performing work for the Tennessee Department of Transportation.

- Contractors whose projects cost less than \$25,000.
- Persons building homes (on private property) for resale in the county of their residence in one of 57 counties described in statute.
- Any person, firm, or church that owns property and constructs thereon single residences, farm buildings, or other buildings for individual use. (Note: Except in Shelby County, a person or firm qualifying under this exemption shall not construct more than one single residence within a period of two years.)
- Single residences constructed by nonprofit entities exempt from federal income taxation under section 501(c)(3) of the Internal Revenue Code of 1986, or by students enrolled in educational institutions under the direct supervision of faculty as part of the curriculum.
- Architects and engineers conducting normal architectural or engineering services.
- Residents of Sequatchie County.
- Engineers, licensed in accordance with Title 62, *Tennessee Code Annotated*, who are managing and supervising the removal, remediation, or clean up of pollutants or wastes from the environment; serving as a “corrective action contractor” as defined by the rules and regulations of the Tennessee Department of Environment and Conservation; conducting subsurface investigation and/or testing by drilling or boring to determine subsurface conditions; conducting geophysical or chemical testing of soil, rock, ground water, or residues; or installing monitoring detection wells or plezometers for evaluating soil or ground water characteristics.
- Subcontractors, except those doing electrical, plumbing, or heating ventilation or air conditioning work costing \$25,000 or more.

OBSERVATIONS AND COMMENTS

The issues discussed below did not warrant findings, but are included in this report because of their effect or potential effect on the operations of the Board for Licensing Contractors.

Collection of Civil Penalties

The board's method for tracking and collecting civil penalties has apparently improved. According to statute, the board may impose a civil penalty of up to \$5,000 per violation. In the past, staff did not compare civil penalties assessed with penalties collected and could provide only partial information on penalties paid and penalties unpaid. According to an April 6, 1994, board memorandum, \$34,500 in penalties assessed between March 1991 and January 1994 had not been paid. However, as of June 30, 1996, collections had improved—only \$2,000 of the \$56,260 in penalties assessed during fiscal year 1996 remained uncollected. (Of the \$34,500 unpaid as of April 1994, slightly less than one-third was collected; \$3,250 was dismissed and the rest remained unpaid. The contractors who failed to pay were either unlicensed at the time or have since lost their license for failure to pay the penalty.)

Complaint-Handling Process

The board's staff receive numerous complaints, primarily from consumers; the Division of Consumer Affairs, the Better Business Bureau, and local codes officials also refer complaints to the board. During fiscal year 1996, the board received and opened cases for 503 complaints. The vast majority of complaints involve small contractors and residential construction, concern cosmetic issues, and are resolved by a board inspector acting as a mediator between the homeowner and the contractor. Usually, at least one day of each three-day board meeting is occupied with informal hearings of unresolved consumer complaints.

In August 1995, the board instituted a new process to handle complaints. The staff attorney now reviews each complaint and makes a recommendation to a subcommittee of three board members. If the attorney is unable to make a recommendation based on the information provided, the complaint is referred to an inspector for further investigation. The subcommittee's recommendations are presented to the full board for a vote. According to the staff attorney, preliminary results of this new process indicate a reduction in the length of board meetings, the time to resolve the complaint, and the inconvenience to the homeowner/complainant. According to the board's open complaint listing as of July 1996, most of the open complaints were in litigation, were ready to be reviewed by the board at its July meeting, or had been received within the last two months.

Unlicensed Contractors

According to board staff, unlicensed contractors are a significant problem in the state. Staff hear about unlicensed contractors primarily from local codes officials but also from homeowners, contractors who were not awarded a bid, contractor associations, or a review of reports listing upcoming and approved construction contracts. In 1991, the executive director was given statutory authority to issue citations against contractors violating licensure requirements. The citation contains a cease and desist order and a civil penalty ranging from \$50 to \$1,000. The unlicensed contractor may be allowed to continue working on the project until the next board meeting, at which time he or she is expected to apply for licensure. Once the licensure process has begun, the civil penalty associated with the citation may be waived. In the meantime, the inspector notifies the homeowner that the board cannot vouch for the contractor's financial security or quality of work until the licensure process is completed.

