



# MICHIGAN

OFFICE OF THE AUDITOR GENERAL

## AUDIT REPORT



THOMAS H. McTAVISH, C.P.A.  
AUDITOR GENERAL

The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

– Article IV, Section 53 of the Michigan Constitution

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Michigan  
Office of the Auditor General  
**REPORT SUMMARY**

*Performance Audit*

Report Number:  
271-0245-08

*Principal Residence Exemption Program*

*Department of Treasury*

Released:  
March 2009

*In 1994, Michigan voters approved Proposal A, which provided an exemption, now known as a principal residence exemption (PRE), from the 18-mill school operating tax. The Department of Treasury administers the PRE Program, which is responsible for ensuring the validity of PREs that are claimed by property owners. This performance audit was required by Section 947, Act 261, P.A. 2008.*

**Audit Objective:**

To assess the effectiveness of the Department's efforts to identify and to audit questionable PREs in counties that have elected to have the State perform these compliance audits.

**Audit Conclusion:**

We concluded that the Department was effective in its efforts to identify and to audit questionable PREs in counties that have elected to have the State perform these compliance audits. However, we noted one reportable condition (Finding 1).

**Reportable Condition:**

The Department should take additional steps to ensure that it has complete and accurate tax assessment roll data when it performs PRE compliance audits (Finding 1).

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**Audit Objective:**

To assess the effectiveness of the Department's efforts to assist and to monitor counties that have elected to perform PRE compliance audits.

**Audit Conclusion:**

We concluded that the Department was moderately effective in its efforts to assist and to monitor counties that have elected to perform PRE compliance audits. We noted three reportable conditions (Findings 2 through 4).

**Reportable Conditions:**

The Department did not provide counties with data on all parcels with questionable PREs that had been claimed by property owners (Finding 2).

The Department could improve its assistance to counties by providing audit guidance, audit-related training, and aid in obtaining and using Statewide data (Finding 3).

The Department should seek amendatory legislation to improve PRE Program reporting by local governmental units (Finding 4).

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**Agency Response:**

Our audit report contains 4 findings and 4 corresponding recommendations. The Department's preliminary response indicated that it agrees with all of the recommendations.

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A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: <http://audgen.michigan.gov>



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AUDITOR GENERAL

March 27, 2009

Mr. Robert J. Kleine  
State Treasurer  
Richard H. Austin Building  
Lansing, Michigan

Dear Mr. Kleine:

This is our report on the performance audit of the Principal Residence Exemption Program, Department of Treasury.

This report contains our report summary; description of program; audit objectives, scope, and methodology and agency responses; comments, findings, recommendations, and agency preliminary responses; four flow charts and two maps, presented as supplemental information; and a glossary of acronyms and terms.

The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL



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## Description of Program

### Statutory History

The Principal Residence Exemption (PRE) Program, formerly known as the Michigan Homestead Exemption Program, was created by Act 237, P.A. 1994 (Sections 211.7cc(1) - 211.7cc(30) of the *Michigan Compiled Laws*), as part of the larger school finance reform legislation passed in that year as a result of voter approval of ballot Proposal A. The legislation allowed homeowners who occupy their property as their principal residence\* to claim an exemption from the 18-mill school operating tax provided for under the State School Aid Act of 1979.

Act 105, P.A. 2003, amended the legislation to allow a county treasurer or county equalization director to elect to audit the validity of PREs in all local tax collecting units located in the county. For taxes levied after December 31, 2005, Act 105 requires the Department of Treasury, which administers the PRE Program, to conduct an audit for each county that does not elect to perform its own audit. To defray costs for conducting the audit, the law permits assessing interest on the additional taxes due related to existing invalid PREs for up to three prior years and provides for sharing the interest collected between the Department and local governmental units impacted by the audit results.

To reduce the property tax burden on homeowners selling their homes during a slow real estate market, Act 96, P.A. 2008, effective April 8, 2008, was enacted to allow a homeowner who has established a new principal residence in Michigan to retain a PRE on property previously exempt as the owner's principal residence. The previous PRE is valid as long as the property is not occupied, is for sale, is not leased, and is not used for any business or commercial purpose. In addition, Act 243, P.A. 2008, effective July 17, 2008, allows a homeowner to retain a valid PRE on his/her principal residence while on active military duty in the United States Armed Forces even if the principal residence is rented or leased.

### Local Governmental Unit PRE Program Activities

As of November 2008, there are 1,857 local governmental units (counties, cities, townships, or villages) in Michigan. To be exempt from the property tax levied on a principal residence by a local school district for school operating purposes, a

\* See glossary at end of report for definition.

homeowner has to file a request, known as an affidavit\*, for the PRE with the local assessor where the property is located. If the request is valid, the local assessor is required to adjust the tax assessment roll\* to reflect the exemption and to send the affidavit to the Department of Treasury. If the request is not valid, the local assessor is required to notify the taxpayer by issuing a denial\* and to send a copy of the denial to the Department. When the property is no longer used as the homeowner's principal residence, the homeowner is to notify the local assessor by completing and submitting a request for rescission\*. The local assessor is to remove the PRE from the tax assessment roll and send a copy of the rescission to the Department. Flow Charts 1 and 2, presented as supplemental information, depict these program activities.

When a county-conducted audit identifies an invalid PRE, the county notifies the homeowner by issuing a denial and is required to send a copy of the denial to the Department. In addition, the local governmental unit in possession of the tax assessment roll is to remove the PRE from the tax assessment roll and to prepare a corrected tax bill for any additional taxes and interest due for up to three prior years, if applicable. In addition, the county is required to report any changes in property taxable value on the tax assessment roll to the Michigan Department of Education. A school district's foundation allowance\* is funded by both State payments from the School Aid Fund and local property taxes. Accordingly, any changes to the 18-mill school operating tax exemption status value of property located within the school district will impact the required share of funding from these sources. Flow Chart 4, presented as supplemental information, depicts this audit process.

#### Department of Treasury PRE Program Activities

The Department of Treasury's program activities included two key initiatives: conducting PRE compliance audits and establishing a new Statewide Web-based PRE database.

