AUDIT OF TAX REDEMPTION OFFICER RECORDS AND ACCOUNTS

For the Three Years Ending June 30, 2008

We found that the elected Orange County Treasurer-Tax Collector properly calculated and collected over **\$241 million** in delinquent property taxes, interest and penalties for the three years ending June 30, 2008.

We identified one **Significant Issue** (finding) and six lesser **Control Findings** regarding the tax redemption process. The **Significant Issue** was regarding supervisory review and timely resolution of items in the suspense account.

AUDIT NO: 2812 REPORT DATE: APRIL 16, 2009

County Internal Auditor: Peter Hughes, Ph.D., MBA, CPA Deputy Director: Eli Littner, CPA, CIA Sr. Audit Manager: Alan Marcum, CPA, CIA Audit Manager: Michael Dean, CPA, CIA Senior Internal Auditor: Lisette Free, CPA



RISK BASED AUDITING Peer Review Compliant – 2001, 2004, 2007

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RISK BASED AUDITING

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To access and view audit reports or obtain additional information about the OC Internal Audit Department, visit our website: www.ocgov.com/audit



OC Fraud Hotline (714) 834-3608

Letter from Dr. Peter Hughes, CPA





Transmittal Letter

Audit No. 2812 April 16, 2009

TO: Members, Board of Supervisors

FROM: Dr. Peter Hughes, CPA County Internal Auditor

SUBJECT: Audit of Tax Redemption Officer Records and Accounts

We have completed an Audit of Tax Redemption Officer Records and Accounts for the three year period ending June 30, 2008. The total dollar volume of redemption taxes and penalties collected during the three years ending June 30, 2008 was approximately **\$204.3 million** for secured taxes and **\$36.8 million** for supplemental taxes. The final **OC Internal Auditor's Executive Report** is attached for your review.

Please note we have a structured and rigorous **Follow-Up Audit** process in response to recommendations and suggestions made by the Audit Oversight Committee (AOC) and the Board of Supervisors (BOS). As a matter of policy, our **first Follow-Up Audit** will begin at <u>six months</u> from the official release of the report. A copy of all our Follow-Up Audit reports is provided to the BOS as well as to all those individuals indicated on our standard routing distribution list.

The AOC and BOS expect that audit recommendations will typically be implemented within six months and often sooner for significant and higher risk issues. Our **second Follow-Up Audit** will begin at <u>six months</u> from the release of the first Follow-Up Audit report, by which time **all** audit recommendations are expected to be addressed and implemented.

At the request of the AOC, we are to bring to their attention any audit recommendations we find still not implemented or mitigated after the second Follow-Up Audit. The AOC requests that such open issues appear on the agenda at their next scheduled meeting for discussion.

We will provide a **Follow-Up Audit Report Form** to the Treasurer-Tax Collector, who should complete this template as our audit recommendations are implemented. When we perform our first Follow-Up Audit approximately six months from the date of this report, we will need to obtain the completed document to facilitate our review.

Letter from Dr. Peter Hughes, CPA



Each month I submit an **Audit Status Report** to the BOS where I detail any material and significant audit findings released in reports during the prior month and the implementation status of audit recommendations as disclosed by our Follow-Up Audits. Accordingly, the results of this audit will be included in a future status report to the BOS.

As always, the OC Internal Audit Department is available to partner with the Treasurer-Tax Collector's Office so that they can successfully implement or mitigate difficult audit recommendations. The Treasurer-Tax Collector is free to call me should he wish to discuss any aspect of our audit report or recommendations.

Additionally, we will be forwarding a **Customer Survey** of Audit Services to the Treasurer-Tax Collector to complete. The Treasurer-Tax Collector will receive the survey shortly after the distribution of our final report.

ATTACHMENTS

Other recipients of this report are listed on the OC Internal Auditor's Executive Report on page 4.

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Audit of Tax Redemption Officer Records and Accounts Audit No. 2812

For the Three Years Ending June 30, 2008

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Audit No. 2812

April 16, 2009

TO: Members, Board of Supervisors

FROM: Dr. Peter Hughes, CPA County Internal Auditor

CPA Deter Augues

SUBJECT: Audit of Tax Redemption Officer Records and Accounts

Audit Highlight

We found that the elected Orange County Treasurer-Tax Collector properly calculated and collected over **\$241 million** in delinquent property taxes, interest and penalties for the three years ending June 30, 2008.

