COUNTY OF ORANGE
INTERNAL AUDIT DEPARTMENT

2005 Recipient of the Institute of Internal Auditors Award for Excellence

Integrity • Objectivity • Independence

Office of the Director
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ALAN MARCUM, MBA, CPA, CIA, CFE, AUDIT MANAGER
AUTUMN MCKINNEY, CPA, CIA, CGFM, AUDIT MANAGER

April 28, 2006

TO: Audit Oversight Committee Members

FROM: Peter Hughes, Ph.D., CPA, Director of Internal Audit

SUBJECT: AOC Meeting May 4, 2006, Agenda Item #6
Audit No. 2513, Audit of Tax Redemption Officer Records and Accounts as of June 30, 2005, Issued February 22, 2006

Attached is the subject audit where we have a professional difference of opinion with the Auditee. Specifically, Finding No. 1, Pages 4 and 5. It is brought to your attention for discussion and deliberation with intent to resolve the issue and close the matter.

Background:
The finding (Finding No. 1) stated that the Treasurer-Tax Collector – Tax Redemption Unit did not pay interest owed to taxpayers on replicated payments refunded later than 60 days or overpayments. The Revenue & Taxation (R&T) Code Sections 2780-2782 require the County to issue refunds on replicated payments (payments made on a tax that has already been paid) to taxpayers within 60 days otherwise interest must be paid to taxpayers in accordance with R&T Code Section 5151, if the refunds meet specific criteria.

Internal Audit Department Position:
We recommend (Recommendation No. 1) that the Treasurer-Tax Collector determines those taxpayers who did not receive interest owed to them on untimely refunds prior to April 20, 2005, and calculate and pay interest to ensure that they are in compliance with the Revenue & Taxation Code requirements.

Treasurer Tax Collector Position:
The Treasurer-Tax Collector in their response stated that "For the period July 1, 2001 to April 19, 2005, 2,387 replicated payment redemption refunds were issued, of which 906 took more than 60 days to be refunded. The vast majority, 658 resulted in interest of less than $1 with only 67 refunds for $10 or more. In accordance with the January 1, 2005 amendment to Revenue and Taxation Code Section 2782, interest is not payable on refunds less than $10. We anticipate remitting interest on these 67 refunds by May 31, 2006."

Impasse:
Internal Audit in their Rejoinder to Treasurer-Tax Collector Response stated that the interest owed to taxpayers for replicated payments mentioned in Recommendation #1 includes replicated payments received by the Tax Collector's Office as far back as 2001. The amended Revenue & Tax Code (Section 2782) which established a ten-dollar minimum threshold for interest that should be refunded to taxpayers for replicated payments was not effective until January 1, 2005. The amended Revenue & Tax Code section and the related Senate Bill do not specifically provide for the retroactive application of this minimum interest threshold to replicated payments received in years preceding the establishment of a minimum interest threshold for taxpayer refunds. Thus, to comply with the Revenue & Tax Code (Section 2782), it appears to us that the Treasurer-Tax Collector must pay interest on all replicated payments that were not returned within 60 days, regardless of the amount of interest due.

Internal Audit Department Conclusion:
We appreciate the cost ineffectiveness of paying out remittances for interest incurred for amounts less than $10. Nevertheless, the Government Code does not appear to specifically or explicitly allow for retroactive applications. As such we recommend that the Treasurer Tax Collector obtain a County Counsel opinion in this regard.

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AUDIT OF TAX REDEMPTION OFFICER RECORDS AND ACCOUNTS AS OF JUNE 30, 2005

For the Period
July 1, 2002 through June 30, 2005

AUDIT NUMBER: 2513 **REPORT DATE: February 22, 2006**

Audit Director:	**Peter Hughes, Ph.D., CPA**
Deputy Director:	**Eli Littner, CPA, CIA**
Audit Manager:	**Alan Marcum, MBA, CPA, CIA**
In-Charge Auditor:	**Nancy N. Ishida, CPA, CIA**
Senior Auditor:	**Abdul Khan, CPA**

AUDIT OF TAX REDEMPTION OFFICER RECORDS AND ACCOUNTS

As of June 30, 2005

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Transmittal Letter

Audit No. 2513

February 22, 2006

TO: The Honorable Board of Supervisors

FROM: Peter Hughes, Ph.D., CPA, Director
Internal Audit Department

SUBJECT: Report on Audit of Tax Redemption Officer Records and Accounts

We have completed our audit of the Tax Redemption Officer Records and Accounts for the three year period ending June 30, 2005. The final report is attached along with the Treasurer-Tax Collector's responses to our recommendations, acting in his capacity as the Tax Redemption Officer.