As of October 2005, 30 counties elected to have the Department perform their compliance audits for the two-year period 2006 and 2007. In December 2005, the Department solicited bids from vendors to perform PRE compliance audits; however, the two bids received were not acceptable. In May 2006, the Department again solicited bids and, in September 2006, entered into a three-year contract valued at approximately \$3 million to audit the validity of PREs in the 30 counties. To conduct the audits, the contractor acquired tax assessment information, implemented a

\* See glossary at end of report for definition.

methodology to identify instances of potentially invalid claims for PREs, designed questionnaires to solicit further information for PREs initially identified as questionable, and made a determination and reported to the Department regarding the potentially invalid PREs identified through this audit process. Map 1, presented as supplemental information, depicts the 30 counties that elected to have the State perform the PRE audits for their counties.

When a State-conducted audit identifies an invalid PRE, the Department notifies the homeowner by issuing a denial and also notifies the county treasurer and the local governmental tax assessing unit. The county treasurer or the local governmental tax assessing unit is responsible for removing the PRE from the tax assessment roll and preparing a corrected tax bill for any additional taxes and interest due for up to three prior years, if applicable. In addition, the county is required to report to the Michigan Department of Education any changes in property taxable value on the tax assessment roll. Flow Chart 3, presented as supplemental information, depicts this audit process.

Beginning in June 2007, the PRE Program was administered by the Property Tax Exemption Section, Property Services Division, Bureau of Local Government Services. The focus of the new PRE Program is to comply with the statutory obligation to provide for audits in counties that elected to have the State do so and to provide information and assistance to counties that elected to perform their own audits.

Prior to 2005, the Department utilized information from various PRE Program forms to maintain a database of PREs. However, the database proved to be unreliable in 2004. The Legislature appropriated funding for the Department in Act 345, P.A. 2006 (the fiscal year 2006-07 General Government Appropriations Act), for the establishment of a new Statewide Web-based PRE database for the purpose of enforcing PRE compliance. The Department contracted in July 2008 with a vendor to develop this new database, which will be accessible to local governmental units. The contractor is to provide three years of data collection and system maintenance and is to annually acquire, in an electronic format, tax assessment roll information from the 83 counties within the State. The Department reported to the Legislature in January 2009 that it had collected data from 81 of the 83 counties Statewide and anticipated that this database would be operational by March 2009.

As of September 30, 2008, the PRE Program had four employees. PRE Program expenditures and the State's share of interest from local governmental units for the three fiscal years 2005-06 through 2007-08 are presented in the following table:

Fiscal Year	PRE Program Expenditures	State's Share of Interest Received
2005-06	\$ 355,643	\$181,522
2006-07	\$1,515,279	\$149,645
2007-08	\$1,123,128	\$345,145

Potential future savings to the School Aid Fund will occur as a result of additional property tax collections for the removal of invalid PREs. The realization of any savings depends on local governmental units' removal of the invalid PRE designation on property, thus making it subject to the 18-mill school operating tax assessment and collection of any retroactive taxes allowed by statute.

In April 2008, the Department surveyed 30 counties to determine the status of the denials issued as a result of the 2007 PRE audits the Department conducted. The following table is a summary of the 6 counties that fully responded to the survey:

County	Number of Denials Forwarded	Number of Property Owners Billed*	Taxes Billed	Interest Billed	Taxes Paid	Interest Paid
A	16	12	\$ 5,148	\$ 878	\$ 5,148	\$ 878
B	165	95	168,749	43,137	95,974	22,753
C	53	25	35,932	8,052	16,564	3,635
D	349	249	572,114	139,728	453,349	16,358
E	416	231	425,455	100,144	209,231	50,392
F	78	32	49,204	12,374	37,180	9,694
Total	<u>1,077</u>	<u>644</u>	<u>\$1,256,601</u>	<u>\$ 304,314</u>	<u>\$ 817,445</u>	<u>\$ 103,711</u>

\* Examples of reasons given by the counties as to why they had not billed property owners retroactive taxes included bona fide purchases\*, qualified agricultural property exemptions, contiguous property, billings by local assessors, and foreclosures.

\* See glossary at end of report for definition.

## Audit Objectives, Scope, and Methodology and Agency Responses

### Audit Objectives

Our performance audit\* of the Principal Residence Exemption (PRE) Program, Department of Treasury, had the following objectives:

1. To assess the effectiveness\* of the Department's efforts to identify and to audit questionable PREs in counties that have elected to have the State perform these compliance audits.
2. To assess the effectiveness of the Department's efforts to assist and to monitor counties that have elected to perform PRE compliance audits.

### Audit Scope

Our audit scope was to examine records and processes related to the Principal Residence Exemption Program. 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 audit procedures, conducted from May through November 2008, included examination of records and activities primarily for the period October 1, 2005 through June 30, 2008.

### Audit Methodology

We conducted a preliminary review to gain an understanding of the PRE Program. This review included interviewing PRE Program staff and reviewing applicable legislation, guidelines, and processes to gain an understanding of the activities of the different governmental units responsible for Program compliance Statewide. We reviewed the Department's contract with the vendor contracted to conduct PRE compliance audits and the Department's request for proposal for the development of a Web-based Statewide database. We reviewed PRE Program related expenditures and the State's share of interest remitted by counties to the Department for the period October 1, 2005 through June 30, 2008. In addition, we reviewed the accuracy of the Department's

\* See glossary at end of report for definition.

Program Report to the Legislature for the period January 1, 2008 through March 31, 2008.

To accomplish our first objective, we interviewed contractor staff and observed the contractor's off-site audit environment, including data security procedures. We reviewed a random sample of 100 PREs identified by the contractor as potentially invalid during the first PRE audit for the period 2006 and 2007. We analyzed the 6,874 denials issued by the Department and the 1,268 appeals of these denials that had been filed by property owners as a result of the first PRE audit. In addition, we conducted a telephone survey with 5 of the 30 counties that elected to have the State perform their PRE audits for the period 2006 and 2007.