We identified one Significant Issue

(finding) and six lesser Control Findings regarding the tax redemption process. The Significant Issue was regarding supervisory review and timely resolution of itmes in the

of items in the suspense account.

OBJECTIVE

The Internal Audit Department conducted an audit of the Treasurer Tax-Collector Redemption Section pursuant to Section 4108.5 of the California Revenue and Taxation Code (Revenue and Taxation Code) for the purpose of evaluating the reliability and integrity of financial and operational tax redemption records and compliance with laws and regulations governing redemption activities. Our audit was conducted in accordance with professional standards established by the Institute of Internal Auditors. As part of obtaining reasonable assurance about the accuracy of redemption collection records and accounts, we performed tests of collection records, penalty and interest calculations, and account reconciliations.

BACKGROUND

The Treasurer-Tax Collector performs the duties of Tax Redemption Officer through the Redemption Section of his Department. These duties, as defined by Part 7 of the Revenue and Taxation Code, include maintaining abstracts of delinquent secured and supplemental taxes; calculating and collecting interest and penalties on delinquent taxes; verifying specific conditions have been met before property is redeemed by property owners; and issuing certificates for redeemed property. The total dollar volume of redemption taxes and penalties collected during the three years ending June 30, 2008 was approximately **\$204.3 million** for secured taxes and **\$36.8 million** for supplemental taxes.

SCOPE

Part 7, Chapter 1, Section 4108.5 of the Revenue and Taxation Code requires an audit once every three years of the records and accounts of the Tax-Collector relating to the performance of his duties as the Tax Redemption Officer. Our audit involved a review of existing operating and accounting practices of the Treasurer-Tax Collector for the three years ending June 30, 2008. Our methodology included inquiry, auditor observation, testing the records and accounts of redemption collections, and reviewing compliance with laws and regulations for redemption activities.



SCOPE EXCLUSIONS

Our audit <u>did not</u> include a review of the property tax apportionment process performed by the Auditor-Controller or of information systems used in the redemption process.

RESULTS

We audited the Treasurer-Tax Collector Redemption Section pursuant to Section 4108.5 of the Revenue and Taxation Code for the purpose of evaluating the reliability and integrity of financial and operational tax redemption records and compliance with laws and regulations governing redemption activities. The Revenue and Taxation Code requires an audit at least once every three years of the records and accounts of the Tax-Collector relating to the performance of his duties as the Tax Redemption Officer.

Based on our audit, the records and accounts of redemption collections appear to be fairly stated.

No Material Weaknesses were identified. However, we did note one (1) Significant Issue and six (6) Control Findings resulting in seven (7) recommendations to enhance existing controls and processes as discussed in the *Detailed Observations*, *Recommendations and Management Responses* section of this report. See *Attachment A* for a description of Report Item Classifications. Based upon the objective of our audit, we noted the records and accounts of redemption collections appear to be fairly stated. We noted improvements were warranted in the following areas:

- Suspense Account: We noted one (1) Significant Issue to improve controls that involves supervisory review and timely resolution of items in the suspense account. We noted several instances where monies were in suspense for over 60 days without any further processing. The Revenue and Taxation Code requires the TTC to pay interest on certain types of refunds that are not returned to the taxpayer within a certain number of days. (See page 5 for details)
- Penalty Cancellations: We noted one (1) Control Finding related to monitoring of processed penalty cancellations. (See page 6 for details)
- Installment Plans: We noted two (2) Control Findings related to retention of taxpayer installment plan agreement sheets and the stated time of redemption under installment plans. (See page 6 for details)



- Account Reconciliations: We noted two (2) Control Findings related to proper segregation of duties and timely review of reconciliations. (See page 7 for details)
- Accounting Statements by TTC to Auditor-Controller: We noted one (1) Control Finding regarding the timing of TTC's accounting statement of monies collected to the Auditor-Controller. (See page 8 for details)

