

August 2, 2006

Internal Audit Report 2006-14
Real Property Exemption
Property Appraisal Division
Finance Department

Introduction. The Property Appraisal Division (Division), headed by the Municipal Assessor, is charged with locating, identifying and valuing all taxable real property and personal property within the Municipality in order to provide a fair and equitable basis for taxation. The Division maintains descriptions of real property, keeps maps showing the ownership and tax districts for the Municipality of Anchorage, and processes property tax exemptions. According to Division staff, there are approximately 95,880 parcels in the Municipality of which 7,135 are exempt and 57,757 are partially exempt. Property tax exemptions are granted based on three elements: (1) verification of ownership, (2) use of property after the owner files an application for exemption with the Division, and (3) the statutory definition. Alaska State Law includes a range of mandatory exemptions (Alaska State Statute 29.45.030, Required exemptions) and optional exemptions (Alaska State Statute 29.45.050, Optional exemptions and exclusions). According to the Computer Assisted Mass Appraisal (CAMA) database records maintained by the Division, the following exemptions were granted as of March 2006:

Senior Citizen or Disabled Veteran Exemptions: Alaska residents 65 years of age or older, disabled veterans, or a resident at least 60 years old who is the widow or widower of a person who qualified for an exemption are exempt from taxation on the first \$150,000 of the assessed value of the real property (8,628 parcels partially exempt).

Religious, Charitable, and Educational Exemptions: Property used exclusively for nonprofit religious, charitable or educational purposes (772 parcels exempt).

Native Exemptions: Real property interests conveyed to a Native individual, Native Group, Village or Regional Corporation which are not developed or leased to third parties or which are used solely for the purposes of exploration are exempt from state and local real property taxes by United States Code, Title 43 (465 parcels exempt).

Veteran's Organizations Exemptions: Property of a nonbusiness organization composed entirely of persons with 90 days or more of active service in the armed forces of the United States (16 parcels exempt).

Fire Protection System (Sprinkler) Exemptions: A structure containing an approved fire protection system that is in working condition and incorporated as a fixture or part of the structure. The exemption is limited to an amount equal to 2 percent of the value of the area covered by the sprinkler (494 parcels partially exempt).

Residential Exemptions: Residential property may be exempted from taxation by ordinance ratified by the voters at an election. A residential exemption may not exceed 10 percent of the assessed value, up to a maximum of \$20,000, for any one residence (48,577 parcels partially exempt).

Community Purpose Exemptions: The property of an organization not organized for business or profit-making purposes and used exclusively for community purposes (48 parcels exempt).

Regional Housing Authority Exemptions: Properties that have been developed, improved, or acquired with federal funds for low-income housing and are owned or managed as low-income housing by regional housing authorities (89 parcels exempt).

Other Exemptions: Other exemptions based on Alaska State law include municipal, state, and federal properties, and nonprofit hospitals and cemeteries (3,655 parcels exempt).

Objective and Scope. The objective of this audit was to determine if real property tax exemptions were being properly administered. Our audit included evaluating the process for granting exemptions, reviewing files for documentation to support the exemptions, and testing selected exemptions for compliance with statutory requirements. Our audit did not include residential exemptions since they were recently implemented. Our audit concentrated on the following exemptions:

- ▶ community purpose
- ▶ senior citizen/disabled veteran
- ▶ charitable
- ▶ veteran's organizations
- ▶ fire protection system (sprinkler)
- ▶ religious
- ▶ native
- ▶ regional housing authority

The audit was conducted in accordance with generally accepted government auditing standards, except for the requirement of an external quality control review, and accordingly, included tests of accounting records and such other auditing procedures as we considered necessary in the circumstances. The audit was performed during the period of February through April 2006. The audit was requested by the Administration.