To accomplish our second objective, we reviewed the Department's efforts to monitor PRE Program activities occurring at local governmental units and gained an understanding of the Program related reporting, including the various PRE Program forms. We analyzed the 7,270 denials that had been sent by local governmental units to the Department for the period October 1, 2007 through June 30, 2008. We conducted a telephone survey with 15 of the 53 counties that elected to perform their own audits for the period 2006 and 2007. We identified the State Tax Commission's on-site process for monitoring compliance by local governmental units with the General Property Tax Act and State Tax Commission rules, known as a 14-Point Review, and assessed the results of these reviews conducted for the period 2002 through 2007. We identified the process for a county to report property taxable value through the Michigan Department of Education's Web-based Taxable Value System.

### Agency Responses

Our audit report contains 4 findings and 4 corresponding recommendations. The Department's preliminary response indicated that it agrees with all of the recommendations.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and the State of Michigan Financial Management Guide (Part VII, Chapter 4, Section 100) require the Department to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

COMMENTS, FINDINGS, RECOMMENDATIONS,  
AND AGENCY PRELIMINARY RESPONSES

# EFFECTIVENESS OF EFFORTS TO IDENTIFY AND TO AUDIT QUESTIONABLE PREs IN COUNTIES THAT ELECTED TO HAVE THE STATE PERFORM THESE COMPLIANCE AUDITS

## COMMENT

**Audit Objective:** To assess the effectiveness of the Department of Treasury's efforts to identify and to audit questionable principal residence exemptions (PREs) in counties that have elected to have the State perform these compliance audits.

**Audit Conclusion:** We concluded that the Department was effective in its efforts to identify and to audit questionable PREs in counties that have elected to have the State perform these compliance audits. However, our assessment disclosed one reportable condition\* related to the completeness and accuracy of the data used in conducting PRE compliance audits (Finding 1).

Section 205.28 of the *Michigan Compiled Laws* defines certain aspects of tax auditing and collection processes as protected, nonpublic data. As a result, this report summarizes opportunities for improvement in the processes. In accordance with generally accepted government auditing standards, we have separately reported specific improvements related to the protected nonpublic processes to the Department of Treasury management.

## FINDING

### 1. Conducting PRE Compliance Audits

The Department should take additional steps to ensure that it has complete and accurate tax assessment roll data when it performs PRE compliance audits. Incomplete and inaccurate tax assessment roll data reduces the Department's effectiveness and efficiency\* in identifying invalid PREs and any related subsequent savings to the School Aid Fund.

For taxes levied after December 31, 2005, Section 211.7cc(14) of the *Michigan Compiled Laws* requires that the Department conduct an annual audit of PREs for those counties that have elected not to perform their own audits. In September 2006, the Department entered into a three-year contract valued at approximately

\* See glossary at end of report for definition.

\$3 million for PRE audits of 30 counties. As a result of the 2007 audits, the Department denied 6,874 PREs. However, the Department's audits were hindered by the lack of complete and consistent tax assessment roll data obtained from multiple local governmental units.

Our review of the Department's PRE audit process included reviewing the results of the audits conducted during 2007 for tax year 2006. In addition, we reviewed a sample of 100 of 7,353 files of properties initially identified as potential audit exceptions, but later accepted as valid PREs by the contractor.

We noted:

- a. The Department's PRE audit data did not include tax assessment roll data for all 83 counties. Because owners may also have claimed a PRE on property located in one of the counties for which the Department did not obtain data, invalid PREs may not have been identified. Based on our review of the contractor's audit results, which identified instances of multiple property ownership, we determined that the Department should obtain tax assessment roll data for all Michigan counties for its PRE audits.
- b. Local governmental units incorrectly recorded PREs on qualified agriculture exempt property. Twelve of the 100 files in our sample indicated that the local governmental unit recorded a PRE on a property that actually had a qualified agricultural property exemption. Although this incorrect recording on the tax assessment roll between the two exemptions may ultimately have no impact on taxes, it negatively impacts the efficiency of the audit process. The Department should issue additional guidance to local governmental units regarding the appropriate use of qualified agricultural property exemptions.
- c. Local governmental units did not uniformly record name and address information on the tax assessment roll. While some recorded the appropriate name and address of the owners of the property, others incorrectly listed mortgage or escrow company addresses on the tax assessment rolls for the property owners. The Department should issue additional guidance to local governmental units to ensure that the tax assessment roll data is accurate.

- d. Local governmental units did not always use a unique parcel identification number. Consequently, duplicate parcel numbers appeared when the contractor merged the tax assessment roll data from some local governmental units. Section 211.25a of the *Michigan Compiled Laws* states that a local governmental unit may establish a uniform numbering system for parcels within its jurisdiction; however, it is not required. The Department may need to issue additional guidance to local governmental units for recording parcel identification numbers on the tax assessment roll.

Subsequent to the 2007 PRE audits, the Department contracted with a vendor to develop the new Statewide Web-based database to annually acquire, in an electronic format, tax assessment roll information from the 83 counties within the State. The new Statewide database may aid in addressing some of the problems with the tax assessment roll data noted above. While the Department does not have direct statutory or administrative authority over local governmental units, the Department should take additional steps as noted above to improve the completeness and accuracy of tax assessment roll data.

### **RECOMMENDATION**

We recommend that the Department take additional steps to ensure that it has complete and accurate tax assessment roll data when it performs PRE compliance audits.

### **AGENCY PRELIMINARY RESPONSE**

The Statewide PRE database, which the Department recently implemented, now contains tax assessment data from all 83 counties. The Department agrees that administration of the PRE Program could be improved were local governmental units to properly treat qualified agricultural property, develop a uniform method of recording taxpayer name and address information, and develop a uniform method of parcel identification. The Department has neither direct statutory nor administrative control over how local governmental units discharge any of these functions. However, the Department informed us that it will continue, within available resources, to offer guidance to local governmental units concerning these functions.

# EFFECTIVENESS OF EFFORTS TO ASSIST AND TO MONITOR COUNTIES THAT HAVE ELECTED TO PERFORM PRE COMPLIANCE AUDITS

## COMMENT

**Audit Objective:** To assess the effectiveness of the Department's efforts to assist and to monitor counties that have elected to perform PRE compliance audits.

