



**Audit of
Tax-Foreclosed Real Estate
Sales to Non-Profit
Organizations**

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City Comptroller

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May 2018

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Office of the Comptroller

May 29, 2018

Honorable Tom Barrett, Mayor
The Members of the Common Council
City of Milwaukee
Milwaukee, WI 53202

Dear Mayor and Council Members:

The attached report summarizes the results of the audit of the Tax-Foreclosed Real Estate Sales to Non-Profit Organizations. The audit was initiated at the request of several members of the Common Council, following media coverage indicating that one known individual was non-compliant with Department of City Development (DCD) non-profit purchasing guidelines. Following this incident, DCD performed an internal review of all sales closed under the program, since its inception in 2011. Based on professional auditor judgement, the small number of sales impacted by the internal control issue that gave rise to this audit, and the limited issues identified by the DCD review, the scope of the audit was narrowed to tax-foreclosed property sales to non-profit organizations at a discounted price that closed from 2015 through 2017. The audit objectives were to:

1. Determine whether buyers are verified as certified non-profit organizations before purchasing a City-owned, tax-foreclosed property at a discounted price.
2. Determine whether any additional instances of real estate sales to defunct non-profit organizations occurred in the prior three years.

The audit concluded that the DCD has implemented useful and beneficial internal controls over the buyer verification process. However, for certain controls identified within this report, enhancements should be made to the control design to ensure operational effectiveness. The audit report includes four recommendations to ensure that DCD's non-profit purchasing program is only available to valid, tax-exempt organizations, as intended.

Audit findings are discussed in the Audit Conclusions and Recommendations section of this report, and are followed by management's response.

Appreciation is expressed for the cooperation extended to the auditors by the personnel of the Department of City Development.

Martin Matson
Comptroller

Aycha Sirvanci, CPA, CIA
Deputy Comptroller



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Special Deputy Comptroller

Honorable Tom Barrett, Mayor
The Members of the Common Council
Audit of Tax-Foreclosed Real Estate Sales to Non-Profit Organizations

Sincerely,

A handwritten signature in black ink that reads "Adam Figon".

Adam Figon, MBA, CRMA
Audit Manager

cc: Martha Brown, Deputy Commissioner – DCD
AF: kp

I. Background

The City of Milwaukee Department of City Development (DCD) offers a variety of properties for sale to the public – including fully rehabilitated homes, tax-foreclosed buildings, vacant lots, surplus municipal facilities, and brownfield properties suitable for redevelopment. Under City Ordinance 304-49 (4) c, DCD may sell a property “for adequate market consideration,” recognizing both monetary as well as non-monetary consideration – such as (but not limited to), neighborhood stabilization; health, safety, and welfare concerns; and promoting home ownership.

Non-Profit Purchasing Guidelines¹

In an effort to rehabilitate vacant City properties, special guidelines have been created to allow non-profit organizations to purchase City-owned properties for a discounted price \$1 or \$1,000. Under the guidelines, a community-based organization (CBO) may purchase a vacant property, with an asking price of \$25,000 or less, that has been on the market for at least 60 days for \$1. For a property with an asking price of \$25,000 or less that has been on the market for less than 60 days, a CBO may purchase the property for \$1,000.



Purchasing City Houses for \$1

The city will sell to non-profit organizations at a reduced price of \$1 if the property has been on the market for AT LEAST 60 DAYS and the asking price is \$25,000 or less.



Purchasing City Houses for \$1,000

The city will sell to non-profit organizations at a reduced price of \$1,000 if the property has been on the market for LESS THAN 60 DAYS and the asking price is \$25,000 or less.

¹ <http://city.milwaukee.gov/Non-ProfitGuidelines#.Wus7xtKWY70>

Among other requirements, buyers must intend to rehabilitate the property. Additionally, after rehabilitation is complete, the property may only be sold to an owner-occupant or can be kept as an investment property and rented to tenants. Because this program is offered to encourage rehabilitation of neighborhoods, simply purchasing a property at the discounted rate and immediately re-selling it for a profit (“flipping”) is prohibited. Accordingly, offers to purchase are reviewed to ensure that buyers will use the property in a way that improves the community.

Deviations from Non-Profit Purchasing Guidelines

However, instances of improper use of the non-profit purchasing program were discovered by DCD and later publicized by the local media. Specifically, in April 2016, three properties were sold to Inner City Development Project, Inc. – an organization whose previously valid tax-exempt status has since been revoked. Shortly after the properties were sold, an individual purporting to be a member of the revoked organization was involved with reselling the properties for a profit, contrary to DCD non-profit purchasing guidelines.

