



TAX REDEMPTION OFFICER

Audit of Tax Redemption Officer
Records and Accounts

*For the Fiscal Years Ended
June 30, 2010, 2011 and 2012*

April 22, 2015



INTERNAL AUDIT DIVISION

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OBJECTIVES, BACKGROUND AND SCOPE

OBJECTIVES

The Internal Audit Division of the Auditor's Office conducted an audit of the Tax Collector's Redemption process pursuant to Section 4108.5 of the California Revenue and Taxation Code (R&T Code). Our audit was made 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 conformance with the *International Standards for the Professional Practice of Internal Auditing* promulgated 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 redemption collections records and accounts, penalty and interest calculations, and account reconciliations.

BACKGROUND

This information is intended to provide a general overview of the property tax process in Santa Barbara County. Included is a broad description of the functions of various County departments from the generation of the property taxes through the establishment and distribution of the redemption roll.

Assessor (Property Valuation)

The Assessor discovers, describes, values and assesses property. The assessed valuation becomes a component of the property owner's property tax bill. A major category of taxable property is real property. Real property includes both secured taxes and secured supplemental taxes.

- **Secured:** Taxes secured by a lien on real property (i.e. land, homes, structures).
- **Secured Supplemental:** Secured property that has undergone a change in ownership or new construction.

The Assessor prepares the assessment rolls which are lists of assessed values of taxable properties. When the annual assessment rolls are completed by the Assessor, they are delivered to the Auditor.

Auditor (Calculation of Tax Amounts)

The Auditor sets the annual tax rates applicable to properties in Santa Barbara County. When the annual secured assessment rolls are received by the Auditor, the Auditor "extends" the assessment roll by applying the tax rate applicable to each parcel or account. Once the extended taxes are determined for all assessments, the tax roll is forwarded to the Tax Collector for billing.

OBJECTIVES, BACKGROUND AND SCOPE

Tax Collector (Billing and Collections)

Annual tax bills, which can be paid in two installments, are mailed each year by November 1st. The first installment of taxes is due November 1st and becomes delinquent after December 10th. The second installment is due February 1st of the following year and is delinquent after April 10th. Taxpayers incur penalties associated with late tax payments made after the delinquent dates. A 10% penalty and \$30 cost (on delinquent second installments) for delinquency are incurred if taxes are paid after December 10th and April 10th. Tax bills that have not been paid by June 30th are transferred to the Tax Collector's redemption roll, where unpaid taxes incur a \$25 redemption fee and accrue 1.5% interest per month.

The Tax Collector is also responsible for property tax collections. As property tax payments are received, they are transmitted to the Auditor for apportionment.

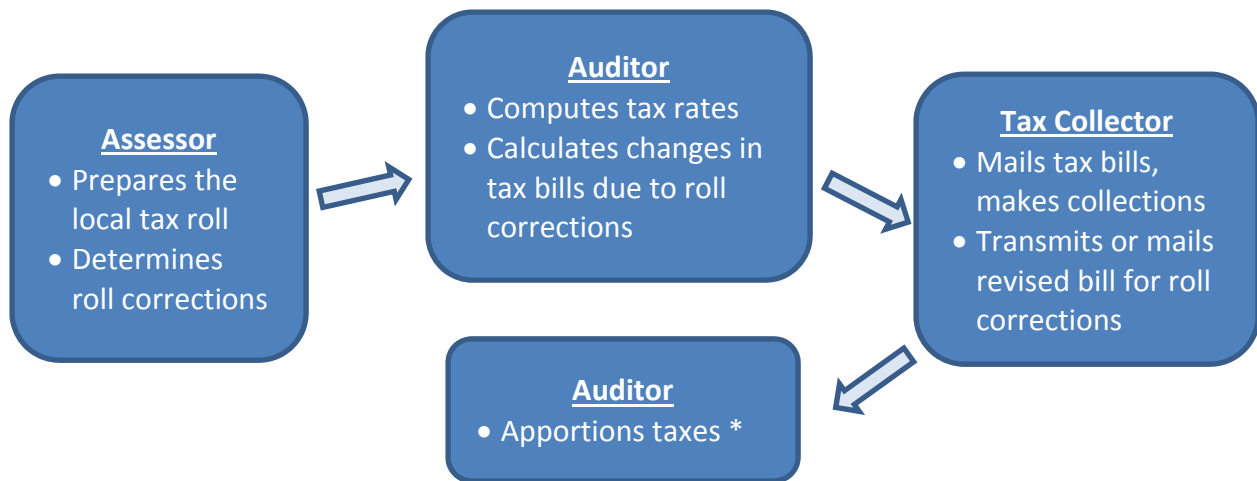
Auditor (Apportionment and Teeter Process)

Collected taxes are apportioned and distributed to all eligible County, cities, schools and special district jurisdictions according to specific formulas and procedures provided by law.

