KERN COUNTY

Audit Report

APPORTIONMENT AND ALLOCATION OF PROPERTY TAX REVENUES

July 1, 2012, through June 30, 2017

BETTY T. YEE
California State Controller

March 2019

BETTY T. YEE
California State Controller

March 13, 2019

The Honorable Mary B. Bedard, CPA, Auditor-Controller-County Clerk
Kern County
1115 Truxtun Avenue
Bakersfield, CA 93301

Dear Ms. Bedard:

The State Controller's Office audited the methods employed by Kern County to apportion and allocate property tax revenues for the period of July 1, 2012, through June 30, 2017. We conducted the audit pursuant to the requirements of Government Code section 12468.

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 Kern County incorrectly calculated the:

- Supplemental property tax apportionment and allocation;
- Qualified electric apportionment and allocation; and
- Vehicle license fee adjustments.

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 Redevelopment Property Tax Trust Fund due to a pending appellate court decision.

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/hf

cc: Janelle Austin, Division Chief
Auditor-Controller's Office
Kern County
Brandon Carter, Senior Accountant
Auditor-Controller's Office
Kern County
David Couch, Chair
Kern County Board of Supervisors
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Audit Report

Summary

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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 calculated the:

- Supplemental property tax apportionment and allocation;
- Qualified electric (QE) apportionment and allocation; and
- Vehicle license fee (VLF) adjustments.

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 Redevelopment Property Tax Trust Fund (RPTTF) due to a pending appellate court decision.

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 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.

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.

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, 2012, through June 30, 2017.

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;
- Performed analytical reviews to assess the reasonableness of property tax revenues;
- Judgmentally selected a non-statistical sample of five from approximately 140 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, unitary regulated railway, and QE property computations used to develop apportionment factors;
- 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 VLF computations used to verify the amount transferred from the ERAF to counties and cities to compensate for the diversion of these revenues;
- Reviewed reports to determine any increases in property tax revenues due cities having low or nonexistent property tax amounts; 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 legal issue discussed in the Supplemental Information section of this audit report, our audit found that Kern County did not comply with California statutes for the apportionment and allocation of property tax revenues for the audit period, as it incorrectly calculated the:

- Supplemental property tax apportionment and allocation;
- QE apportionment and allocation; and
- VLF adjustments.

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

Follow-up on Prior Audit Findings

Findings noted in our prior audit report, for the period of July 1, 2009, through June 30, 2012, issued April 4, 2014, have been satisfactorily resolved by the county, with the exception of the supplemental allocation and apportionment.

Views of Responsible Officials

We issued a draft audit report on December 26, 2018. Mary B. Bedard, CPA, Auditor-Controller-County Clerk, responded by letter dated January 8, 2019 (Attachment), agreeing with the audit results. This final audit report includes the county's response.

Restricted Use

This audit report is solely for the information and use of Kern 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 final 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 13, 2019

Findings and Recommendations

REPEAT FINDING 1— Supplemental Property Tax Apportionment and Allocation

During testing of the supplemental property tax apportionment and allocation process, we found that the county made the following errors:

- Excluded the multi-county K-12 schools' (Gorman Elementary and Antelope Valley High) shares from the supplemental factor calculation instead of redistributing their shares to all other non-basic aid K-12 schools;
- Excluded the multi-county community college's (Antelope Valley Junior College) share from the supplemental factor calculation instead of allocating a proportionate share based on its AB 8; and
- Used incorrect factors in its first apportionment and allocation of actual revenues.

These errors resulted in the misallocation of supplemental property tax revenues to all entities in the county. We have determined that the error, while procedurally incorrect, is not material. The error occurred due to a differing interpretation of applicable statutes and timing differences regarding the availability of the current year factors.

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

<u>Recommendation</u>

We recommend that the county review the aforementioned Revenue and Taxation Code sections and then update its procedures to ensure that supplemental property tax apportionments and allocations are based on proper computations.

In addition, we recommend that the county:

- Redistribute multi-county K-12 schools' share to all other non-basic-aid K-12 schools;
- Allocate shares to multi-county community colleges based on their AB 8 share; and
- Perform a year-end true-up to ensure that entities receive their proportionate share of the revenue.

<u>County's Response</u>

The county concurs with the audit finding and states that it has made the necessary corrections.

FINDING 2— Qualified Electric Allocation and Apportionment

During testing of the QE apportionment and allocation process, we found that the county made several errors in its Tier 1 apportionment and allocation process of QE property tax revenues as follows:

- Did not use prior-year unitary factors for FY 2012-13 through FY 2016-17; and
- Excluded certain school entities and all non-enterprise special districts for FY 2012-13 through FY 2014-15, County Fire and certain hospital enterprises for FY 2012-13 through FY 2016-17, and Mountain Meadows Community Services District (a non-enterprise special district) for FY 2015-16 through FY 2016-17.