Please note, beginning in January 2005, we implemented a more 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). **In the past, we followed-up on Tax Redemption Officer audit recommendations during the subsequent Tax Redemption Officer audit, three years later.** However, as a matter of policy, our first Follow-Up Audit will now begin no later than six months upon the official release of the report. 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 now begin at 12 months from the release of the original 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 Follow-Up Audit approximately six months from the date of this report, we will need to obtain the completed document to facilitate our review.

The Internal Audit Department is an independent audit function reporting directly to the Orange County Board of Supervisors.

As the Director of Internal Audit, I now submit a monthly audit status report to the Board of Supervisors (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 Internal Audit Department is available to partner with the Treasurer-Tax Collector's Office so 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 to the Treasurer-Tax Collector a Customer Survey of Audit Services for completion. The Treasurer-Tax Collector will receive the survey shortly after the distribution of this report. We appreciate the courtesy and cooperation of the Treasurer-Tax Collector's staff during our review.

Attachment

Other recipients of this report:
Members, Audit Oversight Committee
Thomas G. Mauk, County Executive Officer
John M. W. Moorlach, Treasurer-Tax Collector
Gary Cowan, Assistant Treasurer-Tax Collector
Walter Daniels, Chief Deputy Tax Collector
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors

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INTERNAL AUDITOR'S REPORT

Audit No. 2513

February 22, 2006

TO: The Honorable Board of Supervisors

SUBJECT: Audit of Tax Redemption Officer Records and Accounts

Pursuant to Section 4108.5 of the Revenue and Taxation Code, we have completed an audit of the Treasurer-Tax Collector's Office Redemption Section as of June 30, 2005. The objective of our audit was to evaluate the reliability and integrity of financial and operational tax redemption records and to determine compliance with laws and regulations governing redemption activities. We did not review the property tax apportionment process performed by the Auditor-Controller's Office or the computer information systems used by the Redemption Section.

We conducted our audit in accordance with the Standards for the Professional Practice of Internal Auditing 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

Management of the Treasurer-Tax Collector's Office is responsible for establishing and maintaining a system of internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system of internal control are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and transactions are executed in accordance with management's authorization and properly recorded.

Our audit, made for the purpose described above, would not necessarily disclose all material errors and/or irregularities in redemption collection records and accounts or all material noncompliance with laws and regulations for redemption activities. 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. This audit enhances but does not substitute for the Treasurer-Tax Collector's Office continuing emphasis on control activities and self-assessment of control risks.

The Internal Audit Department is an independent audit function reporting directly to the Orange County Board of Supervisors.

Based on our audit, the records and accounts of redemption collections appear to be reliable and fairly stated. **No material weaknesses were identified.** However, we did identify **two significant issues** and four control findings. Opportunities for management to enhance internal controls are noted in the Findings, Recommendations and Management Responses section of this report. See Attachment A for a description of report item classifications. The findings and recommendations contained in this report were discussed with Treasurer-Tax Collector representatives during audit fieldwork.

We appreciate the courtesy and cooperation extended to us during the audit by the personnel of the Treasurer-Tax Collector's Office. If we can be of further assistance, please contact me or Eli Littner, Deputy Director at (714) 834-5899 or Alan Marcum, Audit Manager, at (714) 834-4119.

Respectfully Submitted,

Peter Hughes, Ph.D., CPA
Director, Internal Audit

Attachment A – Report Item Classifications
Attachment B – Treasurer-Tax Collector Management Response

Distribution Pursuant to Audit Oversight Committee Procedure No. 1
Members, Audit Oversight Committee
Thomas G. Mauk, County Executive Officer
John M. W. Moorlach, Treasurer-Tax Collector
Gary Cowan, Assistant Treasurer-Tax Collector
Walter Daniels, Deputy Tax Collector
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors

EXECUTIVE SUMMARY

OBJECTIVES

The Internal Audit Department conducted an audit of 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.