This issue was internally identified by DCD in early 2017, as additional suspicious, purchase transactions were attempted by the individual, but rejected by DCD.

Following an internal review in November 2017, DCD determined that six transactions to four revoked organizations occurred since the program’s inception in 2011, as reported at the January 9, 2018 Zoning, Neighborhood, and Development Committee meeting. Corrective actions – including collaboration with the City Attorney’s Office, law enforcement, as well as local media – have been ongoing since that time. Figure 1 below provides a timeline of events that summarizes the development of the situation:

Figure 1. Timeline of Events



II. Audit Scope and Objectives

The audit examined the Department of City Development processes and controls for verifying tax-exempt status of non-profit organizations that receive discounted sale prices for City-owned, tax-foreclosed real estate. The scope of the audit included sales closed from 2015 through 2017.

The objectives of the audit were to:

1. Determine whether buyers are verified as certified non-profit organizations before purchasing a City-owned, tax-foreclosed property at a discounted price.

2. Determine whether any additional instances of real estate sales to defunct non-profit organizations occurred in the prior three years.

This audit was conducted 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 the findings and conclusions based on the audit objectives. Internal Audit believes that the evidence obtained provides a reasonable basis for the audit's findings and conclusions based on the audit objectives.

Methodology

The audit's methodology included developing an understanding of processes and controls for verifying the tax-exempt status of non-profit organizations that have submitted an offer to purchase a tax-foreclosed property owned by the City. The audit procedures, which were developed to evaluate the processes and controls necessary to meet the audit's objectives, included process walk-throughs, inspection of relevant supporting documentation, and detailed tests of controls. Procedures and tests were conducted that:

- Reviewed internal policies, procedures, and guidelines;
- Tested all non-profit sales closed from 2015 through 2017 for compliance with purchasing guidelines; and
- Tested all non-profit sales closed in 2018 for implementation of enhanced controls.

III. Organization and Fiscal Impact

The mission of the Department of City Development is to improve the quality of life in Milwaukee by guiding and promoting development that creates jobs, builds wealth, and strengthens the urban

environment. DCD has a wide range of responsibilities in housing, planning, development, business assistance, real estate, and marketing. The objectives of the department² are to:

- Increase the annual amount of net new construction in the community.
- Increase total employment and develop quality employment in the City.
- Support stable, high quality housing and commercial developments throughout the City.
- Increase total sales, rehabilitation efforts, and redevelopment of City-owned real estate.
- Increase commerce and neighborhood vitality in Milwaukee.

DCD currently staffs 80 employees; 17 of which work in the area of real estate. These 17 employees administer residential and commercial property programs as part of citywide efforts to reduce the impact of foreclosures. To this end, approximately 500 tax-foreclosed real estate sales of City-owned property occur annually. Table 1 below provides detailed information about the number of annual tax-foreclosed sales to both community-based organizations and non-CBOs from 2015 through February 2018.

Table 1. Annual Tax-Foreclosure Real Estate Sales

Sale Type	Year Sale Closed			
	2015	2016	2017	2018
Non-CBO Sale	479	467	400	69
CBO Sale	50	36	29	7
Total	529	503	429	76

IV. Audit Conclusions and Recommendations

The audit evaluated the Department of City Development controls over the processes used to verify community-based organizations as valid, tax-exempt, non-profits. Based on professional auditor judgement, the small number of sales affected by the internal control issue that gave rise to this

² City of Milwaukee – 2018 Adopted Plan and Budget Summary, p. 61.
http://city.milwaukee.gov/ImageLibrary/User/crystali/Budget-Books/2018_Adopted_Budget_Summary.pdf

audit, and the limited issues identified by the DCD review, the scope of the audit was narrowed to tax-foreclosed property sales to non-profit organizations at a discounted price. The audit's scope was limited to the period of 2015 through 2017, rather than to 2011 when the non-profit purchasing program was initiated.

The audit concluded that the DCD has implemented useful and beneficial internal controls over the buyer verification process. However, for certain controls identified within this report, enhancements should be made to the control design to ensure operational effectiveness. The audit report includes the following four recommendations to ensure that DCD's non-profit purchasing program is only available to valid, tax-exempt organizations, as intended.

1. Verify an organization's tax-exempt status by calling the IRS.
2. Retain supporting documentation.
3. Update procedures to require documentation of IRS tax-exempt status verification.
4. Update procedures with a list of allowable exceptions to the buyer verification process.