**Audit Conclusion:** We concluded that the Department was moderately effective in its efforts to assist and to monitor counties that have elected to perform PRE compliance audits. Our assessment disclosed three reportable conditions related to providing counties with data on questionable PREs, improvements in assistance to counties, and improvements in PRE Program reporting (Findings 2 through 4).

Section 205.28 of the *Michigan Compiled Laws* defines certain aspects of tax auditing and collection, processes as protected, nonpublic data. As a result, this report summarizes opportunities for improvement in the processes. In accordance with generally accepted government auditing standards, we have separately reported specific improvements in the protected nonpublic processes to the Department of Treasury management.

## FINDING

### 2. Providing Data on Questionable PREs

The Department did not provide counties with data on all parcels with questionable PREs that had been claimed by property owners. As a result, the effectiveness of the counties identifying all invalid PREs on property within their counties may have been reduced.

Section 211.7cc(11) of the *Michigan Compiled Laws* requires the Department to provide annually to a county treasurer or county equalization director a list of questionable PREs for a county opting to perform PRE audits.

The Department did not provide data on all questionable and potentially invalid PREs to counties that had opted to perform the PRE audits for the two-year election period 2006 and 2007. In addition, 4 (44%) of the 9 counties that we surveyed responded that the lack of data on all questionable PREs from the State may have negatively impacted the effectiveness of their audits.

The Department informed us that it did not provide data on questionable PREs because it did not believe that the PRE Statewide data was accurate. In 2003 and 2004, the Department provided lists of questionable PREs to counties generated from queries of the database used to track the exemptions. At that time, the Department identified approximately 70,000 potentially invalid PREs and contacted taxpayers to provide further proof of eligibility. However, because information in the database was questionable, these activities resulted in identifying only approximately 3,000 invalid PREs and caused considerable taxpayer concern.

The Department contracted in July 2008 with a vendor to develop the new Statewide Web-based database and to provide three years of data collection and system maintenance. The contractor is to annually acquire, in an electronic format, tax assessment roll information from the 83 counties within the State. The Department informed us that it believes that it will use the new Statewide Web-based database to provide counties with data on all questionable PREs.

### **RECOMMENDATION**

We recommend that the Department provide counties with data on all parcels with questionable PREs that have been claimed by property owners.

### **AGENCY PRELIMINARY RESPONSE**

Section 7cc(11) of the General Property Tax Act provides, in part, that "[t]he department of treasury shall annually provide the county treasurer or his or her designee or the county equalization director or his or her designee a list of parcels of property located in that county for which an exemption may be erroneously claimed." While the Department has routinely provided such leads to counties when questionable PREs have been brought to their attention, the Department's efforts were hampered by the fact that the previous affidavit database was not uniformly reliable. The Department informed us that, with the implementation of the new Statewide PRE database, it will, within available resources, be able to provide more accurate leads lists to counties that have elected to maintain their own audit programs.

## **FINDING**

### **3. Providing Additional Assistance to Counties**

The Department could improve its assistance to counties by providing audit guidance, audit-related training, and aid in obtaining and using Statewide data. While the Department does not have direct statutory or administrative authority over local governmental units, such assistance would promote effective county PRE compliance audits.

Section 211.7cc(10) of the *Michigan Compiled Laws* permits a county, rather than the Department, to elect to audit the validity of PREs claimed on property for all local governmental units within the county. When the Department created its new PRE Program in November 2006, it indicated that a focus was to provide information and assistance to counties that elected to perform their own audits.

In our review of the Department's PRE Program and in surveys we conducted with 15 of the 53 counties that elected to perform PRE audits for the two-year election period 2006 and 2007, we noted the following opportunities for Program improvement:

- a. The Department could improve its assistance to counties by developing audit guidance in conducting PRE audits.

The Department developed "Guidelines for the Michigan Homeowner's Principal Residence Exemption Program." However, this booklet provided only general instruction for interpreting and applying the PRE legislation and not specific guidance on audit techniques or best practices for identifying potentially invalid PREs. The Department informed us that although it planned to develop additional manuals, such as "best practices" for the PRE Program, it had not yet done so. Among the counties surveyed, we noted a variety of techniques, which ranged in effectiveness, employed to identify potentially invalid PREs.

- b. The Department could improve its assistance to counties by providing audit-related training in conducting PRE audits.

Ten of 15 counties that we surveyed indicated that they would like PRE audit training from the Department. Although some counties responded that they

had received training provided by the Department, it had occurred more than three years ago and was not audit specific.

- c. The Department could improve its assistance to counties by aiding them in obtaining and using Statewide data.

We noted inconsistencies among the 15 surveyed counties in their awareness of and ability to obtain and use data from State agencies and other sources related to property owner identification. The majority of counties in our survey identified access to Statewide data as a need.

### **RECOMMENDATION**

We recommend that the Department improve its assistance to counties by providing audit guidance, audit-related training, and aid in obtaining and using Statewide data.

### **AGENCY PRELIMINARY RESPONSE**

The General Property Tax Act does not require the Department to provide counties with audit guidance, audit-related training, or assistance in obtaining and using Statewide data. However, the Department informed us that it will continue to assist counties in regards to these functions within available resources. The Statewide PRE database, which the Department recently implemented, should be of particular assistance to counties in gaining access to timely, Statewide PRE information.

### **FINDING**

#### **4. Improving PRE Program Reporting**

The Department should seek amendatory legislation to improve PRE Program reporting by local governmental units. Such improvements would allow the Department to help ensure that counties are conducting PRE audits, measure the impact of the PRE Program on the State's School Aid Fund, and reduce current PRE Program inefficiencies.

Sections 211.7cc(10) and 211.7cc(12) of the *Michigan Compiled Laws* allow a county to elect to audit PREs within its jurisdiction and to enter into agreements with the local governmental unit assessors to implement and administer PRE

audits. The statute does not require that counties report the results of their audits, including changes to the taxable value of property identified as having had invalid PREs.

