

Municipality
of
Anchorage



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Rick Mystrom, Mayor

OFFICE OF THE INTERNAL AUDITOR

June 13, 1996

Internal Audit Report 96-06
Business Personal Property Tax
Property Appraisal Division

Introduction. Anchorage Municipal Code Title 12.10 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. To facilitate this, each year the Municipality sends a tax form to all businesses listed on the previous year's tax rolls. Also, notices are placed in the newspaper prior to the April 15 due date to remind taxpayers to file.

The current tax form requires the taxpayer to report business assets at original installed cost. Personal/Business Property Section personnel depreciate the original cost according to the date of acquisition to obtain the assessed value. In 1994, the assessed valuation of personal property totaled \$1.4 billion. The corresponding tax revenue totaled \$25.8 million.

Scope. The objectives of this audit were to determine whether procedures were effective in ensuring that Business Personal Property tax returns were filed as required and whether the returns were accurate. We also reviewed a complaint filed by a citizen which addressed these same two issues. The audit was conducted in accordance with generally accepted government auditing standards and accordingly, included tests of records and such other auditing procedures as we considered necessary in the circumstances. The audit was requested by the Chief Fiscal Officer and was performed during the period of October 1995 through February 1996.

Overall Evaluation. The Personal/Business Property Section did not have adequate procedures in place to ensure that all individuals/business filed business personal property tax returns as required. The Section also did not have adequate procedures to ensure that the returns that were filed were always accurate.

Based on our audit tests and review of business personal property tax records, we estimate that between 25% to 35% of businesses operating in Anchorage may not be filing a business personal property return. However, in our opinion, the tax impact may be closer to 5% to 10% due to the nature of the businesses that are not filing. Further, in our opinion, the reported inventory and business equipment may be understated by 5% to 10%. (See full text management comments at Attachment A.)

FINDINGS AND RECOMMENDATIONS

1. No Written Office Procedures.

- a. Finding.** Standard written office procedures had not been developed for the Personal/Business Property Section. Our review and observations revealed that each employee appeared to accomplish various tasks independently, potentially duplicating work that could have previously been accomplished by another employee. In addition, we found that the tasks that were being performed by the staff were not consistently and uniformly documented to evidence what had been done, which businesses had been reviewed and what the conclusions were. Further, criteria had not been established identifying when supervisory approval was required and when employees could take actions without approval. In our opinion, detailed documentation of what has been done and found is a key element of a productive office. Further, providing employees standard procedures and clear direction on how

to accomplish the mission of the organization is a proven method of increasing the efficiency and effectiveness of an organization.

- b. **Recommendation.** Standard written procedures should be developed and implemented for the Personal/Business Property Section. The procedures should provide clear and uniform direction for accomplishing assigned tasks and criteria for supervisory review.
- c. **Management Comments.** Management concurred and stated that a standard procedures manual will be developed to compile all existing and necessary procedures. (See full text management comments at Attachment A.)
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

2. **Procedures Not Effective for Determining Whether Business Personal Property Returns Were Filed.**

- a. **Finding.** Procedures were not effective for ensuring that business personal property tax returns were filed as required. The Personal/Business Property Section utilized a variety of methods to identify businesses that had not filed a tax return. These methods included reviewing the yellow pages, the Polk and Hill Donnelly directories, newspapers, periodicals, field canvasses, property transfers, bankruptcies and so forth. However, these reviews and discovery procedures did not ensure a thorough, systematic and supervised process to identify businesses that had not filed a tax return. We also noted that a data base was not maintained of all businesses that had been reviewed by each of the Section's staff to prevent a duplication of effort in

future research of businesses that had not filed a tax return. However, we were told that a data base was recently implemented to prevent future duplication of effort.

In 1989, the Personal/Business Property Section automated the data base of all businesses that filed a business personal property tax return. The old system was comprised of manual index cards. Further, in 1995, a new method of identifying businesses was implemented. The business license data base obtained from the State of Alaska was matched to the Municipal data base of businesses that had filed a tax return in 1995. However, the process excluded all business licenses with a mailing address zip code outside the Anchorage area, potentially excluding valid businesses with a physical location in Anchorage. This data match identified 20,552 businesses with a current business license that were not in the tax roll data base. There were approximately 7,700 businesses on the Municipal data base that had filed a tax return in 1995. Personal/Business Property Section personnel estimated that it would take from 15 to 18 months to research these businesses to determine if they were required to file a tax return. A pilot project was conducted to determine how effective this process would be. All 552 licensed businesses with a mailing address in zip code 99524 that did not match with the Municipal data base were selected for the pilot project. After several Invite to File letters and other research, 204 of the 552 businesses (35%) were added to the tax rolls. Using this information, projections were made by the Section to arrive at increased tax revenues of between \$596,000 and \$806,000.

