

# INTERNAL AUDIT REPORT

2013-07

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Business Personal Property Tax

Property Appraisal Division  
Finance Department

September 12, 2013

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*Mayor Dan Sullivan*

September 12, 2013


Honorable Mayor and Members of the Assembly:

I am pleased to present **Internal Audit Report 2013-07, Business Personal Property Tax, Property Appraisal Division, Finance Department** for your review. A brief summary of the report is presented below.

In accordance with the 2013 Audit Plan, we have completed an audit of Business Personal Property Tax, Property Appraisal Division. The objective of this audit was to determine if business personal property returns were properly processed, audited, and if taxable businesses were identified and assessed. Specifically, we reviewed the Property Appraisal Division's audit function and determined if the discovery methodology was adequate to ensure that all taxable personal properties were discovered and included in the tax rolls. We selected a sample of businesses to determine if tax returns were timely filed and if late filing penalties were properly applied, if applicable. Furthermore, we reviewed and determined if exemptions granted to business personal property complied with statutory requirements. We also reviewed the Property Appraisal Division's policy and procedures manual to determine if staff complied with the procedures. Finally, we reviewed Property Appraisal Division's training records to determine if staff received adequate training specific to processing, valuing, and auditing business personal property tax returns. This audit did not include mobile homes.

Generally, training appeared to be adequate; however, the processing and auditing of business personal property tax returns as well as the identification and assessment of taxable businesses need improvement. Specifically, Property Appraisal Division's audit function was based on cursory reviews instead of audits substantiated by appropriate documentation to support findings and adjustments. Adjustments were not always properly approved and adjustments to business property values were not always properly supported. In addition, businesses with a mailing address outside of Anchorage were excluded from the discovery process. Furthermore, small businesses with an original assessed value under \$20,000 were not always reevaluated to determine if they were still exempt from taxation. Finally, the Business Personal Property Assessment Return form used by businesses to submit the required personal property data was confusing and Anchorage Municipal Code did not authorize personal property exemptions for a community purpose.

There were seven findings in connection with this audit. Management was responsive to the findings and recommendations.



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September 12, 2013

**Internal Audit Report 2013-07  
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 of Anchorage (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 reviews all Business Personal Property Assessment Returns (Assessment 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, the Municipality sends a tax bill to each taxpayer later in the year. As of March 21, 2013, the total assessed value of all business personal property for 2012 was approximately \$3.0 billion and resulted in about \$47.5 million of tax revenue. Personal Property Taxes are the second largest revenue base for the Municipality after Real Property Taxes.

**Objective and Scope.** The objective of this audit was to determine if business personal property returns were properly processed, audited, and if taxable businesses were identified and assessed. Specifically, we reviewed the Section's audit function and determined if the discovery methodology was adequate to ensure that all taxable personal properties were discovered and included in the tax rolls. We selected a sample of businesses to determine if tax returns were timely filed and if late filing penalties were properly applied, if applicable. Furthermore, we reviewed and determined if exemptions granted to business personal property complied with statutory requirements. We also reviewed the Section's policy and procedures manual to determine if staff complied with the procedures. Finally, we reviewed the Section's training records to determine if staff received adequate training specific to processing, valuing, and auditing business personal property tax returns. 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 February through April 2013. The audit was requested by the Administration.

**Overall Evaluation.** Generally, training appeared to be adequate; however, the processing and auditing of business personal property tax returns as well as the identification and assessment of taxable businesses need improvement. Specifically, the Section's audit function was based on cursory reviews instead of audits substantiated by appropriate documentation to support findings and adjustments. Adjustments were not always properly approved and adjustments to business property values were not always properly supported. In addition, businesses with a mailing address outside of Anchorage were excluded from the discovery process. Furthermore, small businesses with an original assessed value under \$20,000 were not always reevaluated to determine if they were still exempt from taxation. Finally, the Business Personal Property Assessment Return form used by businesses to submit the required personal property data was confusing and 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 on cursory reviews instead of audits substantiated by appropriate documentation to support findings and adjustments. A similar finding was reported previously in Internal Audit Report 2007-08. 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 219 audits of taxable businesses for 2012. Our review of these audits revealed the following:

*Random Audits Not Performed* - Personal Property Section staff did not perform random audits in 2011 and 2012. The Section's manual requires that random audits be conducted annually on at least one percent of all accounts that filed the previous year with a value exceeding \$20,000. The Section's manual also states that "Random sample audits serve to test the integrity, equity and uniformity of the assessment rolls and they also encourage taxpayer compliance in reporting."