In an attempt to reduce the number of unlicensed contractors, the board now sponsors seminars for persons seeking limited licenses. The first three-day seminar was held at Cleveland State Community College in September 1995. Since then, the course has been held at several other community colleges. Attendance at the three-day seminar exempts the contractor from taking the written examination for a limited license in residential construction up to \$70,000. As a result of these classes, seven contractors were licensed in the limited category in November 1995, 36 in January 1996, 36 in March 1996, and 12 in May 1996.

Applicant Interviews

Section 62-6-111(a)(2), *Tennessee Code Annotated*, states that any person who has submitted an acceptable application to the board is entitled to an examination, which may be "written and/or oral." Currently, the board requires each applicant to pass a written examination and an interview with a board member. Interviews are conducted at the board's regular bimonthly meetings.

Based on auditor observation, interviews usually lasted only five to ten minutes, raising questions about the usefulness of this part of the process. Because some applicants must come from out-of-state or another part of Tennessee, the interview may be very time-consuming and inconvenient. The board has considered exempting certain applicants from the interview process and has the authority to do so. Thus far, however, the board has taken no action. Developing criteria for exemption, and decreasing the number of applicants required to pass through the interview process, could make the board's operations more efficient.

FINDINGS AND RECOMMENDATIONS

1. The board did not implement all recommendations from an investigative report

Finding

The Division of State Audit, in conjunction with the Tennessee Bureau of Investigation, conducted a review of improper licenses issued from July 1, 1991, through December 31, 1992. The report, *Review of Payments Circumventing Licensing Procedures*, was released in December 1993. The review found significant internal control weaknesses in the issuance of licenses, including inadequate supervision of board employees. As a result, 19 licenses were issued without one or more of the following: completion of the application and payment of the application fee, a passing exam score, or completion of the board interview. The report recommended several actions for the Department of Commerce and Insurance to institute to improve internal controls. Some recommendations were implemented and some are no longer relevant because of procedural changes. However, several recommended improvements in internal controls have not been made.

Security of contractor and investigative files should be reviewed and improved. Security of the files has not been improved since the investigative report. The location of the files, with no walls and with other regulatory boards' office space on either side, makes it very difficult to ensure file security. Although board staff mentioned no recent problems, security is still a concern, particularly because of the serious problems in the past.

Checks should be restrictively endorsed. Although application and renewal forms instruct applicants to send payment to the Department of Revenue (not to the board), the board still receives payments. According to the executive director, checks received with applications or renewals are taken to the cashier's office almost immediately. However, there is no process requiring board staff to restrictively endorse these checks upon receipt.

Board-member approvals of licenses should be included in minutes of the board meetings. According to a review of board meeting minutes, board-member approval of licenses are not always recorded in the minutes. In light of the serious problems in the past with bogus licenses, it is essential that all approvals be independently recorded in the minutes.

Recommendation

The board should take steps to implement the internal controls recommended by the Division of State Audit investigative report.

Management's Comment

Department of Commerce and Insurance:

We concur. Internal controls have been established by the Board for Licensing Contractors to alleviate recurrence (e.g., the present computer system). The new system does not allow an employee who enters information, relative to a contractor's application, the ability to approve said information. Approval must be done by another employee. This security procedure virtually assures that problems which occurred in the past cannot recur again. Second, all board members are required to affix their complete signature to any document(s) requiring their approval. Third, all examination scores are required to be submitted by the examination vendor on state-sealed tamper-proof paper.

Security of contractor and investigative files should be reviewed and improved. We concur. Because of limited space assigned to the Regulatory Boards, it has been nearly impossible to physically secure the contractors' licensing files. The Department of Commerce and Insurance is presently making every effort to secure additional space for several of the Regulatory Boards, including the Board for Licensing Contractors.

Checks should be restrictively endorsed. We concur. All checks received in the Board for Licensing Contractors' office are now recorded and endorsed prior to forwarding them to the cashier's office.