Additional details regarding the recommendations for improvement are provided in the remaining sections of this report.

A. Verification of Tax-Exempt Status

In early 2017, following the discovery that three City-owned properties were sold at a discounted price to a defunct non-profit organization, DCD independently implemented a control to review every non-profit's tax-exempt status, going forward, via the IRS Tax Exempt Organization (EO) website³ (see Image 1 below) as part of its buyer verification process, which is performed prior to acceptance of an offer to purchase.

³ <https://apps.irs.gov/app/eos/>

Image 1. IRS Tax Exempt Organization Search Webpage

IRS

Search

Help | News | Language

Charities & Nonprofits Tax Pros

File Pay Refunds Credits & Deductions Forms & Instructions

Home > Charities and Non-Profits > Search for Charities > Tax Exempt Organization Search

Tax Exempt Organization Search

Select Database ⓘ Search By ⓘ Search Term ⓘ

Search All Employer Identification Numl Enter EIN Number

City State Country

Enter City All States United States

Search Reset Search Tips

Past Sales Testing

Between 2015 and 2017, 115 sales of tax-foreclosed real estate to community-based organizations were closed by DCD. Audit procedures were designed to determine whether any additional instances of real estate sales to defunct non-profit organizations occurred in the three years prior to 2018 by reviewing each organization's tax-exempt status on the IRS EO website. All 115 transactions were reviewed.

Audit testing determined that for two transactions (one in June 2015 and one in October 2017), an organization's status as revoked was not posted to the IRS website, at the time of sale, due to an administrative lag period between the revocation date and the website posting date, which ranges from approximately three to nine months.

- Consequently, based on the information available to DCD at the time of sale, through the IRS website, each organization's tax-exempt status appeared to be valid.
- The revoked status was later posted to the website and backdated.

It is not possible for DCD to obtain the most up-to-date information about an organization's IRS tax-exempt status through the IRS EO website alone. To check whether an organization is currently recognized by the IRS as tax-exempt, inquirers should contact Customer Account Services. However, DCD has not incorporated this step into its buyer verification process; and generally identifies these previously-valid organizations when a new offer is received from the organization and the buyer verification process is performed anew (see Image 1 above).

Recommendation 1: Verify an organization's tax-exempt status by calling the IRS.

Real-time information regarding an organization's tax-exempt status should be obtained by contacting the IRS Tax Exempt and Government Entities Customer Account Services line at (877) 829-5500.

Management should:

- Incorporate a status verification call to the IRS into the written Background Check procedures.
- Call the IRS to verify CBO tax-exempt status at the time of close.
- Update the Residential Buyer Checklist with a checkbox, confirming phone call to the IRS was performed.

B. Document Retention

DCD has developed Buyer Check Procedures, which guide staff through the process of verifying the credentials of a prospective buyer that has submitted an offer to purchase a City-owned property. In accordance with these procedures, all sales to community-based organizations must include verification and documentation of non-profit status. This is achieved through the following (as applicable):

- Using the Residential Buyer Checklist.

- Checking the IRS Exempt Organization website to confirm tax-exempt status of the organization.
- Checking the Wisconsin Department of Financial Institutions (WDFI) website to confirm registration and good standing as a legal Wisconsin entity.
- Reviewing the articles of organization of the non-profit organization.

Figure 2 below provides a basic illustration of the current CBO buyer verification process.



Audit procedures were designed to determine whether verification of tax-exempt status was performed for all sales to CBOs from 2015 through mid-February 2018, as evidenced by supporting documentation in each sale file.

Audit testing indicated that supporting documentation evidencing verification of valid IRS tax-exempt status, in the form of a completed Residential Buyer Checklist, was not consistently retained for non-profit organizations. Similarly, supporting documentation evidencing verification of valid registration with the WDFI and/or CBO articles of organization were not consistently retained for religious organizations. In some instances, the omission of supporting documentation occurred because individual transactions were part of a bulk sale, which included multiple properties. Supporting documentation was obtained and retained in one of the individual bulk sale files and simply not copied and carried over to the other property files within the bulk sale transaction.

Recommendation 2: Retain supporting documentation.

To strengthen existing processes and controls surrounding CBO sales to non-profit organizations, Management should ensure all required supporting documentation is retained in each sale file before signing off on the Residential Buyer Checklist, including but not limited to the following (as applicable):

- Residential Buyer Checklist
 - Articles of Organization
 - Screen prints of an organization's registration status with the IRS and/or WDFI
-
-

C. Documented Procedures

In accordance with best practice, including the *2013 COSO Framework – Principle 12*: Management should implement control activities through policies that establish what is expected and through procedures that put policies into action.

