MADERA COUNTY

Audit Report

APPORTIONMENT AND ALLOCATION OF PROPERTY TAX REVENUES

July 1, 2014, through June 30, 2019

BETTY T. YEE
California State Controller

June 2020

BETTY T. YEE
California State Controller

June 16, 2020

The Honorable Todd Miller, CPA, Auditor-Controller
Madera County
200 West 4th Street, Suite 2300
Madera, CA 93637

Dear Mr. Miller:

The State Controller's Office audited the methods employed by Madera County to apportion and allocate property tax revenues for the period of July 1, 2014, through June 30, 2019. 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. Specifically, we determined that Madera County incorrectly calculated the:

- Supplemental property tax apportionment and allocation;
- Unitary and operating nonunitary apportionment and allocation;
- Unitary regulated railway apportionment and allocation;
- Reimbursement of property tax administrative costs; and
- Vehicle License Fee adjustments.

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

Sincerely,

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

JLS/as

cc: Jim Boyajian, Assistant Auditor-Controller
Madera County
Catherine Nainoa, Chief Accountant-Auditor
Madera County
Brett Frazier, Chairman
County Board of Supervisors
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 the methods employed by Madera County to apportion and allocate property tax revenues for the period of July 1, 2014, through June 30, 2019.

Our audit found instances of noncompliance 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:

- Supplemental property tax apportionment and allocation;
- Unitary and operating nonunitary apportionment and allocation;
- Unitary regulated railway apportionment and allocation;
- Reimbursement of property tax administrative costs; and
- Vehicle License Fee (VLF) adjustments.

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 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 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.

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 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 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, 2014, through June 30, 2019.

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 70 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 (total) 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 and unitary regulated railway 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 Redevelopment Property Tax Trust Fund deposits;
- 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; 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

Our audit found that Madera 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;
- Unitary and operating nonunitary apportionment and allocation;
- Unitary regulated railway apportionment and allocation;
- Reimbursement of property tax administrative costs; 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, 2005, through June 30, 2014, issued September 9, 2015, have been satisfactorily resolved by the county, with the exception of unitary and operating nonunitary apportionment and allocation, unitary regulated railway apportionment and allocation, and VLF adjustments.

Views of Responsible Officials

We issued a draft audit report on April 20, 2020. Todd Miller, Auditor Controller, responded by letter dated May 26, 2020 (Attachment), accepting the audit results. The county's complete response is included as an attachment to this audit report.

Restricted Use

This audit report is solely for the information and use of Madera County, the Legislature, the California Department of Finance, and 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

June 16, 2020

Findings and Recommendations

FINDING 1— Supplemental Property Tax Apportionment and Allocation

During testing of the supplemental apportionment and allocation process, we found that the county incorrectly computed the supplemental apportionment factors. For FY 2014-15 through FY 2018-19, the county incorrectly adjusted the supplemental apportionment factors for the ERAF, school districts, community college districts and the County Office of Education (school programs) for the VLF shift and negative ERAF. This resulted in a misallocation of tax revenues to all affected taxing entities. This error occurred due to a differing interpretation of the statutes. We did not quantify the monetary impact for the each taxing entity due to various errors affecting the computation and allocation.

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.

Recommendation

We recommend that the county:

- Review RTC sections 75.60, 75.71, and 100.2, and update its procedures;
- Recalculate the supplemental apportionment factors for FY 2014-15 through FY 2018-19;
- Make monetary adjustments to ERAF, school districts, and community college districts; and
- Make monetary adjustments to all other affected taxing entities, if the amounts are significant.

County's Response

> We accept the finding. County Auditor Controller staff corrected the calculation for…FY 2014-15 through FY 2018-19.

FINDING 2— Unitary and Operating Nonunitary Apportionment and Allocation (Repeat Finding)

During testing of the unitary and operating nonunitary apportionment and allocation process, we found that the county had attempted to correct the unitary apportionment factors for the prior audit finding in December 2014. We reviewed the county's corrections and found the following errors:

- Used incorrect base revenue factors and adjusted total base revenue by railroad revenue for FY 2007-08; and
- Used current-year excess factors instead of prior-year AB 8 factors net of RDA for FY 2007-08 through FY 2011-12.

