

Internal Audit Department

O R A N G E C O U N T Y
6th Largest County in the USA

AUDIT OF TAX REDEMPTION OFFICER RECORDS AND ACCOUNTS

For the Three Years Ended
June 30, 2011

We found that the elected Orange County Treasurer-Tax Collector properly calculated and collected over **\$544 million** in delinquent property taxes, interest and penalties for the three years ending June 30, 2011.

We identified **one (1) Significant Control Weakness** and **two (2) Control Findings** regarding the tax redemption process. The **Significant Control Weakness** dealt with the segregation of duties over penalty cancellations, and the **Control Findings** dealt with the adequacy of the method used to review processed and approved penalty cancellations; and policies and procedures over redemption account reconciliations.

AUDIT NO: 1113
REPORT DATE: OCTOBER 17, 2012

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RISK BASED AUDITING

GAO & IIA Peer Review Compliant – 2001, 2004, 2007, 2010



American Institute of Certified Public Accountants Award to Dr. Peter Hughes as 2010 Outstanding CPA of the Year for Local Government

GRC (Government, Risk & Compliance) Group 2010 Award to IAD as MVP in Risk Management



2009 Association of Certified Fraud Examiners' Hubbard Award to Dr. Peter Hughes for the Most Outstanding Article of the Year – Ethics Pays



2008 Association of Local Government Auditors' Bronze Website Award



2005 Institute of Internal Auditors' Award for Recognition of Commitment to Professional Excellence, Quality, and Outreach



ORANGE COUNTY BOARD OF SUPERVISORS'
Internal Audit Department

GAO & IIA Peer Review Compliant - 2001, 2004, 2007, 2010

Providing Facts and Perspectives Countywide

RISK BASED AUDITING

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OC Fraud Hotline (714) 834-3608

Letter from Dr. Peter Hughes, CPA

Transmittal Letter



Audit No. 1113 October 17, 2012

TO: Shari L. Freidenrich, CPA
Treasurer-Tax Collector

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

SUBJECT: Audit of Tax Redemption Officer
Records and Accounts

We have completed an Audit of Tax Redemption Officer Records and Accounts for the three year period ending June 30, 2011. The total dollar volume of redemption taxes and penalties collected during the period was approximately **\$506 million** for secured taxes and **\$38.7 million** for supplemental taxes. We performed this audit in accordance with our *FY 2011-12 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and the Board of Supervisors. Our final report is attached for your review.

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

The AOC and BOS expect that audit recommendations will typically be implemented within six months and often sooner for significant and higher risk issues. Our **second Follow-Up Audit** will begin at six months from the release of the first Follow-Up Audit report, by which time **all** audit recommendations are expected to be addressed and implemented. At the request of the AOC, we are to bring to their attention any audit recommendations we find still not implemented 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 have attached a **Follow-Up Audit Report Form**. Your agency should complete this template as our audit recommendations are implemented. When we perform our first Follow-Up Audit six months from the date of this report, we will need to obtain the completed document to facilitate our review.

Each month I submit an **Audit Status Report** to the BOS where I detail any critical 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 your staff so that they can successfully implement difficult audit recommendations. Please feel free to call me should you wish to discuss any aspect of our audit report or recommendations. Additionally, we will request your department complete a **Customer Survey** of Audit Services. You will receive the survey shortly after the distribution of our final report.

ATTACHMENTS

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

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Records and Accounts
Audit No. 1113*

For the Three Years Ended June 30, 2011

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Audit No. 1113

October 17, 2012

TO: Shari L. Freidenrich, CPA
Treasurer-Tax Collector

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

SUBJECT: Audit of Tax Redemption Officer Records and Accounts

Audit Highlight

We found that the elected Orange County Treasurer-Tax Collector properly calculated and collected over **\$544 million** in delinquent property taxes, interest and penalties for the three years ending June 30, 2011.

We identified **one (1) Significant Control Weakness** and **two (2) Control Findings**. The **Significant Control Weakness** dealt with the segregation of duties over penalty cancellations, and the **Control Findings** dealt with the adequacy of the method used to review processed and approved penalty cancellations; and policies and procedures over redemption account reconciliations.

OBJECTIVES

In accordance with our *FY 2011/2012 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and Board of Supervisors, we conducted an audit of the Treasurer Tax-Collector Redemption Section pursuant to Section 4108.5 of the California Revenue and Taxation Code (Revenue and Taxation Code) for the purpose of evaluating the reliability and integrity of financial and operational tax redemption records and compliance with laws and regulations governing redemption activities.