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 taxes; calculating and collecting interest and penalties on delinquent secured 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 fiscal year 2004-05 was approximately $42.6 million for secured taxes and $4.9 million for supplemental taxes. Tax Redemption refunds totaled approximately $1.6 million. Tax records are maintained on the Assessment Tax System (ATS).

SCOPE

Part 7, Chapter 1, Section 4108.5 of the Revenue and Taxation Code requires an audit 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 as of June 30, 2005. Our audit methodology included inquiry, auditor observation, testing the records and accounts of redemption collections, and reviewing compliance with laws and regulations for redemption activities. Our audit did not include a review of the property tax apportionment process performed by the Auditor-Controller or of information systems used in the redemption process.

CONCLUSION

Based on our audit, the records and accounts of redemption collections appear to be reliable and fairly stated. **No Material Weaknesses were identified.** However, **we identified two Significant Issues**, and four Control Findings, which are noted in the Detailed Observations, Recommendations and Management Responses section of this report. See Attachment A for a description of report item classifications.

One of the Significant Issues relates to compliance with the Revenue and Taxation Code in paying interest on refunds (Finding No. 1), and the other (Finding No. 2) relates to user access rights to the Assessment Tax System. The four Control Findings are related to the following: timeliness of refunds to taxpayers; internal controls over penalty cancellations; accuracy of the installment receipt calculation; and documenting the review of system changes.

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

Interest on Refunds

Finding No. 1 – SIGNIFICANT ISSUE

The Treasurer-Tax Collector – Tax Redemption Unit did not pay interest owed to taxpayers on replicated payments refunded later than 60 days or overpayments. The Revenue & Taxation (R&T) Code Sections 2780-2782 require the County to issue refunds on replicated payments (payments made on a tax that has already been paid) to taxpayers within 60 days otherwise interest must be paid to taxpayers in accordance with R&T Code Section 5151, if the refunds meet specific criteria. **(Repeat of Prior Audit #2209, Finding No. I, report issued February 18, 2003, titled: Audit of Tax Redemption Officer Records and Accounts as of June 30, 2002. Management concurred in their response to our finding and agreed to corrective action.)**

Although required by the R&T Code, prior to the implementation of the Tax Redemption automated refund interest calculation feature on April 20, 2005, the Treasurer-Tax Collector did not have a procedure requiring the calculation of interest payments owed to taxpayers on refunds for replicated and overpayments. The Treasurer-Tax Collector added this feature to the Assessment Tax System (ATS) in order to enable the system to automatically calculate interest on refunds for replicated payments and overpayments. However, we were unable to determine whether the system was operating as intended since application of the new feature was limited to taxpayer refunds paid after the implementation date.

Recommendation No. 1

We recommend that the Treasurer-Tax Collector determine those taxpayers who did not receive interest owed to them on untimely refunds prior to April 20, 2005, and calculate and pay interest to ensure that they are in compliance with the Revenue & Taxation Code requirements.

Treasurer-Tax Collector Response

We partially concur. We have been here before. Our response to your Recommendation No. 1 of the Audit Report No. 2209, dated February 13, 2003, was as follows:

The volume of tax refunds has increased due to a change in tax deposit policy for payments in the wrong amount and for replicated payments. Prior to fiscal year 2001, the Redemption Division returned all overpayments, underpayments and replicated payments. Title Companies, which are the largest payer of delinquent property taxes, requested that we immediately deposit tax payments for incorrect amounts and replicated payments. This has improved cash flows, internal control of checks in the office and customer service. However, with staffing levels remaining constant and staff being shifted to meet peak payment processing periods a backlog of refunds, including replicated payments, has resulted. Prior to this change in policy replicated payments were refunded within the 60-day period as required by Revenue and Taxation Code Sections 2780-2782.