Management's Responsibilities for Internal Controls

In accordance with the Auditor-Controller's County Accounting Manual section S-2 - Internal Control Systems, "All County departments/ agencies shall maintain effective internal control systems as an integral part of their management practices. This is because management has primary responsibility for establishing and maintaining the internal control system. All levels of management must be involved in assessing and strengthening internal controls. Control systems shall be continuously evaluated and weaknesses, when detected, must be promptly corrected." The criteria for evaluating an entity's internal control structure is the Committee of Sponsoring Organizations (COSO) control framework. Our audit of the Tax Redemption Officer enhances and complements, but does not substitute for the Treasurer-Tax Collector's continuing emphasis on control activities and self-assessment of control risks.

Inherent Limitations in Any System of Internal Control

Because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. Specific examples of limitations include, but are not limited to, resource constraints, unintentional errors, management override, circumvention by collusion, and poor judgment. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or the degree of compliance with the procedures may deteriorate. Accordingly, our audit would not necessarily disclose all weaknesses in the Treasurer-Tax Collector's operating procedures, accounting practices and compliance with County policy. In connection with our audit, nothing came to our attention that caused us to believe that internal control over redemption activities was materially deficient. However, our audit was not directed primarily toward obtaining knowledge of such internal control.

Acknowledgment

We appreciate the courtesy extended to us by Treasurer-Tax Collector staff. If we can be of further assistance, please contact me directly or Eli Littner, Deputy Director at 834-5899 or Alan Marcum, Senior Audit Manager at 834-4119.



Attachments

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Audit Oversight Committee Thomas G. Mauk, County Executive Officer Chriss W. Street, Treasurer-Tax Collector Paul Gorman, Chief Assistant Treasurer-Tax Collector Jennifer Burkhart, Assistant Treasurer-Tax Collector Robin Russell, Assistant Treasurer-Tax Collector, Administration Dan Puglia, Budget Manager, Treasurer-Tax Collector Ginika Echebiri, Accounting/Compliance Manager, Treasurer-Tax Collector Patricia Hutt, Redemption Supervisor, Treasurer-Tax Collector Foreperson, Grand Jury Darlene J. Bloom, Clerk of the Board of Supervisors



SUSPENSE ACCOUNT

The Treasurer-Tax Collector (TTC) places payments into a suspense account for further research and possible refund to the taxpayer when they are unable to apply a redemption payment to the taxpayers' account for reasons such as overpayment, short payment, duplicate payment, etc. Additionally, monies may be placed into the suspense account due to a correction or cancellation of an original tax assessment or penalty and a refund is issued to the taxpayer.

Observation No. 1 – Supervisory Review & Resolution of Suspense Account Items (Significant Issue)

The TTC does not perform a supervisory review of items in the suspense account to ensure long-outstanding items in the suspense account are resolved timely. We reviewed 40 items in the suspense account, and noted 14 instances where monies had been in suspense for over 60 days before being cleared (between 63 and 345 days). In addition, four (4) items reviewed in the suspense account are currently outstanding (not cleared, refunded or otherwise disposed of) for between 98 and 975 days. Furthermore, we created an aging report of items in the suspense account and noted an additional three outstanding items between 1,478 and 5,702 days.

The Revenue and Taxation Code requires the TTC to pay interest on certain types of refunds that are not returned to the taxpayer within a certain number of days.

In response to an observation in a prior audit report issued February 18, 2003, TTC created reports in the Assessment Tax System (ATS) that show an aging of all items in the suspense account. However, the report is no longer being utilized as a tool to review items in the suspense account.

Recommendation No. 1

We recommend the TTC perform regular supervisory reviews of the suspense account to ensure suspense account items are resolved within a reasonable timeframe.

Treasurer-Tax Collector Management Response:

Concur. Management has reinstituted its policy requiring a supervisory review of items posted to the suspense account. The supervisor will review the Assessment Tax System (ATS) suspense account report every two weeks. In addition accounting staff will review outstanding items in the suspense account on a weekly basis and provide an update to the supervisor on long outstanding items.

