

TAX REDEMPTION OFFICER

Audit of Tax Redemption Officer Records and Accounts

For the two year period ending July 1, 2014

October 21, 2016



INTERNAL AUDIT DIVISION
SANTA BARBARA COUNTY AUDITOR-CONTROLLER

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Overview

Objectives

The Internal Audit Division of the Auditor-Controller's Office conducted an audit of the Tax Collector's tax 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. 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 section provides an overview of the property tax process in Santa Barbara County. Included is a broad description of the functions of the three 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 tax bill. A major category of taxable property is real property, which includes land, buildings and structures. Taxes on real property are secured by a lien on the property, and may include supplemental taxes for properties that have undergone a change in ownership or completed 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. 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.

Tax Collector (Billing and Collections)

Annual tax bills 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 for tax payments made after the delinquent dates. A 10% penalty and \$30 cost (on delinquent second installments) 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.

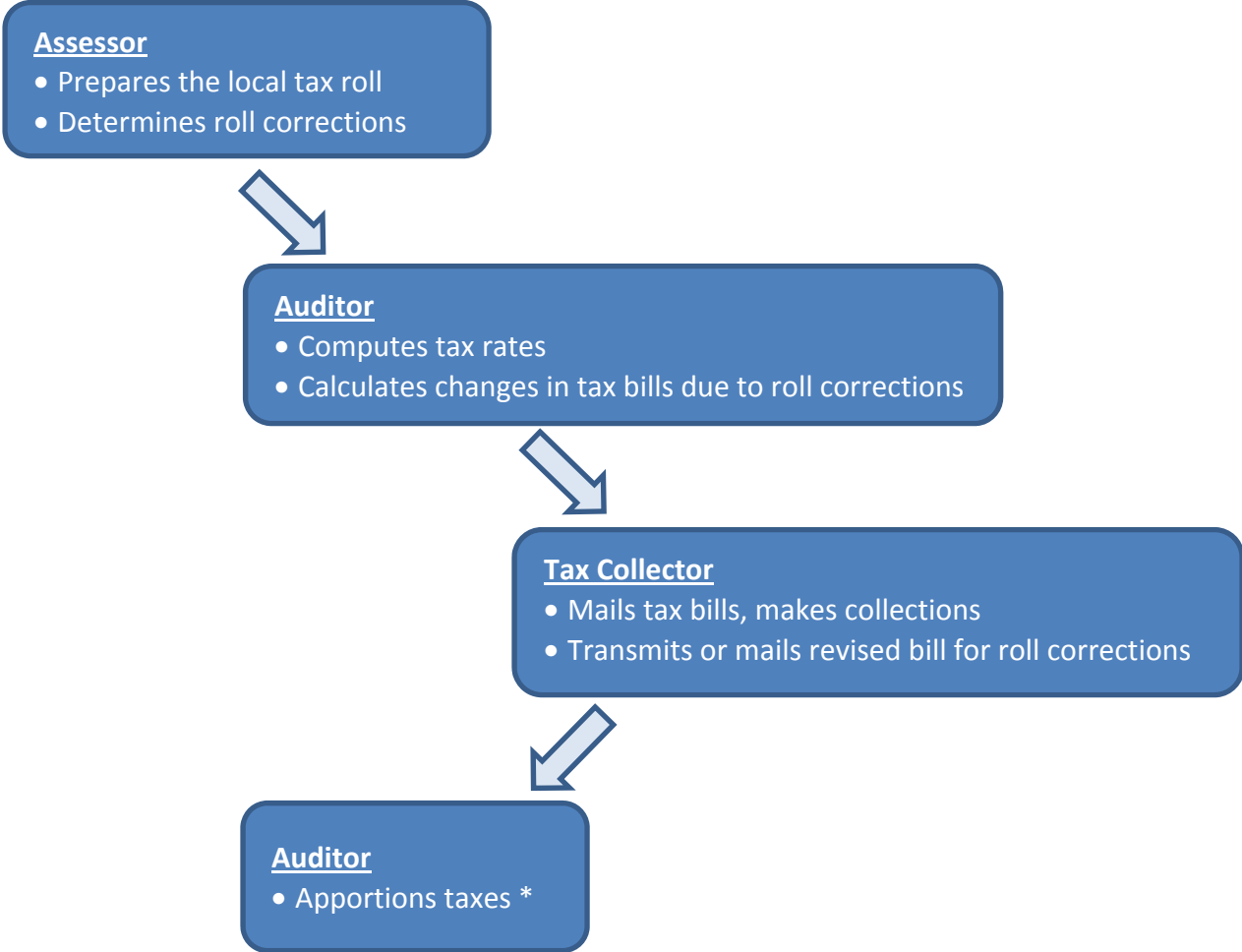
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Auditor (Apportionment and Teeter Process)