To test the reasonableness of the conclusions, we selected 524 businesses from the Yellow Pages and personal observations of businesses in Anchorage and determined whether a business personal property tax form had been filed for 1995. Our test revealed that 130 businesses (25%) had not filed a business personal property tax return for 1995.

- b. **Recommendation.** A system should be established for ensuring that business personal property tax returns are filed as required. The Chief Fiscal Officer should consider a one time contract to identify businesses in the Anchorage area that should be reporting business personal property in order to create a comprehensive data base within a reasonable time frame. Once a current data base has been established, new businesses could be identified on a continual basis to keep the data base current. A variety of methods could be used such as receiving information from the State Department of Revenue on new business licenses, and publishing in the newspaper a list of businesses that had filed to encourage citizens to identify non-reporters. The methods should be standardized and documented in the Section's procedures.

In addition, a one time effort should be considered to encourage all businesses who have not filed to submit a tax return. With Assembly approval, an amnesty period waiving back taxes and penalties might be established as an incentive to file. Businesses would not be faced with the potential financial hardship of back taxes and penalties and the Municipality would increase their tax role.

- c. **Management Comments.** Management concurred and stated that a thorough and systematic process has been developed and is being utilized to provide an effective system for identifying business for which a return should be filed. (See full text management comments at Attachment A.)
- d. **Evaluation of Management Comments.** Management comments were generally responsive to the audit finding and recommendation.

3. **Procedures For Reviewing Business Personal Property Tax Returns Could be Improved.**

- a. **Finding.** The procedures used by the Personal/Business Property Section for determining the accuracy of business personal property tax returns required improvement. Returns were reviewed for reasonableness by Section personnel while processing in the returns. However, there were no Section procedures or criteria for this process and the determination of reasonableness was left up to the judgment of each individual. Questionable returns were reviewed through a variety of procedures ranging from a phone call to a physical observation of the records. Further, the review procedures or the results were not consistently documented because there was no standard format prescribed by the Section for this process.

We also found that a formal audit process was not utilized by the Section where a representative random sample of returns was audited each year. We did find that a few on-site reviews were being conducted during the year but standard audit steps were not utilized leaving the scope, objectives of the audit, and the method of documentation of the review to the discretion of the individual performing the review. In 1987, the Internal Audit Department performed an audit of statistically selected returns. This audit revealed an 82% error rate for the tax returns reviewed. In our opinion, a formal audit process of statistically selected returns can act as a strong incentive to prepare tax returns accurately.

- b. **Recommendation.** Standard procedures should be developed and implemented for reviewing the accuracy and completeness of business personal property returns. The procedures should include the objectives of the review, applicable methods of verification of information and standard documentation requirements. We also recommend that a formal audit process should be implemented to include statistical

selection criteria, standard audit objectives and procedures, and documentation of findings. The process should ensure that each return has an equal chance of being selected for audit. In addition, those returns with large fluctuations or questionable activity should continue to be reviewed.

- c. **Management Comments.** Management concurred and stated that procedures for discovery and audit of Business Personal Property Tax Returns will be written and compiled in a Standard Operating Procedures Manual. The written procedures will include objectives, criteria, procedures and documentation guidelines. (See full text management comments at Attachment A.)
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

4. **Citizen Complaint.**

A complaint was made by a citizen regarding business personal property tax inequities. The citizen projected that an additional \$60 million in taxes could be levied if all unreported business inventory and personal property was captured. Our discussions with the complainant revealed that his projections were based on a variety of statistical data. He stated that he had obtained the U.S. Business Inventory statistics which he adjusted for Anchorage to arrive at \$2.2 billion for the potential business inventory amount. Even though the projection appeared to be mathematically sound, we were not able to determine if this correlation was reasonable and applicable to the business inventory on hand in Anchorage on the first of January. Another example was the use of employment data for Anchorage multiplied by an estimated dollar amount for office equipment used by an employee. Again, due to the many variables, this estimate may not be representative of what the dollar amount of business property was in Anchorage. He also stated that there were around 450 liquor

licenses and that none were reporting business personal property. However, our review found that generally liquor dispensing businesses filed tax returns because of the approval process for liquor license renewals. The complainant also provided numerous examples of inconsistent and unreasonable business personal property amounts that had been reported to the Municipality by a variety of businesses. These examples raised numerous questions of why certain businesses reported such small amounts on their tax returns. However, these examples required on-site audits and further research to determine the accuracy of the reported amounts.