Many payments received from taxpayers cannot be applied against outstanding bills without research. Interest is due on amounts overpaid 60 days from the date the full amount of the tax has been paid. As such, interest payments only apply to overpayments on paid bills. Partial payments do not earn interest. When the TTC receives a partial payment, we attempt to contact taxpayers by letter and often we cannot



take action until taxpayers respond. In addition we receive many payments on bills for taxpayers in bankruptcy and cannot apply those payments until a tax bill is fully paid. Bankruptcies are often ongoing for an extensive period of time which can delay the final application of payments required to fully pay a tax bill.

PENALTY CANCELLATIONS

In certain circumstances, the TTC may cancel delinquency penalties and related fees in accordance with the Revenue and Taxation Code.

Observation No. 2 – Monitoring of Penalty Cancellations (Control Finding)

To help ensure penalty cancellations are processed appropriately, the TTC implemented periodic spot checks. The Redemption Supervisor selects a sample of processed cancellations from the back-up documentation and compares them to information in the ATS.

While this procedure would help ensure penalties are canceled accurately, it would not detect undocumented, unauthorized penalty cancellations. In response to an observation in a prior audit report issued February 18, 2003, TTC created a report in ATS that shows all processed penalty cancellations and that report was used by the Redemption Supervisor to spot check processed penalty cancellations. However, the report is no longer being utilized to conduct the spot checks.

Recommendation No. 2

We recommend TTC strengthen controls over penalty cancellations by ensuring processed penalty cancellations are spot checked using an ATS report showing all processed penalty cancellations.

Treasurer-Tax Collector Management Response:

Concur. The supervisor will monitor monthly penalty cancellations processed by printing a list from ATS and selecting a random sample to review. The review will be documented and maintained by the supervisor.

INSTALLMENT PLAN (FIVE-YEAR POSTPONEMENT PLAN)

A taxpayer with property on the Delinquent Roll may elect to pay the redemption amount in five (5) installments or less, as allowed by Part 7, Chapter 3 of the Revenue and Taxation Code. The first installment payment must equal at least 20% of the amount due. The TTC requires taxpayers under installment plans to sign an acknowledgement of the installment plan, referred to as a "Taxpayer Information Regarding Installment Plan" agreement sheet. Section 4217 of the Revenue and Taxation Code states that, "any person may elect to pay delinquent taxes in installments under this article at any time prior to 5 p.m. on the last business day prior to the day when the Tax Collector obtains the power to sell property."



Observation No. 3 – Retention of Taxpayer Installment Plan Agreement Sheets (Control Finding)

We reviewed 15 installment plan accounts and noted that four (4) accounts did not have on file a signed taxpayer installment plan agreement sheet ("Taxpayer Information Regarding Installment Plan"). According to TTC staff, the agreement sheets were obtained; however, for an unknown reason, they were not retained.

Recommendation No. 3

We recommend the TTC ensure all documents related to installment plans, including "Taxpayer Information Regarding Installment Plan" agreement sheets are retained.

Treasurer-Tax Collector Management Response:

Concur. We currently image the completed installment plan agreement forms and destroy the original documents. To avoid clerical errors we have instituted a procedure to check and verify indexing before imaging, and verify the retrieval of the information after imaging and before destroying the originals.

Observation No. 4 – Time to Redeem (Control Finding)

TTC sends a "Notice of Impending Tax Collector's Power to Sell" form to taxpayers who have defaulted under their Installment Plan.

The notice says the right to redeem the property will "terminate at the close of business (4:45 p.m.) on the last business day prior to the date the tax sale begins." However, the Revenue and Taxation Code requires the right of redemption to terminate at 5:00 p.m.

Recommendation No. 4

We recommend the TTC revise the "Notice of Impending Tax Collector's Power to Sell" form to indicate the right of redemption will terminate at 5:00 p.m. on the last business day prior to the date the tax sale begins.

Treasurer-Tax Collector Management Response:

Concur. We have made changes to the "Notice of Impending Tax Collector's Power to Sell" letter that the right to redeem property will terminate at the close of business (5:00 p.m.) on the last business day prior to the date the tax sale begins. This change has been implemented on our correspondence and also on the auction information available to the public on our website.