Overall Evaluation. Overall, the majority of exemptions granted by the Division were properly administered. However, the administration of some of the exemptions could be improved. Specifically, we found that not all of the exemptions were reviewed on an annual basis and some exemption files contained insufficient documentation to support the decision to grant an exemption. In addition, a CAMA report listed several exemption categories that were not supported by the Anchorage Municipal Code (AMC) or Alaska State Law. Moreover, the Division did not always assess a value for exempted property, making it impossible to analyze the impact of exemptions on the distribution of the tax burden. Finally, approvals for late filings for the Senior Citizen/Disabled Veteran Property Tax Exemption Program were not in compliance with the AMC.

FINDINGS AND RECOMMENDATIONS

1. Exemptions Not Reviewed Annually.

- a. Finding.** The Division did not perform annual reviews of all exemptions as required by AMC 12.05.045, Assessor. Although the Division monthly reviews all properties with ownership changes, it does not annually review exemptions without ownership changes to determine eligibility. During 2005, the Division only performed reviews of religious and senior citizen/disabled veteran exemptions. Prior to the reviews in 2005, only a few periodic reviews have been completed on exempted property. AMC 12.05.045 states, “The assessor shall review annually those properties that are exempt from taxation to determine whether such properties continue to qualify for an exemption.” The annual review of exemptions ensures that properties are correctly assessed and validates the ownership and usage of the properties. For example, during the last documented review of religious exemptions prior to 2005, the Division sent out re-certification letters with attached affidavits to verify that ownership and usage of the properties still met the eligibility criteria for the exemption. A similar finding was included in Internal Audit Report 2001-7.
- b. Recommendation.** The Municipal Assessor should perform annual reviews for all exemptions in accordance with AMC 12.05.045 to ensure tax exempt properties continue to qualify for the exemption, or revise the AMC to eliminate the requirement.
- c. Management Comments.** Management stated, “Active monitoring of changes to recorded title and periodic field inspection does constitute annual review of exempt property. Improved information systems which document review and inspection related to exemption status are required. Written policy and procedure regarding documentation and verification of exempt status is required and will be completed

by year end 2006. In addition, the Assessor's office is developing an automated system to reconcile other public records, including the Permanent Fund Dividend Program, with the current list of eligible property owners for the Residential Senior Citizen and Disabled Veteran Programs."

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

2. **Exemption Files Contain Insufficient Documentation.**

- a. **Finding.** Exemption files did not always contain sufficient documentation to support the decision to grant an exemption. For example, 3 of the 31 native exemptions we reviewed had no file. The 28 remaining exemptions were combined into one file that was neither organized nor contained documentation to support the exemptions. In addition, our review of 23 regional housing authority exemptions revealed that no documentation had been maintained to support the exemptions.

Moreover, according to an internal review by Division staff, the majority of religious exemption files did not contain sufficient documentation to support the exemptions. In 2005, Division staff conducted a review of all religious exemptions and identified missing documentation. Missing documentation included copies of the deeds or patents, Internal Revenue Service determinations of nonprofit status, articles of incorporation, usage statements, and photographs of the property. Proper documentation is necessary to support the validity of property exemptions. We addressed a similar finding in Internal Audit Report 2001-7.

- b. **Recommendation.** The Municipal Assessor should ensure that exemption files contain adequate documentation to support the exemption.

- c. **Management Comments.** Management stated, “Documentation relevant to exemption status is contained in two data systems. The primary system is the CAMA computerized data system which retains information regarding ownership, location, physical description, inspection dates, comments by staff, and exemption status. This system is generally adequate and contains sufficient data to administer the exemptions.

“The second data system is a paper file system which includes the original application and the documents and correspondence which supports the exempt status. This system is currently inadequate and under review. Management is developing a program for upgrade and replacement of this system including written policy and procedure for its construction and maintenance. This system upgrade should be substantially finished by year end 2006. It will take at least two years to update supporting documentation to the standards currently being established. It is possible that a digital imaging system can replace all paper documents and make search, maintenance, and cross reference of the information much more efficient in the near future.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

3. **Exemption Categories Not Supported by AMC or State Law.**

- a. **Finding.** A report from the CAMA system listed five different exemptions, containing 2,085 parcels, not supported by the AMC or Alaska State Law. The exempt value for the exempt parcels totaled \$1,895,100.