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. Currently, only four taxing entities have not elected to participate in the Teeter Plan.

The responsibilities, in general, of each department for the property tax process are as follows:



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

Overview

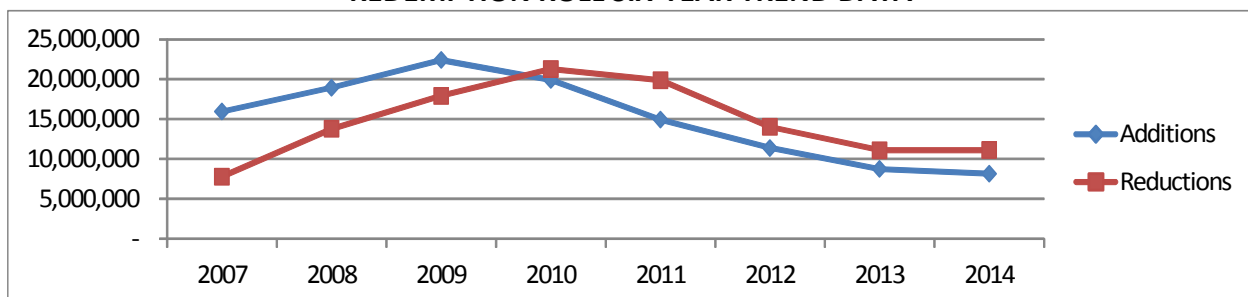
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The following statement and trend chart detail the additions and reductions recorded to the redemption roll as of July 1, 2013 and 2014:

TAX REDEMPTION FINANCIAL STATEMENT		
	7/1/2013	7/1/2014
BEGINNING BALANCE	\$ 20,717,322	\$ 18,358,710
ADDITIONS		
Delinquent taxes added	6,527,018	5,270,116
Delinquent penalties (10%)	652,660	526,976
Delinquent costs (\$30)	55,320	52,280
Redemption fee (\$25)	38,050	31,245
Redemption penalty (1.5% per month)	1,290,920	2,065,143
Payment plan interest	108,324	150,463
Payment refunds	26,823	609
Returned items	16,471	34,516
TOTAL ADDITIONS	<u>8,715,586</u>	<u>8,131,348</u>
REDUCTIONS		
Redemption payments	10,051,575	11,041,296
Change in assessed value	913,636	46,906
Manual deletions	108,987	7,159
TOTAL REDUCTIONS	<u>11,074,198</u>	<u>11,095,361</u>
ENDING BALANCE*	<u>\$ 18,358,710</u>	<u>\$ 15,394,697</u>
Total Secured Tax Due	<u>\$ 677,860,939</u>	<u>\$ 711,233,511</u>
Redemption Balance as % of Tax Due	2.71%	2.16%

* The above Statement is on the cash basis of accounting and does not include \$4,384,518 of redemption fees, penalties, and payment plan interest earned at July 1, 2014, but not yet received. In addition, the Statement does not reflect any corrections made to the redemption roll subsequent to the years presented.

REDEMPTION ROLL SIX-YEAR TREND DATA



Overview

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The trend illustrates the impact of the economic recession and recovery on the redemption roll. 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 were 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 both declined through 2013 as economic conditions gradually improved, and leveled off near pre-recession levels by 2014. As of July 1, 2014, the total amount of taxes, penalties and fees on the redemption roll amounted to approximately \$19.8 million. The redemption roll balance as a percentage of total secured tax due for each year also declined from 2010 (4.36%) to 2014 (2.16%).

