MONO COUNTY

Reissued Audit Report

APPORTIONMENT AND ALLOCATION OF PROPERTY TAX REVENUES

July 1, 2008, through June 30, 2015

BETTY T. YEE
California State Controller

June 2019

BETTY T. YEE
California State Controller

June 28, 2019

Janet Dutcher, CPA, CGFM, Director of Finance
Mono County
25 Bryant Street, #2
Bridgeport, CA 93517

Dear Ms. Dutcher:

The State Controller's Office audited the methods employed by Mono County to apportion and allocate property tax revenues for the period of July 1, 2008, through June 30, 2015. The audit was conducted pursuant to the requirements of Government Code section 12468.

This reissued report updates our previous report dated December 11, 2017. We are reissuing this report to update the Objective, Scope, and Methodology section. This reissued report also provides additional information in the Revised Background section and in the Revised Findings and Recommendations section. These revisions do not affect the audit conclusion.

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 Mono County incorrectly calculated the:

- Annual tax increment apportionment factors;
- Supplemental apportionment factors;
- Unitary and operating nonunitary apportionment factors; and
- Vehicle License Fee adjustment.

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/ls

cc: Stephanie Butters, Assistant Director of Finance
Mono County
Bob Gardner, Chair
Mono County Board of Supervisors
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 Mono County to apportion and allocate property tax revenues for the period of July 1, 2008, through June 30, 2015.

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:

- Annual tax increment (ATI) apportionment factors;
- Supplemental apportionment factors;
- Unitary and operating nonunitary apportionment factors; and
- Vehicle License Fee (VLF) adjustment.

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) 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 (SB) 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, 2008, through June 30, 2015.

To achieve our objective, we:

- Interviewed key personnel to gain an understanding of the county's property tax apportionment and allocation processes;
- 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 30 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 are used in the computation of the ATI apportionment factors;
    - 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 property tax administration cost reports and recomputed administrative costs associated with work performed for apportioning and allocating property tax 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 agencies to 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

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 Mono County incorrectly calculated the:

- ATI apportionment factors;
- Supplemental apportionment factors;
- Unitary and operating nonunitary apportionment factors; and
- VLF adjustment.

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

Follow-up on Prior Audit Findings

The county has satisfactorily resolved the findings noted in our prior audit report, for the period of July 1, 2002, through June 30, 2008, issued February 25, 2009.

Views of Responsible Officials

We issued a draft audit report on September 14, 2017. Janet Dutcher, Director of Finance, responded by letter dated September 29, 2017, agreeing with the audit results. The county's response is included as an attachment to this report.

On January 2, 2019, we informed Stephanie Butters, Assistant Director of Finance, of this reissued audit report and the reason for reissuance.

Reason for Reissuance

This reissued report updates our previous report dated December 11, 2017. We are reissuing this report to update the Objective, Scope, and Methodology section. This reissued report also provides additional information in the Revised Background section and in the Revised Findings and Recommendations section. These revisions do not affect the audit conclusion.

Restricted Use

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

June 28, 2019

Revised Findings and Recommendations

REVISED FINDING 1— Computation and Distribution of Annual Tax Increment

During testing of the ATI process, we found that the county used incorrect assessed values for the FY 2008-09 increment computation. This error resulted in an estimated inflated total increment of $296,019. The miscalculation occurred due to a clerical error.

RTC sections 96 through 96.5 provide the legal requirements for the computation of ATI and the apportionment and allocation of property tax revenues.

ATI is the difference between the total amount of property tax revenues computed each year using the equalized assessment roll and the sum of the amounts allocated pursuant to RTC section 96.1(a). Each TRA will receive an increment based on its share of the incremental growth in assessed valuations. ATI added to the tax computed for the prior fiscal year will develop the apportionments for the current fiscal year.

<u>Recommendation</u>

We recommend that the county:

- Implement policies and procedures to ensure that correct assessed values are used in the computation of the ATI;
- Recompute the FY 2008-09 ATI; and
- Make necessary adjustments to the ERAF and affected entities.