The Revenue and Taxation Code requires an audit at least once every three years of the records and accounts of the Tax-Collector relating to the performance of his/her duties as the Tax Redemption Officer. Our audit was conducted in accordance with professional standards established by the Institute of Internal Auditors.

As part of obtaining reasonable assurance about the accuracy of redemption collection records and accounts, we performed tests of collection records, penalty and interest calculations, and account reconciliations.

RESULTS

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

No **Critical Control Weaknesses** were identified. However, we did note **one (1) Significant Control Weakness** and **two (2) Control Findings**. The **Significant Control Weakness** dealt with the segregation of duties over penalty cancellations, and the **Control Findings** dealt with the adequacy of the method used to review processed and approved penalty cancellations; and policies and procedures over redemption account reconciliations.



The following table summarizes our findings and recommendations for this audit. See further discussion in the *Detailed Results, Findings, Recommendations and Management Responses* section of this report. See *Attachment A* for a description of Report Item Classifications.

Finding No.	Finding Classification - (see Attachment A)	Finding and Page No. in Audit Report	Recommendation	Concurrence by Management?
1.	Significant Control Weakness	Improper Segregation of Duties over Penalty Cancellations (pgs. 5-6)	Treasurer-Tax Collector ensures that the duties of approving penalty cancellations and reviewing processed and approved penalty cancellations are segregated.	Yes
2.	Control Finding	The Method Used To Review Processed and Approved Penalty Cancellations Should Be Improved (pg. 6)	Treasurer-Tax Collector maintain a signature list that includes sample signatures of staff authorized to approve penalty cancellations to be used by the reviewer of processed and approved penalty cancellations.	Yes
3.	Control Finding	Redemption Account Reconciliation Policies and Procedures Should Be Updated (pgs. 6-7)	Treasurer-Tax Collector update its redemption account reconciliation procedure. Documented policies and procedures should be reviewed and approved by management. The most current policies and procedures should be readily accessible for reference by personnel responsible for the redemption account reconciliation.	Yes



BACKGROUND

The Treasurer-Tax Collector performs the duties of Tax Redemption Officer through the Redemption Section of her Department. These duties, as defined by Part 7 of the Revenue and Taxation Code, include maintaining abstracts of delinquent secured and supplemental taxes; calculating and collecting interest and penalties on delinquent taxes; verifying specific conditions have been met before property is redeemed by property owners; and issuing certificates for redeemed property. The total dollar volume of redemption taxes and penalties collected during the three years ending June 30, 2011 was approximately **\$506 million** for secured taxes and **\$38.7 million** for supplemental taxes.

SCOPE AND METHODOLOGY

Part 7, Chapter 1, Section 4108.5 of the Revenue and Taxation Code requires an audit once every three years of the records and accounts of the Tax-Collector relating to the performance of his/her duties as the Tax Redemption Officer. Our audit involved a review of existing operating and accounting practices of the Treasurer-Tax Collector for the three years ending June 30, 2011. Our methodology included inquiry, auditor observation, testing the records and accounts of redemption collections, and reviewing compliance with laws and regulations for redemption activities.

SCOPE EXCLUSIONS

Our audit 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.

Management's Responsibilities for Internal Controls

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

Inherent Limitations in Any System of Internal Control

Because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. Specific examples of limitations include, but are not limited to, resource constraints, unintentional errors, management override, circumvention by collusion, and poor judgment. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or the degree of compliance with the procedures may deteriorate. Accordingly, our audit would not necessarily disclose all weaknesses in Treasurer-Tax Collector's operating procedures, accounting practices, and compliance with County policy.

ACKNOWLEDGMENT

We appreciate the courtesy extended to us by the Treasurer-Tax Collector personnel during our audit. If we can be of further assistance, please contact me directly at 834-5475 or Alan Marcum, Senior Audit Manager at 834-4119.



Attachments

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors
Members, Audit Oversight Committee
Robert J. Franz, Interim County Executive Officer
Paul Gorman, Chief Assistant Treasurer-Tax Collector
Jennifer Burkhart, Assistant Treasurer-Tax Collector
Robin Russell, Assistant Treasurer-Tax Collector, Administration
Dan Puglia, Budget Manager, Treasurer-Tax Collector
Kamal Singh, Remittance Processing Manager, Treasurer-Tax Collector
Patricia Hutt, Redemption Supervisor, Treasurer-Tax Collector
Foreperson, Grand Jury
Susan Novak, Clerk of the Board of Supervisors



Finding No. 1 – Improper Segregation of Duties over Penalty Cancellations (Significant Control Weaknesses)

Summary

The Redemption Supervisor is authorized to approve penalty cancellations under \$5,000, but also on a monthly basis performs “spot-checks” of a sample of processed and approved penalty cancellations to ensure only approved penalty cancellations were processed.