Entities have the option for taxes to be distributed under the Teeter Plan. The Teeter Plan provides taxing entities a predictable revenue stream by allowing the County to advance uncollected property taxes on tax defaulted properties to participating taxing entities. All unpaid taxes that have been advanced through the Teeter Plan are owned by the County and subject to the County's collection efforts. Interest collections from redemption payments reimburse the County for this financing arrangement.

Overview of Department Responsibilities

The flowchart below depicts, in general, the responsibilities of each department for the property tax process:



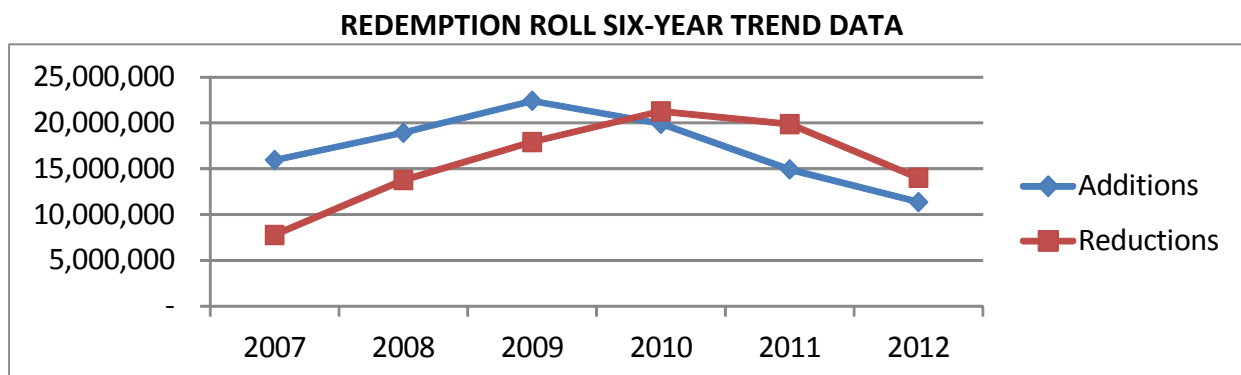
*Note that taxes apportioned to Teeter entities are based on amounts levied, not collected.

OBJECTIVES, BACKGROUND AND SCOPE

The following statement and trend chart detail the additions and reductions recorded to the redemption roll for the fiscal years ended June 30, 2010, 2011 and 2012:

| TAX REDEMPTION FINANCIAL STATEMENT | | | |
|---|-----------------------|-----------------------|-----------------------|
| | 2010 | 2011 | 2012 |
| BEGINNING BALANCE | \$ 29,707,661 | \$ 28,341,299 | \$ 23,374,826 |
| ADDITIONS | | | |
| Delinquent taxes added | 15,592,951 | 10,948,471 | 8,270,282 |
| Delinquent penalties (10%) | 1,559,139 | 1,094,655 | 826,649 |
| Delinquent costs (\$30) | 109,650 | 88,960 | 66,230 |
| Redemption fee (\$25) | 65,890 | 59,480 | 46,315 |
| Redemption penalty (1.5% per month) | 2,375,338 | 2,458,998 | 1,951,192 |
| Payment plan interest | 43,581 | 53,352 | 63,451 |
| Payment refunds | 86,405 | 187,713 | 38,539 |
| Bad checks | 61,882 | 16,469 | 88,185 |
| TOTAL ADDITIONS | 19,894,836 | 14,908,098 | 11,350,843 |
| REDUCTIONS | | | |
| Redemption payments | 21,108,277 | 19,390,817 | 13,220,549 |
| Change in assessed value | 29,822 | 335,803 | 406,914 |
| Manual deletions | 123,099 | 147,951 | 380,884 |
| TOTAL REDUCTIONS | 21,261,198 | 19,874,571 | 14,008,347 |
| ENDING BALANCE* | \$ 28,341,299 | \$ 23,374,826 | \$ 20,717,322 |
| Total Secured Tax Due | \$ 649,532,347 | \$ 655,635,036 | \$ 663,045,069 |
| Redemption Balance as % of Tax | 4.36% | 3.57% | 3.12% |

* The above Statement is on the cash basis of accounting and does not include \$3,886,517 of redemption fees, penalties, and payment plan interest earned at June 30, 2012, but not yet received.



