

LEGISLATIVE AUDIT DIVISION

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MEMORANDUM

TO: Legislative Audit Committee Members

FROM: Joe Murray, Performance Audit Manager

CC: Dan Bucks, Director, Department of Revenue
Alan Peura, Deputy Director, Department of Revenue
Cynthia Monteau Moore, Administrator, Property Assessment Division
Margaret Kauska, Administrator, Information Technology and Processing Division

DATE: June 2011

RE: Performance Audit Follow up (12SP-15): Improving Controls Over the Property Reappraisal Process (orig. 10P-11)

ATTACHMENTS: Original Performance Audit Summary

Introduction

In September 2010, we presented our performance audit titled "*Improving Controls Over the Property Reappraisal Process.*" The audit directed nine recommendations to the Department of Revenue (department) aimed at strengthening property reappraisal activities. We conducted follow-up work to assess the department's progress in implementing the recommendations. This memo summarizes the results of the work we conducted.

Overview

Our audit directed nine recommendations to the Department of Revenue to strengthen its property reappraisal process. Recommendations related to improving documentation of reappraisal activities, defining expectations for property inspections, improving the department review process for contested appraisals, and improving controls over the department's computer system that maintains property tax records and calculates property assessments. Follow-up work found the department making progress in all nine recommendations. The department has implemented three of the recommendations and six are being implemented.

Background

Montana is only one of two states that are a "mass appraisal" state. Mass appraisal is the process of valuing a group of properties as of a given date using common data and standardized methods. This appraisal system gathers data using physical inspection of properties, computer modeling, aerial photography, etc. The department is responsible for reappraising all real property for tax purposes on a

six-year cycle. Because of the complexity of the reappraisal process, it is governed by several state laws, administrative rules, professional appraisal standards, and department policies and procedures. The department's property reappraisal responsibilities are performed by staff located in Helena's Property Assessment Division and four geographic regions around the state. Staff located in local department offices conduct reappraisal activities within their assigned regions. The department is responsible for reappraising more than 950,000 parcels of property statewide. To assist in the administration of property reappraisal for these parcels, the department uses a property appraisal computer system called Orion. Orion maintains and calculates property value information for the department. The department considers Orion to be the official record for property values. In the event property owners are dissatisfied with the appraised value of their property, state law allows for taxpayers to appeal the department's appraisal. Appeals can be made to the department, the County Tax Appeal Board, or State Tax Appeal Board.

Follow-Up Audit Findings

The performance audit report contained nine recommendations to the department. As part of follow-up work, we examined program materials and interviewed department staff. The following sections summarize information relating to follow-up audit work and the implementation status of recommendations.

RECOMMENDATION #1

We recommend the Department of Revenue strengthen controls for documenting reappraisal activities.

Implementation Status: Being Implemented

Work conducted in our original audit identified a number of inconsistencies in how reappraisal activities were documented. Areas where inconsistent documentation was identified included property characteristics in local property records not matching data in Orion, the appraisal method used to value property, and use of different types of documentation to qualify land less than 160 acres as agricultural land. Our follow-up work found the department taking various steps to strengthen its reappraisal process. For example, department appraisers have begun to use laptop computers to help improve appraisal documentation. Each laptop is installed with software that provides access to property appraisal forms so appraisers can enter property assessment data directly on the computer when appraising property. The laptops also include "sketching software" that allows appraisers to draw property dimensions when necessary. According to the department, information from the laptops can then be automatically uploaded to Orion which will help improve the accuracy and consistency of property appraisal data. Department officials indicated they are working on adding other capabilities to the laptops such as obtaining data related to building permits, electrical permits, sales, and deed transfers. Department officials said they are still in the testing phase with the laptops and approximately half of the department's appraisers are using them. Department officials estimate it may be about one year before testing is complete and all field appraisers are using them.