To reduce the time period required to process tax refunds and to pay interest on any replicated payments refunded later than 60 days we are doing the following:

- A work request has been submitted to electronically compute interest on replicated payments similar to the calculation currently done on assessment appeal and assessment roll correction tax refunds.
- We will then monitor the cost of interest paid to determine if it exceeds the cost of adding another staff member to process tax refunds.

- Negotiate with our remittance processing vendor, Wausau Corporation, to develop a database of check images for automatic payment of tax refunds, including replicated payments.

Consequently, we have done the following:

- On March 26, 2003 we submitted to County Counsel a request for an opinion clarifying what is considered a "replicate payment" and whether interest should be paid when the amount computed is less than $10. Opinion Number 2003-094 was received on June 4, 2003 and work was immediately commenced to make the appropriate program changes (see attached).
- In June 2003, we submitted a work request to our Assessment Tax System contractor, ARK Technologies, to electronically compute interest on replicated payments. Interest calculations were automated for the Secured and Supplemental tax rolls in July of 2004. Unsecured tax roll refund interest calculations were automated in August of 2004. By doing this we were able to pay interest on replicated payments for the largest of the four property tax rolls first prior to the initiation of changes to the Redemption tax roll. The Redemption refund program was very complicated and as noted in your audit report, interest calculations were automated on April 20, 2005.
- We enhanced our refund processing capabilities with the assistance of our remittance processing vendor, Wausau Financial Services, by implementing a data base of check images for the payment of refunds. This task was accomplished in November 2003.
- We determined that the cost of adding another staff member to process tax refunds is greater than the total interest that could be saved on replicated payments greater than 60 days. Consequently, we did not seek Board approval to add another position.

For the period July 1, 2001 to April 19, 2005, 2,387 replicated payment redemption refunds were issued, of which 906 took more than 60 days to be refunded. The vast majority, 658 resulted in interest of less than $1 with only 67 refunds for $10 or more. In accordance with the January 1, 2005 amendment to Revenue and Taxation Code Section 2782, interest is not payable on refunds less than $10. We anticipate remitting interest on these 67 refunds by May 31, 2006.

Internal Audit Department Rejoinder to Treasurer-Tax Collector Response
The interest owed to taxpayers for replicated payments mentioned in Recommendation #1 includes replicated payments received by the Tax Collector's Office as far back as 2001. The amended Revenue & Tax Code section which established a ten-dollar minimum threshold for interest that should be refunded to taxpayers for replicated payments was not effective until January 1, 2005. The amended Revenue & Tax Code section and the related Senate Bill do not specifically provide for the retroactive application of this minimum interest threshold to replicated payments received in years preceding the establishment of a minimum interest threshold for taxpayer refunds.

Assessment Tax System (ATS) Access

Finding No. 2 – SIGNIFICANT ISSUE
We found that five out of the six employees who were identified in the prior audit as having inappropriate user access to the Assessment Tax System (ATS) still have inappropriate access. **(Repeat of Prior Audit #2209, Finding #IV, report issued February 18, 2003, titled: Audit of Tax Redemption Officer Records and Accounts As of June 30, 2002. Management concurred in their response to our finding and agreed to corrective action.)** In addition, based on this audit finding, a total of 62 Information Technology (IT) user access changes have been submitted to the Treasurer-Tax Collector IT to correct user profiles that needed to be changed or deleted.

The Treasurer-Tax Collector utilizes the ATS computer system database to maintain tax payment information. Access to perform redemption transactions in ATS should be restricted so that users are allowed to perform only transactions necessary to perform their current job responsibilities. As a result of a previous audit finding, Treasurer-Tax Collector management implemented user profiles and specific procedures for granting access to ATS in an effort to ensure employee's abilities to perform transactions in ATS are appropriate. However, the procedures do not include adequate provisions for identifying incompatible access resulting from subsequent employee status changes such as job rotation, transfer, or promotion.

Periodic review of employee ATS access profiles by an immediate supervisor will help identify incompatible capabilities in ATS and appropriate access restriction will help prevent unauthorized transactions.

Recommendation No. 2
We recommend that the Treasurer-Tax Collector's Office implement procedures to ensure Assessment Tax System user profiles are reviewed and evaluated on a regular basis and access are appropriately restricted.