The data presented above illustrates the impact of the economic recession and recovery on the County's redemption roll.

OBJECTIVES, BACKGROUND AND SCOPE

At fiscal year ended June 30, 2006, the total amount of taxes, penalties and fees on the redemption roll amounted to approximately \$12 million. As the economy began to decline in 2007, and unemployment rose, the percentage of property tax delinquencies increased. In 2007, foreclosures in Santa Maria were nearly four times higher than any time in the past twenty years. Taxes, penalties and fees on the redemption roll grew by approximately 67% during fiscal year 2007 and amounted to approximately \$20 million at the end of fiscal year.

During fiscal year 2008, the rate of additions and reductions to the redemption roll rose by approximately 16% and 85%, respectively. According to the UCSB Economic Forecast Project, in 2008, foreclosures peaked for Santa Maria and Goleta, amounting to 1,101 and 49, respectively. Increases and decreases on the redemption roll during fiscal year 2008 are attributed to the continued decline in the economy and increase in mortgage companies redeeming foreclosed properties. Santa Barbara foreclosures peaked in 2009 with 155 foreclosures. At June 30, 2009 the redemption roll amounted to approximately \$30 million.

As the economy began to improve in 2010, and ownership of properties with delinquent tax bills transferred to mortgage companies or new individual property owners, additions to the redemption roll due to new delinquencies began to decline while reductions to the redemption roll due to redemption payments reached their peak. Additions and reductions to the redemption roll continued to decline through 2011 and 2012 as economic conditions gradually improved, with reductions due to redemption payments exceeding additions due to new delinquencies. At fiscal year end June 30, 2012, the total amount of taxes, penalties and fees on the redemption roll amounted to approximately \$21 million. The redemption roll balance as a percentage of total secured tax due for each year also declined from 2010 to 2012.

SCOPE

Part 7, Chapter 1, Section 4108.5 of the R&T Code requires an audit be performed 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 Tax Collector for the three year period ended June 30, 2012. Our methodology included inquiry, auditor observation, testing the records and accounts of redemption collections, and reviewing compliance with laws and regulations for redemption activities.

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

Based on our audit, the records and accounts of the Tax Redemption Officer appear to be fairly stated, in all material respects, and in compliance with R&T Code Sections 4101 through 4379. However, our audit disclosed that certain actions and improvements were needed in the tax redemption process. Summarized below are details of the areas where improvements were needed. We have identified each area by risk, as described in Appendix A.

POLICIES AND PROCEDURES:

Policies and procedures help ensure that necessary actions are taken to address risks that may hinder the achievement of an entity's objectives. Policies and procedures should be reasonably designed to provide that:

1. Duties are adequately segregated to prevent fraud and errors.
2. Unauthorized system modifications do not occur.
3. Information is communicated effectively and timely to reduce the risk of errors and to promote operational efficiency.

Observation No. 1 - Segregation of Duties (High Risk) (Repeat Finding)

Segregation of duties, the process of disseminating the tasks and associated privileges for a specific business process among multiple users, is one of the key concepts of internal control. In a perfect system, no one person should handle more than one of the four types of functions: authorization, custody, record keeping, and reconciliation. We noted members of the Auditor's Office handle all four types of functions, including:

- The ability to authorize property tax refunds.
- Custody of refund checks.
- Access to modify taxpayer addresses before processing refunds.
- Recording transactions to the general ledger and property tax systems.
- Reconciling cash to the general ledger and property tax systems.

We also noted members of the Tax Collector's Office that process refunds also have custody of the refund checks before the checks are mailed.

Without adequate segregation of duties or mitigating controls, the opportunity exists to perpetrate and conceal fraudulent activity.

Recommendation

Procedures should be designed to ensure that the authorization, custody, record keeping, and reconciliation duties are separated, whenever possible. If duties cannot be separated, compensating controls, such as prudent supervisory review, should be employed.

