KINGS COUNTY

Audit Report

APPORTIONMENT AND ALLOCATION OF PROPERTY TAX REVENUES

July 1, 2015, through June 30, 2021

MALIA M. COHEN

California State Controller

February 2023

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California State Controller

February 14, 2023

The Honorable James P. Erb, CPA, Director
Kings County Finance Department
1400 W. Lacey Boulevard
Hanford, CA 93230

Dear Mr. Erb:

The State Controller's Office audited Kings County's process for apportioning and allocating property tax revenues for the period of July 1, 2015, through June 30, 2021. We conducted the audit pursuant to the requirements of Government Code section 12468.

Our audit found that the county incorrectly calculated the:

- Supplemental property tax administrative costs;
- Unitary regulated railway apportionment and allocation; and
- Vehicle license fee shifts.

If you have any questions, please contact Lisa Kurokawa, Chief, Compliance Audits Bureau, by telephone at (916) 327-3138.

Sincerely,

Original signed by

KIMBERLY TARVIN, CPA
Chief, Division of Audits

KT/ac

Attachment

cc: Joe Neves, Chairman
  Kings County Board of Supervisors
Robert Knudson, Assistant Director
  Kings County Finance Department
Kristina McKay, Property Tax Manager
  Kings County Finance Department
Chris Hill, Principal Program Budget Analyst
  Local Government Unit
  California Department of Finance

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Audit Report

Summary

The State Controller's Office (SCO) audited Kings County's process for apportioning and allocating property tax revenues for the period of July 1, 2015, through June 30, 2021.

Our audit found that the county incorrectly calculated the:

- Supplemental property tax administrative costs;
- Unitary regulated railway apportionment and allocation; and
- Vehicle license fee (VLF) shifts.

Background

After the passage of Proposition 13 in 1978, the California State Legislature (Legislature) enacted new methods for apportioning and allocating property tax revenues to local government agencies, school districts, and community college districts. The main objective was to provide these agencies and districts with a property tax base that would grow as assessed property values increased. The method has been further refined in subsequent laws passed by the Legislature.

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

Property tax revenues are apportioned and allocated to local government agencies, school districts, and community college districts using prescribed formulas and methods defined in the Revenue and Taxation Code. In general, property tax revenues that an agency or district receives each fiscal year is based on the amount received in the prior year plus a share of the property tax growth within its boundaries.

The AB 8 process involves several steps, including the transfer of revenues from school and community college districts to local government agencies and the development of the tax rate area (TRA) annual tax increment (ATI) apportionment 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 factor 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 apportionment factors.

Subsequent legislation removed from the AB 8 process revenues generated by unitary and operating nonunitary properties, pipelines, regulated railway companies, and qualified electric properties. These revenues are now apportioned and allocated 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 apportioned and allocated to school and community college districts by the county auditor according to instructions received from the county superintendent of schools or the chancellor of the California community colleges.

Taxable property includes land, improvements, and other properties that are accounted for on the property tax rolls, which are primarily maintained by the county assessor. Tax rolls contain an entry for each parcel of land, including parcel number, owner's name, and value. The types of property tax rolls are:

- *Secured Roll*—Property that, in the opinion of the assessor, has sufficient value to guarantee payment of the tax levies and that, if the taxes are unpaid, the obligation can be satisfied by the sale of the property by the tax collector.
- *Unsecured Roll*—Property that, in the opinion of the assessor, does not have sufficient permanence or other intrinsic qualities to guarantee payment of taxes levied against it.
- *State-Assessed Roll*—Utility properties composed of unitary and operating nonunitary value assessed by the California State Board of Equalization.
- *Supplemental Roll*—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 tax revenues, Senate Bill 418, which requires the SCO to audit the counties' apportionment and allocation methods and report the results to the Legislature, was enacted in 1985.

Apportionment and allocation of property tax revenues can result in revenues to an agency or agencies being overstated, understated, or misstated. Misstated revenues occur when at least one taxing agency receives more revenue than it was entitled to, while at least one taxing agency receives less revenue than it was entitled to.

The agency that received less tax revenue than its statutory entitlement would have standing to require that adjustments be made by the county, either on a retroactive or prospective basis. SCO does not have enforcement authority or standing to require the county to take corrective action with respect to misallocation of tax revenues, unless the misallocation resulted in overpaid state funds (funds intended for the ERAF, school districts, or community college districts). SCO has authority to recover misallocations resulting in overpaid state funds pursuant to Government Code (GC) sections 12410, 12418, and 12419.5.