*Supporting Documentation Incomplete* - Documentation required by the Section's manual was incomplete for all 19 desk audits we tested. Specifically, for desk audits the manual required an announcement letter and an audit results letter to be sent to the taxpayer. However, for the 19 desk audits we reviewed, we did not find announcement letters, result letters, and adequate documentation to support adjustments. In addition, 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.

*Audit Tracking Incomplete, Inaccurate, and Unreliable* - Information contained in the Section's spreadsheet used to track audits was incomplete, inaccurate, and unreliable. For example, according to Section staff, they conducted "other" audits. However, the spreadsheet did not contain these "other" audits and staff were not able to provide even basic information such as the number of other audits conducted, type of audits conducted, and businesses that were audited. In addition, definitions for the types of audits found in the manual did not match the definitions in the audit spreadsheet. For

example, the term “desk audit” was entered for all 219 audits contained in the database. However, our review found none of the audits met the definition of desk audits described in the Section’s manual.

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 Audit Checklist* - Section staff had not completed an audit procedures checklist for all 19 audits tested. The Section’s manual requires the completion of an audit checklist for all telephone, desk, and formal audits. According to Section staff, they stopped using the audit checklist several years ago, but could not clearly tell us why it was discontinued.

*No Meaningful Audit Selection Methodology* - The Section did not have a meaningful method to select audits. According to Section management, all 219 audits in the Section’s 2012 Audit database were selected during the processing of annual BPARs because they were improperly prepared in the appraiser’s judgment. Although a variety of meaningful methodologies existed to select businesses to audit, staff did not effectively employ any of these methodologies.

- b. **Recommendation.** The Municipal Assessor should ensure that audits are conducted and properly documented according to their policy and procedures manual or revise the Section’s policy and procedures.
  
- c. **Management Comments.** Management stated, “Management concurs. As noted by Internal Audit, the Personal Property section manual refers to four types of audits to

be performed by staff on business personal property accounts including: Formal Audit, Random Audit, Desk Audit and Other Audit. Further Management agrees that Formal Audits and Random Audits have not been performed by the Personal Property sections since 2007 due to reduction in staffing levels since 2007.

“During the review process with Internal Audit, Management identified that the section manual does not define the assessment cycles that involve the assessment roll creation in relation to activities for account review as well as activities that occur after the assessment roll certification has occurred. Further the terminology employed for “audits” was not defined in relation to when the audits would occur, either prior to the creation of the assessment roll or after the certification of the assessment roll. This distinction between these two activities is vital in defining the correct application of audit procedures. The issue of terminology distinction came to light upon the review of activities by section staff prior to the assessment roll certification that included phone and desk audits since 2008 as noted in the table below.

YEAR	PHONE	DESK
2008	400	14
2009	253	20
2010	200	13
2011	365	10
2012	219	9

“Management will update the section manual by the end of 1Q2014 to include a clarification of the activities related to the assessment roll creation/certification and procedures for auditing within each work cycle for clarification. Further, management will update the audit procedures and practices to ensure compliance with the section manual by the end of 2Q2014.”

