CITY AND COUNTY OF SAN FRANCISCO

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2007, through June 30, 2012

JOHN CHIANG
California State Controller

April 2014

JOHN CHIANG
California State Controller

April 29, 2014

The Honorable Ben Rosenfield, Controller
City and County of San Francisco
1 Dr. Carlton B. Goodlett Place, Room 316
San Francisco, CA 94102-4694

Dear Mr. Rosenfield:

The State Controller's Office audited the methods employed by the City and County of San Francisco (County) to apportion and allocate property tax revenues for the period of July 1, 2007, through June 30, 2012. The audit was conducted pursuant to the requirements of Government Code section 12468.

Our audit found that the County complied with California statutes, except that it:

- Rounded AB 8 factors to four decimals places
- Incorrectly allocated Unitary Railroad Property Tax Revenues by:
  - Excluding ERAF from allocation
  - Using incorrect RDA factors
- Incorrectly allocated Unitary Qualified Electric Property Tax Revenues by:
  - Excluding ERAF from the allocation
  - Including RDAs in the allocation

If you have any questions, please contact Elizabeth Gonzalez, Chief, Local Government Compliance Bureau, by phone at (916) 324-0622.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/kw

Attachment

cc: James Whitaker, Property Tax Manager
City and County of San Francisco
David Chiu, President
San Francisco County Board of Supervisors
Jody Martin, Principal Consultant
Joint Legislative Budget Committee
Peter Detwiler, Staff Director
Senate Local Government Committee
Elvia Dias, Committee Assistant
Senate Local Government Committee
Dixie Martineau-Petty, Secretary
Assembly Local Government Committee
Gayle Miller, Staff Director
Senate Revenue and Taxation Committee
Oksana Jaffe, Chief Consultant
Assembly Revenue and Taxation Committee
Neil McCormick, Executive Director
California Special Districts Association

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Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by the City and County of San Francisco (County) to apportion and allocate property tax revenues for the period of July 1, 2007, through June 30, 2012.

Our audit found that the County complied with California statutes for the allocation and apportionment of property tax revenues, except that it:

- Rounded AB 8 factors to four decimals places
- Incorrectly allocated Unitary Railroad Property Tax Revenues by:
  - Excluding ERAF from allocation
  - Using incorrect RDA factors
- Incorrectly allocated Unitary Qualified Electric Property Tax Revenues by:
  - Excluding ERAF from the allocation
  - Including RDAs in the allocation

Background

After the passage of Proposition 13 in 1978, the California State Legislature enacted new methods for allocating and apportioning property tax revenues to local government agencies and public schools. The main objective was to provide local government agencies with a property tax base that would grow as assessed property values increased. These methods have been further refined in subsequent laws passed by the Legislature.

One key law was Assembly Bill (AB) 8, Chapter 282, Statutes of 1979, which established the method of allocating property taxes for fiscal year (FY) 1979-80 (base year) and subsequent fiscal years. The methodology is commonly referred to as the AB 8 process or the AB 8 system.

The property tax revenues that local government agencies receive each fiscal year are based on the amount received in the prior year, plus a share of the property tax growth within their boundaries. Property tax revenues are then apportioned and allocated to local agencies and schools using prescribed formulas and methods defined in the Revenue and Taxation Code.

The AB 8 base process involved numerous steps, including the transfer of revenues from schools to local agencies (AB 8 shift) and the development of the tax rate area annual tax increment apportionment factors (ATI factors), which determine the amount of property tax revenues to be allocated to each jurisdiction.

The total amount to be allocated to each jurisdiction is then divided by the total amount to be allocated to all entities to determine the AB 8 apportionment factor (percentage share) for each entity for the year. The AB 8 factors are computed each year for all entities, using the revenue amounts established in the prior year. These amounts are adjusted for growth annually, using ATI factors.

Subsequent legislation removed revenues generated by unitary and nonunitary properties, regulated railway companies, and qualified electric properties from the AB 8 process. These revenues are now allocated and apportioned under separate processes.