ACCOUNT RECONCILIATIONS

TTC staff perform account reconciliations between tax redemption financial records and the Auditor-Controller's general ledger twice a month. Reconciliations are a significant control designed to detect errors and irregularities. Reconciliations should be performed by a person without duties related to transaction processing.



Also, reconciliations should be reviewed by a supervisor timely to ensure the reconciliations are performed timely, completely, and accurately, and to ensure appropriate action is taken to research and resolve reconciling items.

Observation No. 5 – Segregation of Duties (Control Finding)

Staff in TTC Accounting prepare and review account reconciliations related to redemption. We noted the person primarily responsible for processing redemption transactions also researches and resolves reconciling items noted on the reconciliations.

Recommendation No. 5

We recommend the TTC segregate duties to ensure the person primarily responsible for processing redemption transactions does not also have reconciliation duties.

Treasurer-Tax Collector Management Response:

Concur. Management has reviewed and revised the duties of Redemption staff to ensure the person primarily responsible for processing redemption transactions does not also have reconciliation duties.

Observation No. 6 – Timely Review of Reconciliations (Control Finding)

We reviewed eight (8) reconciliations of redemption accounts and noted two (2) were reviewed by a supervisor more than 70 days after the reconciliations were prepared.

Recommendation No. 6

We recommend the TTC ensure account reconciliations are reviewed by a supervisor in a timely manner.

Treasurer-Tax Collector Management Response:

Concur. The policy of the TTC is to review all reconciliations on a timely basis. Management has emphasized the importance of completing the review of reconciliations in a timely manner. Since these occurrences, reconciliations of the redemption accounts continue to be reviewed in a timely manner; i.e., within 30 days or less.

ACCOUNTING STATEMENTS BY TTC TO AUDITOR-CONTROLLER

The Revenue and Taxation Code, Section 4108, Part 7, Chapter 3, requires the TTC to account to the Auditor-Controller once every twelve months for monies collected during the preceeding month.

Observation No. 7 – Accounting Statements by TTC to Auditor-Controller (Control Finding)

TTC prepares "Secured Redemption Collection Reports" and "Supplemental Redemption Collection Reports" annually to account to the Auditor-Controller in compliance with the Revenue and Taxation



Code. The "Supplemental Redemption Collection Report" for FY 07/08 was submitted to the Auditor-Controller in September 2008, more than 14 months after the same report was submitted for FY 06/07.

Recommendation No. 7

We recommend the TTC ensure its "Secured and Supplemental Redemption Collection Reports" are submitted to the Auditor-Controller at least once every twelve months.

Treasurer-Tax Collector Management Response:

Concur. To ensure that both of these reports are submitted to the Auditor-Controller in a timely manner, going forward, the TTC will develop and monitor a log to track when these reports are due and when they've been submitted to the Auditor-Controller.



ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit observations and recommendations, we will classify audit report items into three distinct categories:

Material Weaknesses:

Audit findings or a combination of Significant Issues that can result in financial liability and exposure to a department/agency and to the County as a whole. Management is expected to address "Material Weaknesses" brought to their attention immediately.

> Significant Issues:

Audit findings or a combination of Control Findings that represent a significant deficiency in the design or operation of processes or internal controls. Significant Issues do not present a material exposure throughout the County. They generally will require prompt corrective actions.

Control Findings:

Audit findings concerning <u>internal controls</u>, <u>compliance issues</u>, or <u>efficiency/effectiveness issues</u> that require management's corrective action to implement or enhance processes and internal controls. Control Findings are expected to be addressed within our follow-up process of six months, but no later than twelve months.