Our review of the Department's efforts to monitor PRE Program activities occurring at local governmental units and various PRE Program related reporting disclosed:

- a. The Department lacks sufficient statutory authority to determine whether local governmental units conducted statutorily required PRE audits.

The Department developed two methods of obtaining information about the 53 counties opting to perform PRE audits. The Department conducted a survey of the 53 counties in April 2008. Six of the 18 counties that responded indicated that they had not conducted audits in 2007. Our survey of 15 of the 53 counties disclosed an additional 6 counties that responded that they had not conducted PRE audits.

Also, the Department tracked PRE interest remitted to it by counties for the State's 10% share of the interest on additional taxes due when invalid PREs were identified and denied. The Department received PRE related interest from the 53 counties totaling \$203,000 for the period October 1, 2005 through May 31, 2008. In addition, during this period, 10 of the 53 counties did not remit interest to the Department. Five of these 10 counties border one of the Great Lakes and may have a greater potential for non-PRE vacation residences.

- b. The Department lacks the ability to determine the impact of county-conducted PRE audits on funding to school districts paid from the School Aid Fund.

Local governmental units are responsible for identifying and removing invalid PREs from the tax assessment rolls and reporting taxable value changes to the Michigan Department of Education. However, local governmental units are not required to report the results of their audits to the Department. The lack of reporting audit results to the Department hinders the Department's ability to determine the impact of the county-conducted PRE audits on the School Aid Fund.

Changes in taxable value due to PRE audits are not distinguishable when reported by counties to the Michigan Department of Education because taxable value is reported at an aggregated value at the county or school district level. Also, any changes to this value throughout the year are impacted by numerous other factors, such as Michigan Tax Tribunal decisions and the real estate market in general.

Because a school district's foundation allowance is funded by both State payments from the School Aid Fund and local property taxes, any changes to the taxable value of property located within the school district impacts the share of funding from each of these sources. Invalid PREs reduce property owners' taxes, thus increasing the share of the school districts' foundation allowance paid from the School Aid Fund.

- c. The Department should identify and then seek amendatory legislation to eliminate unnecessary PRE Program reporting.

PRE statutes require that local governmental units forward to the Department copies of various forms detailing PRE activity on property, including Homeowner's Principal Residence Exemption Affidavit forms (affidavits), Request to Rescind Homeowner's Principal Residence Exemption forms (rescissions), and Notice of Denial of Homeowner's Principal Residence Exemption forms (denials). Formerly, the Department used these forms to maintain a Statewide database of PREs. However, the State will update a new Statewide Web-based database annually with electronically obtained county data.

### **RECOMMENDATION**

We recommend that the Department seek amendatory legislation to improve PRE Program reporting by local governmental units.

### **AGENCY PRELIMINARY RESPONSE**

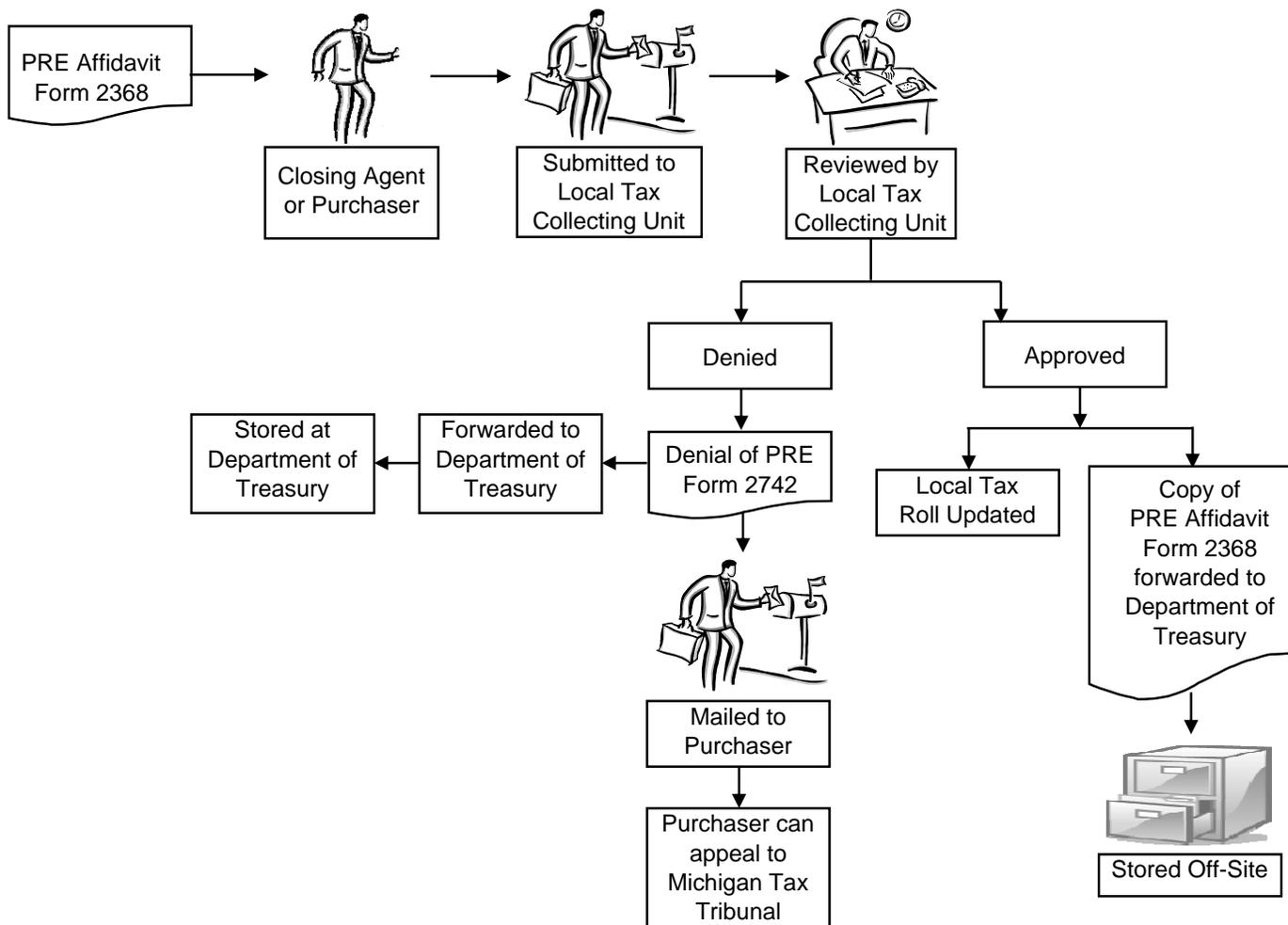
The Department agrees with this recommended opportunity for improvement and informed us that it will, again, seek legislative support for amendatory legislation for reporting requirements by local governmental units.

