

June 12, 2007

**Internal Audit Report 2007-8
Business Personal Property Tax
Property Appraisal Division
Finance Department**

Introduction. Anchorage Municipal Code (AMC) Title 12.10, *Personal Property Taxation*, states that all business personal property and inventory located within the Municipality on January 1 of the tax year is subject to taxation. All persons owning business personal property or inventory subject to taxation are required to file a return by April 20 of the tax year. The Personal Property Section (Section), a unit of the Property Appraisal Division (Division), is charged with identifying, locating and valuing all taxable business personal property. Section staff review all tax returns, establish an assessed value and send an assessment notice to the taxpayer. Starting in 2005, every business receives a business property exemption of \$20,000 which is deducted from the assessed value. Based on the assessed value minus the \$20,000 exemption, a tax bill is sent to each taxpayer later in the year. The exemption provided the greatest benefit to small businesses and was intended to improve the administrative efficiency of the Municipal tax system. The table below shows the number of accounts and total assessed value of business personal property before and after the implementation of the \$20,000 exemption:

Business Personal Property Tax Impact of \$20,000 Exemption (Unaudited)		
Year	Number of Accounts	Total Assessed Value
2004	16,088	\$1,988,677,451
2005	5,813	\$2,056,281,174
2006	5,386	\$2,298,365,965

Source: Personal Property Section

To facilitate the filing of a tax assessment return, the Section implemented an electronic filing system (e-file) in 2005. In 2006, 1,418 businesses e-filed, roughly 26 percent of the total tax roll. The total assessed value for all personal property in 2006, approximately \$2.3 billion, resulted in about \$36 million of tax revenue for the Municipality. Collected revenue for the last three years has exceeded budgeted revenue.

Objective and Scope. The objective of this audit was to determine if business personal property returns were properly processed and audited, and if taxable businesses were identified. Specifically, we reviewed the Section's audit function. We determined if a sample of businesses were included in the Section's database. We also selected a sample of businesses to determine if tax returns had been timely filed and if late filing penalties had been properly applied, if applicable. Furthermore, we evaluated the process for granting personal property exemptions, reviewed files for documentation to support the exemptions, and tested selected exemptions for compliance with statutory requirements. In addition, we reviewed the Section's policies and procedures manual (manual) to determine if the Section complied with its internal procedures. This audit did not include mobile homes.

The audit was conducted in accordance with generally accepted government auditing standards, except for the requirement of an external quality control review, and accordingly, included tests of accounting records and such other auditing procedures as we considered necessary in the circumstances. The audit was performed during the period of October 2006 through January 2007. The audit was requested by the Administration.

Overall Evaluation. Generally, business personal property returns were properly processed. In addition, taxable businesses were being identified. However, the audit function was based more on cursory reviews than audits substantiated by appropriate documentation. In addition, the Section's policy and procedures manual was outdated. Finally, staff training needed improvement, and the AMC did not authorize personal property exemptions for a community purpose.

FINDINGS AND RECOMMENDATIONS

1. **Audit Function Needs Improvement.**

- a. **Finding.** The Section's audit function was based more on cursory reviews than audits substantiated by appropriate documentation to support findings and adjustments. The Alaska Association of Assessing Officers states, "The purpose of an audit is to verify that all personal property items have been reported and that the information given is accurate." According to the Section's manual, there are four types of audits: review audits, telephone audits, desk audits, and formal audits. The Section reported a total of 200 audits of taxable businesses for 2006. Of these 200 audits, 169 were telephone audits and 31 were desk audits. No formal audits had been conducted and few of the audits were for the largest retailers in Anchorage. Our review of 27 desk audits and 25 telephone audits (52 total audits) revealed the following:

Supporting Documentation Incomplete - Documentation required by the Section's manual was incomplete for 33 of the 52 audits tested. Most records we found existed in hard copy format with some narrative comments found in the personal property computer system. For desk audits, the manual required an announcement letter and an audit results letter to be sent to the taxpayer. However, for the 27 desk audits we reviewed, we found only 10 audit announcement letters and 14 audit result letters. While we found some of the records required to perform a desk audit, such as fixed asset listings and tax returns, audit work papers had not been prepared to provide a clear understanding of the purpose and source of the work performed and the conclusions that were reached. Clear and understandable work papers are essential to support findings and recommendations.

No Audit Checklist - Section staff had not completed an audit procedures checklist for all 52 audits tested. The Section's manual requires the completion of a formal audit procedures checklist for all telephone audits resulting in a net adjustment of assessed value and for all desk and formal audits. According to Section staff, the audit procedures checklist was used only as a guide, and was not completed.

Net Adjustments Not Properly Substantiated - Twelve of 14 adjustment amounts above \$100,000 were not substantiated by a desk review audit or by a full audit. As a result, the necessary documentation to support the adjustment was not available. The Section's manual states, "Generally, any adjustment [in assessed value] over \$100,000 will require a minimal desk review audit. An adjustment over \$500,000 requires a full audit."

Audit Tracking Inaccurate and Unreliable - Information contained in the spreadsheet used to track audits did not always match the backup documentation found in the Section's files. For example, 14 of 52 reported adjustments could not be supported. When asked, Section staff were not always able to explain how they arrived at the adjusted amounts that had been entered into the audit spreadsheet. In addition, the definitions and descriptions for the types of audits found in the manual did not match the descriptions in the audit spreadsheet. For example, the term "full audit" was entered into the spreadsheet 22 times, but "full audit" was not defined in the Section's manual. One reason for this could be that the manual was outdated and needed to be revised to reflect current business practices.