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

Views of Responsible Officials

Tax Collector: *Partially agree. FIN WEB was implemented in September 2009. Tax Collector management now reviews and authorizes all warrant requests. Tax Collector Management is actively involved in minimizing the tax monies (including redemption) introduced into trust funds, and the majority of insufficient checks are returned instead of being placed into trust. New refund processing procedures are currently being developed in conjunction with the installation of the new Aumentum property tax system.*

Auditor: *Partially agree. Our office does employ many compensating controls over areas identified in the audit and are always looking for control enhancement and improvement. Staff does not have rights to post any FIN transactions. In addition, management does not have the right to post any UPL entries (these include most apportionment transactions and all MVC disbursements for refunds) to FIN. All FIN transactions must be reviewed and approved by the manager and must include attached documentation supporting the transaction. Also reconciliations of FIN balances and transactions have secondary and/or management review.*

In addition, all roll corrections transactions exceeding certain dollar thresholds require manager review and approval. All roll correction transactions in the Roll Correction Database application require supporting documentation attached to the record. Additionally, we recently enhanced the Roll Correction Database application so the original name and address provided from the Assessor is always maintained in the system and any change to a name or address and the reason why is required to be documented and approved by a second person.

Furthermore, we no longer take custody of those few warrants that cannot be automatically mailed through the accounts payable process as they require supplemental information to be included in the mailing. Rather, the additional information is provided to front administrative staff along with instructions for them to be included with the warrant for mailing. Warrants returned as undeliverable are recorded in a database by individuals not processing refunds and are researched for better addresses when received and periodically thereafter as time permits. We are currently exploring the possibility of administrative staff maintaining custody of the returned warrants while we are researching them.

Finally, we are currently in the process of implementing the new Aumentum property tax accounting system which should also enhance our control environment.

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

Observation No. 2 - Roll Corrections and Modifications (Medium Risk) (Repeat Finding)

Roll corrections are various adjustments and corrections made to the rolls based on new information or the discovery of errors. Roll corrections must be processed through all offices involved in the tax process. During the audit, we noted six instances out of a sample of 25 roll corrections where it took more than six months from the date the Auditor received the Tax Roll Change Form from the Assessor to the date the Auditor requested the Tax Collector to make the correction in the tax redemption system. We further noted that there continues to be no formal interdepartmental procedure for processing roll corrections. Without a formal procedure, roll corrections may not be processed accurately and efficiently by all departments.

Recommendation

We recommend that management develop a formal interdepartmental policy and procedure to communicate and process roll corrections. The procedure should consider incorporating efficiencies throughout all departments involved. Furthermore, a process should be implemented where assessed property values are reconciled to billed property values to ensure that all required changes are processed.

Views of Responsible Officials

Tax Collector: *Agree. The example in the above recommendation notes a delay in the Auditor processing the Assessor's Tax Roll Change Form. The recent upgrade of the Auditor's and Tax Collector's property tax system provides an opportunity to explore, define, and execute process improvements in that area.*

Auditor: *Agree. One of the most important aspects to ensure all roll corrections are processed correctly and timely is to receive all correction data in electronic format rather than some on paper forms. The Assessor has been working with our department to develop an electronic interface between their systems and our new Aumentum system as a means to pass all related assessment transactions to us. As we finalize the process design we will document these procedures and will work with our tax administration partners to formalize an interdepartmental policy. As to the delays in processing those roll corrections noted in the audit, these were complicated commercial property corrections requiring the coordination of information from multiple parties including the Assessor, the lessee, lessor, property manager, mortgage company and property owner.*

Assessor: *Agree. The Assessor does have roll correction procedures on processing roll corrections and escapes. The procedures include how to submit a correction to the Auditor-Controller and Tax Collector and general concepts on how the correction is processed by the Auditor. In developing our procedures, we worked with both departments to determine the best way of providing the required information they needed in order for them to process the changes.*

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

With the new Property Tax System (Aumentum), we understand the importance of revising our procedures and working with the other departments on a formal interdepartmental policy to provide better efficiencies and communication.

