Secretary of State Audit Report

Kate Brown, Secretary of State

Gary Blackmer, Director, Audits Division

Oregon Department of Revenue: Property Tax Deferral Program: Financial Review

Summary

The Senior and Disabled Citizens' Property Tax Deferral Program (program) was established by the Oregon State Legislature in 1964 with the purpose of allowing low income seniors and citizens with qualifying disabilities to remain in their homes. The program is administered by the Department of Revenue (department), and allows qualifying individuals to borrow funds from the department to pay their property taxes. The department places a lien against the property to recover the amount of the loan, plus interest, when the house is sold.

In the past several years economic, budgetary, and statutory changes have affected the financial elements of the program.

The objective of our audit was to determine if internal controls implemented for the property tax deferral program were adequately designed to ensure compliance with legislative requirements, program solvency, and proper financial reporting for the program. For the most part, we found the design of the department's internal controls was appropriate to promote program solvency, ensure compliance with program requirements, and facilitate appropriate financial reporting. We noted two areas where the department could improve its monitoring of liabilities and reporting of its interest receivable.

Agency Response

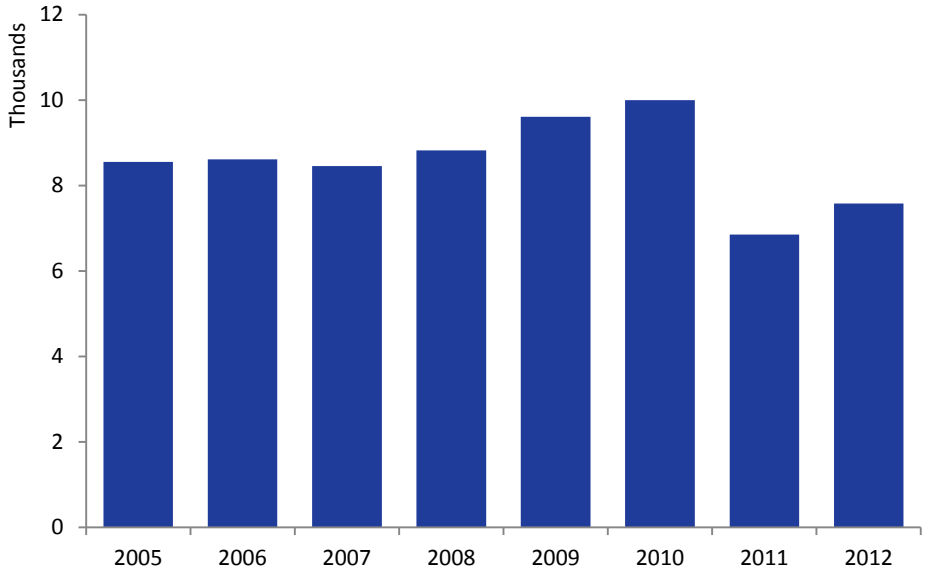
The agency response is attached at the end of the report.

Audit Results

Background

The Oregon Senior and Disabled Property Tax Deferral Program was created by the Oregon Legislature in 1964. The purpose of the program is to help low income seniors and individuals with qualifying disabilities stay in their homes by deferring property taxes against the value of the home. The Department of Revenue pays the individual's property taxes each year the individual remains within the eligible program requirements. To secure its interest, the department establishes a lien against the property through the appropriate county. When the participant's status changes, such as when the home sells or transfers ownership, the lien is enforced, and the department recovers the amount of the loan plus interest.

Figure 1: Senior Property Tax Deferral Participation



Various factors affecting the program

Economic, budgetary, and statutory changes have affected the financial elements of the program. For example, due to economic conditions and the housing market collapse beginning in 2008, there were fewer home sales, and loan repayments decreased. Concurrently, program participation increased significantly to 10,000 in 2010, and additional loans were issued. Although interest was still accruing on the outstanding loans, the cash inflows used to make additional program loans were reduced.

Additionally, in 2008, the department transferred $14.3 million of program funds to Oregon Project Independence, as required by Senate Bill 870 from the 2005 legislative session. Oregon Project Independence is administered by the Department of Human Services, and provides assistance to individuals 60 years or older, or suffering from Alzheimer's disease or a

related disorder. This transfer of program funds combined with reduced cash inflows and increased program participation resulted in a situation where the department no longer had sufficient funds for new participants.

In 2010, the department had insufficient funds to operate the program, and faced an inability to make the appropriate payments to the counties. As a result, the Oregon Legislature passed Senate Bill 939 to allow the department to borrow $19 million from the Oregon Common School Fund. Furthermore, the Legislature reviewed the tax deferral program and made significant changes to program requirements and eligibility restrictions for program participants. The 2011 Legislature passed House Bill 2543, which implemented the following program changes:

- placed an upper limit on the real market value of eligible property;
- required proof of insurance for the property;
- required at least five years of residency in the home before application;
- set a household income limit;
- excluded homes with reverse mortgages;
- set a household asset limit; and
- required certification of eligibility every two years.