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. This audit covers the two-year period ended July 1, 2014. A new property tax system was implemented in fiscal year 2014-15. We did not include this time period in our audit and will perform a separate including that period at a later date. The methodology for our audit included inquiry, auditor observation, testing the records and accounts of redemption collections, and reviewing compliance with laws and regulations for redemption activities.

Observations, Recommendations, and Responses

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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.

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 (*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. During our audit, we 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 refund processing and custody duties are separated, whenever possible. If duties cannot be separated, compensating controls, such as prudent supervisory review, should be employed.

Views of Responsible Officials

Tax Collector: *Partially Agree. Since FIN WEB was implemented in September 2009, Tax Collector management reviews and authorizes all warrant requests. This review provides a prudent supervisory review which mitigates the segregation of duties observation. In addition, beginning May 2015, Corelogic refunds are electronically transferred, no warrants are issued. 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.*

Observations, Recommendations, and Responses

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

Roll corrections are various adjustments and corrections made to the rolls based on new information or the discovery of errors. During the period under audit, roll corrections were processed through all offices involved in the tax process. We identified seven 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 Tax Collector made the correction in the tax redemption system. We further noted that there continues to be no formal interdepartmental procedure for processing roll corrections and mailing associated tax bills. Without a formal procedure, roll corrections may not be processed accurately and efficiently.

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: *Partially Agree. The example in the above recommendation notes a delay in the Auditor processing the Assessor's Tax Roll Change Form. The Tax Collector considers the delayed processing of roll corrections the highest risk to the accuracy of the redemption roll.*

The Auditor is responsible for processing and maintaining roll corrections submitted by the Assessor per Revenue and Taxation Code 4834. Due to the limitation of the old mainframe property tax system the Tax Collector's Fiscal Division was involved in the cancellation of penalties, interest, and cost for certain roll corrections. In the new property tax system the Tax Collector no longer has a direct role in processing roll corrections.

We agree the Auditor and the Assessor need to develop procedures to process roll corrections within a shorter timeframe than the more than six months noted in the observation. Adequate resources should be devoted to executing a plan to fix this critical function.

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*

Observations, Recommendations, and Responses

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design we will document these procedures and will work with our tax administration partners to formalize an interdepartmental policy.

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.*

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 – Written Policies and Procedures

Policies and procedures are an integral part of an entity's planning, implementing, reviewing, and accountability for stewardship of government resources for achieving effective results. During our audit we noted that the Auditor's Office does not have written policies and procedures for the property tax apportionment or the undeliverable rebate escheatment processes. Lack of documented policies and procedures could result in inconsistent practices or processing errors due to lack of knowledge if responsibilities are transitioned to a new or inexperienced employee.

Recommendation

We recommend that the Auditor's Office develop written procedures for the property tax processes, which include procedures for performing calculations and reviewing these calculations.

Views of Responsible Officials

Auditor: *Agree. Development of written policies and procedures will be forthcoming after the new Aumentum system is in a stable production state. The new system may change how current procedures are performed.*

Observation No. 4 – Cancellation of Penalties

California law assumes that property owners know that property is subject to taxation and when taxes are due. Under R&T Code Section 4985 any delinquent penalty, cost, redemption penalty, interest, or redemption fee, due to an error of the Tax Collector, the Auditor, or the Assessor shall, upon satisfactory proof submitted by the Tax Collector, Auditor, or Assessor, be cancelled by the Auditor.

Observations, Recommendations, and Responses

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During our audit, we noted two instances where the mailing address in the system did not entirely match the mailing address provided by the taxpayer for receiving tax statements. The Assessor determined this to be their error and sent a request to the Auditor and the Tax Collector to cancel the late penalties incurred by the taxpayer. The Assessor's request did not include supporting documentation evidencing the error. The late penalties were also canceled by the Tax Collector without evidence of the Auditor's approval. Both transactions were processed in the mainframe system using the "value change" transaction code due to a system limitation.