Observation No. 3 - Undelivered Refunds (Medium Risk) (Repeat Finding)

The Auditor's Office is responsible for issuing refunds to taxpayers whose properties have been devalued by the Assessor. There are three situations that result in amounts outstanding:

- A taxpayer is notified that a claim for funds should be made, but a claim is not made by the taxpayer.
- A warrant (check) is sent to the taxpayer, but not cashed.
- A warrant (check) is returned to the County and the payee cannot be located.

As of March 31, 2014, there was approximately \$2.45 million in unpaid refunds outstanding in the tax rebate funds for the period 2008 through 2014. We selected all outstanding refunds over \$100,000 and identified four of seven refunds that had been outstanding for longer than one year.

The Auditor's Office tracks outstanding refunds, but there is no formal process for researching and resolving large unclaimed or undelivered refunds. Lack of a formal process may increase the likelihood that refunds due to taxpayers are not claimed or delivered. In addition, there continues to be no formal process to escheat undelivered refunds. Lack of a formal process for escheating undeliverable refunds may result in an increased risk of misappropriation.

Recommendation

We recommend that the Auditor establish a formal monthly process for researching and resolving unclaimed and undelivered refunds over a certain threshold. Further, we recommend that the Auditor establish a formal annual process for escheatment of undeliverable refunds.

Views of Responsible Officials

Auditor: *Partially agree. We agree there is no formal process in place to resolve unclaimed and uncashed warrants. Due to the implementation of the new Aumentum property tax system, the operations unit does not have excess resources to focus on resolving the older outstanding items while concurrently implementing the new system. Consequently, the Auditor's Office has established a team, to resolve the outstanding refunds (including the last two items above) as well as to provide input in the development of new processes. In addition, as technical resources become available from the Aumentum project a rewrite of the Roll Correction Database is planned in order*

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

to increase controls and to provide the reconciliation and aging functionality necessary to better manage and escheat (when necessary) stale unclaimed and uncashed refunds. To accomplish this will require the continued commitment of resources and technology dedicated to the Property Tax Systems Operations.

It should be noted that four “refunds” above are really the aggregate of multiple refund transactions spanning multiple years and multiple parcels and in some case multiple parties. One item in particular has been a long standing complicated problem between the Taxpayers and the Assessor regarding overlapping escapes and refunds over several tax years related to multiple parcels of a shopping center. We are waiting to process updated supplemental corrections before we can process the subsequent tax year corrections noted in the audit. While the Assessor processed these supplemental corrections on their side, these corrections have not yet been processed in Aumentum as all supplemental transactions have been delayed as part of its implementation. Processing the refund component before the resolution of the related escapes issues and out of sequence with the pending supplemental transactions would be premature.

SYSTEM DESIGN:

Under California R&T Code Section 4110, the Tax Collector, is required to maintain systems that index tax-defaulted property. These records should be kept regularly to reflect the status of all properties on the redemption roll.

Systems should reliably process information to ensure compliance with applicable laws and regulations and allow staff to readily obtain pertinent information. Specifically, the tax redemption system should be designed in such a way to ensure that:

1. The balance of taxes owed on redemption properties is accurate.
2. Charges of penalties and interest are made in accordance with law.

We found system errors and noted that programming of certain data was sometimes unreliable. Specifically we noted the following issues during the audit:

Observation No. 4 - Redemption Reporting (Medium Risk) (Repeat Finding)

On the mainframe system, the Tax Collector could not generate a report listing properties on the redemption roll that includes totals. Only a summary report with a total balance of taxes due, without individual property details, could be generated from the mainframe system. In addition, we identified errors in the tax redemption summary reports produced by the mainframe system whereby the transactions listed in the reports do not sum to the totals on the report. Further, we identified errors in the mainframe programming whereby the beginning of year redemption balance plus all mainframe transactions for the year did not equal the end of year mainframe balance for 2010, 2011 and 2012. The variances ranged from -\$6,000 to +\$7,000.

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

Recommendation

We recommend that the Tax Collector build a report that shows a list of properties delinquent at June 30. We further recommend that the Tax Collector identify and correct errors in any tax redemption reports and programming.