<u>County's Response</u>

The county concurs with the finding and will take steps to correct the errors identified in the report.

REVISED FINDING 2— Supplemental Property Tax Apportionment

During testing of the supplemental apportionment process, we found that in FY 2014-15, the county incorrectly included VLF adjustments. We have determined that the error, while procedurally incorrect, is not material.

The miscalculation occurred because county staff were not aware of the California Supreme Court ruling in *City of Alhambra v. County of Los Angeles* (55 Cal. 4th 707, 149 Cal. Rptr. 3d 247, 288 P.3d 431, 12 Cal. Daily Op. Serv. 12,771, 2012 Daily Journal D.A.R. 15,617), which required the elimination of the VLF adjustment from the apportionment factors calculation beginning in FY 2014-15.

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 the aforementioned court ruling; and
- Update its policies and procedures to exclude the VLF adjustment from its calculation of the supplemental apportionment factors.

County's Response

The county concurs with the finding and will take steps to correct the errors identified in the report.

REVISED FINDING 3— Unitary and Operating Nonunitary Apportionment

During testing of unitary and operating nonunitary apportionment factors, the county made the following errors, which resulted in incorrect apportionment factors:

- Used incorrect prior-year AB 8 revenues to apportion in-excess revenue in FY 2008-09; and
- Used incorrect prior-year factors to apportion current year up to 102 percent revenue in FY 2011-12 and FY 2014-15.

Due to various factors affecting the computation, we did not quantify the effect of these errors. The errors occurred because county staff misinterpreted the applicable statute.

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 QE 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 policies and procedures to ensure that correct values are used in the unitary and operating nonunitary apportionment computation;
- Recompute the unitary and operating nonunitary apportionment factors beginning with FY 2008-09; and
- Make the necessary adjustments to affected entities, if significant.

County's Response

The county concurs with the finding and will take steps to correct the errors identified in the report.

REVISED FINDING 4— Vehicle License Fee and Sales and Use Tax Adjustments

During testing of the county's VLF adjustment process, we found that the county made the following errors:

- Excluded utilities assessed values in FY 2008-09; and
- Excluded unsecured homeowner exemption values from FY 2010-11 through FY 2014-15.

The errors resulted in estimated overpayments to the county totaling $57,534, and to the Town of Mammoth totaling $239,631. The errors occurred due to the county's misinterpretation of applicable statute.

RTC section 97.70 provides the legal requirements for VLF adjustments.

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

Recommendation

We recommend that the county:

- Review RTC section 97.70 and update its policies and procedures to ensure that the county include the unsecured utilities and homeowner exemption values;
- Recompute its VLF growth and shift amounts; and
- Make necessary adjustments to the ERAF and affected entities.

County's Response

The county concurs with the finding and will take steps to correct the errors identified in the report.

Attachment—
County's Response to Draft Audit Report

DEPARTMENT OF FINANCE
AUDITOR-CONTROLLER
COUNTY OF MONO

Stephanie M. Butters
Assistant Finance Director
Auditor-Controller

Janet Dutcher, CPA, CGFM
Director of Finance

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September 29, 2017

Mr. Jim L. Spano, CPA
Assistant Division Chief
State Controller's Office
Division of Audits
P.O. Box 942850
Sacramento, CA 94250-5874

RE: Response to Mono County Draft Property Tax Apportionment Audit Report

Dear Mr. Spano,

We have received and reviewed the draft Property Tax Apportionment and Allocation System Audit Report conducted by your office for the period of July 1, 2008, through June 30, 2015. We would like to thank the State Controller's audit staff for their assistance throughout the audit process and this opportunity to improve our processes.

The County of Mono concurs with the findings and recommendations noted in the Property Tax Apportionment and Allocation System Audit report and we are taking the steps required to correct those apportionment errors identified in the report. We are also working on improving our processes to minimize opportunities for future errors.

We appreciate the professionalism exhibited by your audit team and the assistance they provided.

Sincerely,

Janet Dutcher, CPA, CGFM
Director of Finance
County of Mono, California

State Controller's Office
Division of Audits
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http://www.sco.ca.gov