For the current audit period, we found that the county continued to use the incorrect excess factors for FY 2014-15, FY 2016-17, and FY 2017-18. These errors resulted in misallocations of tax revenues to all affected taxing entities for FY 2007-08 through FY 2018-19. We did not quantify the monetary impact for each affected taxing entity due to various errors affecting the computation and allocation. The errors occurred due to a differing interpretation of the statutes.

This is a repeat finding. See Finding 2 of our previous report on Madera County's property tax apportionment and allocation system (S15-PTX-0003) dated September 9, 2015.

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 RTC section 100, and update its procedures;
- Recalculate the unitary apportionment factors for FY 2007-08 through FY 2018-19;
- Make monetary adjustments to ERAF, school districts, and community college districts; and
- Make monetary adjustments to all other affected taxing entities, if the amounts are significant.

County's Response

> We accept the finding. County Auditor Controller staff recalculated the base-year revenue factors from 2007-08 and the AB8 factors net of RDA for 2007-08 through 2018-19.

FINDING 3— Unitary Regulated Railway Apportionment and Allocation (Repeat Finding)

During testing of the unitary regulated railway apportionment and allocation process, we found that the county had attempted to correct the unitary regulated railway factors for the prior audit finding in December 2014. We reviewed the county's corrections and found the following errors:

- Used incorrect base revenue factors for FY 2007-08 and FY 2011-12;
- Used current-year excess factors instead of prior-year AB 8 factors net of RDA for FY 2008-09 through FY 2011-12, and FY 2013-14; and
- Used an incorrect tax rate to estimate the total unitary regulated railway revenue instead of using the unitary tax rate for FY 2007-08 through FY 2013-14.

For the current audit period, we found that the county made the following errors:

- Used current-year excess factors instead of prior-year AB 8 factors net of RDA for FY 2014-15, FY 2015-16, FY 2017-18, and FY 2018-19; and
- Used an incorrect tax rate to estimate the total unitary regulated railway revenue for FY 2014-15 through FY 2018-19.

These errors resulted in misallocations of tax revenues to all affected taxing entities for FY 2007-08 through FY 2018-19. We did not quantify the monetary impact for each affected taxing entity due to various errors affecting the computation and allocation. These errors occurred due to a differing interpretation of the statutes.

This is a repeat finding. See Finding 3 of our previous report on Madera County's property tax apportionment and allocation system (S15-PTX-0003) dated September 9, 2015.

RTC section 100.11 provides the legal requirements for the apportionment and allocation of 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 sections 100.11, and update its procedures;
- Recalculate the unitary apportionment factors for FY 2007-08 through FY 2018-19;
- Make monetary adjustments to ERAF, school districts, and community college districts; and
- Make monetary adjustments to all other affected taxing entities, if the amounts are significant.

County's Response

> We accept the finding. County Auditor Controller staff recalculated the base-year revenue factors from 2007-08 and the AB8 factors net of RDA for 2007-08 through 2018-19 excess factors have been corrected for FY 2014-15 through FY 2018-19.

FINDING 4— Reimbursement of Property Tax Administrative Costs

During testing of the reimbursement of property tax administrative costs process, we found that the county made the following errors:

- Incorrectly used FY 2013-14 administrative apportionment factors for FY 2014-15; and
- Incorrectly used current-year AB 8 factors with the RDA adjustment as the administrative apportionment factors for FY 2015-16 through FY 2018-19.

This resulted in misallocation to all affected taxing entities for FY 2014-15 through FY 2018-19. We did not quantify the monetary impact for each affected taxing entity due to various errors affecting the computation and allocation. These errors occurred because of differing interpretation of the statutes.

RTC section 95.3 provides the legal requirements for reimbursement of property tax administrative costs.

The County Assessor, the County Tax Collector, the Assessment Appeals Board, and the Auditor-Controller all incur administrative costs associated with the apportionment and allocation of property tax revenues. Applicable statutes enable the county to be reimbursed by local agencies for the aforementioned costs.