GC section 12410 provides the SCO with broad authority to "superintend the fiscal concerns of the state." GC section 12418 provides the SCO with the authority to "direct and superintend the collection of all money due the State, and institute suits in its name" against all debtors of the State. GC section 12419.5 provides the SCO with the authority to offset any amounts due the State against any amounts owed to the debtor by the State.

Revenue and Taxation Code (RTC) section 96.1(b) allows a reallocation of current audit findings and unresolved prior audit findings.

RTC section 96.1(c)(3) limits a cumulative reallocation or adjustment to one percent of the total amount levied at a one-percent rate of the current year's original secured tax roll. For reallocation to the ERAF, school districts, or community college districts, a reallocation must be completed in equal increments within the following three fiscal years, or as negotiated with the SCO.

Audit Authority

We conducted this audit under the authority of GC section 12468, which requires the SCO to audit the apportionment and allocation of property tax revenues on a one-, three-, or five-year cycle, depending on the city and county's population. The audit results are reported annually to the Legislature along with any recommendations for corrective action.

Objective, Scope, and Methodology

Our audit objective was to determine whether the county complied with Revenue and Taxation Code, Health and Safety Code, and Government Code requirements pertaining to the apportionment and allocation of property tax revenues.

A property tax bill contains the property tax levied at a one percent tax rate pursuant to the requirement of Proposition 13. A tax bill may also contain special taxes, debt service levies on voter-approved debt, fees, and assessments levied by the county or a city. The scope of our audit was the distribution of the one percent 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.

The audit period was July 1, 2015, through June 30, 2021.

To achieve our objective, we performed the following procedures:

- We gained an understanding of the county's process for apportioning and allocating property tax revenues by interviewing key personnel.
- We reviewed the county's written procedures for apportioning and allocating property tax revenues.
- We reviewed documents supporting the transaction flow for apportioning and allocating property tax revenues.
- We judgmentally selected a non-statistical sample of five from approximately 100 taxing jurisdictions within the county for all fiscal years in the audit period.

  The actual number of taxing jurisdictions can vary from year to year based on jurisdictional changes. For testing purposes, we included the ERAF in our sample of taxing jurisdictions. We also tested a special district, a school district, a city, and the county. We selected only one of each type of local agency because when the apportionment and allocation for one jurisdiction is incorrect, the error affects every other taxing jurisdiction.

We tested the sampled jurisdictions as follows:

- We tested apportionment and allocation reports to verify computations used to develop property tax apportionment factors.
- We tested TRA reports to verify that the correct TRA factors were used in the computation of the ATI.
- We reviewed supplemental property tax administrative costs and fees to determine whether recovery costs associated with administering supplemental taxes were based on actual costs and did not exceed five percent of revenues collected, as prescribed in statute (see Finding 1).
- We verified computations used to develop supplemental property tax apportionment factors.
- We verified unitary and operating nonunitary, unitary regulated railway, and qualified electric property computations used to develop apportionment factors (see Finding 2).
- We reviewed redevelopment agency reports and verified computations used to develop the project base amount and the tax increment distributed to the redevelopment agency.
- We reviewed Redevelopment Property Tax Trust Fund deposits.
- We reviewed property tax administration cost reports and recomputed administrative costs associated with work performed for apportioning and allocating property tax revenues to local government agencies, school districts, and community college districts.
- We reviewed ERAF reports and verified computations used to determine the shift of property taxes from local government agencies to the ERAF and, subsequently, to school and community college districts.
- We reviewed the Sales and Use Tax letter and verified VLF computations used to determine the amount transferred from the ERAF to counties and cities to compensate for the diversion of these revenues (see Finding 3).
- We reviewed California State Board of Equalization jurisdictional change filing logs and their impact on the tax apportionment and allocation system.

Errors found were not projected to the intended (total) population.

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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Conclusion

Our audit found that Kings County did not comply with statutory requirements for the apportionment and allocation of property tax revenues for the audit period. Specifically, we determined that the county incorrectly calculated the:

- Supplemental property tax administrative costs;
- Unitary regulated railway apportionment and allocation; and
- VLF shifts.

These instances of noncompliance are described in the Findings and Recommendations section.