Policies and procedures promote consistency, define expectations, serve as a training tool, and provide continuity to operations. Written policies and procedures should be developed and enforced for all department operations; made accessible and communicated to all personnel; and reviewed and updated, as needed.

Audit procedures were designed to confirm that DCD has implemented and documented comprehensive procedures for the sale of City-owned real estate at a discounted price to community-based organizations (CBOs). Audit testing indicated that although policies and procedures governing DCD's buyer verification process have been implemented and documented, procedures do not include the following:

- A step to capture the tax-exempt status of a community-based, as reflected on the Internal Revenue Service Exempt Organization website.
- A list of allowable exceptions to the buyer verification process, such as City agencies and well-known entities (i.e. Housing Authority of the City of Milwaukee (HACM) or Habitat for Humanity).

Adding these additional controls to DCD's existing Buyer Check Procedures would strengthen the buyer verification process and ensure that DCD can support its decision to approve or deny a non-profit sale.

Recommendation 3: Update procedures to require documentation of IRS tax-exempt status verification.

Management should strengthen buyer verification controls by retaining a screenshot of the IRS Exempt Organization webpage in the sale file after performing a search for a community-based organization.

Recommendation 4: Update procedures with a list of allowable exceptions to the buyer verification process.

Management should clarify the buyer verification process by adding a list of City agencies and other organizations that do not require verification of tax-exempt status to the buyer check procedures and note allowable exceptions in the sale file. The list should indicate why each organization is not subject to the buyer check process.



Department of City Development
City Plan Commission
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May 21, 2018

Adam Figon, MBA, CRMA
Audit Manager
Office of the Comptroller
City Hall, Room 404

Dear Mr. Figon:

This letter provides the Department of City Development's response to the findings and recommendations of the audit of Tax-Foreclosed Real Estate Sales to Non-Profit Organizations, conducted by your office earlier this year.

We find the recommendations helpful and have implemented several.

Recommendation 1 and 3

Current real estate procedures require that non-profit buyers submit a copy of the IRS letter of determination indicating that the organization is exempt from income taxes. The staff also checks the IRS website to determine whether the organization is in current compliance with IRS regulations. The recommendations add two steps to this buyer verification process.

- Include a screenshot of the IRS website, showing the organization's status, in the sale file (recommendation 3). This recommendation has been implemented.
- Because information on the IRS website is updated every 30 days, it is possible that an organization's status has changed between the time an offer to purchase is accepted and the sale is closed. Thus the audit recommends that real estate staff call the IRS to get real-time information before the sale closes (recommendation 1).

By June 30, 2018, the closing procedure for sales to non-profit organizations will include the requirement to make and document a phone call to the IRS. If the web site or phone call indicates that the organization is no longer in compliance with IRS regulations, the organization will be ineligible to purchase the property at the non-profit price.

Recommendation 2

DCD real estate staff have been trained on the importance of retaining all documentation relating to buyer verification in the sales file. They have been instructed to include a copy of the screen shot indicating that the organization is in compliance with IRS requirements and/or a screen shot indicating the organization is registered with the Wisconsin Dept. of Financial Institutions.

Recommendation 4

By June 30, 2018, the real estate section will compile the recommended list of organizations and agencies exempt from the IRS verification process. Staff will continue to check those agencies for adherence to City buyer policies such as those that prohibit sale of property to tax-delinquent buyers or buyers with unaddressed building code violations.

We appreciate the professional approach taken by members of your staff who conducted the audit.

Sincerely,



Martha L. Brown
Deputy Commissioner

C: Amy Turim, Manager, Real Estate Development Services

Martin Matson
Comptroller

Aycha Sirvanci, CPA, CIA
Deputy Comptroller



Office of the Comptroller

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May 29, 2018

Honorable Tom Barrett, Mayor
The Members of the Common Council
City of Milwaukee
Milwaukee, WI 53202

Dear Mayor and Council Members:

With this letter, the Office of the City Comptroller acknowledges receipt of the preceding report, which communicates the results of the Audit of Tax-Foreclosed Real Estate Sales to Non-Profit Organizations. I have read the report and support its conclusions. Implementation of the stated recommendations will help improve City processes.

The City Comptroller was not involved in any portion of the work conducted in connection with the audit. At all times, the Internal Audit Division worked autonomously in order to maintain the integrity, objectivity, and independence of the audit, both in fact and in appearance.

Sincerely,

Martin Matson,
Comptroller