Treasurer-Tax Collector Response
We concur and have completed. In August 2005 we developed a report for supervisors and managers to review user profiles for proper access. The report has undergone streamlining and other improvements and new procedures have been implemented to ensure that management and supervisors monitor compliance.

Timeliness of Refunds to Taxpayers

Finding No. 3 – Control Finding
We found that refunds due to taxpayers as a result of short payments, over payments, and roll corrections were not processed timely. Of the 30 sampled refunds, 18 (60%) of the refunds had a processing time in excess of 60 days. Two of the roll correction refunds had been outstanding over 2,900 days at the time they were brought to the Treasurer-Tax Collector's attention.

The Treasurer-Tax Collector's Office stated that the delays in processing refunds were due to the lack of staffing available to properly identify and track refunds, but staffing had recently been increased to improve processing time. We confirmed that recent refunds had been processed in a timelier manner.

Recommendation No. 3
We recommend that Treasurer-Tax Collector's Office process refunds due to taxpayers in a timely manner.

Treasurer-Tax Collector Response
We concur. We requested our Information Technology Division to redesign and/or reformat our current Refund Report to sort and present the oldest refunds due at the beginning of the report. The report was completed as of January 24, 2006. To ensure that refunds are processed timely by the Redemption Division the following procedures are now in place:

- Refunds are to be worked daily. The only exception will be during the busy periods of December and April when staff is busy with peak property tax collections.
- Refund counts are maintained and employees will sign and date those refunds processed on a weekly basis.

- The Redemption Supervisor and Tax Collection Manager will review reports and counts weekly to ensure compliance.

Internal Controls Over Penalty Cancellations

Finding No. 4 – Control Finding
Internal controls over penalty cancellations need to be improved. The Deputy Tax Collection Manager reviews the Penalty Cancellation Report for individual penalty cancellation transactions over $5,000. However, most penalty cancellations are below this threshold. We reviewed two months of penalty cancellations and found that none of the 83 individual transactions met the $5,000 threshold for management review.

We were informed that Tax Redemption management set a manager review threshold of $5,000 because they thought the penalty cancellations under $5,000 that had been input into the ATS system were being reviewed by the Redemption Supervisor. However, this expectation had not been communicated to the Redemption Supervisor.

Since the system does not require online approvals for penalty cancellations, it is important that an effective review procedure be implemented for penalty cancellation transactions that have been input into the system to detect unauthorized or inappropriate transactions.

Recommendation No. 4
We recommend that the Treasurer-Tax Collector improve internal controls to ensure that penalty cancellations are appropriate and properly authorized.

Treasurer-Tax Collector Response
We concur and completed. We conducted penalty cancellation training for all staff. All penalties over $5,000 are authorized by the manager and records are imaged. In addition, the Redemption Supervisor is now required to monitor penalties under $5,000, place an authorization signature on the penalty waiver form and image the documents for reference and for future audits. Finally, the Tax Collection Manager will periodically conduct spot audits to ensure compliance. Randomly ten penalty cancellation parcels for amounts under $5,000 will be selected. The records will be examined to ensure that imaged documentation contains the proper authorization and amounts according to the penalty cancellation amounts in the Assessment Tax System data base.

Inaccurate Installment Receipt Calculation

Finding No. 5 – Control Finding
We found that the interest amount on an installment receipt provided to a taxpayer was not accurate for 1 out of 15 Installment Plan receipts (i.e., agreements).

The interest amount of $446.71 on the installment receipt generated by the Assessment Tax System (ATS) was not accurate and did not agree with the interest amount of $297.80 on the ATS screen-print generated from ATS. We were informed by Treasurer-Tax Collector Information Technology staff that they were aware of the situation and the problem was due to a “glitch” in the system macro that automatically calculates the interest amount for the installment payment receipt. In this instance, the system error caused the interest amount appearing on the taxpayer’s receipt to be higher than the amount of interest actually owed.

Recommendation No. 5
We recommend that the Treasurer-Tax Collector have the Information Technology staff correct the system problem to ensure that installment receipts contain accurate interest amounts.

Treasurer-Tax Collector Response
We concur and completed.