In our opinion, all of the examples and methods that were used by the complainant were valid indicators of potential questionable filings and could be used by the Personal/Business Property Section in formulating a work plan. However, we were not able to substantiate the \$60 million additional tax revenue projected by the complainant. We believe that a more reasonable projection of potential business personal property tax revenue would be a 10% to 20% increase over the current tax receipts.

Discussion With Responsible Officials. The results of this audit were discussed with appropriate Municipal officials on April 5, 1996.

Audit Staff:
Jane Harper
Brenda Applegate

APPENDIX A

MUNICIPALITY OF ANCHORAGE

RECEIVED

MEMORANDUM

JUN 05 1996

DATE: June 5, 1996

INTERNAL AUDITOR

TO: Jerry Anderson, Chief Fiscal Officer *JA*

FROM: Tom R. Pitman, Municipal Assessor *Tom R. Pitman*

SUBJECT: Business Personal Property Tax Audit Response

Attached are my responses on the findings and recommendations made by the Director of Internal Audit from the Internal Audit Report on the Business Personal Property Valuation System in the Property Appraisal Division.

FINDING: Overall Evaluation. "The Personal/Business Property Section did not have adequate procedures in place to ensure that all individuals/businesses filed business personal property tax returns as required. The Section also did not have adequate procedures to ensure that the returns that were filed were always accurate."

CONCURRENCE/NON-CONCURRENCE: **Concur**

No set of procedures can adequately ensure that all individuals or businesses file business personal property tax returns as required. Therefore, constant efforts are necessary to discover those who do not file. No set of procedures are adequate enough to ensure that returns are always accurate. Therefore, constant auditing of returns filed is necessary.

Anchorage Municipal Code 12.10.040 requires "every person who owns or controls personal property the tax situs of which is the municipality as of January 1 of each year must file a personal property tax return indicating ownership of control of the personal property."

The Property Appraisal Division continuously attempts to discover businesses which do not file. Escaped businesses are notified by mail and for those which fail to file, an involuntary filing is made. Procedures are in place to discover taxable business personal property in the Municipality of Anchorage. However, no system can ensure that all business file every year.

Business Personal Property Returns that are filed are reviewed for accuracy in accordance with International Association of Assessing Officers Standards provided below. In 1995 the Personal Property Section filed 2,962 forced (involuntary) filings on \$67,509,421 of value and worth approximately \$1,215,170 in taxes based on an 18 mill rate.

The Division follows guidelines set by the International Association of Assessing Officers in its Standard on Valuation of Personal Property which states "The overall objective of the audit and verification process is to promote proper reporting to the extent possible with available resources." The Standard also states "In general, emphasis should be placed on the audit of new accounts, major accounts, accounts with significant changes from the previous year, and accounts that are suspected of being improperly reported."

ACTION TAKEN/TO BE TAKEN: Procedures are in place to accomplish the objective of the Division. However, written procedures have not been compiled and placed in a Standard Operating Procedure Manual.

The Division will develop a written Standard Operating Procedures Manual which will formally establish discovery and auditing procedures for the Personal Property Section.

COMPLETION DATES - ACTUAL/ESTIMATED:

This manual will be completed by December 31, 1996.

FINDING NO. 1: No Written Office Procedures.

CONCURRENCE/NON-CONCURRENCE: **Concur**

The Personal Property Section follows standards and procedures provided in the Alaska Statute 29.45, Anchorage Municipal Code 12.10, the International Association of Assessing Officers Standard on Valuation of Personal Property, the General Audit Guidelines of the California State Board of Equalization and court rulings.

However, these guidelines have not been compiled into a Personal Property Valuation Standard Operating Procedure manual for the staff.

ACTION TAKEN/TO BE TAKEN:

A standard procedures manual will be developed to compile all existing and necessary procedures for providing clean and uniform direction for accomplishing assigned tasks and criteria for supervisory review into one booklet for use by the staff.

COMPLETION DATES - ACTUAL/ESTIMATED:

The Standard Operating Procedures Manual is estimated to be completed by December 31, 1996.

FINDING NO. 2: Procedures Not Effective for Determining Whether Business Personal Property Returns Were Filed.

A data base was not maintained of all businesses that had been reviewed by each of the Section's staff to prevent a duplication of effort in future research of businesses that had not filed a tax return.

CONCURRENCE/NON-CONCURRENCE: **Concur.**

A thorough and systematic process has been developed and is being utilized to provide an effective system for identifying business for which a return should be filed. Since the middle of 1995 a computerized system has been in place for electronically matching businesses maintained on the Municipality Data Base with the data on the State of Alaska Business License Tape. The program is referred to as Business Property Identification and Tracking System (BPITS). The data base is on file and is being used effectively. The Personal Property Section has already mailed out over 2,000 invitations to file in three zip code areas. The responses are currently being processed.