Due to the lack of backup documentation in the files and the inconsistencies in definitions, it is questionable if all of the information contained in the spreadsheet accurately reflected completed audits. As a result, reliable information to summarize completed audit work was not available for management reports.

No Meaningful Audit Selection Methodology - The Section had no meaningful method to select audits. Instead, Section staff judgmentally selected audits when they recognized “red flags” during the regular review of assessment returns. Although a variety of meaningful methodologies exist to select businesses to audit, Section staff did not effectively employ any of these methodologies.

- b. **Recommendation.** The Municipal Assessor should ensure that all audit work is properly documented and resultant findings and conditions are supported.
- c. **Management Comments.** Management stated, “Management Concur. Administration requested this audit to facilitate staffing and structure review of the Personal Property section of Property Appraisal. Finding one provides external validation that a systematic review of the section is appropriate and an internal transition in progress. Management is in the process of reorganizing division resources to include converting section positions to auditors and to establish technical auditing capabilities. It is anticipated that this process will be complete by January, 2008.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

2. **Section’s Manual Outdated.**

- a. **Finding.** The Section’s manual was outdated and did not properly reflect current business practices. According to the Section’s supervisor, the manual had been pieced together over the past years and the procedures were vague and general, and needed to have more step-by-step details. For example, the manual did not reflect the current personal property computer system nor provide detailed instructions on

how to process and audit personal property tax returns. A similar finding was reported previously in Internal Audit Report 96-06.

In addition, when we reviewed the Section's manual, we discovered that the instructions for the e-filing system were outdated when compared to the current online instructions. Since Section management did not have access to the online instructions, the instructions were included in the hard copy manual with the intention to help Section staff provide better customer service to taxpayers calling in with questions regarding the e-filing process.

- b. **Recommendation.** The Municipal Assessor should ensure that the Section's manual is updated and properly reflects current business practices.
- c. **Management Comments.** Management stated, "Management concurs. A complete rewrite of the section policy and procedures manual is in progress. The recommended revision of the section manual is consistent with the overall section review in progress. Section manual revision is anticipated to be complete by December, 2007."
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

3. **Staff Training Inadequate.**

- a. **Finding.** Section staff had not received adequate training specific to processing, valuing, and auditing business personal property tax returns. Training and experience are important to efficiently and accurately process and audit personal property tax assessment returns. Even though the majority of the Section's staff attended a week-

long training course on the 'Fundamentals of Mass Appraisal,' offered by the International Association of Assessing Officers, the training did not appear very relevant to business personal property tax responsibilities. Mass appraisal techniques primarily apply to real property.

- b. **Recommendation.** The Municipal Assessor should ensure that Section staff receive training specific to business personal property valuation and auditing.
- c. **Management Comments.** Management stated, "Management concurs. The organizational structure of Personal Property is under management review. Overall staff training will be developed consistent with the results of the systematic section review in progress."
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

4. **Exemption Category Not Supported by AMC.**

- a. **Finding.** The AMC did not authorize personal property exemptions for a community purpose. As a result, community purpose exemptions granted for personal property may not be valid. AMC 12.15.012, *Residential real property exemption*, provides for community purpose exemptions for real property. However, AMC 12.10, *Personal Property Taxation*, does not provide the community purpose exemption for business personal property. The community purpose exemption is an optional exemption and is not required by Alaska State Law. According to the Section's personal property exemption list, 51 organizations received a community purpose exemption; however, we were unable to substantiate this number since the type of exemption for some organizations was not specified.

Alaska State Statutes Section 29.45.050 (b), *Optional exemptions and exclusions*, states, “A municipality may by ordinance (1) classify and exempt from taxation (A) the property of an organization not organized for business or profit-making purposes and used exclusively for community purposes if the income derived from rental of that property does not exceed the actual cost to the owner of the use by the renter.” However, the Assessor’s office was unable to provide an ordinance authorizing the exemption.

- b. **Recommendation.** The Municipal Assessor should ensure that community purpose exemptions are properly authorized by the AMC.

- c. **Management Comments.** Management stated, “Management agrees that Municipal Code needs to be clarified; however it has been the long standing interpretation by the Municipal Assessor that the definition of property is provided under Anchorage Municipal Code (AMC) 12.05.020 that describes property to ‘...mean any property other than real property’. Further (AMC) 12.15.015 (I) provides for Community Purpose exemptions.

“In 1994 Community Purpose exemptions were adopted by the Anchorage Assembly in AO 94-228 (S-2) that included a sunset clause for expiration on December 31, 1997 unless re-authorized by the Anchorage Assembly. On December 16, 1997 in the Anchorage Assembly approved passage of AO 97-146 that provided for the current Municipal Code for Community Purpose exemptions.

“Review of the Community Purpose exemptions for personal property indicates that 76 accounts are currently exempt. It should be noted that no new Community Purpose exemptions have been granted for personal property since 2003. The

distribution of the years in which the exemptions were granted is provided in the table below.

Year Exemption Granted	Number of Exemptions
2003	4
2002	4
2001	6
2000	12
1999	16
1998	22
1997	6
1996	1
1995	1
1994	4

“Further, management is in the process of developing an ordinance to clarify the language for Community Purpose exemptions for personal property.”

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

Discussion With Responsible Officials. The results of this audit were discussed with appropriate Municipal officials.

Audit Staff:
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