# SUPPLEMENTAL INFORMATION

**PRINCIPAL RESIDENCE EXEMPTION (PRE) PROGRAM**

Department of Treasury

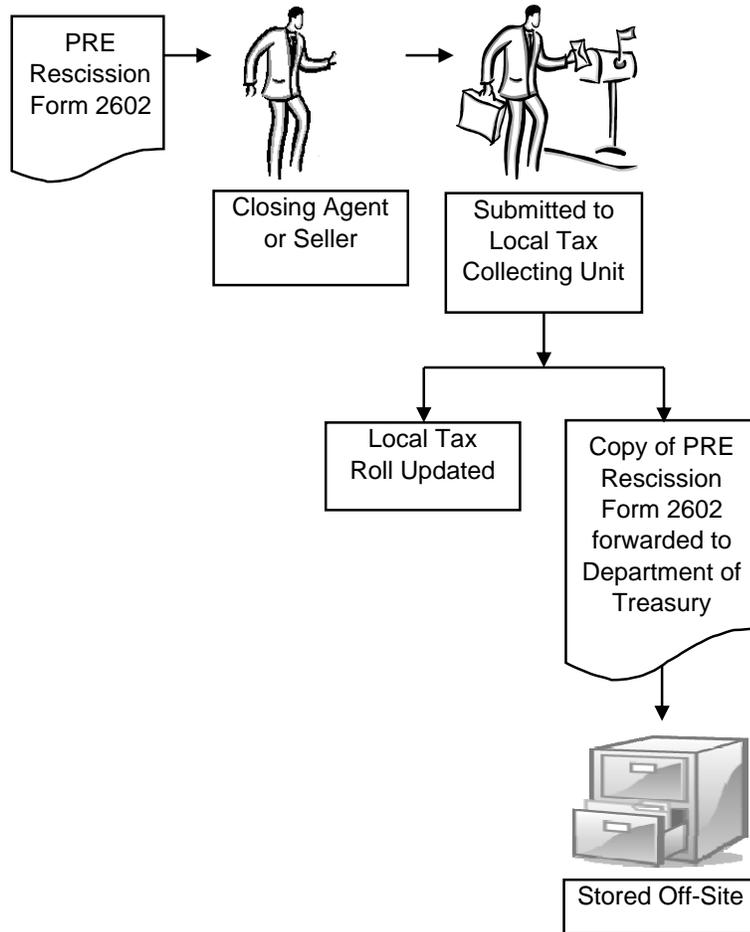
Process to Request a PRE on Property  
As of November 2008



Source: Auditor prepared based on information obtained during the audit and Section 211.7cc of the *Michigan Compiled Laws*.