The initial pilot project under BPITS involved 574 Business Licenses in zip code 99524. The matching, filing and review process resulted in the following discoveries:

Business Licenses Not Matched on MOA Data Base	574
Businesses filing under other names	22
Businesses added to assessment rolls	204
Other (no longer in business, bad addresses, not traceable, etc.)	<u>348</u>
Total	574

A systematic review of the returns, follow up on questionable addresses, follow up on licenses no longer reflecting an active business, making determination on exemption requests and filing involuntary filings will be continued in the same manner as on the initial pilot project shown above.

This Business Property Identification and Tracking System is considered a systematic and effective process for identifying business that have not filed a tax return.

We agree that at the time of the audit review formal and written procedures to prevent duplication of effort were not in place, but that situation has been remedied.

ACTION TAKEN/TO BE TAKEN:

Systematic procedures to discover business and ensure that tax returns are filed:

The Business Property Identification and Tracking System and discovery efforts will continue until compete matching has occurred.

Once the initial process is completed and all Zip Codes have been covered, notices will be sent to all new business license holders when the annual State Business License listing is received.

An additional 2,000 invitations to file were mailed to Zip Code areas 99510 and 99501 in February, 1996 and in March, 1996 and the returns will be added, found not applicable or involuntary filings will be made on those who do not respond.

Duplication of effort:

Prior to the completion of the audit, the staff had completed a tracking system to be used by all staff for prevention of duplication. That system is now in place and is being used regularly.

COMPLETION DATES - ACTUAL/ESTIMATED:

The business tracking and discovery proces using the business license matching program is expected to require at least 18 months of effort to allow for production of regular tax rolls, mail notices, answer inquiries, process mail, research incomplete information, value filed returns, prepare involuntary filings, determine exemptability and complete appeals issues. The date of completion of original discovery and placement on tax rolls is expected to be complete by December 31, 1997.

FINDING NO 3: The Procedures For Reviewing Business Personal Property Tax Returns Could be Improved.

A formal audit process was not utilized by the Section where a representative random sample of returns was audited each year.

CONCURRENCE/NON-CONCURRENCE: **Concur**

Procedures for reviewing Business Personal Property Tax Returns could be improved through written Standard Operating Procedures which ensure consistent approaches to valuation review.

A random sample of returns is not audited each year.

Determinations of reasonableness of returns is left to the judgement of the business examiners. In mass appraising, and with trained staff, this is appropriate.

Existing section procedures or criteria for reviewing for reasonableness of returns will be written in a Standard Operating Procedures Manual.

Standard audit procedures are utilized. The same formalized listing of financial records are requested for each audit and the methodology utilized in conducting the audit is dependent upon the records provided. An audit review sheet is compiled for each audit to summarize the findings.

A log has been maintained with completed AUDIT CHECK LIST forms on all reviews made. A summary of the check lists is contained in the front of the log by company name, area, year, adjustment, roll, annual total and comments.

ACTION TAKEN/TO BE TAKEN:

Procedures for discovery and audit of Business Personal Property Tax Returns will be written and compiled in a Standard Operating Procedures Manual. The written procedures will include objectives, criteria, procedures and documentation guidelines.

A random sample process has been delayed so a "selective" audit process can continue. This "selective" audit process has been in place since the Division received funding for two auditors in 1989. The "selective" audit process should be continued until funding for resources is provided to allow for "random" audits.

COMPLETION DATES - ACTUAL/ESTIMATED:

This action will be completed by December 31, 1996

FINDING: A 1987 Internal Audit was completed of statistically selected returns prior to establishing two business examiner positions. An 82% error rate was found including over-reporting and under-reporting of returns (28% were overstated and 54% were understated. The 82% error rate reflected the number of errors, but only a net 7.8% understatement of values (the values were not understated by 82%).

CONCURRENCE/NON-CONCURRENCE: **Concur.**

ACTION TAKEN/TO BE TAKEN:

After the results of the audit were published, the Property Appraisal Division hired two Business Property Assessment Examiners. The hiring of these two positions have resulted in a net increase to the assessment rolls of \$250 million to date.

During 1995 an electronic business matching system tied to the State of Alaska Business License database was completed and implemented to discover businesses that are not on the assessment rolls. Two additional auditor positions were added to the staff during the 1995 tax year.

COMPLETION DATES - ACTUAL/ESTIMATED:

The business matching program is in effect and on-going. The Examiners' efforts are continuing.