The department has also made other changes to help improve appraisal documentation. For example, an "agricultural production record form" has been drafted and should provide a more consistent method to document how lands less than 160 acres qualify as agricultural land. It requires taxpayers to document the type of product produced on the land (grain, hay, livestock, etc.). This form also requires taxpayers to attach documentation showing agricultural products grown on the property were consumed by people or livestock. Examples of required documentation include information on the amount of hay grown and fed to livestock or evidence of sales transactions (receipts, cancelled checks, etc.) for crops produced on the land. The department also made a change to administrative rule that requires the department to document reasons certain appraisal methods were used. For example, the preferred method for valuing commercial properties is through the use of the income approach. To obtain this information the department sends

income and expense report forms to all commercial property owners. When this information is returned, the information is compiled into models used to value commercial properties. ARM 42.20.107 discusses valuation methods for commercial properties and it was amended to require department staff to document in the official record the reasons valuation methods other than the income approach are used to value commercial properties. For example, if the department has a low rate of return for the income and expense reports and they decide to use an alternative valuation method this now needs to be documented in Orion.

RECOMMENDATION #2

We recommend the Department of Revenue define expectations for the minimum number of property inspections to be conducted during each reappraisal cycle.

Implementation Status: Being Implemented

Our original audit found that appraisal standards recommend physically inspecting properties to obtain the most accurate valuation. Although the department is not statutorily required to physically inspect all properties during each reappraisal cycle, our audit work found the department had not clearly defined expectations for the number of properties that should be inspected. Department officials indicated the number of parcels that exist in the state make it difficult for department staff to physically inspect each one. Our follow-up found that while the department has not defined a specific number of properties to inspect, it has prioritized the types of properties it expects physical inspections to be conducted. For example, department officials said the first priority is property where taxpayers questioned the department's appraised value and request a review of that value. The department also expects staff to physically inspect new construction and property that has been sold to verify the sale. Department officials also indicated they are in the process of developing the department's 2015 reappraisal work plan. They indicated this work plan will include benchmarks for the percentage of properties that should be physically inspected statewide. The work plan is not yet completed, but department officials expect it to be finalized by the end of 2012.

RECOMMENDATION #3

We recommend the Department of Revenue comply with current procedure for department reviews.

Implementation Status: Being Implemented

Department reviews are an important part of the property reappraisal process because it provides taxpayers an opportunity to protest property values. Department procedures require responses to taxpayer requests for department review to occur within thirty days or extensions to this timeframe to be granted if all parties agree. Our original audit work found the department was not complying with this procedure. During the 2011 Legislative Session, Senate Bill 295 was passed requiring the department to provide more timely responses to taxpayers when they request a department review of their appraised value. In response, the department is finalizing a "taxpayer appeal packet." This packet will provide taxpayers requesting a department review with information on how the department arrived at its appraised value. It will include appraisal data such as comparable sales, appraisal methodology used to value the property, the reasons that a specific appraisal methodology was used, etc. Department officials indicated the overall goal is to improve communication with taxpayers and help them determine how the department came up with its appraised values. This packet should be completed sometime this summer. The department has also drafted a follow-up letter to send to taxpayers to keep them apprised of the status of their department review request if they are unable to meet with the taxpayer within 30 days. Department officials said the letter will be used on a statewide basis and it should be in place within the next few months.

RECOMMENDATION #4

We recommend the Department of Revenue establish standardized methods for documenting supervisory review.

Implementation Status: Being Implemented

Our audit recommendation related to needed improvements in how the department documented supervisory reviews of appraisal work. For a short term solution, the department is currently using a spreadsheet to document supervisory review of appraisal activities. This includes any changes made to property values which now require supervisors to document their approval of the change. The spreadsheet shows property value before a change was made, after a change was made, and the reason the change occurred. For its long term solution, the department is working on adding fields to the Orion database so supervisory review of appraisals and any corresponding changes can be documented directly in the database. The department anticipates the change will be completed by the end of 2012.

RECOMMENDATION #5

We recommend the Department of Revenue identify, compile, and analyze management information to improve the property reappraisal process.

Implementation Status: Implemented

Our original audit found the department needed additional information to better manage the reappraisal process. According to the department, the major change has been development of a Statistical Analysis Software. This software allows managers and staff to build customized reports related to property and where property is located. Department officials indicated managers run reports using a variety of factors such as building or electrical permits, property that has been visited or not visited during a reappraisal cycle, properties located within natural disaster areas, etc. Based on interviews with department officials, these reports should help the department better direct staff resources during the reappraisal cycle.

