

IMPERIAL COUNTY

Reissued Audit Report

APPORTIONMENT AND ALLOCATION OF PROPERTY TAX REVENUES

July 1, 2007, through June 30, 2016



BETTY T. YEE
California State Controller

March 2019



BETTY T. YEE
California State Controller

March 29, 2019

The Honorable Josué G. Mercado, CPA, Auditor-Controller
Imperial County
940 West Main Street, Suite 100
El Centro, CA 92243

Dear Mr. Mercado:

The State Controller's Office audited the methods employed by Imperial County to apportion and allocate property tax revenues for the period of July 1, 2007, through June 30, 2016. The audit was conducted pursuant to the requirements of Government Code section 12468.

This reissued report updates our previous report dated November 17, 2017. We are reissuing this report to update the Objective, Scope, and Methodology section, and provide additional information in both the Background section and the Findings and Recommendations section. We also updated the information in the Supplemental Information section (previously the Observation section). These revisions do not affect the audit conclusion.

We did not make a determination on the validity of the following, as stated in the Supplemental Information section of this audit report:

- Qualified electric property tax revenue allocation, because of pending legal guidance regarding whether the Educational Revenue Augmentation Fund is entitled to a portion of the property tax revenue; and
- The county's methodology for apportioning the residual balance from the Redevelopment Property Tax Trust Fund, because of a pending appellate court decision.

Without consideration of these two legal issues, our audit found instances of noncompliance with California statutes for the apportionment and allocation of property tax revenues for the audit period. We determined that the county incorrectly computed the:

- Supplemental property tax apportionment factors;
- Unitary and operating nonunitary apportionment factors; and
- Regulated railway apportionment factors.

The Honorable Josué G. Mercado,
CPA, Auditor-Controller

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March 29, 2019

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

Sincerely,

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

JLS/as

cc: Ryan E. Kelley, Chairman
Imperial County Board of Supervisors
Ann McDonald, Assistant Auditor-Controller
Imperial County
Ivonne Ramirez, Property Tax Manager
Imperial County
Chris Hill, Principal Program Budget Analyst
Local Government Unit
California Department of Finance

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Reissued Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by Imperial County to apportion and allocate property tax revenues for the period of July 1, 2007, through June 30, 2016.

We did not make a determination on the validity of the following, as stated in the Supplemental Information section of this audit report:

- Qualified electric (QE) property tax revenue allocation, because of pending legal guidance regarding whether the Educational Revenue Augmentation Fund (ERAF) is entitled to a portion of the property tax revenue; and
- The county's methodology for apportioning the residual balance from the Redevelopment Property Tax Trust Fund (RPTTF), because of a pending appellate court decision.

Without consideration of these two legal issues, our audit found instances of noncompliance with California statutes for the apportionment and allocation of property tax revenues for the audit period. We determined that the county incorrectly computed the:

- Supplemental property tax apportionment factors;
- Unitary and operating nonunitary apportionment factors; and
- Regulated railway apportionment factors.

Revised 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 local government agencies, school districts, and community college 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 (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.

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 government agencies, school districts, and community college districts using prescribed formulas and methods defined in the Revenue and Taxation Code.

The AB 8 process involves several steps, including the transfer of revenues from school and community college districts to local government agencies (AB 8 shift) 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 (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 from the AB 8 process revenues generated by unitary and operating nonunitary properties, pipelines, regulated railway companies, and QE properties. These revenues are now apportioned and allocated under separate processes.

Other legislation established an 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.

Revenues generated by the different types of property tax are apportioned and allocated to local government agencies, school districts, and community college districts 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, 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 State Board of Equalization (BOE).
- *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 State Controller 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 State Controller with broad authority to “superintend the fiscal concerns of the state.” GC section 12418 provides the State Controller 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 State Controller with the authority to offset any amounts due the State against any amounts owing 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 State Controller.

Revised Objective, Scope, and Methodology

The objective of our audit 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.

The audit period was July 1, 2007, through June 30, 2016.

To achieve our objective, we:

- Interviewed key personnel to gain an understanding of the county’s process for apportioning and allocating property tax revenues;
- Reviewed the county’s written procedures for apportioning and allocating property tax revenues (we did not review the county’s written procedures for apportioning and allocating QE property due to pending legal guidance, as stated in the Supplemental Information section of this audit report);
- Performed analytical reviews to assess the reasonableness of property tax revenues;