Exemptions Not Supported by AMC	Parcels	Exempt Value
Utility	82	\$94,700
Condo Master	1,181	\$492,500
Condo Common	224	\$155,200
Homeowner Association	197	\$518,500
Common Area	401	\$634,200
TOTAL:	2,085	\$1,895,100

Source: CAMA database

According to the Municipal Assessor, these categories were not true exemptions even though they were coded as exemptions.

- b. Recommendation.** The Municipal Assessor should ensure that exempted parcels are accurately categorized in CAMA.
- c. Management Comments.** Management stated, “This is a problem of semantics, labeling, and the construction of internal reports. There are not five categories of exempt property unsupported by municipal code.

“There are five categories of property records for which no value should be assessed included in our current reports regarding exempt property. Understanding the distinction between the different elements of the bundle of rights which compose real property and their associated value is beyond the knowledge of the auditors and the scope of their assignment.

“The auditors are correct in noting that the current CAMA system is producing reports which include information which is confusing and potentially misleading to anyone who does not have a depth of knowledge regarding the legal distinctions regarding real property and assessment for taxation in particular. Management is

taking immediate steps regarding the labeling of this property and changing the summary reports associated with property legally exempt from taxation. New reports will be created regarding the elements of real property which are accounted for elsewhere in the assessment records. Documentary support for these elements of real property is contained in paper files, retained in the assessment office regarding condominium declarations, homeowner association agreements, recorded plats and other recorded legal documents.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

4. **No Assessed Value for Some Exempt Property.**

- a. **Finding.** The total value of all exempt property could not be determined since some tax-exempt parcels were not valued by the Assessor’s office. Without accurate values for all exempt properties, it is impossible to analyze the impact of exemptions on the distribution of the tax burden. In addition, the Governmental Accounting Standards Board (GASB) Statement No. 44 requires the value of all tax-exempt property to be included in the statistical section of the comprehensive annual financial reports for fiscal years beginning after June 15, 2005. When we asked Division staff why some parcels had assessed values and others did not, we were told that some of these properties may have been appraised before a change in ownership made them eligible for an exemption. A similar finding was included in prior Internal Audit Report 2001-7.
- b. **Recommendation.** The Municipal Assessor should consider assessing a value to all tax-exempt properties.

- c. **Management Comments.** Management stated, “The primary mission of assessment is to provide a fair and equitable basis for taxation and the generation of tax revenue to support the Municipality. It is our intent to conform to all laws and regulations related to that task, including financial reporting requirements imposed by GAAP.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

5. **Approvals for Late Filings Not in Compliance with Municipal Policy and Procedure.**

- a. **Finding.** The Municipal Assessor approved late applications for the Senior Citizen and Disabled Veteran Property Tax Exemption Program contrary to Municipal Policy and Procedure (P&P) 24-18, Processing Late Filed Applications for the Senior Citizen/Disabled Veterans Property Tax Exemption Program. P&P 24-18 states, “The Chief Fiscal Officer shall review the application, supporting documentation and the Assessor’s recommendation. If the Chief Fiscal Officer determines that the late filing was due to good cause, he shall approve the waiver and have the Assessor accept the application as timely filed.” However, our review revealed that the final determination to approve late filings was made by the Municipal Assessor and not by the Chief Fiscal Officer. Division staff were unable to provide a written signature authority delegating the approval of late filings to the Municipal Assessor. Prior audit report 2001-7 addressed a similar finding.
- b. **Recommendation.** The Municipal Assessor should ensure that late applications are sent to the Chief Fiscal Officer for approval as required by P&P 24-18.
- c. **Management Comments.** Management stated, “The auditors were correct in noting this deficiency in written authorization. In recent years this authorization has been granted via verbal approval and through the working relationship between the CFO

and the Assessor. There have been recent significant changes to municipal code and administrative policy regarding both the CFO and the Assessor. Management will immediately cure the deficiency with written authorization or change the P&P.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

Discussion With Responsible Officials. The results of this audit were discussed with appropriate Municipal officials on July 24, 2006.

Audit Staff:
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