Recommendation

We recommend that the county:

- Review RTC section 95.3, and update its procedures;
- Recalculate the administrative apportionment factors for FY 2014-15 through FY 2018-19; and
- Make monetary adjustments to all affected taxing entities, if the amounts are significant.

County's Response

> We accept the finding. County Auditor Controller staff corrected the administrative apportionment factors and the AB8 factors for FY 2013-14 [through FY] 2018-19.

FINDING 5— Vehicle License Fee Adjustments (Repeat Finding)

During our review of the VLF adjustment process, we found that the county had attempted to correct the VLF adjustment for the prior audit finding in December 2014. We reviewed the county's corrections and found that the county incorrectly calculated the VLF percentage growth by double-counting the aircraft assessed values for FY 2006-07 through FY 2013-14.

For the current audit period, we found that the county did not adjust VLF growth for annexation in FY 2018-19. The calculations show that the county over-allocated to the county and cities a total of $510,958 for FY 2014-15 through FY 2018-19. This error occurred due to a clerical error.

This is a repeat finding. See Finding 4 of our previous report on Madera County's property tax apportionment and allocation system (S15-PTX-0003) dated September 9, 2015.

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 section 97.70, and update its procedures; and
- Recalculate the VLF adjustment for FY 2006-07 through FY 2018-19.

County's Response

> We accept the finding. County Auditor Controller staff corrected the double-assessed aircraft values for 2006-07 through 2013-14. We recalculated the VLF growth, taking into account the annexation in 2018-19.

Attachment—
County's Response to Draft Audit Report

TODD E. MILLER, CPA
AUDITOR-CONTROLLER
COUNTY OF MADERA
200 WEST 4TH ST., SUITE #2300, MADERA, CALIFORNIA 93637
559.675.7707 / FAX 559.661.3006 / TDD 559.675.8970

May 26, 2020

Jim L. Spano, CPA
State Controller's Office
Division of Audits
PO Box 942850
Sacramento CA 94250

Enclosed please find County of Madera Auditor-Controller responses to State Controller's findings in the Audit of Madera County's Property Tax Apportionment and Allocation System covering fiscal years 2014-15 through 2018-19.

We want to take this opportunity to thank the State Controller for the assistance we received in administering the property tax apportionment and allocation process in Madera County. I commend the State Controller's audit staff for their knowledge and diligence in their review and recommendations for corrections to the process in Madera County. We look forward to the State Controller's future regularly scheduled audits of the County's tax apportionment and allocation process.

Sincerely,

Todd E. Miller, CPA
Madera County Auditor-Controller

TODD E. MILLER, CPA
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Response to Findings in the Audit Report of Property Tax Apportionment and Allocation System of Madera County, July 1, 2014 through June 30, 2019.

Finding 1 – Supplemental Property Tax Apportionment and Allocation

We accept the finding. County Auditor Controller staff corrected the calculation for the FY 2014-15 though FY 2018-19.

Finding 2 – Unitary & Operating Non-unitary Apportionment and Allocation (Repeat Finding)

We accept the finding. County Auditor Controller staff recalculated the base year revenue factors from 2007-08 and the correct AB8 factors net of RDA for 2007-08 through 2018-19.

Finding 3 – Unitary Regulated Railway Apportionment and Allocation (Repeat Finding)

We accept the finding. County Auditor Controller staff recalculated the base year revenue factors from 2007-08 and the correct AB8 factors net of RDA for 2007-08 through 2018-19. The correct excess factors have been corrected for FY 2014-15 through FY 2018-19.

Finding 4 – Reimbursement of Property Tax Administrative Costs

We accept the finding. County Auditor Controller staff corrected the administrative apportionment factors and the AB8 factors for FY 2013-14 and 2018-19.

Finding 5 – Vehicle License Fee Adjustments (Repeat Finding)

We accept the finding. County Auditor Controller staff corrected the double assessed aircraft values for 2006-07 through 2013-14. We recalculated the VLF growth taking into account the annexation in 2018-19.

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