PRINCIPAL RESIDENCE EXEMPTION (PRE) PROGRAM  
Department of Treasury

Process to Rescind a PRE on Property  
As of November 2008

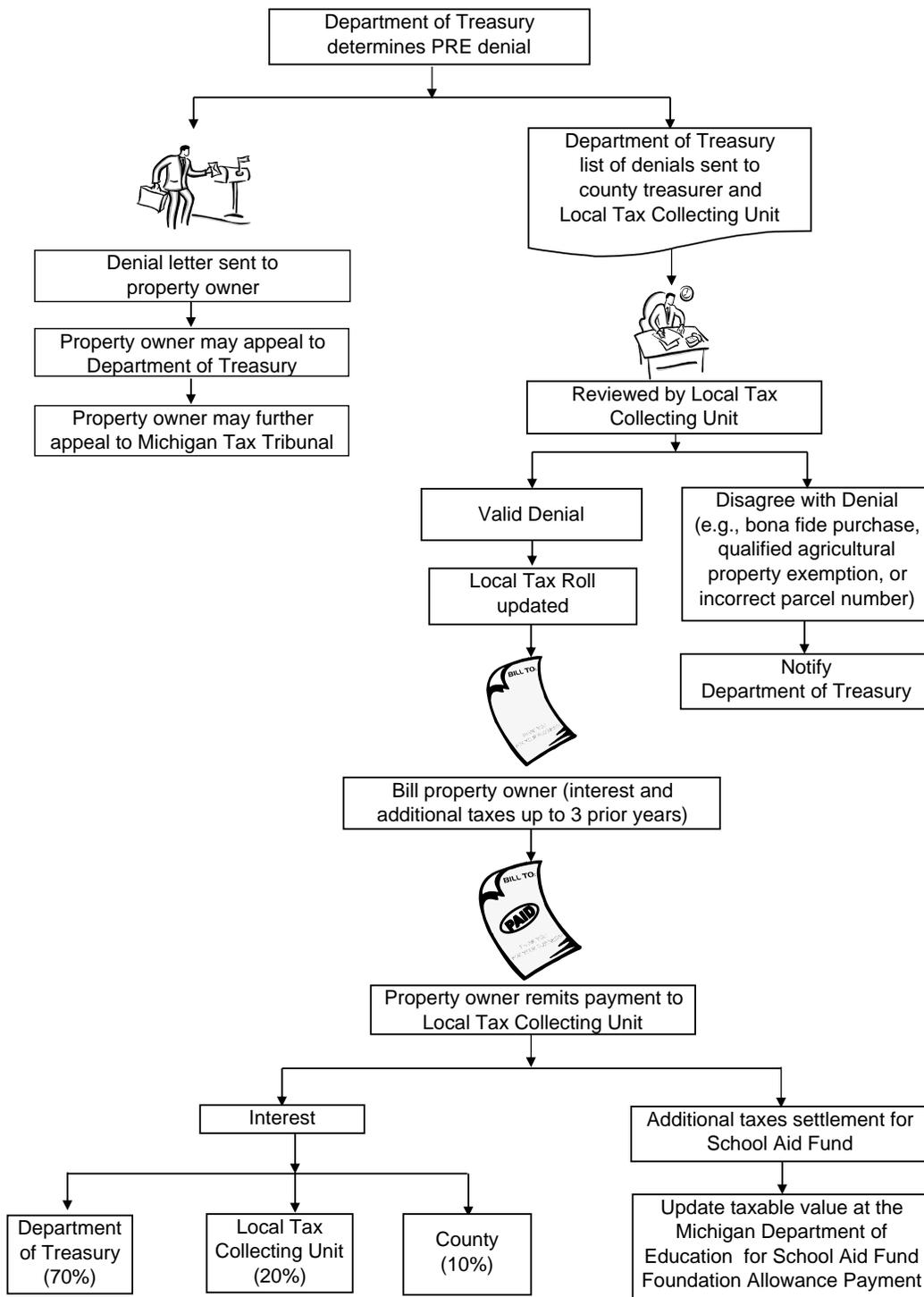


Source: Auditor prepared based on information obtained during the audit and Section 211.7cc of the *Michigan Compiled Laws*.

**PRINCIPAL RESIDENCE EXEMPTION (PRE) PROGRAM**

Department of Treasury

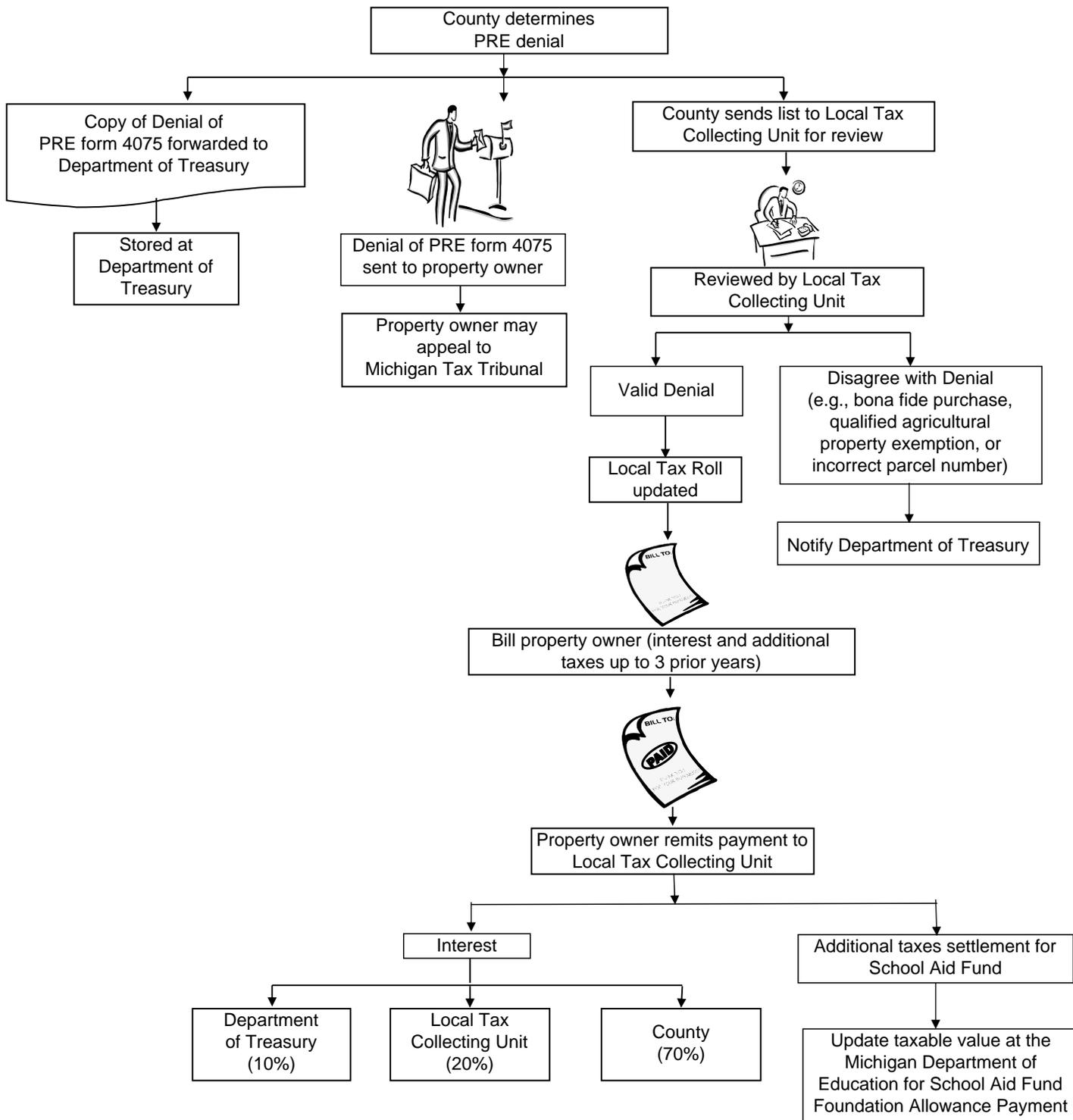
PRE Audit Process for State-Conducted Audit  
As of November 2008



Source: Auditor prepared based on information obtained during the audit and Section 211.7cc of the Michigan Compiled Laws.