Recommendation

We recommend that the Tax Collector, Auditor, and Assessor develop formal policies that define what constitutes an error as well as the supporting documentation that adequately evidences each type of error. In addition, the departments should implement a formal approval and routing procedure to ensure all cancellations are made in accordance with R&T Code Section 4985. Penalty cancellations should not be processed as value changes in the new property tax system.

Views of Responsible Officials

Tax Collector: *Agree. This is a repeat finding. The Tax Collector's Office provided a detailed response, describing the existing cancellation process in 2011 as part of the 2007-2009 Redemption Audit. The process has remained essentially the same with some modifications based on meetings with the Auditor and Assessor.*

Revenue and Taxation Code 4985 states that "delinquent penalty...shall upon satisfactory proof submitted by the tax collector, the auditor, or the assessor, be canceled by the auditor." Revenue and Taxation Code 4985.1 allows for the auditor to transfer that function to the tax collector in chartered counties only.

Upon closer review of the Revenue and Taxation Code 4985, it brings into question whether the Tax Collector should cancel the penalties observed under that code section, as the auditor is the only official authorized to perform this function. Limitations within the old mainframe property system may have prevented the Auditor from performing that function. We believe the new property tax system does allow the Auditor to perform penalty cancellations, giving the taxpayer at least 30 days to pay without penalties.

The Tax Collector agrees to work with the Auditor and Assessor to satisfy the requirement for adequate proof and determine how best to process the penalty cancellation.

Auditor: *Agree. The Auditor agrees to work with the Tax Collector and Assessor on formalizing policies and documentation, and on the penalty cancellation process given the new Aumentum system.*

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Assessor: *Agree. The Assessor currently has a process in place to inform the Treasurer Tax Collector and Auditor-Controller to remove Treasurer Tax Collector penalties. The recommendations are based on information in the Assessor's possession. When applicable, the Assessor will provide the back-up documentation in compliance with Revenue & Taxation Code Section 408.*

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. 5 - Redemption Reporting (*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 2013 and 2014. The variances ranged from -\$700 to +\$19,000.

Recommendation

We recommend that the Tax Collector build a report that shows a list of delinquent properties.

Views of Responsible Officials

Tax Collector: *Agree. The mainframe property tax system that was used during the period this audit covers did not have the necessary reporting and analysis tools necessary to resolve this finding. The project to replace the mainframe property tax*

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system took precedent over new development, such as resolving the issues noted in the finding, on the mainframe system. Since going live on the new property tax system, the Tax Collector has built the report in Microsoft Excel format that meets the requirements listed in the recommendation.

Observation No. 6 – Manual Processing (*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 multiple tax years are on redemption and one is being paid through bankruptcy, the Tax Collector must make manual adjustments to apply the bankruptcy payments.
- 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.
- To cancel penalties on specific tax years, the Tax Collector must manually change the original record and separate the tax years onto different redemption records.

Recommendation

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

Views of Responsible Officials

Tax Collector: *Agree. Yes, the items noted in the observation existed in the mainframe property tax system that was used over two years ago. The items listed no longer exist or the specific manual processes noted have significantly changed. The Tax Collector will continue to review our current process and evaluate the need to mitigate identified risks or eliminate the manual process.*

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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 was no viable alternative under the mainframe systems that were terminated two years ago. In addition we already determined that correction processes in the new Aumentum system will provide some enhancements in this area but have also learned it is very inefficient and requires workarounds for many types of correction transactions – some that were actually able to be processed in the old system. Regardless, experience has shown that 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 4101) sets forth the statutory requirements specific to property tax redemption. In the course of our audit, we noted the following requirements that were not met.

Observation No. 7 – Redemption Roll Certification

According to R&T Code Section 4374 the Auditor must certify that the abstract list contains a true and correct statement of all information relating to property on which all or any part of the taxes are unpaid. During our audit, we noted that the June 30, 2014 abstract list was not certified timely and contained clerical errors.

Recommendation

We recommend that the Auditor certify the abstract list within one year of closing the roll. We also recommend that a secondary review of the certification is performed by someone other than the preparer.

Views of Responsible Officials

Auditor: *Agree. The Auditor will certify the abstract list within one year of closing the roll. Additionally, a secondary review of the certification will be performed by someone other than the preparer.*

Acknowledgement

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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