Undocumented Review of System Changes

Finding No. 6 – Control Finding
We found that Assessment Tax System (ATS) changes, such as changes to the calculation of fees or penalties are reviewed by an employee independent of writing the program changes, however, the independent review is not documented.

Independent review of program changes should be documented as it is an important internal control to prevent unauthorized or erroneous changes to information technology programs and to establish accountability.

Recommendation No. 6
We recommend that the Treasurer-Tax Collector Information Technology staff document their independent review of program changes to the Assessment Tax System.

Treasurer-Tax Collector Response
We partially concur. All requests for enhancements and/or program modifications are documented through e-mails from the requesting Supervisor to the IT Manager.

All changes are unit-tested and turned over to the users and/or other developers for testing. The programs are moved to production only after these programs are tested and approved (communicated through e-mail). The process to move the program to production is documented through various steps and forms submitted to the Data Center.

An independent review of programs is not practical to do; program changes can involve several hundred lines of code. The Department believes the most efficient and effective way of verifying the correctness of the program is by user testing and making sure that the condition in question is part of the test plan.

ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit observations and recommendations, we have classified 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 immediately address "Material Weaknesses" brought to their attention.

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 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.

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PUBLIC INFORMATION OFFICER

February 17, 2006

Dr. Peter Hughes, CPA
Director, Internal Audit
County of Orange
400 Civic Center Drive West
Building 12, Room 232
Santa Ana, CA 92701-4521

RECEIVED
FEB 17 2006
INTERNAL AUDIT DEPARTMENT

Dear Dr. Hughes:

Pursuant to Audit Oversight Committee Procedure No. 1, we have prepared our response to the Draft Report on the Audit of Tax Redemption Officer Records and Accounts for the three years ending June 30, 2005 (Audit Report No. 2513). Each response references the recommendation number from your report.

Recommendation No. 1
We recommend that the Treasurer-Tax Collector determine those taxpayers who did not receive interest owed to them on untimely refunds prior to April 20, 2005, and calculate and pay interest to ensure that they are in compliance with the Revenue and Taxation Code requirements.

Treasurer-Tax Collector Response
We partially concur. We have been here before. Our response to your Recommendation No. 1 of the Audit Report No. 2209, dated February 13, 2003, was as follows:

The volume of tax refunds has increased due to a change in tax deposit policy for payments in the wrong amount and for replicated payments. Prior to fiscal year 2001, the Redemption Division returned all overpayments, underpayments and replicated payments. Title Companies, which are the largest payer of delinquent property taxes, requested that we immediately deposit tax payments for incorrect amounts and replicated payments. This has improved cash flows, internal control of checks in the office and customer service. However, with staffing levels remaining constant and staff being shifted to meet peak payment processing periods a backlog of refunds, including replicated payments, has resulted. Prior to this change in policy replicated payments

Dr. Peter Hughes, CPA
2/17/2006
Page 2

were refunded within the 60-day period as required by Revenue and Taxation Code Sections 2780-2782.

To reduce the time period required to process tax refunds and to pay interest on any replicated payments refunded later than 60 days we are doing the following:

- A work request has been submitted to electronically compute interest on replicated payments similar to the calculation currently done on assessment appeal and assessment roll correction tax refunds.
- We will then monitor the cost of interest paid to determine if it exceeds the cost of adding another staff member to process tax refunds.
- Negotiate with our remittance processing vendor, Wausau Corporation, to develop a database of check images for automatic payment of tax refunds, including replicated payments.

Consequently, we have done the following:

- On March 26, 2003 we submitted to County Counsel a request for an opinion clarifying what is considered a "replicate payment" and whether interest should be paid when the amount computed is less than $10. Opinion Number 2003-094 was received on June 4, 2003 and work was immediately commenced to make the appropriate program changes (see attached).
- In June 2003, we submitted a work request to our Assessment Tax System contractor, ARK Technologies, to electronically compute interest on replicated payments. Interest calculations were automated for the Secured and Supplemental tax rolls in July of 2004. Unsecured tax roll refund interest calculations were automated in August of 2004. By doing this we were able to pay interest on replicated payments for the largest of the four property tax rolls first prior to the initiation of changes to the Redemption tax roll. The Redemption refund program was very complicated and as noted in your audit report, interest calculations were automated on April 20, 2005.
- We enhanced our refund processing capabilities with the assistance of our remittance processing vendor, Wausau Financial Services, by implementing a data base of check images for the payment of refunds. This task was accomplished in November 2003.
- We determined that the cost of adding another staff member to process tax refunds is greater than the total interest that could be saved on replicated payments greater than 60 days. Consequently, we did not seek Board approval to add another position.