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

2. **Adjustments Were Not Always Properly Approved.**

- a. **Finding.** Adjustments were not always properly approved. Our review revealed that three adjustments resulting in a reduction in value of more than \$100,000 were not properly approved. For example, a business filed an amended return that resulted in a \$479,038 deduction in assessed value that was not approved by the Assessor. The Section's policy and procedures manual requires that "If an adjustment, amended filing or deletion will result in a reduction in value of \$100,000 or greater, it must be approved prior to the actual adjustment. Any reduction in value of \$100,000, but less than \$500,000, must be approved by the Assessor. Any reduction in value of \$500,000 or greater must be approved by both the Assessor and Chief Fiscal Officer."
- b. **Recommendation.** The Municipal Assessor should ensure that adjustments resulting in a reduction in value of \$100,000 or greater to be properly approved and audited as required by the Section's policy and procedures manual or revise their policy and procedures.
- c. **Management Comments.** Management stated, "Management concurs. As noted in the management comments under finding 1 of this audit, management identified that the section manual does not define the assessment cycles that involve the assessment roll creation in relation to activities for account review as well as activities that occur after the assessment roll certification has occurred. Further the requirements for documentation during assessment roll creation and after assessment roll certification will need to be updated to reflect the appropriate level of documentation for



adjustments. The distinction between these two activities is vital in defining the correct application of the documentation for approval of adjustment procedures.

“Review of adjustments to the certified personal property assessment roll have been made according to the section manual as noted in the table below for prior years since 2008.

Year	# of Adjustment	# required approval
2008	759	69
2009	713	50
2010	411	25
2011	454	41
2012	601	22

“The example identified by Internal Audit in this finding is consistent with the necessity for Management to update the section manual to reflect the point in time requirements for the Assessor’s approval for value adjustments. Management will update the section manual to specify the correct application of the documentation for the approval of adjustments by the end of 1Q2014.”

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

3. **Adjustments Not Always Adequately Supported.**

- a. **Finding.** Adjustments to business property values were not always properly supported. Specifically, 30 of 58 adjustments we tested were not supported by documentation and 14 adjustments resulting in a value reduction of more than \$100,000 were not supported by a desk review audit or a full audit. The Section’s

policy and procedures manual states that documentation for adjustments should include both the amended filing and backup documentation. In addition, the Section's policy and procedures manual states, "Generally, any adjustment over \$100,000 will require a minimal desk review audit."

- b. **Recommendation.** The Municipal Assessor should ensure that adjustments are supported by adequate documentation to adjustment amounts.
  
- c. **Management Comments.** Management stated, "Management concurs. Consistent with Findings 1 and 2, management has identified that clarification of the section manual and the specific processes required for adjustments during the assessment roll creation and after the assessment roll certification needs clarification.

"Management will update the Personal Property manual to define the criteria for an audit as a result of a value reduction of the certified assessment roll. Further, management will define any exceptions to the criteria for an audit as a result of activities to an account that were caused by an activity by section staff, such as the application of a depreciation factors by the end of 1Q2014."

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

#### 4. **Business Personal Property Not Always Discovered and Assessed.**

- a. **Finding.** Businesses with a mailing address outside of Anchorage were excluded from the discovery process. The Section's primary method to identify taxable businesses was to match the businesses with Anchorage mailing addresses on the State business license database against the Municipality's Business Personal Property

database. Businesses not found in the Municipality's Business Personal Property database received a tax discovery package to complete and return. However, businesses having an Anchorage location, but a mailing address outside of Anchorage, were excluded from the process.

- b. **Recommendation.** The Municipal Assessor should ensure that the Personal Property Section develops a process to discover taxable businesses located within the Municipality with a mailing address other than Anchorage.
  
- c. **Management Comments.** Management stated, "Management concurs. The Personal Property process to discover potential new taxpayers is as a result of the download of new business licenses filed with the State of Alaska (State) on an annual basis. The process of selecting business license information from the State is a complex process that requires the technical assistance of Information Technology staff.

"Management is reviewing the viability of expanding the data download process from the State based on the non-995 zip codes to determine if it is cost effective to mail discovery packets to non-995 zip codes. Personal Property will conduct a pilot study for the 2014 tax year to evaluate the cost vs. benefit analysis of the data download process. In January 2013 personal property mailed roughly 4,500 discovery packet to new business license holders. Only about 5% of these created new business assessment for the 2013 year."

