NEVADA COUNTY

Audit Report

APPORTIONMENT AND ALLOCATION OF PROPERTY TAX REVENUES

July 1, 2017, through June 30, 2023

MALIA M. COHEN
California State Controller

May 2024

MALIA M. COHEN
CALIFORNIA STATE CONTROLLER

May 7, 2024

The Honorable Gina Will, Auditor-Controller
Nevada County
950 Maidus Avenue, Suite 230
Nevada City, CA 95959

Dear Ms. Will:

The State Controller's Office audited Nevada County's process for apportioning and allocating property tax revenues for the period of July 1, 2017, through June 30, 2023. We conducted the audit pursuant to the requirements of Government Code section 12468.

Our audit found that the county incorrectly calculated the unitary and operating nonunitary apportionment and allocation factors.

If you have any questions regarding this report, 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

Copy: The Honorable Ed Scofield, Chair
  Nevada County Board of Supervisors
 Shannon Cotter, Administrative Analyst II
  Property Tax Division
  Nevada County Auditor-Controller's Office
 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 Nevada County's process for apportioning and allocating property tax revenues to determine whether the county complied with California statutes for the period of July 1, 2017, through June 30, 2023.

Our audit found an instance of noncompliance with California statutes for the apportionment and allocation of property tax revenues for the audit period. Specifically, we found that the county incorrectly calculated the unitary and operating nonunitary apportionment and allocation (unitary) factors.

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, the amount that an agency or district receives is based on the amount received in the prior year plus a share of the property tax growth within their 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. The 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). The 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 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, 2017, through June 30, 2023.

To achieve our objective, we performed the following procedures:

- We interviewed key personnel to gain an understanding of the county's process for apportioning and allocating property tax revenues.
- 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 assessed the reliability of data from the property tax system by interviewing county staff members knowledgeable about the system, tracing transactions through the system, and recalculating documents produced by the system. We determined that the data was sufficiently reliable for purposes of this report.

- We judgmentally selected a non-statistical sample of five from approximately 48 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. The five sampled taxing jurisdictions include a special district, a school district, a city, the county, and the ERAF. 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 annual tax increment.
  - 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.
  - 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 the Finding).
  - We reviewed Redevelopment Property Tax Trust Fund deposits.
  - We reviewed property tax administrative 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 verified the Vehicle License Fee computations used to determine the amount transferred from the ERAF to counties and cities to compensate for the diversion of these revenues.
  - 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 Nevada County did not comply with California statutes for the apportionment and allocation of property tax revenues for the audit period. Specifically, we determined that the county incorrectly calculated the unitary factors.

This instance of noncompliance is described in the Finding and Recommendation section.

Follow-up on Prior Audit Findings

Our prior audit report, for the period of July 1, 2010, through June 30, 2017, issued on July 6, 2018, disclosed no findings.

Views of Responsible Officials

We issued a draft audit report on March 19, 2024. Nevada County's representative responded by letter dated March 19, 2024, agreeing with the audit results. This final audit report includes the county's response as an attachment.

Restricted Use

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

May 7, 2024

Finding and Recommendation

FINDING—
Unitary and operating nonunitary apportionment and allocation

During our testing of the unitary and operating nonunitary apportionment and allocation process, we found that the county incorrectly calculated the unitary factors as follows:

- For FY 2020-21 through FY 2022-23, the county included total unitary debt service revenue when it calculated the estimate of 1% unitary revenue; and
- For FY 2022-23, the county used FY 2020-21 unitary factors instead of FY 2021-22 unitary factors when it calculated 102% of prior-year revenue.

The errors resulted in a misallocation of property tax revenues to all affected taxing entities.

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 the county incorrectly implemented the applicable statute.

RTC section 100 provides the legal requirements for apportioning and allocating unitary and operating nonunitary property tax revenues.

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.

RTC section 723 defines unitary properties as properties "that are operated as a unit in the primary function of the assessee" (i.e., public utilities, railroads, or qualified electric properties) and on which the California State Board of Equalization "may use the principle of unit valuation." 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."

RTC section 723.1 defines operating nonunitary properties as properties "that the assessee and its regulatory agency consider to be operating as a unit," but the California State Board of Equalization considers "not part of the unit in the primary function of the assessee."

<u>Recommendation</u>

We recommend that the county:

- Review RTC sections 100(c) and 100.01 and update its procedures;
- Recalculate the unitary factors for FY 2020-21 through FY 2022-23; and

- Make monetary adjustments to all affected jurisdictions if the amounts are material.

<u>County's Response</u>

> The County agrees with this finding and has followed the recommendations outlined by the SCO. The County corrected the unitary factors for FY 2020-21 through FY 2022-23 and adjusted apportionment amounts [for] the affected taxing entities. The County will utilize the corrected factors for subsequent years to comply with RTC sections 100(c) and 100.01 and has updated [its] procedures accordingly.

Attachment—
County's Response to Draft Audit Report

NEVADA COUNTY
CALIFORNIA

GINA S. WILL, AUDITOR-CONTROLLER

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March 19, 2024

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

Dear Ms. Kurokawa,

We have reviewed the State Controller's Office draft audit report of Nevada County's process for apportioning and allocating property tax revenues for the period of July 1, 2017 through June 30, 2023. Our response is provided below for your reference and inclusion in the final audit report.

<u>Finding: Unitary and Operating Nonunitary Apportionment and Allocation</u>

The SCO found that the county incorrectly calculated the unitary factors for FY 2020-21 through FY 2022-23, resulting in a misallocation of property tax revenues to all affected taxing entities. The SCO recommends updating procedures to reflect RTC sections 100(c) and 100.01, recalculating unitary factors for FY 2020-21 through FY 2022-23, and adjusting apportionments to all affected jurisdictions.

<u>Response:</u>

The County agrees with this finding and has followed the recommendations outlined by the SCO. The County corrected the unitary factors for FY 2020-21 through FY 2022-23 and adjusted apportionment amounts to the affected taxing entities. The County will utilize the corrected factors for subsequent years to comply with RTC sections 100(c) and 100.01 and has updated our procedures accordingly.

We would like to thank SCO staff for their time and assistance during this audit. Please let us know if you have any questions or if I may assist further.

Sincerely,

Gina S. Will
Auditor-Controller

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www.sco.ca.gov