ATTACHMENT B: Treasurer-Tax Collector Management Responses

	OFFICE OF THE TREASURER-TAX COLLECTOR	CHRISS W. STREET TREASURER-TAX COLL&CFOR
	HALL OF FINANCE & RECORDS 11 CIVIC CENTER PLAZA, G58 POST OFFICE BOX 1438 SANTA ANA, CA 92702 www.ttc.ocgov.com	PAUL C, GORMAN, C.P.A., CTP CHILL ASSISTANT TREASTREETAN COLLEC JENNIFER BURKHART, CFA ASSISTAT TREASTREETAN COLLECTOR ROBIN RUSSELL ASSISTANT TREASTREETAN COLLECTOR (DBI/SQT&PLP)
	April 15, 2009	
Dire Cour 12 C	Peter Hughes, CPA etor, Internal Audit ity of Orange ivic Center Plaza, Room 232 A Ana, CA 92701	
Dear	Dr Hughes:	
prepa Offic	ant to Audit Oversight Committee Administrative Procedure Norred our response to the draft results of your Management Letter on Ta er Records and Accounts for the three year period ended June 30 nmendation numbers used in your report reference our response.	x Redemption
We r	mmendation No. 1 ecommend the TTC perform regular supervisory reviews of the susper e suspense account items are resolved within a reasonable timeframe.	se account to
	surer-Tax Collector Management Response:	
poste (ATS outst	ur. Management has reinstituted its policy requiring a supervisory revi d to the suspense account. The supervisor will review the Assessment) suspense account report every two weeks. In addition accounting sta anding items in the suspense account on a weekly basis and provide an visor on long outstanding items.	Tax System ff will review
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ATTACHMENT B: Treasurer-Tax Collector Management Responses (continued)

Page 2 of 3 Dr. Peter Hughes, CPA
Management Letter Response
April 15, 2009
Recommendation No. 2
We recommend TTC strengthen controls over penalty cancellations by ensuring
processed penalty cancellations are spot checked using an ATS report showing all
processed penalty cancellations.
Treasurer-Tax Collector Management Response:
Concur. The supervisor will monitor monthly penalty cancellations processed by printing
a list from ATS and selecting a random sample to review. The review will be documented
and maintained by the supervisor.
Recommendation No. 3
We recommend the TTC ensure all documents related to installment plans, including "Taxpayer Information Regarding Installment Plan" agreement sheets are retained.
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Treasurer-Tax Collector Management Response:
Concur. We currently image the completed installment plan agreement forms and destroy the original documents. To avoid clerical errors we have instituted a procedure to check
and verify indexing before imaging, and verify the retrieval of the information after
imaging and before destroying the originals.
Recommendation No. 4
We recommend the TTC revise the "Notice of Impending Tax Collector's Power to Sell"
form to indicate the right of redemption will terminate at 5:00 p.m. on the last business
day prior to the date the tax sale begins.
Treasurer-Tax Collector Management Response:
Concur. We have made changes to the "Notice of Impending Tax Collector's Power to
Sell" letter that the right to redeem property will terminate at the close of business (5:00
p.m.) on the last business day prior to the date the tax sale begins. This change has been implemented on our correspondence and also on the auction information available to the
public on our website.
Recommendation No. 5
We recommend the TTC segregate duties to ensure the person primarily responsible for
processing redemption transactions does not also have reconciliation duties.
Treasurer-Tax Collector Management Response:
Concur. Management has reviewed and revised the duties of Redemption staff to ensure
the person primarily responsible for processing redemption transactions does not also
have reconciliation duties.
Page 2 of 3



ATTACHMENT B: Treasurer-Tax Collector Management Responses (continued)

Page 3 of 3 Dr. Peter Hughes, CPA Management Letter Response April 15, 2009
Recommendation No. 6 We recommend the TTC ensure account reconciliations are reviewed by a supervisor in a timely manner.
Treasurer-Tax Collector Management Response: Concur. The policy of the TTC is to review all reconciliations on a timely basis. Management has emphasized the importance of completing the review of reconciliations in a timely manner. Since these occurrences, reconciliations of the redemption accounts continue to be reviewed in a timely manner; i.e., within 30 days or less.
Recommendation No. 7 We recommend the TTC ensure its "Secured and Supplemental Redemption Collection Reports" are submitted to the Auditor-Controller at least once every twelve months.
Treasurer-Tax Collector Management Response: Concur. To ensure that both of these reports are submitted to the Auditor-Controller in a timely manner, going forward, the TTC will develop and monitor a log to track when these reports are due and when they've been submitted to the Auditor-Controller.
If you have additional questions or follow-up comments; please contact me at 834-2288.
Very truly yours,
Paul C. Sorman
Paul C. Gorman Chief Assistant Treasurer-Tax Collector
Page 3 of 3