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

5. **\$20,000 Exemption Not Always Reevaluated.**

- a. **Finding.** Small businesses with an original assessed value under \$20,000 were not always reevaluated to determine if they were still exempt from taxation. Specifically, the Section did not have a process to discover businesses which were exempt from taxation due to the \$20,000 exemption, but may have since exceeded the \$20,000 exemption in assessed value.
  
- b. **Recommendation.** The Municipal Assessor should ensure that the Personal Property Section periodically reevaluate those businesses receiving the \$20,000 exemption to determine if the total amount of their business personal property is still less than \$20,000.
  
- c. **Management Comments.** Management stated, “Management concurs. Since the implementation of the \$20,000 business personal property exemption in 2005, several factors have impacted the Sections ability to conduct detailed review of the exemption program. These factors include a reduction in staffing, and increase in the total amount of accounts exempt under this program. Section staff has been reduced by 3 employees since 2005 thereby limiting the ability of the Section to perform review of the taxpayers claiming the \$20,000 business personal property exemption. In 2013 management reviewed 52 accounts that have been under \$20,000. It was determined that these businesses are still in operation and may have grown. Staff will be contacting them to determine if they are still under the \$20,000 threshold and will assess business accounts that are not in conformance to the exemption requirements.

“In 2014, management will develop a pilot program to review exempt properties. Additional staffing may be requested by Management for the review process if needed.”

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

6. **Business Personal Property Assessment Return Form Confusing.**

- a. **Finding.** The Business Personal Property Assessment Return form used by businesses to submit the required personal property data was confusing. Specifically, the form contained 22 schedules to classify and value business personal property. Businesses were asked to complete the schedule(s) that relate to their businesses. However, it was sometimes difficult for a business to determine which schedule(s) to use. As a result, some assessed values might be incorrect due to personal property being listed on the wrong schedule(s). For example, in 2011 a cellular phone operator listed its communication switches under schedule 4, *Computers and Data Processing Equipment*, which has a 6 year depreciation life. However, for the 2012 assessment, Section staff decided the communication switches should be listed under schedule 9, *Connex/Underground Storage Tank*, which has a 15 year depreciation life. The business appealed the Section's decision. The appeal resulted in the communication switches being listed under schedule 6, *Construction and Manufacturing Equipment*, which has an 8 year depreciation life.
- b. **Recommendation.** The Municipal Assessor should ensure that the classification schedule for personal property items provides clear instructions as to the items that should be entered onto the schedules.
- c. **Management Comments.** Management stated, "Management concurs. The Business Personal Property Assessment return was redesigned while the section was under the management of Treasury in 2003. In 2003, management considered the process of

taxpayers reporting assets on an individual asset basis rather than an aggregate basis, however it was determined at that time that the process would be too burdensome to the taxpayers.

“Management has initiated revisions to the assessment return forms from a defined schedule (such as office furniture and equipment – schedule 3) to a life table for each asset to be identified by the life of the asset. Management is developing a detailed list of assets and associated life’s to be provided with the business personal property returns for taxpayers use. Review of the section database modifications required for the return modification is underway. Upon review of the cost and IT staffing requirements for programming changes to the Personal Property database, management will evaluate the viability of making changes to the assessment return forms.”

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

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

- a. **Finding.** Anchorage Municipal Code 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 12.15.015, *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 database, 53 organizations received a community purpose exemption; however, we were unable to verify this number since the type of

exemption for 102 organizations was not specified, and in other cases, it was unclear which exemption was being applied to the accounts. A similar finding was reported previously in Internal Audit Report 2007-08.

- b. **Recommendation.** The Municipal Assessor should not provide the community purpose exemption to business personal property until AMC 12.10 has been revised to allow such exemption.
  
- c. **Management Comments.** Management stated, “Management concurs. Management will request legal services to review the historical Assembly Ordinances (AO 94-228 S-2 and AO 97-146) and Municipal Code (12.05.020 and 12.15.015) regarding the applicability of the community purpose exemptions for both real and personal property. If required, Management will request Municipal Code changes based advice of counsel by the end of the first quarter of 2014.”
  
- 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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