2014

Prepared by the
Division of
Legislative Audit

DEPARTMENT OF REVENUE

A Summary of 2012 and 2013 Audit Recommendations

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Department of Commerce, Community, and Economic Development, and Department of Revenue
Alaska Film Production Tax Incentive Program Financial Compliance and Select Performance Issues

Audit Control Numbers
08-30065-12
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Report Conclusions

Based on our review, we concluded the following:

- The Department of Commerce, Community, and Economic Development's (DCCED) Alaska Film Office and the Department of Revenue's Tax Division generally adhere to film tax approval, issuance, and redemption statutes and regulations when administering the Alaska Film Production Tax Incentive Program (AFPTIP). Film tax credits are made available to qualified producers, properly calculated using qualified expenditures, and appropriately approved. Total film tax credits issued have not exceeded $100 million, and all redeemed AFPTIP credits have been used within three years of being issued to offset corporate income taxes.

- Although state agencies materially complied with statutes and regulations relating to the AFPTIP, areas for improvement were identified in DCCED's approval and redemption processes.

- The AFPTIP has generated a net positive economic impact in the State. The results of an economic impact study from July 2008 through February 2012 indicate direct spending from AFPTIP approved productions has generated $2 in economic output for every $1 in Alaska Film Production Tax Credits (tax credit) issued. Additionally, the study estimates that direct spending by production companies generated 432 Alaska resident full time equivalent direct and indirect jobs at a cost, in credits issued, of $56,600 per full time equivalent job.

- In general terms, DCCED's Alaska Film Office eligibility and application review is adequately designed to protect the State's best interests. However, improvements are needed. Necessary improvements include developing written criteria for evaluating whether a production is not in the State's best interests, and strengthening residency verification and documentation requirements to ensure the State is provided the information necessary to adequately review and approve tax credit calculations.

- Except for internship certifications, DCCED's Alaska Film Office is sufficiently meeting its statutory program responsibilities. The Alaska Film Office is promoting Alaska as a viable film location, cooperating with private entity organizations, and providing production assistance. Although identified as one of its statutory duties, the Alaska Film Office has not yet certified any internship programs.

- **Recommendation A:** The Department of Revenue's Tax Division director should improve procedures for tracking and reporting the use of tax credits.

  The Tax Division uses a query of the Tax Accounting System to identify and track the film tax credits redeemed and to ensure the film tax credits were only applied to corporate income taxes as required by statute. The current Tax Accounting System query only captures film tax credits greater than $10,000, creating a risk that reported credit redemptions could be inaccurate, or that the credit could be abused by taxpayers.

- ✓ **Agency Response:** Agreed.

  The Department of Revenue stated that the query was changed to capture all credits, regardless of amount. The Department of Revenue has also implemented a procedure whereby the tax returns of corporations that have been issued a film production tax credit certificate are manually reviewed to determine if the film credit has been claimed.

- ❖ **Current Status**

State of Alaska
Single Audit
for the
Fiscal Year Ended
June 30, 2012

Department of Revenue

Audit Control Number
02-40013-13

There are two primary objectives for the State of Alaska, Single Audit for the Fiscal Year Ended June 30, 2012 (Statewide Single Audit). The first is to determine if the State of Alaska's financial statements are fairly presented in accordance with generally accepted accounting principles. The second is to determine if the State has materially complied with the various federal laws, regulations, and contract provisions when expending federal financial assistance.

The Department of Revenue (department) had two recommendations in the FY 12 Statewide Single Audit.

- **Prior Audit Recommendation A:** The commissioner should ensure staff within the Tax Division implement controls to improve the auditing of oil and gas severance tax revenues.

  From FY 08 through FY 11, significant control deficiencies over the Tax Division's auditing of severance tax revenues were reported. Control deficiencies included insufficient audit oversight, a lack of standard procedures to guide the audit process, inadequate audit reviews, and untimely tax return reviews and reconciliations. Historically, the department's audit section has relied upon standard audit programs and supervisor review and oversight to ensure that their audits are timely and accurate, and that audit results can withstand the scrutiny of the administrative appeal process and, in some cases, litigation.

  With the passage of the Petroleum Profits Tax (enacted in August 2006) and Alaska's Clear and Equitable Share (enacted in November 2007) legislation, management's controls over the auditing of severance taxes have deteriorated.

  Legislative Audit's 2012 Position: While Tax Division management has made improvements in audit oversight, written standard procedures, and audit reviews, the control deficiencies identified in prior audits have not been fully addressed for FY 12. Because audits subject to the new procedure span multiple years, the Division of Legislative Audit was unable to evaluate the full implementation of the written procedures. Furthermore, the annual tax reporting template has not yet been finalized.

- ✓ **Agency Response:** Agreed.

  The department agreed that management needs to continue improving audit oversight by standardizing audit procedures and controls. According to department management, written standard procedures were drafted and implemented in FY 11. In FY 13, the department expects to conduct current and new audits under the written standard procedures. The department is also working with a contractor to update and streamline the annual tax return reporting template.

- ❖ **Current Status**

- **Recommendation B:** DOR's Permanent Fund Dividend Division (PFDD) director should improve system controls to protect the integrity of the Dividend Application Information System (DAIS).

  Two deficiencies were noted in DAIS controls. During FY 12, an edit check was inappropriately removed. There was also an inadequate segregation of duties between DAIS programs. Staff vacancies and competing priorities contributed to the errors. During FY 12, DAIS generated approximately $662 million of expenditures. Without proper segregation of duties or effective edit controls, the risk of unallowable or improper dividend expenditures increases.

- ✓ **Agency Response:** Agreed

  The PFDD is taking steps to mitigate risk associated with single points of control within its payment system.

- ❖ **Current Status**