- Judgmentally selected a non-statistical sample of five from approximately 73 taxing jurisdictions within the county for all fiscal years in the audit period (the actual number of taxing jurisdictions, which include the ERAF, can vary from year to year based on jurisdictional changes). Errors found were not projected to the intended population. Then, we:
 - Recomputed apportionment and allocation reports to verify computations used to develop property tax apportionment factors;
 - Tested TRA reports to verify that the correct TRA factors were used in the computation of the ATI;
 - 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;
 - Verified computations used to develop supplemental property tax apportionment factors;
 - Verified unitary and operating nonunitary computations used to develop apportionment factors;
 - Reviewed redevelopment agency (RDA) reports and verified computations used to develop the project base amount and the tax increment distributed to the RDA;
 - Reviewed RPTTF deposits and distributions. As stated in the Supplemental Information section of this audit report, we did not make a determination on the validity of the county's methodology for apportioning the residual balance from the RPTTF, due to a pending appellate court decision;
 - 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;
 - 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;
 - Reviewed the Sales and Use Tax letter and recomputed Vehicle License Fee (VLF) computations used to verify the amount transferred from the ERAF to counties and cities to compensate for the diversion of these revenues; and
 - Reviewed BOE jurisdictional change filing logs and their impact on the tax apportionment and allocation system.

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.

We limited our review of the county's internal controls to gaining an understanding of the transaction flow to develop appropriate auditing procedures. We did not evaluate the effectiveness of internal controls relevant to the apportionment and allocation of property tax revenues. We did not audit the county's financial statements.

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. A property tax bill contains the property tax levied at a one percent tax rate pursuant to the requirement of Proposition 13. A 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 is concerned with 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.

Conclusion

Without consideration of the two legal issues described in the Supplemental Information section (previously the Observation section), our audit found that Imperial County did not comply with California statutes for the apportionment and allocation of property tax revenues for the audit period. Specifically, we found that Imperial County incorrectly calculated the:

- Supplemental property tax apportionment factors;
- Unitary and operating nonunitary apportionment factors; and
- Regulated railway apportionment factors.

Follow-up on Prior Audit Findings

The county corrected the ERAF allocation for the library share of the ERAF shift identified in the prior audit report dated July 21, 2009, for the period of July 1, 2001, through June 30, 2007. However, the county has not repaid the \$959,203 owed to the ERAF. The county concurs with this finding and the amount owed, and is working on legislation to forgive the amount owed. We will follow up on this finding in our next audit.

Views of Responsible Officials

We issued a draft audit report on June 26, 2017. Douglas R. Newland, CPA, Auditor-Controller, responded by letter dated July 10, 2017, agreeing with both the audit results for Findings 1 through 3 and the supplemental information (previously included in the Observation section), and providing a comment on Finding 4. The county's response is included as an attachment to this report.

In response to the county's comment on Finding 4, we removed the finding from the Findings and Recommendations section and placed it in the Follow-up on Prior Audit Findings section of this report.

On September 17, 2018, we informed Ann McDonald, Assistant Auditor-Controller, of this reissued audit report and the reason for the reissuance.

**Reason for
Reissuance**

This reissued report updates our previous report dated November 17, 2017. We are reissuing this report to update the Objective, Scope, and Methodology section, and provide additional information in both the Background section and the Findings and Recommendations section. We also updated the information in the Supplemental Information section (previously the Observation section). These revisions do not affect the audit conclusion.

Restricted Use

This audit report is solely for the information and use of Imperial 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

JIM L. SPANO, CPA
Chief, Division of Audits

March 29, 2019

Revised Findings and Recommendations

FINDING 1— Supplemental Property Tax Apportionment and Allocation

During testing of the supplemental property tax apportionment and allocation process, we found that the county misallocated supplemental property tax revenues to all affected taxing entities for each fiscal year in the audit period. Specifically, the county:

- Included a multi-county school for FY 2007-08 through FY 2015-16; and
- Adjusted the supplemental apportionment factors for VLF and negative ERAF for FY 2014-15 and FY 2015-16.

The error occurred because the county misinterpreted the requirements outlined in the Revenue and Taxation Code. Due to the various errors affecting the computation and apportionment, we did not quantify the monetary impact for each affected taxing entity.

RTC sections 75.60, 75.71, and 100.2 provide the legal requirements for the apportionment and allocation of the supplemental property tax revenue.

Supplemental property tax revenues enable counties to tax a property retroactively for the period when a change in ownership or completion of new construction occurs.

Recommendation

We recommend that the county:

- Review the aforementioned sections of the Revenue and Taxation Code, and establish and implement procedures to properly compute the supplemental property tax apportionment factors; and
- Recalculate the supplemental property tax apportionment factors for FY 2015-16 onward.

County's Response

The county concurs with the finding and has made the recommended changes.