RECOMMENDATION #6

We recommend the Department of Revenue:

- A. Implement and follow a complete change control process that meets industry standards.**
- B. Ensure the test environment reflects the current Orion production environment.**

Implementation Status: Implemented

In response to our recommendation, the department has implemented a new change control process that is applicable to all their systems, including Orion. In our audit report, we recommended a change control process that meets industry standards, which require management approval, system development, testing, and acceptance. We reviewed recent change control documentation and confirmed the process is in line with best practices. When a change to an application is made, it needs to be tested in a test environment prior to implementing it into production. This is necessary to ensure the change will work and won't negatively impact the system. For this to be effective, the test environment must reflect the production environment. We recommended the department ensure the test environment reflects the current Orion production environment. In response, department information technology staff explained they attempted to create a real time update to the test environment, but based on the architecture of Orion, they were unable to do it. The primary problem is the way Orion is configured. Constantly replicating to the test environment would draw all the processing resources making Orion performance extremely slow for the users. Instead, they developed a manual process where the test environment is updated once a week. Although the test environment is only updated weekly instead of in real time, it is still an improvement over the four month gap we identified in our report.

RECOMMENDATION #7

We recommend the Department of Revenue:

- A. Limit system user access for "user configurability" and "override" capabilities.**
- B. Require all system changes to go through established change control procedures.**
- C. Develop and implement management procedures to review instances of "overrides" for correctness and authorization.**

Implementation Status: Being Implemented

The department has taken steps to address this recommendation but still has improvements to make. We recommended the department limit user access for "user configurability" and "override" capabilities. Any formal access security reviews at the department should involve the department's information technology security officer. During follow-up, we met with the security officer and there have been limited discussions with Property Assessment Division (PAD) management about reviewing or limiting access. The security officer is currently in the process of setting up meetings with PAD management to review all levels of access for all Orion users, including user configurability and override. Since user configurability allows users to modify system calculations and processing, we recommended they establish a change control process to ensure changes are request, approved, and tested. During follow-up work, we were not able to verify a change control process has been implemented for changes to Orion resulting from user configurability. The only control they have added is the creation of fields in Orion where users enter the justification for performing an override. We reviewed a selection of overrides that have occurred during 2012 and verified that many users are entering justification for changes. However, users are not required to enter justification and out of the 1,164 overrides we reviewed, we still found 27 records that did not include a justification. Although the department has not implemented a formal change control process, they have implemented some level of control by requesting justification when overrides occur. This control could be strengthened further by requiring justification be entered in Orion.

Our recommendation also indicated the department should implement management procedures to review overrides. We confirmed PAD management has created a report that includes the occurrence of an override and the reasoning behind it. The intent is to make the report available to each regional manager so they can review overrides made by their staff. At this point, the report has been developed, but a formal process for reviewing it has not been established and it has not yet been made available to all regional managers.

RECOMMENDATION #8

We recommend the Department of Revenue activate input controls to ensure complete and accurate entry of data into Orion.

Implementation Status: Being Implemented

During our audit, we identified instances where required data was missing in Orion property tax records. Our recommendation suggests they implement input controls to ensure critical data is required when creating a property tax record. In response to our recommendation, the department has begun reviewing existing system edits (i.e. input controls). We observed records being created and confirmed in several cases the edits are working and an error message will appear if critical data is missing. However, our review of Orion did note inconsistencies on whether or not input controls had been activated. For example, data fields related to property types could not be changed because input controls had been activated while fields related to the address for a property could still be changed. According to the department, the process of identifying fields that require edits is ongoing.

RECOMMENDATION #9

We recommend the Department of Revenue review hardware capabilities to determine if Orion can more appropriately handle processing.

Implementation Status: Implemented

In 2010, the department contracted with a third-party to analyze Orion processing and architecture to identify ways to improve performance. In January 2011, the contractor issued a report recommending the department work with the Orion vendor to improve performance. Actions recommended include activating settings designed to automatically optimize system performance, streamlining data searches to improve processing speed, and continue monitoring performance and work with the vendor to address issues. The department is currently in the process of adopting these recommendations.

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