**PRINCIPAL RESIDENCE EXEMPTION (PRE) PROGRAM**  
Department of Treasury

PRE Audit Process for County-Conducted Audit  
As November 2008

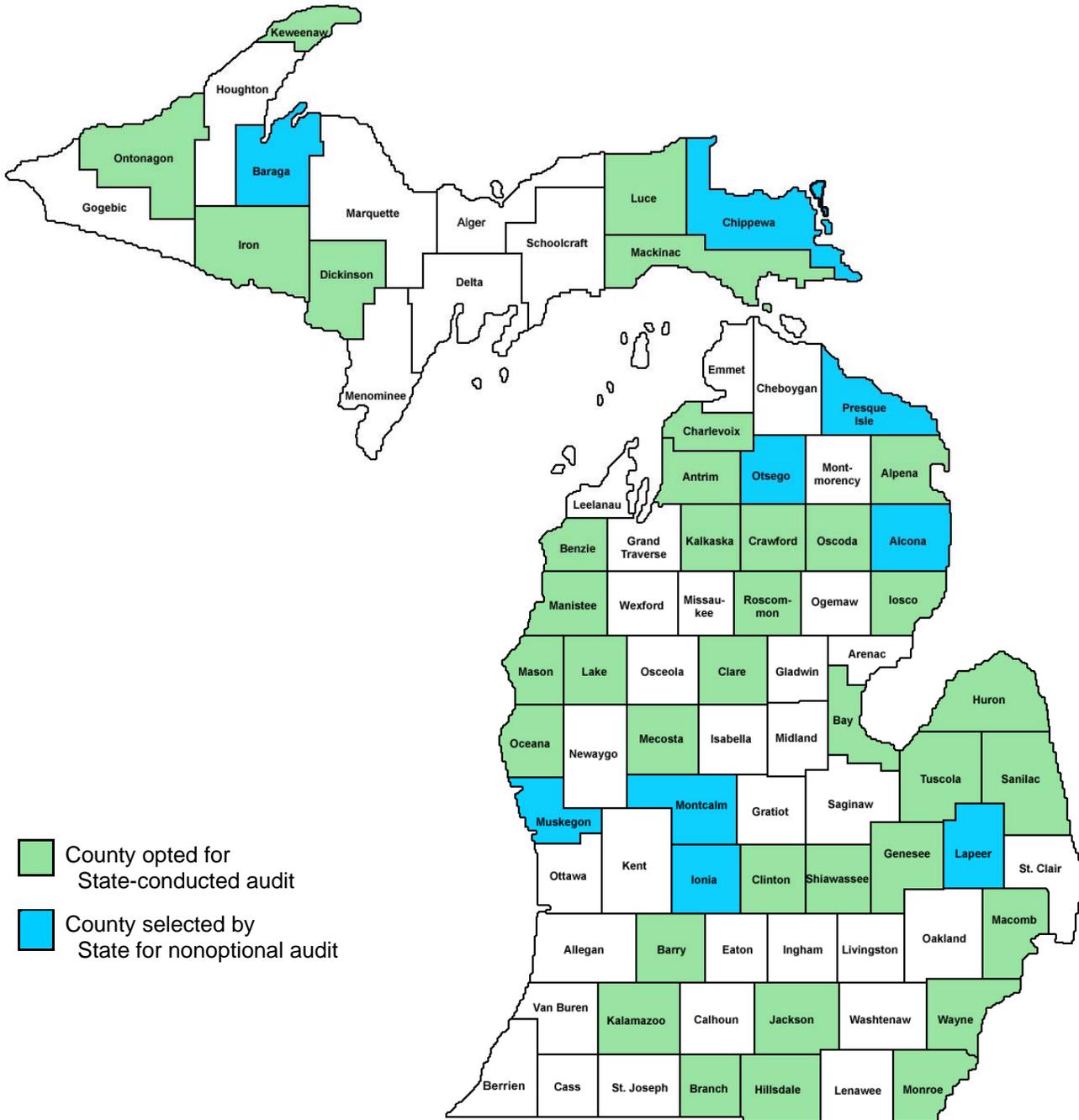


Source: Auditor prepared based on information obtained during the audit and Section 211.7cc of the Michigan Compiled Laws.



PRINCIPAL RESIDENCE EXEMPTION PROGRAM  
Department of Treasury

Counties Audited by the State in Second PRE Audit  
Conducted During 2008



# GLOSSARY

## Glossary of Acronyms and Terms

affidavit	A form completed by a homeowner and filed with the local assessor where the property is located to claim a PRE.
bona fide purchase	When property has been transferred to a purchaser before additional taxes and interest were billed to a seller as the result of a denied PRE. The local tax collecting unit notifies the Department of Treasury, which then bills the seller for all additional taxes and interest.
conditional rescission	A form completed by a homeowner and filed with the local assessor which, under certain circumstances, enables a person who has established a new principal residence to retain a PRE on property previously exempt as the owner's principal residence.
denial	A notification sent to a homeowner that a PRE has been denied. A denial can be issued by a local assessor, a county, or the Department of Treasury.
effectiveness	Success in achieving mission and goals.
efficiency	Achieving the most outputs and outcomes practical with the minimum amount of resources.
foundation allowance	An annual funding level established by the Legislature for school districts. It represents a district's per-pupil revenue for general operating purposes. The foundation allowance is not the same for every school district, and each school district's foundation allowance is composed of varying levels of funding from the School Aid Fund and from local property taxes.

performance audit	An economy or efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve program operations, to facilitate decision making by parties responsible for overseeing or initiating corrective action, and to improve public accountability.
PRE	principal residence exemption.
principal residence	The one place where a person has his or her true, fixed, and permanent home to which, whenever absent, he or she intends to return. This shall continue to be the principal residence until another residence is established.
reportable condition	A matter that, in the auditor's judgment, falls within any of the following categories: an opportunity for improvement within the context of the audit objectives; a deficiency in internal control that is significant within the context of the objectives of the audit; all instances of fraud; illegal acts unless they are inconsequential within the context of the audit objectives; significant violations of provisions of contracts or grant agreements; and significant abuse that has occurred or is likely to have occurred.
rescission	A form completed by a homeowner and filed with the local assessor to remove a PRE from property that was previously exempt.
tax assessment roll	A listing prepared by a local unit assessor and submitted to a county equalization department that provides the assessed value of each property within a local governmental unit. The tax assessment roll is prepared from the local governmental unit's property assessment records and is to include certain specific data elements, such as the name and address of the property owner and the legal description or the approved parcel identification number for the property.