FINDING 2— Unitary and Operating Nonunitary Apportionment and Allocation

During testing of the unitary and operating nonunitary apportionment and allocation process, we found that the county incorrectly calculated the unitary and operating nonunitary excess apportionment factors for FY 2015-16, which resulted in misallocated revenues to the affected taxing entities. The error occurred because the county used the wrong prior-year AB 8 factor. Due to the various errors affecting the calculation, we did not quantify the monetary impact for each affected taxing entity.

RTC section 100 provides the legal requirements for the apportionment and allocation of the unitary and operating nonunitary property tax revenues.

Unitary properties are those properties on which BOE “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, railroads, or qualified electric properties). RTC section 723.1 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 tax revenues. The system created the unitary and operating nonunitary base-year and developed formulas to compute the distribution factors for the fiscal years that followed.

Recommendation

We recommend that the county:

- Review the aforementioned section of the Revenue and Taxation Code, and establish and implement procedures to properly calculate the unitary and operating nonunitary excess apportionment factors; and
- Recalculate the unitary and operating nonunitary excess apportionment factor for FY 2015-16.

County’s Response

The county concurs with the finding and has made the recommended changes.

FINDING 3— Unitary Regulated Railway Apportionment and Allocation

During testing of the regulated railway apportionment and allocation process, we found that the county incorrectly calculated the regulated railway excess apportionment factors because it included the VLF adjustments for FY 2014-15 and FY 2015-16, which resulted in misallocated revenues to the affected taxing entities. The error occurred because the county misinterpreted the requirements outlined in the Revenue and Taxation Codes. Due to the various errors affecting the calculation, we did not quantify the monetary impact for each affected taxing entity.

RTC section 100.11 provides the legal requirements for the apportionment and allocation of the 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 are operated as a unit in a primary function of the assessee.

Recommendation

We recommend that the county:

- Review the aforementioned sections of the Revenue and Taxation Code, and establish and implement procedures to properly calculate the regulated railway excess apportionment factors; and
- Recalculate the regulated railway excess apportionment factors for FY 2014-15 and FY 2015-16.

County's Response

The county concurs with the finding and has made the recommended changes.

Revised Supplemental Information

Revised—Qualified Electric Property

RTC section 100.95 provides the legal requirements for the apportionment and allocation of QE property tax revenues. Qualified property is “all plant and associated equipment, including substation facilities and fee-owned land and easements, placed in service by the public utility on or after January 1, 2007.”

During the audit, we did not review the county’s methodology for apportioning and allocating QE property tax revenues, due to pending legal guidance regarding whether the ERAF is entitled to a portion of the QE property tax revenue. After conclusion of our audit, we received the required legal guidance, which states that the ERAF is not entitled to a portion of the QE property tax revenue.

Our conclusion in this audit remains unchanged because we did not apply any audit procedures related to the QE property tax apportionment and allocation process. We will audit the county’s methodology for apportioning and allocating QE property in our subsequent audit.

Redevelopment Property Tax Trust Fund

On May 26, 2015, the Sacramento County Superior Court ruled in the Case No. 34-2014-80001723-CU-WM-GDS between the cities of Chula Vista, El Cajon, Escondido, Poway, San Diego, San Marcos, and Vista (petitioners) and the San Diego County Auditor-Controller (respondent) regarding the methodology in apportioning the residual balance from the RPTTF.

The Court stated, in part:

(1) that a cap on the residual amount each entity can receive be imposed in an amount proportionate to its share of property tax revenue in the tax area; and (2) the calculation of the residual share an entity is entitled to receive must be done by considering the property tax available in the Redevelopment Property Tax Trust Fund after deducting only the amount of any distributions under paragraphs (2) and (3) of subdivision (a) of Section 34183.

On September 17, 2015, the respondent appealed the ruling to the Court of Appeal of the State of California. As the appellate court has not decided on the case, we will follow up on this issue in a subsequent audit.

**Attachment—
County's Response to Draft Audit Report**

Douglas R. Newland, CPA
Auditor-Controller
douglasnewland@co.imperial.ca.us



County Administration Center
940 Main Street, Suite 108
El Centro, California 92243
Telephone: 442-265-1277
FAX: 442-265-1298

AUDITOR-CONTROLLER

July 10, 2017

Elizabeth Gonzalez
Bureau Chief
SCO Division of Audits
Box 942850
Sacramento, CA 94250-5874

Dear Ms. Gonzalez;

I have reviewed the preliminary audit report for our property tax audit which your office recently performed. I agree with Findings 1-3 and the two Observations. We have made the recommended changes as you asked.

In regard to Finding 4, I agree and will be meeting with our legislative officer to put a bill together to ask for forgiveness of the amount owed. We will present the bill in the fall session, as that will be the optimum time since the current sessions are ending and I think the bill would be better received in the fall.

Sincerely,


Douglas Newland
Auditor-Controller.

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

<http://www.sco.ca.gov>