Other legislation established an Educational Revenue Augmentation Fund (ERAF) in each county. Most local government agencies are required to transfer a portion of their property tax revenues to the fund. The fund is subsequently allocated and apportioned to schools by the county auditor according to instructions received from the county superintendent of schools or the State Chancellor of Community Colleges.

Revenues generated by the different types of property tax are apportioned and allocated to local agencies and schools using prescribed formulas and methods, as defined in the Revenue and Taxation Code. Taxable property includes land, improvements, and other properties that are accounted for on the property tax rolls maintained primarily by the county assessor. Tax rolls contain an entry for each parcel of land, including the parcel number, the owner's name, and the value. Following are the types of property tax rolls:

- *Secured Roll*—This roll contains property that, in the opinion of the assessor, has sufficient value to guarantee payment of the tax levies and that, if necessary, can be sold by the tax collector to satisfy unpaid tax levies.

- *Unsecured Roll*—This roll contains property that, in the opinion of the assessor, does not have sufficient "permanence" or have other intrinsic qualities to guarantee payment of taxes levied against it.

- *State-Assessed Roll*—This roll contains public utility and railroad properties, assessed as either unitary or nonunitary property by the State Board of Equalization.

- *Supplemental Roll*—This roll contains property that has been reassessed due to a change in ownership or the completion of new construction, where the resulting change in assessed value is not reflected in other tax rolls.

To mitigate problems associated with the apportionment and allocation of property taxes, Senate Bill 418 was enacted in 1985 requiring the State Controller to audit the counties' apportionment and allocation methods and report the results to the California State Legislature.

Objective, Scope, and Methodology

Our audit objective was to review the County's apportionment and allocation of property tax revenues to local government agencies and public schools within its jurisdiction to determine whether the County complied with Revenue and Taxation Code requirements.

To meet the objective, we reviewed the County's procedures for apportioning and allocating property tax revenues used by the County auditor and the processes used by the tax collector and the assessor.

We performed the following procedures:

- Conducted tests to determine whether the County correctly apportioned and allocated property tax revenue.
- Interviewed key personnel and reviewed supporting documentation to gain an understanding of the County's property tax apportionment and allocation processes.
- Reviewed apportionment and allocation reports prepared by the County showing the computations used to develop the property tax distribution factors.
- Reviewed tax rate area (TRA) reports to verify that the annual tax increment was computed properly.
- Reviewed County unitary and operating nonunitary reports and Board of Equalization reports and verified the computations used by the County to develop the unitary and operating nonunitary property tax distribution factors.
- Reviewed redevelopment agency (RDA) reports prepared by the County and verified the computations used to develop the project base amount and the tax increment distributed to the RDA.
- Reviewed successor agency Recognized Obligation Payment Schedule (ROPS) and County apportionment and allocation reports addressing payments to the Redevelopment Property Tax Trust Fund (RPTTF).
- Reviewed ERAF reports prepared by the County and verified the computations used to determine the shift of property taxes from local agencies to the ERAF and, subsequently, to public schools.

We conducted this performance audit under the authority of Government Code sections 12468 and 12410. We did not audit the County's financial statements. We conducted this performance audit 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 our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The audit covered the period of July 1, 2007, through June 30, 2012. Our audit scope was limited to:

- Reviewing operational procedures and significant applicable controls over the apportionment and allocation process;

- Examining selected property tax apportionment and allocation records; and

- Reviewing related property tax revenue data used to determine the apportionment and allocation computation process.

A property tax bill contains the property tax levied at a 1% tax rate pursuant to the requirement of Proposition 13. A bill may also contain special taxes, debt services levies on voter-approved debt, fees, and assessments levied by the County or a city. The scope of our audit is concerned with the distribution of the 1% tax levy. Special taxes, debt service levies on voter-approved debt, fees, and assessments levied by the County or a city are beyond the scope of our audit and were not reviewed or audited.

