



Performance Audit:

Tax Department

Durham County Internal Audit Department

July 17, 2013



COUNTY OF DURHAM

Richard Edwards
Internal Audit Director
rcedwards@dconc.gov

Internal Audit Department

200 E. Main Street, 4th Floor
Durham, NC 27701
(919) 560-0042
FAX: (919)560-0057

Audit Committee

Fred Foster, Jr
Brenda Howerton
William Pierce
Ellen W. Reckhow
Manuel L. Rojas
Michael M. Ruffin
Harrison Shannon

July 17, 2013

Michael M. Ruffin, County Manager:

Internal Audit has completed its audit of the Tax Department's appraisal process in regards to fairness and equity. We found the Department considers the factors set by the law in its consideration of determining the value of individual property.

We made one recommendation. The recommendation is to maintain records of individual parcels in a manner that property owners can determine how the assessor arrived at its value. The intent of the recommendation is to bring the Department into compliance with the Statute regarding the intent of records as to provide an audit trail for the assessor, and to act as a management control mechanism.

Appropriate implementation of the recommendation will reduce the likelihood of property owners sustaining claims against the Tax Administrator and bad publicity, embarrassment, and lack of confidence in the appraisal process.

The Tax Department was provided a copy of the draft report. The Director expressed agreement with the report and will begin implementation of the recommendation. The Tax Administrators comments are included in the report as Appendix 1 on page 8.

I appreciate the courtesy and cooperation provided by Tax Administration representatives during this audit.

Richard Edwards, CIA, CGAP
Internal Audit Director

XC: Kim Simpson, Tax Administrator
Audit Oversight Advisory Committee

INTRODUCTION

This performance audit of the Tax Department's procedures to assure fairness in its real property appraisal processes was approved by the Audit Oversight Committee in the fiscal year 2013 Audit Plan. The Audit Committee approved this audit because of the unknown risks in the department and lack of a recent audit of any of the Department's processes and operations.

We conducted this audit in accordance with generally accepted government auditing standards. The standards require that I plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. I believe the evidence obtained provides a reasonable basis for the findings and conclusions based upon the audit objectives.

A performance audit is an engagement that provides assurance or conclusions based on an evaluation of sufficient, appropriate evidence against stated criteria, such as specific requirements, measures, or defined business practices. Performance audits provide objective analysis so that management and those charged with governance and oversight can use the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.

AUDIT OBJECTIVE, SCOPE AND METHODOLOGY

Our primary audit objective was to evaluate the adequacy of local property tax valuation practices to determine if they are fair, consistent, and in compliance with statutory provisions and professional standards. To meet our objective we reviewed property tax appeals because they would (1) taxpayer concerns with their appraisals, (2) how the Tax Administrator treated each of the individual appeals, and (3) the extent to which the Tax Administrator followed the Statutes in making appraisal decisions.

We reviewed tax year 2012 appeals. We focused on appeals that were reviewed by the Tax Administrator and decisions made before the case went before the Board of Equalization and Review (E&R Board). We reasoned that such cases would provide insight into whether the Tax Administrator handled cases judiciously and in accordance with the Statutes. Our opinions regarding case adjudication was determined by whether evidence was available to demonstrate Tax Administrator actions complied with governing Statute.

We randomly selected and reviewed 146 of the 840 appeals for calendar year 2012. This does not include twenty-eight appeals pending with the Property Tax Commission. Additionally, we discussed individual cases with Tax Administrator representatives to gain an understanding of the methods used to arrive at the conclusions they communicated to taxpayers.

Our sample was chosen based upon a confidence level of 95% and a confidence interval of seven. The confidence level was chosen to keep our sample to a manageable size

considering the resources available. Also, we did not intend to project our results to the total population.

BACKGROUND

The tax department assessed 102,494 real estate parcels in calendar year 2012. The value of these assessments was \$24.9 billion on January 1st of that year. During the year additional properties came on line as well as some properties were removed from the status of taxable property.

Before taxes are assessed, the property must be appraised. The appraisal process takes many avenues. Properties are assessed at its “best and highest use” or the greatest good of the property and are classified as income producing or non-income producing. Income producing properties are rental or business use property and can be a standalone unit or a multiple dwelling or multiple use property such as an office complex.

The NC State Statute requires the Tax Administrator to identify and list all taxable real property. The Tax Administrator accomplishes this by on site visits to some properties while many properties are appraised by using information gathered in questionnaires or most commonly a mass appraisal as established in its “uniform schedules of values, standards, and rules.” Home sales comparisons are a major factor in determining appraised value. On a schedule determined by the state, with exceptions if it the Board of County Commissioners chooses an earlier period, a revaluation is done every eight years. The last revaluation was conducted in 2008.

Property owners dissatisfied with their appraised values have the right to appeal the appraised value during the revaluation or at a time between revaluations. In 2012 less than one percent or 840 taxpayers appealed their tax appraisals. The predominate reason taxpayers provided for appealing was that the appraisal was too high for the neighborhood or in comparison to other properties in the area.

Appeals are made to the E&R board. The Tax Administrator’s representatives review appeals, per a directive from the E&R Board, in preparation for a Board hearing. The purpose of the review is to resolve areas of the appeal that does not require a formal hearing. Of the 146 appeals we reviewed, the Tax Administrator settled 138 appeals with property owners thus eliminating the need for formal review by the E&R Board. Eight property owners in our sample went through with a formal appeal. Of the 138 settled by the Tax Administrative staff;

- 106 were resolved in favor of the taxpayer resulting in a reduced appraisal value,
- 29 did not result in a change in appraisal value, and
- 3 resulted in an increase in the appraisal.