Details

Penalties and fees may be canceled for reasons specified by Revenue and Taxation Code Section 4985. Only limited staff can process and approve penalty cancellations. The Redemption Supervisor has the ability to approve penalty cancellations under \$5,000. In addition, the Redemption Supervisor “spot-checks” a sample of penalty cancellations for authorized signer and initiator, completeness of information, correct amount, the reason for the cancellation is supported by documentation, and ensures documentation was properly scanned into ONBASE.

The amount to redeem defaulted taxes consists of the base tax plus the following penalties and fees:

1. Basic Penalty (10% of base tax amount)
2. Redemption Penalty (1.5% calculated monthly on the defaulted amount)
3. Redemption Fee (\$15 one-time charge)
4. Cost (\$23 one-time charge)

Penalties and fees may be canceled for reasons specified by the Revenue and Taxation Code Section 4985, such as:

1. The taxpayer can demonstrate that the current or prior year tax was paid on the wrong parcel by mistake.
2. The taxpayer shows proof that the payment was not made timely because of information expressly given to the taxpayer in writing by the County.
3. A penalty may be canceled to correct an error on the part of the Assessor, Auditor-Controller or Tax Collector with appropriate documentation.
4. The taxpayer was hospitalized on the last payment date and provides proof to the satisfaction of the Tax Collector.
5. The taxpayer did not receive bill due to a wrong mailing address.
6. The payment was postmarked by the U.S. Postal Service no later than the last payment date.

To ensure errors and/or irregularities are detected, duties should be segregated so the person primarily responsible for reviewing processed and approved penalty cancellations does not have the ability to approve penalty cancellations.

Recommendation No. 1

We recommend that the Treasurer-Tax Collector ensures that the duties of approving penalty cancellations and reviewing processed and approved penalty cancellations are segregated.

Treasurer-Tax Collector Management Response

Concur. The Treasurer-Tax Collector assigned the monthly “spot-checks” of a sample of processed and approved penalty cancellations to the Manager of Taxpayer Services and removed this position from the list of authorized approvers for penalty cancellations.



The Treasurer-Tax Collector's actions establish strong segregation of duties for penalty cancellations.

Finding No. 2 – The Method Used To Review Processed and Approved Penalty Cancellations Should Be Improved (Control Finding)

Summary

The Redemption Supervisor reviews a sample of processed and approved penalty cancellations to ensure only approved penalty cancellations were processed. We found that the Redemption Supervisor was not always able to identify the signature of the individuals who approved the penalty cancellations.

Details

Penalties and fees may be canceled for reasons specified by the Revenue and Taxation Code. Only limited staff can process and approve penalty cancellations. The Redemption Supervisor reviews a sample of processed and approved penalty cancellations to ensure only approved penalty cancellations were processed.

The Treasurer-Tax Collector maintains a typed listing of staff authorized to process and approve penalty cancellations; however, the listing does not include a sample of signatures. Having a signature list that includes samples of signatures will assist the reviewer in determining that only authorized staff have approved the cancellations.

Recommendation No. 2

We recommend that the Treasurer-Tax Collector maintain a signature list that includes sample signatures of staff authorized to approve penalty cancellations to be used by the reviewer of processed and approved penalty cancellations.

Treasurer-Tax Collector Management Response

Concur. The Treasurer-Tax Collector updated the authorized list for approving and processing penalty cancellations to include an Attachment A with a space for each staff to sign their name. In addition, the Treasurer-Tax Collector updated the Penalty Cancellation Form adding a space for all the staff to both print and sign their name.

Finding No. 3 – Redemption Account Reconciliation Policies and Procedures Should Be Updated (Control Finding)

Summary

Redemption Account "Reconciliation Procedure", created in 1999, is outdated, refers to staff no longer within the department and to non-existent job titles and in some cases, does not accurately reflect current reconciliation practices.

Details

Treasurer-Tax Collector Administration staff reconciles Redemption account balances monthly from the Treasurer-Tax Collector's Assessment Tax System to the Auditor-Controller's General Ledger. Reconciliations are reviewed by supervisory or management staff in the Administration Services section.



Policy and procedural manuals are a set of written instructions that document a recurring activity. The development and use of policy and procedural manuals are an integral part of a successful quality assurance system as it provides personnel with the information to perform their duties properly, facilitates consistency in the quality and integrity of an end-result, and ensures compliance with governing documentation.