For the period July 1, 2001 to April 19, 2005, 2,387 replicated payment redemption refunds were issued, of which 906 took more than 60 days to be refunded. The vast majority, 658 resulted in interest of less than $1 with only 67 refunds for $10 or more. In accordance with the January 1, 2005 amendment to Revenue and Taxation Code Section

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2782, interest is not payable on refunds less than $10. We anticipate remitting interest on these 67 refunds by May 31, 2006.

Recommendation No. 2
We recommend that the Treasurer-Tax Collector's Office implement procedures to ensure Assessment Tax System user profiles are reviewed and evaluated on a regular basis and access are appropriately restricted.

Treasurer-Tax Collector Response
We concur and have completed. In August 2005 we developed a report for supervisors and managers to review user profiles for proper access. The report has undergone streamlining and other improvements and new procedures have been implemented to ensure that management and supervisors monitor compliance.

Recommendation No. 3
We recommend that Treasurer-Tax Collector's Office process refunds due to taxpayers in a timely manner.

Treasurer-Tax Collector Response
We concur. We requested our Information Technology Division to redesign and/or reformat our current Refund Report to sort and present the oldest refunds due at the beginning of the report. The report was completed as of January 24, 2006. To ensure that refunds are processed timely by the Redemption Division the following procedures are now in place:

- Refunds are to be worked daily. The only exception will be during the busy periods of December and April when staff is busy with peak property tax collections.
- Refund counts are maintained and employees will sign and date those refunds processed on a weekly basis.
- The Redemption Supervisor and Tax Collection Manager will review reports and counts weekly to ensure compliance.

Recommendation No. 4
We recommend that the Treasurer-Tax Collector improve internal controls to ensure that penalty cancellations are appropriate and properly authorized.

Treasurer-Tax Collector Response
We concur and completed. We conducted penalty cancellation training for all staff. All penalties over $5,000 are authorized by the manager and records are imaged. In addition, the Redemption Supervisor is now required to monitor penalties under $5,000, place an authorization signature on the penalty waiver form and image the documents for reference and for future audits. Finally, the Tax Collection Manager will periodically conduct spot audits to ensure compliance. Randomly ten penalty cancellation parcels for amounts under $5,000 will be selected. The records will be examined to ensure that

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imaged documentation contains the proper authorization and amounts according to the penalty cancellation amounts in the Assessment Tax System data base.

Recommendation No. 5
We recommend that the Treasurer-Tax Collector have the Information Technology staff correct the system problem to ensure that installment receipts contain accurate interest amounts.

Treasurer-Tax Collector response:
We concur and completed.

Recommendation No. 6
We recommend that the Treasurer-Tax Collector Information Technology staff document their independent review of program changes to the Assessment Tax System.

Treasurer-Tax Collector response:
We partially concur. All requests for enhancements and/or program modifications are documented through e-mails from the requesting Supervisor to the IT Manager.

All changes are unit-tested and turned over to the users and/or other developers for testing. The programs are moved to production only after these programs are tested and approved (communicated through e-mail). The process to move the program to production is documented through various steps and forms submitted to the Data Center.

An independent review of programs is not practical to do; program changes can involve several hundred lines of code. The Department believes the most efficient and effective way of verifying the correctness of the program is by user testing and making sure that the condition in question is part of the test plan.

If you or your staff have any questions on the above response, please contact my Assistant Treasurer-Tax Collector, Gary Cowan, at 834-3545.

Very truly yours,

John M. W. Moorlach

Attachment

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BENJAMIN P. de MAYO
COUNTY COUNSEL

T-100

MEMORANDUM

Confidential Attorney-Client Privileged Communication

June 4, 2003

TO: Gary Cowan, Assistant Tax Collector
Treasurer-Tax Collector

FROM: Ann E. Fletcher, Deputy County Counsel

SUBJECT: Replicated Payments

This memorandum responds to your March 26, 2003 memorandum and will confirm the oral advice recently provided.