Follow-up on Prior Audit Findings

Kings County has satisfactorily resolved the findings noted in our prior audit report, for the period of July 1, 2008, through June 30, 2015, issued on May 8, 2017, with the exception of supplemental property tax administrative costs, as shown in the Appendix.

Views of Responsible Officials

We issued a draft audit report on December 22, 2022. The county responded by email on January 19, 2023, agreeing with the audit results.

Restricted Use

This audit report is solely for the information and use of Kings County, the Legislature, the California Department of Finance, 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 audit report, which is a matter of public record and is available on the SCO website at www.sco.ca.gov.

Original signed by

KIMBERLY TARVIN, CPA
Chief, Division of Audits

February 14, 2023

Findings and Recommendations

FINDING 1—Supplemental property tax administrative costs (Repeat Finding)

During our testing of the county's process for reimbursing supplemental property tax administrative costs, we found that the county did not properly document actual supplemental property tax administrative costs as required by statute.

As a result of this error, the county inappropriately charged the affected jurisdictions for administering the supplemental roll. We did not quantify the monetary impact for each affected taxing entity due to the cumulative effect of the errors affecting the computation and allocation. The error occurred because the county incorrectly implemented the applicable statute.

RTC section 75.60 provides the legal requirements for reimbursing supplemental property tax administrative costs.

The statute allows a county to charge an administrative fee for collecting supplemental property tax revenues. This fee is not to exceed five percent of the supplemental property tax revenues collected.

<u>Recommendation</u>

We recommend that the county review RTC section 75.60 and update its procedures to ensure documentation of actual costs incurred for administrating the supplemental roll.

<u>County's Response</u>

The county agreed with the finding and recommendation.

FINDING 2—Unitary regulated railway apportionment and allocation

During our testing of unitary regulated railway apportionment and allocation, we found that the county incorrectly calculated the excess factor by including the VLF adjustment for FY 2017-18, FY 2018-19, and FY 2020-21.

This error resulted in misallocation of revenue to the county's general fund, cities, and the ERAF. We did not quantify the monetary impact for each affected taxing entity due to the cumulative effect of the errors affecting the computation and allocation. The error occurred because the county incorrectly implemented the applicable statute.

RTC section 100.11 provides the legal requirements for apportioning and allocating unitary regulated railway property tax revenues.

Unitary regulated railway properties are facilities that were completely constructed and placed in service after January 1, 2007. RTC section 723 defines unit valuation of a property that is operated as a unit in a primary function of the assessee.

Recommendation

We recommend that the county:

- Review RTC section 100.11 and update its procedures to ensure that the VLF adjustment is removed from the railway;
- Recalculate the railway excess factor allocations for FY 2017-18 through FY 2020-21; and
- Make monetary adjustments to its general fund, cities, and ERAF.

County's Response

The county agreed with the finding and recommendation.

FINDING 3— Vehicle License Fee adjustments

During our testing of VLF adjustments, we found that the county incorrectly calculated the VLF shift by adjusting for annexations in FY 2015-16, FY 2018-19, and FY 2019-20.

This error resulted in a misallocation of property tax revenues to the county's general fund, cities, and ERAF. We could not quantify the monetary impact due to the cumulative effect of the various errors affecting the computation and allocation. The errors occurred because county staff members incorrectly implemented the applicable statute.

RTC section 97.70 provides the legal requirements for VLF adjustments.

The VLF permanently provided additional property tax revenues to cities and counties in lieu of the discretionary VLF revenues that these agencies previously received.

Recommendation

We recommend that the county:

- Review RTC sections 97.69 and 97.70 and update its procedures;
- Recalculate the VLF adjustments for FY 2015-16 through FY 2020-21; and
- Make monetary adjustments to its general fund, cities, and ERAF.

County's Response

The county agreed with the finding and recommendation.

Appendix—
Summary of Prior Audit Findings

The following table shows the implementation status of Kings County's corrective actions related to the findings contained in our prior audit report, dated May 8, 2017:

Prior Audit Finding Number	Prior Audit Finding Title	Implementation Status
1	Supplemental property tax apportionment	Fully implemented
2	Supplemental property tax administrative costs	Not implemented – see current Finding 1
3	Redevelopment agencies	Fully implemented
4	Unitary and operating nonunitary apportionment	Fully implemented
5	Regulated railway apportionment	Fully implemented
6	Vehicle licensing fee and sales and use tax adjustments	Fully implemented

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