We limited our review of the County's internal controls to gaining an understanding of the transaction flow in order to develop appropriate auditing procedures. We did not evaluate the effectiveness of all internal controls.

In addition, we tested transactions used to apportion and allocate property taxes and performed other procedures deemed necessary. This report relates solely to the method used by the County to apportion and allocate property taxes.

Conclusion

Our audit found that, except for the items discussed in the Findings and Recommendations section of this report, the City and Country of San Francisco (County) complied with California statutes for the apportionment and allocation of property tax revenues for the period of July 1, 2007, through June 30, 2012. The County should correct the items discussed in the Findings and Recommendations section.

Follow-up on Prior Audit Findings

The County has satisfactorily resolved the findings noted in our prior audit report, issued December 2008.

Views of Responsible Officials

We issued a draft audit report on February 26, 2014. Ben Rosenfield, Controller, responded by letter dated March 11, 2014 (Attachment). He agreed with the audit results.

Restricted Use

This report is solely for the information and use of the City and County of San Francisco, the California Legislature, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

April 29, 2014

Findings and Recommendations

FINDING 1— Calculation and distribution of ATI

In fiscal year (FY) 2010-11 and FY 2011-12, the County rounded the base tax rate (AB 8 factors) to four decimals.

Requirements for the apportionment and allocation of the annual tax increment (ATI) are found in Revenue and Taxation Code sections 96 through 96.5. The annual increment of property tax, which is the change in assessed value from one year to the next, is allocated to tax rate areas (TRA) on the basis of each TRA's share of the incremental growth in assessed valuations. The tax increment is then multiplied by the jurisdiction's ATI apportionment factors for each TRA. These factors were developed in the 1979-80 base year and are adjusted for jurisdictional changes. The tax increment is then added to the tax computed for the prior fiscal year to develop the apportionment for the current fiscal year.

Recommendation

While the finding per any single fund is immaterial for the periods under audit, over time the dollar amounts incorrectly allocated will grow to a material amount.

The County should use factors with a minimum of eight decimal places.

County Response

The County agreed with the finding and made the appropriate corrections.

FINDING 2— Unitary-railroad apportionment

From FY 2007-08 through FY 2011-12, the County made the following errors in determining the allocation of Unitary Railroad Property Tax Revenues:

1. Excluded ERAF
2. Used incorrect RDA factors

During the audit period, these errors caused:

1. ERAF to be under-allocated by $133,583
2. The General Fund to be over-allocated by $113,907 (including portions in the Children's, Library Preservation, and Open Space funds)
3. RDAs to be over-allocated by $22,563

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in Revenue and Taxation Code section 100.

Unitary properties are those properties on which the Board of Equalization “may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee” (i.e., public utilities and railroads). The Revenue and Taxation Code further states, “Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee.”

In FY 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The Legislature established the unitary and operating nonunitary base year and developed formulas to compute the distribution factors for the fiscal years that followed.

Recommendation

The County should remit from the General Fund its portion of the underpayment to ERAF ($113,907).

RDAs have since been dissolved and misapportioned revenues have either been used for a debt obligation or redistributed to the affected entities.

County Response

The County agreed with the finding and made the appropriate corrections.

FINDING 3— Unitary qualified electric apportionment

In FY 2011-12, the County made the following errors in determining the allocation of Unitary Qualified Electric Property Tax Revenues:

1. Excluded ERAF
2. Included RDAs

During the audit period, these errors caused:

1. ERAF to be under-allocated by $255,405
2. The General Fund to be over-allocated by $255,516 (including portions in the Children’s, Library Preservation, and Open Space funds)
3. RDAs to be over-allocated by $199,678

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in Revenue and Taxation Code section 100.

Unitary properties are those properties on which the Board of Equalization “may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee” (i.e., public utilities and railroads). The

Revenue and Taxation Code further states, "Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee."

In FY 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The Legislature established the unitary and operating nonunitary base year and developed formulas to compute the distribution factors for the fiscal years that followed.

Recommendation

The County should remit from the General Fund the underpayment to ERAF ($255,405).