As of November 2012, the program had approximately 7,600 participants with an outstanding loan balance (principal) of about $111 million, and outstanding interest liabilities of about $34 million. The program solvency had improved, and the department had repaid the $19 million loan from the Common School Fund.

A number of risks are inherent in the program, such as changes in the economy and decline of housing values, over which the department has no control. Both of these risks can increase the demand for enrollment in the program and the ability of the department to collect the amount due. Despite these risks, we found that the design of the department's internal controls generally was appropriate to promote program solvency, ensure compliance with program requirements, and facilitate appropriate financial reporting. However, as described below, we identified two issues where the department could improve its procedures.

Program interest receivables were not reported

For most tax programs, tracking of taxpayer liabilities, payments, penalties, and interest are performed through the department's Integrated Tax Accounting Application (ITA). Periodically throughout the year, the department summarizes the payments from the various tax programs and records the data in the Statewide Financial Management Application (SFMA), which is the state's accounting system. Taxpayer liabilities (i.e., receivables for the department) are generally recorded in SFMA at year-end.

For the Senior and Disabled Property Tax Deferral Program, we found that although loan amounts were recorded in SFMA, procedures had not been developed to ensure interest receivable was reported in SFMA. Based upon information provided by department staff as of March 2013, we estimate the department underreported interest receivable by approximately $34 million.

Recommendation

We recommend department management develop and implement procedures to ensure interest receivable for the Senior and Disabled Property Tax Deferral Program is reported in SFMA.

Regular reviews are needed to ensure liens adequately cover participants' liabilities

When the department makes the first property tax payment, staff places a lien on the property. Department staff estimates the amount of the lien based upon factors such as life-expectancy of the participant and the annual amount of property taxes. Periodically, program staff produces a report from the ITA system that identifies program participants whose lien amount is nearing the initial estimated liability. Program staff will increase the lien by $20,000 to ensure the department is able to recover payments made on behalf of participants plus interest.

During our audit, we performed tests to determine if the department had established an appropriate lien amount to cover the program participants' liability. Of the 35 properties reviewed, one had a lien amount approximately $7,500 less than the participant's liability.

Follow-up discussions with program staff disclosed that the process to identify properties needing lien adjustments occurs infrequently, usually once in July when new applications are processed, and again in November when the department sends property tax payments to the counties. For the one exception identified, it appeared that accumulated interest increased the participant's liability over the lien amount between lien adjustment process dates.

Recommendation

We recommend department management consider performing its lien adjustment process on a more frequent schedule to ensure sufficient liens exist to cover participants' liabilities.

Objectives, Scope and Methodology

We initiated our audit to determine if: 1) the program was operating within the parameters determined by the Oregon Legislature; 2) the department had established appropriate controls to ensure program solvency; and 3) appropriate controls had been established to ensure accurate financial reporting.

To meet our objectives, we performed the following procedures:

- conducted interviews with key program staff;
- identified and tested key control procedures;
- reviewed data relating to program participants and outstanding loan and interest balances;
- reviewed the current application form template and renewal form template; and
- reviewed documentation relating to liens that had been established against properties.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Our fieldwork was conducted in April and May 2013.

Oregon
John A. Kitzhaber, MD, Governor

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July 30, 2013

Gary Blackmer, Director
Secretary of State, Audits Division
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Dear Mr. Blackmer,

This letter is our management response to the audit report on the Department of Revenue Property Tax Deferral Financial Review. We appreciate the professional and collaborative manner in which the Secretary of State staff performed this audit.

Please accept the following responses to the recommendations contained in the report:

Recommendation:
We recommend department management develop and implement procedures to ensure the interest receivable for the Senior and Disabled Property Tax Deferral Program is reported in SFMA.

Response:
We agree – A process has been implemented to record a monthly accrual of interest receivable in SFMA.

Recommendation:
We recommend department management consider performing its lien adjustment process on a more frequent schedule to ensure sufficient liens exist to cover participants' liabilities.

Response:
We agree - By October 1, 2013, management will implement a process to review lien sufficiency no less than once a quarter.

Thank you for the opportunity to respond.

Sincerely,

Kris Kautz

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About the Secretary of State Audits Division

The Oregon Constitution provides that the Secretary of State shall be, by virtue of her office, Auditor of Public Accounts. The Audits Division exists to carry out this duty. The division reports to the elected Secretary of State and is independent of the Executive, Legislative, and Judicial branches of Oregon government. The division audits all state officers, agencies, boards, and commissions and oversees audits and financial reporting for local governments.

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The courtesies and cooperation extended by officials and employees of the Oregon Department of Revenue during the course of this audit were commendable and sincerely appreciated.