Additionally, during the Tier 2 process, the county did not allocate QE revenues equally to water districts for FY 2012-13 through FY 2016-17, when the QE property was provided services by more than one water district.

These errors resulted in misallocation of QE property tax revenues to all affected entities in the county. However, we cannot quantify the monetary impact due to various errors affecting the calculation. The errors occurred due to differing interpretations of applicable statutes.

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."

<u>Recommendation</u>

We recommend that the county review the aforementioned Revenue and Taxation Code section and then update its procedures to ensure that QE apportionments and allocations are based on proper computations.

In addition we recommend that the county:

- For Tier 1 allocations, use prior year unitary factors to allocate QE property tax revenues to the county, County Fire, all school entities, hospital enterprises and non-enterprise special districts within the county; and
- For Tier 2 allocations, allocate QE property tax revenues equally among water districts when the QE property is provided by more than one water district.

<u>County's Response</u>

The county concurs with the audit finding and states that it has made the necessary corrections.

FINDING 3— Vehicle License Fee Adjustments

During testing of the VLF process, we found that the county incorrectly excluded aircrafts' and redevelopment agencies' property assessed values from its VLF calculations. The exclusion of assessed values resulted in an incorrect VLF growth percentage, which was subsequently used in calculating VLF adjustment amounts.

For the selected sample entities, the estimated monetary effects are as follows:

	Fiscal Year				Total Due to
	2012-13	2013-14	2014-15	2015-16	(Due from)
County	$ 267,758	$ 98,183	$ 16,747	$ (603,486)	$ (220,798)
City of Delano	(18,792)	(608,682)	(636,073)	(778,293)	(2,041,840)
City of Shafter	22,840	56,966	47,133	31,094	158,033

RTC section 97.70 provides the legal requirements for VLF adjustments. The error occurred due to a differing interpretation of this statute.

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 the aforementioned Revenue and Taxation Code section and then update its procedures to ensure that the VLF adjustment process is based on proper computations.

In addition, beginning in FY 2012-13, we recommend that the county:

- Recalculate growth percentage and shift amounts; and
- Make monetary adjustments to the affected entities.

County's Response

The county concurs with the audit finding and states that it has made the necessary corrections.

Supplemental Information

Redevelopment Property Tax Trust Fund

On May 26, 2015, the Sacramento County Superior Court ruled in 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 for 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, Third Appellate District.

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

Mary B. Bedard, CPA
Auditor-Controller-County Clerk

KERN COUNTY AUDITOR-CONTROLLER-COUNTY CLERK
1115 Truxtun Avenue, 1st and 2nd Floor • Bakersfield, CA 93301-4639

January 8, 2019

State Controller's Office, Division of Audits
Attn: Lisa Kurokawa, Chief, Compliance Audits Bureau
PO Box 942850
Sacramento, CA 94250

Re: ALLOCATION AND APPORTIONMENT OF PROPERTY TAX REVENUES AUDIT
JULY 1, 2012 – JUNE 30, 2017

Dear Ms. Kurokawa:

We have reviewed the draft audit report for the allocation and apportionment of property tax revenues for Kern County. The following are our responses to the audit findings.

Repeat Finding 1 - Supplemental Property Tax Allocation and Apportionment

Response: The finding in the 2012 audit stated "The county included multi-county schools in the supplemental apportionment," with the recommendation that the county exclude multi-county schools in all future supplemental apportionments. We attempted to implement this recommendation. The finding in the current audit indicates that we implemented the recommendation incorrectly by excluding the multi-county schools' shares from the supplemental factor calculation instead of redistributing their shares. We concur with the current finding and have made the necessary corrections.

Finding 2 - Qualified Electric Allocation and Apportionment

Response: The 2012 audit included the following recommendation: "The county should recalculate the Qualified Electric apportionment factors beginning in FY 2009-10, to include only the affected school entities within the tax rate areas. Furthermore, the county should only calculate base factors in a year in which there are new Qualified Electric properties, and only for those new tax rate areas." We implemented this recommendation. The finding in the current audit includes the fact that we excluded certain school entities and did not use prior-year unitary factors for FY 2012-13 through FY 2016-17, which we did per the recommendation in the previous audit. However, we do concur with the current finding and have made the necessary corrections.

Finding 3 – Vehicle License Fee Adjustments

Response: We concur and have made the necessary corrections.

We appreciate the opportunity to address the proposed findings and recommendations. If you wish to discuss this further, please do not hesitate to contact me.

Sincerely,

Mary B Bedard

Mary B Bedard, CPA
Auditor-Controller-County Clerk

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

http://www.sco.ca.gov

S17-PTX-0020