Board-member approvals of licenses should be included in minutes of the board meetings. We concur. The Board for Licensing Contractors now includes in minutes of all meetings a copy of applicants approved by the board. Previously they were kept under separate cover.

Chairman of the Board for Licensing Contractors:

Security of contractor and investigative files should be reviewed and improved. We concur; but we are limited by the amount of office space provided the board at its current location on the first floor of Davy Crockett Tower. Request has been made for additional floor space with the goal being controlling access to all files.

Checks should be restrictively endorsed. We concur; the board office has never been provided an endorsement stamp to "restrictively endorse checks that fall into the hands of board office personnel." All checks, when received, are endorsed by hand, recorded, and taken to the cashier's office immediately.

Board-member approvals of licenses should be included in minutes of the board meetings. I concur in part; our July board meeting has been extended by one-half day to begin early on Monday July 21, at 1:00 p.m. for discussing board business and improvements in the operation of the board. One of the specific items is to improve the new applicant process. Previous reports have suggested the interviews are not always necessary. This, coupled with the need for the

minutes to reflect the action taken, will be discussed at length, with my goal being a resolution to improve this process within the next two board meetings. The logistics of nine board members physically approving what can be up to 400 applicants are quite involved, as you might imagine.

2. Communication between board staff and the department's Information Systems' staff needs to be improved

Finding

During the audit, board staff raised many concerns about the capabilities of the regulatory boards' computer system, implemented in 1993. According to staff, the system was slow and would not produce all needed information on licensees, complaints, and license status. Since the completion of audit work, the system's hardware and software have been replaced (in October and November 1996), and the system's speed and capabilities greatly enhanced. However, because of insufficient communication between board staff and Information Systems' staff, board staff are not fully aware of all the system's capabilities, and Information Systems' staff are not aware of all the board's information needs. Improved communication and additional training of board staff appear necessary to ensure that the board obtains the reports and information it needs and that board staff are able to use the system to access the available information in the desired format.

Discussions with Information Systems' staff indicate that virtually all the information board staff need is available through the regulatory boards' computer system. However, some of the reports must be developed and generated by Information Systems' staff, in response to a request for service approved by the department's Assistant Commissioner for the Regulatory Boards. This process requires that board staff be able to clearly define the information they need, why they need it, and when. Other types of information may only be available if board staff have entered certain codes or supplied certain specific information when initially entering license or complaint data into the system.

Board staff received training on the computer system initially; however, because of staff turnover, system enhancements, and changes in the types of information needed, additional training for board staff is necessary. The Division of Regulatory Boards has its own trainer on staff to assist the boards as requested, and Information Systems' staff have also indicated their willingness to work with board staff to ensure staff are able to obtain needed information and are using the computer system to its full capabilities.

Recommendation

Board and Information Systems' staff should discuss the board's information needs and questions concerning the regulatory boards' computer system. Where possible (given the system's capabilities), Information Systems' staff should work with the board to help provide needed reports, listings, and analysis of information. Board staff should receive training (as needed) to ensure they fully understand the system and its capabilities.

Management's Comment

Department of Commerce and Insurance:

We concur. The department is currently developing training for Regulatory Boards System users that addresses the issues and needs of specific users including the Board for Licensing Contractors. Additionally, management is committed to developing the communication skills of staff to ensure that required system modifications are properly defined and that those requirements are effectively disseminated to Information Systems' staff.

Chairman of the Board for Licensing Contractors:

We concur, and our staff will work closely with the Information Systems' staff both to communicate the type of information needed and participate in training necessary to utilize the system to its fullest extent.

RECOMMENDATIONS

ADMINISTRATIVE

The following areas should be addressed to improve the efficiency and effectiveness of the Board for Licensing Contractors' operations.

1. The board should take steps to implement the internal controls recommended by the Division of State Audit investigative report.

2. Board and Information Systems' staff should discuss the board's information needs and questions concerning the regulatory boards' computer system. Where possible (given the system's capabilities), Information Systems' staff should work with the board to help provide needed reports, listings, and analysis of information. Board staff should receive training (as needed) to ensure they fully understand the system and its capabilities.