BACKGROUND

The Treasurer-Tax Collector department receives approximately 10,000 duplicate tax payments annually. Typically, duplicate (or replicated) payments occur when both a homeowner and mortgage company make a payment for the same tax obligation. In 1986, the Legislature added sections 2780 through 2783, chapter 2.3, part 5, division 1 of the Revenue and Taxation Code, requiring counties to pay interest on replicated payments not returned to the payor within 60 days.[1] You have asked certain questions about replicated payments, as rephrased below.

QUESTION NO. 1

If a tax bill installment is already paid and a second payment is made for the same tax installment but in an incorrect (and often smaller amount), is the second payment considered a replicated payment?

ANSWER

Yes. Where a tax installment has already been paid, a second payment is treated as a replicated payment, regardless of the amount.

[1] Unless otherwise specified, subsequent statutory references are to the Revenue and Taxation Code.

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ANALYSIS

Section 2780.5 provides:

> For purposes of this chapter, "replicated payment" means a payment, submitted by or on behalf of a taxpayer, which is indicated for application to a specific tax or tax installment which has already been paid, whether or not the prior payment and the replicated payment are in the same amount.

Under the foregoing express language, to be a replicated payment for purposes of section 2780, *et seq*., the second payment need not be for the correct amount, and it is irrelevant whether the second payment is for a smaller amount.[2]

QUESTION NO. 2

When the County calculates interest on a replicated payment under section 2782, when should interest begin and end?

ANSWER

Interest should be calculated beginning with the 60th day after the County receives the replicated payment through the day preceding the day on which the County mails the payment.

ANALYSIS

Section 2782 provides:

> If a replicated tax payment is not returned to the tendering party within 60 days as provided in this chapter, the county shall, in addition to returning the replicated payment as soon as practicable, pay the tendering party interest on the amount of replicated payment at the rate provided in Section 5151. The interest shall be computed for the period beginning 60 days after the county receives the replicated payment to the date the replicated payment is returned to the tendering party.

Under section 2782, the interest calculation should begin on the 60th day after the County receives the replicated payment. Section 2782 further provides that interest will continue to accrue "*to* the date the replicated payment is returned to the tendering party." (Emphasis added.) In our view, this means that interest accrues through the day preceding the day on which the

[2] There is no case law that discusses sections 2780 through 2783.

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County mails the payment. Interest should not be paid only to the issue date of the check to the payor, unless the issue date is also the mailing date.

QUESTION NO. 3

Since section 2782 refers to section 5151 for the interest rate on returned replicated payments, and section 5151 does not require interest to be paid unless the interest is $10.00 or more, must the County pay interest on replicated payments even if the interest payment is less than $10.00?

ANSWER

Yes. If any replicated payment in not timely returned to the taxpayer, the County must pay interest, regardless of the amount of interest due.

ANALYSIS

Section 2782 is set forth above and requires the payment of interest "at the rate provided in Section 5151." Section 5151(a) contains the interest calculation for tax refunds and provides in pertinent part:

> (a) Interest at the greater of 3 percent per annum or the county pool apportioned rate shall be paid, when that interest is ten dollars ($10) or more, on any amount refunded under Section 5096.7, or refunded to a taxpayer for any reason whatsoever. However, no interest shall be paid under the provisions of this section if the taxpayer has been given the notice required by Section 2635 and has failed to apply for the refund within 30 days after the mailing of that notice.

Section 2782 refers to section 5151 for the "rate" of interest, but does not contain any dollar threshold under which interest need not be paid. The rate of interest required by section 5151 is whichever is greater, 3% per annum or the County pool rate. We do not believe that the "rate" referred to in section 2782 includes the $10.00 threshold in section 5151. We suggest that you consider pursuing legislative amendment of section 2782 to include an interest threshold. We are available to provide any assistance required in that regard.

Please do not hesitate to contact me if you have any further questions.

Ann E. Fletcher

AEF:br

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