RDAs have since been dissolved and misapportioned revenues have either been used for a debt obligation or redistributed to the affected entities.

County Response

The County agreed with the finding and made the appropriate corrections.

Schedule 1—
Summary of Misallocations to the Educational Revenue Augmentation Fund
July 1, 2007, through June 30, 2012

Finding No.	Fiscal Years Affected	Amount Due to (Owed from) the ERAF
2	FY 2007-8 through FY 2011-12	$ 133,583
3	FY 2011-12	255,405
Total		$ 388,988

Attachment—
County's Response to Draft Audit Report

CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

Ben Rosenfield
Controller

Monique Zmuda
Deputy Controller

March 11, 2014

Ms. Elizabeth Gonzalez
Chief, Local Government Compliance Audits Bureau
State Controller's Office
Division of Audits
P.O. Box 942850
Sacramento, CA 94250-5874

Dear Ms. Gonzalez,

We have reviewed the State Controller's Office's (SCO's) draft audit report on the City and County of San Francisco's (County's) property tax apportionment and allocation system for the period of July 1, 2007 through June 30, 2012 for the purposes of determining the County's compliance with the California Revenue and Taxation (R&T) Code and applicable rules and regulations.

Below are our comments regarding SCO's audit findings:

Finding 1:

- The County rounded AB 8 factors to four decimal places in fiscal years (FY) 2010-11 and 2011-12.

Response: The County agrees with this finding. For FY 2013-14, the County utilized AB 8 factors with eight decimal places in its annual property tax rate ordinances and will continue to do so in future annual property tax rate ordinances.

Finding 2:

- The County excluded the Educational Revenue Augmentation Fund (ERAF) and used incorrect Redevelopment Agency (RDA) factors when determining the allocation of Unitary Railroad Property Tax Revenues.

Response: The County agrees with this finding. There has been confusion across the state in past years about whether or not the ERAF should be included in the unitary apportionment process, and the County received a finding in the SCO's previous property tax apportionment and allocation system audit (covering FY 2004-05 through FY 2006-07) for including the ERAF as a taxing entity in our unitary apportionment. It does seem clear in R&T Code Section 100.11 (effective January 1, 2007) that unitary railroad property tax revenues should be allocated to the ERAF. Also, R&T Code Section 100.11

indicates that a RDA shall not receive any property tax revenues from unitary railroad assessments.

Adjustments were made in FY 2013-14 to our unitary railroad property tax revenue apportionment process to include the ERAF and exclude the Successor Agency to the San Francisco Redevelopment Agency, and the County will continue to do this in future apportionments. The County shall remit **$113,907** to compensate for the underpayment to the ERAF as identified by the SCO.

Finding 3:

- The County excluded the Educational Revenue Augmentation Fund (ERAF) and included the Redevelopment Agency (RDA) when determining the allocation of Unitary Qualified Electric Property Tax Revenues.

Response: The County agrees with this finding. There has been confusion across the state in past years about whether or not the ERAF should be included in the unitary apportionment process, and the County received a finding in the SCO's previous property tax apportionment and allocation system audit (covering FY 2004-05 through FY 2006-07) for including the ERAF as a taxing entity in our unitary apportionment. It does seem clear in R&T Code Section 100.95 (effective September 29, 2010) that unitary qualified electric property tax revenues should be allocated to the ERAF. Also, R&T Code Section 100.95 indicates that all other entities besides the County and school entities shall not receive any property tax revenues from unitary qualified electric assessments.

Adjustments were made in FY 2013-14 to our unitary qualified electric property tax revenue apportionment process to include the ERAF and exclude the Successor Agency to the San Francisco Redevelopment Agency, and the County will continue to do this in future unitary apportionments. The County shall remit **$255,405** to compensate for the underpayment to the ERAF as identified by the SCO.

We appreciate the State Controller's Office's assistance during this audit. Please let us know if you have any questions.

Sincerely,

Ben Rosenfield
Controller

State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874

http://www.sco.ca.gov

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