As demonstrated in the above paragraph, property owners have the opportunity to reject the Tax Administrator’s decision and continue the appeal with the E&R Board. Fifty-eight of the 840 appellants continued their appeals with the E&R Board after the Administrative review. We do not know the disposition of appeals that went before the E&R Board

however, in our sample, eight of 146 appeals or approximately 5.5 percent continued to the Board for formal review. The E&R Board revised one appraisal downward as recommended by the Tax Administrator and did not make revisions to the others thus sustaining the Tax Administrator's decision in all cases we reviewed.

SUMMARY OF AUDIT RESULTS

Based upon the results of our audit, the Tax Department is fair and consistent in the treatment of property appraisals. However, the Tax Administrator's record keeping process for each parcel needs to be improved to comply with the state Statute. That Statute requires the Tax Administrator or the assessor to "maintain records in sufficient detail to enable owners to ascertain the method, rules, and standards by which their property values were determined. The current method of displaying data in the property records does not allow for property owners to easily make that determination.

Tax Administrator appeal decisions were appropriate

Audit results showed appeal decisions made by the Tax Administrator were appropriate in accordance with governing statutes. We made our determination of appropriateness based upon evidence in the Tax Administrator's files for each parcel and its adherence to NC General Statute 105-317 (a) (1) and (2). Those Statutes are cited below as follows:

(1) In determining the true value of land, to consider as to each tract, parcel, or lot separately listed at least its advantages and disadvantages as to location; zoning; quality of soil; waterpower; water privileges; dedication as a nature preserve; conservation or preservation agreements; mineral, quarry, or other valuable deposits; fertility; adaptability for agricultural, timber-producing, commercial, industrial, or other uses; past income; probable future income; and any other factors that may affect its value except growing crops of a seasonal or annual nature.

(2) In determining the true value of a building or other improvement, to consider at least its location; type of construction; age; replacement cost; cost; adaptability for residence, commercial, industrial, or other uses; past income; probable future income; and any other factors that may affect its value.

Each file we reviewed had evidence that this information was included as appropriate in each appraisal.

Property record cards are not easy to understand

The statute cited above also provides guidance regarding how records for each parcel will be maintained. Statute 105-317 (b) (3) specifically cites that;

"A separate property record be prepared for each tract, parcel, lot, or group of contiguous lots, which record shall show the information

required for compliance with the provisions of G.S. 105-309 insofar as they deal with real property, as well as that required by this section. (The purpose of this subdivision is to require that individual property records be maintained in sufficient detail to enable property owners to ascertain the method, rules, and standards of value by which property is appraised.)”

The property record cards could be more useful to property owners if they were enhanced with additional explanatory features. Records include information that shows how values are calculated but most of it is contained in computerized forms with codes, etc., that are not understandable to the untrained person without the benefit of potentially extensive explanation by a Tax Administrator representative.

For example, one case file had information indicating that income had been the factor that led to the appraisal decision. In discussing the case thoroughly with the appraisers, it was explained that although income was considered as a factor, the final appraised value was based upon cost/market value. Without significant explanations by the appraisers, the property owner would not have known the method by which the property was appraised. However, records were available and provided that more clearly explained how the value was determined.

The Statute is clear that property owners should be able to review property records and determine the rules, methods, and standards of value used to appraise their property. The Statute does not address the amount and type of explanation required to facilitate understanding but we believe the intent was to make it more readily apparent than the current system allows.

We believe enhancing the understandability of the record card by the increased use of notes, for example, will reduce the likelihood of (1) property owners sustaining claims against the Tax Administrator and (2) bad publicity, embarrassment, and lack of confidence by taxpayers and property owners. Assuring that property owners can determine from the records what rules, methods, and standards are used will have the effect of providing more assurance that the processes are done correctly because there is a record and audit trail to follow. It also decreases the risk of a forgotten step that may have an adverse effect in any legal action against the Tax Administrator.

RECOMMENDATIONS

The following recommendation is designed to meet multiple purposes. They are to; (1) further comply with the Statutes, (2) provide an audit trail for the assessor, and (3) act as a management control mechanism to avoid errors and omissions in the appraisal process. We recommend that the Tax Administrator maintain adequate records for each parcel that provides information in such a manner that an average property owner can reasonable determine how his or her real property values were arrived. This should take the form of additional notes or other explanatory methods that assure that it meets the intent of the Statute. Such a system of record keeping has the potential of assisting the Tax

Administrator in quickly resolving taxpayer concerns and providing the taxpayer with assurance that his or her appraisal is within the boundaries of the laws.

Appendix 1: Agency Comments



Tax Administration

Richard Edwards
Internal Audit Director

July 16, 2013

Subject: Tax Administration Performance Audit

Tax Administration concurs with the recommendations made within the draft audit report. The following actions will be taken to comply with the suggestions set forth:

1. We will begin immediately with any new construction, adding additional comments on the property record card that will assist the taxpayer with a better understanding of how we derived at the value.
2. There are over 103,000 parcels that will require this additional explanation as suggested by the auditor. Due to the large number of records impacted, it is my recommendation that additional comments be added to each parcel during the 2016 revaluation process. This will allow time for computer system programmers to work with our office and assist with the application of such comment for all 103,000 parcels. Should this recommendation not be acceptable, our office would be in jeopardy of our current workloads being completed. Going forward we do commit to updating the records with enhanced comments as we process appeals, or new construction permits.
3. Due to the importance of our appraisal process to Durham County, we will also request that the Department of Revenue and the School of Government review our appraisal process and make any further appraisal recommendations that will strengthen our department workflows and reporting practices.

Thank you for the professionalism and patience extended during this audit. It is our goal to provide the citizens of Durham County a fair and equitable valuation process and implementing the above steps will help to achieve that goal.

A handwritten signature in cursive script that reads "Kimberly H. Simpson".

Kimberly Simpson
Tax Administrator