Views of Responsible Officials

Tax Collector: *Agree. The Tax Collector and the Auditor are engaged in a multi-year process to install a new tax system purchased from Thomson Reuters (Aumentum) to replace our mainframe tax system with modules averaging thirty years old. Several years ago the departments made a determination to make no further modifications to our mainframe system and devote all of our limited resources to the new system as we have been advised by IT that any modification of our aged mainframe could result in a catastrophic failure. Completion of the Aumentum installation will result in a new tax billing and collection system with many enhanced processes. The recommended report that shows a list of properties delinquent at June 30 is one of the new reports under development.*

Observation No. 5 – Manual Processing (Low Risk) (Repeat Finding)

We noted areas where the system utilized during the audit period required manual adjustments to process redemption transactions:

- Taxes, penalties, etc. must be added back to the roll manually when checks are returned for non-sufficient funds.
- Under certain circumstances, such as a taxpayer bankruptcy, the Tax Collector must manually add defaulted taxes to the redemption roll.
- When a taxpayer initiates an installment plan, the Tax Collector performs a manual calculation of the installment payment amounts.
- When a tax roll change is processed by the Auditor, the Auditor performs a manual calculation of the amount to be refunded or due.
- To record a cancellation of delinquent charges resulting from a roll correction as a cancellation in the system, the entire tax record must be deleted and rebuilt.

Recommendation

Manual processes are generally inefficient and increase the risk of error. Wherever possible, the system should be designed to minimize manual entries.

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

Although, individually, Observation 4 (Redemption Reporting) and Observation 5 (Manual Processing) are considered low risk, the combined risk of these items, with a lack of segregated duties communicated in Observation 1, result in an overall medium risk.

Views of Responsible Officials

Tax Collector: *Agree. Yes, the prior installment plan form provided an informational forecast of the projected required installment payments. However, the actual installment plan and required payments had been calculated by the mainframe. The new form does not contain a manually calculated projection of installment payments. The Tax Collector welcomes more modern processes to replace the 30 year old mainframe tax system that has many manual processes. The Auditor and Tax Collector Offices have been exploring the best system options for many years, and selected the Aumentum tax system in 2010. The manual processing of certain tasks, including those redemption roll deficiencies noted in Observation No.7, are inefficient. We believe that the Aumentum system should alleviate many of the current system inefficiencies. The Tax Collector believes the necessary flexibility to eliminate the current manual processing issues mentioned will exist in the Aumentum tax system.*

Auditor: *Agree. The mainframe system used during the period under audit was never designed or programed to perform all the complicated calculations necessary to correct all redemption bills. Those requiring calculation are done outside of the Redemption system using another application, the Roll Correction Database, that automates to the extent possible these calculations and the refunding process. While this is an inefficient process there is no viable alternative and we are looking towards the new Aumentum system to provide enhancements in this area. However, there will always be unique situations that any system will not be able to correctly address which will require continued manual intervention.*

COMPLIANCE:

In order to protect public interest, governmental agencies must act within legal parameters. Part 7 of Division 1 of the R&T Code (commencing with 4110) sets forth the statutory requirements specific to property tax redemption. In the course of our audit, we noted the following statutory requirement that was not met by the County.

Observation No. 6 – Installment Plan Tax Form (Low Risk) (Repeat Finding)

The Tax Collector’s installment plan form did not contain all elements required by R&T Code Section 4106.1. Specifically, the document did not contain a statement that receipts will not be issued for payments made by mail unless a receipt is requested by the person making payment. In addition, the form did not display an appropriate place for the taxpayer to request a receipt.

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

Recommendation

We recommend the Tax Collector revise the installment plan form to include a statement that taxpayers can obtain a receipt of redemption from the Tax Collector's website.

Views of Responsible Officials

Tax Collector: *Agree. The Tax Collector has implemented the suggestion and revised the Installment Plan Form to include a statement that taxpayers may request a receipt.*

Acknowledgment

We appreciate the courtesy extended to us by the Assessor, Auditor, and Tax Collector's offices. If we can be of further assistance, please contact us at 568-2100.

Respectfully Submitted,

A handwritten signature in cursive script that reads "Heather Fletcher".

Heather Fletcher, CPA
Audit Manager

APPENDIX A

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

- **High Risk:**
Audit findings or a combination of “Medium Risk” findings that can result in financial liability and exposure to a department/agency and to the County as a whole.
- **Medium Risk:**
Audit findings or a combination of “Low Risk” findings that represent a significant deficiency in the design or operation of processes or internal controls.
- **Low Risk:**
Audit findings concerning internal controls, compliance issues, or efficiency/effectiveness issues that are intended to assist management in implementing or enhancing processes and internal controls.