The development and use of policy and procedural manuals minimizes variation and promotes quality through consistent implementation of a process, even if there are temporary or permanent personnel changes. Policy and procedural manuals can be used as a part of a personnel training program, since they should provide detailed work instructions.

Policies and procedures minimize opportunities for miscommunication and can address quality control concerns. When historical data are being evaluated for current use, policy and procedural manuals can also be valuable for reconstructing project activities when no other references are available. In addition, policy and procedural manuals can be used as checklists by management for monitoring quality assurance.

The benefits of policy and procedural manuals include reduced work effort, along with improved comparability and credibility.

Recommendation No. 3

We recommend that the Treasurer-Tax Collector update its redemption account reconciliation procedure. Documented policies and procedures should be reviewed and approved by management. The most current policies and procedures should be readily accessible for reference by personnel responsible for the redemption account reconciliation.

Treasurer-Tax Collector Management Response

Concur. The Treasurer-Tax Collector is in the process of updating its Redemption Account Reconciliation Policies and Procedures to reflect the current procedures followed by the Administrative Services unit. The procedures will be updated by December 31, 2012.



ATTACHMENT A: Report Item Classifications

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

▶ **Critical Control Weaknesses:**

Audit findings or a combination of Significant Control Weaknesses that represent serious exceptions to the audit objective(s), policy and/or business goals. Management is expected to address Critical Control Weaknesses brought to their attention immediately.

▶ **Significant Control Weaknesses:**

Audit findings or a combination of Control Findings that represent a significant deficiency in the design or operation of internal controls. Significant Control Weaknesses require prompt corrective actions.

▶ **Control Findings:**

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



ATTACHMENT B: Treasurer-Tax Collector Management Responses



OFFICE OF THE TREASURER-TAX COLLECTOR SHARI L. FREIDENRICH, C.P.A.

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INTERDEPARTMENTAL COMMUNICATION

To: Dr. Peter Hughes, MBA, CPA, CIA, Internal Audit Director
From: Shari L. Freidenrich, CPA, CCMT, CPFA, ACPFIM *SF*
Date: September 27, 2012
Subject: Response to Draft Report on Tax Redemption Officer Records and Accounts for the Three Year Period Ending June 30, 2011

Finding No. 1 – Improper Segregation of Duties over Penalty Cancellations. The Redemption Supervisor is authorized to approve penalty cancellations under \$5,000, but also on a monthly basis performs “spot-checks” of a sample of processed and approved penalty cancellations to ensure only approved penalty cancellations were processed.

Recommendation No. 1

We recommend that the Treasurer-Tax Collector ensures that the duties of approving penalty cancellations and reviewing processed and approved penalty cancellations are segregated.

Treasurer-Tax Collector Response to Recommendation No. 1 **Concur.**

The Treasurer-Tax Collector assigned the monthly “spot-checks” of a sample of processed and approved penalty cancellations to the Manager of Taxpayer Services and removed this position from the list of authorized approvers for penalty cancellations. The Treasurer-Tax Collector’s actions establish strong segregation of duties for penalty cancellations.

Finding No. 2 – The Method Used To Review Processed and Approved Penalty Cancellations Should Be Improved. The Redemption Supervisor was not always able to identify the signature of the individuals who approved the penalty cancellations.

Recommendation No. 2

We recommend that the Treasurer-Tax Collector maintain a signature list that includes sample signatures of staff authorized to approve penalty cancellations to be used by the reviewer of processed and approved penalty cancellations.

Mission: Ensure safe and timely receipt, deposit, collection and investment of public funds.



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

Treasurer-Tax Collector Response to Recommendation No. 2 **Concur.**

The Treasurer-Tax Collector updated the authorized list for approving and processing penalty cancellations to include an Attachment A with a space for each staff to sign their name. In addition, the Treasurer-Tax Collector's updated the Penalty Cancellation Form adding a space for all the staff to both print and sign their name.

Finding No. 3 – Redemption Account Reconciliation Policies and Procedures should be updated. The “Reconciliation Procedure” is outdated and, in some cases, does not accurately reflect current reconciliation practices.

Recommendation No. 3

We recommend that the Treasurer-Tax Collector update its redemption account reconciliation procedure. Documented policies and procedures should be reviewed and approved by management. The most current policies and procedures should be readily accessible for reference by personnel responsible for the Redemption account reconciliation.

Treasurer-Tax Collector Response to Recommendation No. 3 **Concur.**

The Treasurer-Tax Collector is in the process of updating its Redemption Account Reconciliation Policies and Procedures to reflect the current procedures followed by the Administrative Services unit. The procedures will be updated by December 31, 2012.