# SAN BERNARDINO COUNTY

Audit Report

## APPORTIONMENT AND ALLOCATION OF PROPERTY TAX REVENUES

*July 1, 2013, through June 30, 2017*


BETTY T. YEE

California State Controller



June 2019

BETTY T. YEE
California State Controller

June 28, 2019

Ensen Mason, CPA, CFA, Auditor-Controller/Treasurer/Tax Collector
San Bernardino County
268 West Hospitality Lane, 4th Floor
San Bernardino, CA 92415

Dear Mr. Mason:

The State Controller's Office audited the methods employed by San Bernardino County to apportion and allocate property tax revenues for the period of July 1, 2013, 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. Specifically, we determined that San Bernardino County incorrectly calculated the:

- Supplemental property tax apportionment and allocation;
- Regulated railway apportionment and allocation;
- Qualified electric property apportionment and allocation; and
- Property tax administrative costs.

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: Douglas R. Boyd, Assistant Auditor-Controller/Treasurer/Tax Collector
San Bernardino County
Linda Santillano, Chief Deputy, Property Tax Division
San Bernardino County
Franciliza Zyss, Property Tax Manager
San Bernardino County
Curt Hagman, Chairman
San Bernardino County Board of Supervisors
Chris Hill, Principal Program Budget Analyst
Local Government Unit
California Department of Finance

# Contents

# Audit Report

## Summary

The State Controller's Office (SCO) audited the methods employed by San Bernardino County to apportion and allocate property tax revenues for the period of July 1, 2013, through June 30, 2017.

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;
- Regulated railway apportionment and allocation;
- Qualified electric (QE) property apportionment and allocation; and
- Property tax administrative costs.

## 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, 2013, 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 188 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 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 Vehicle License Fee (VLF) computations used to verify the amount transferred from the ERAF to counties and cities to compensate for the diversion of these revenues;
- 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 that San Bernardino 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:

- Supplemental property tax apportionment and allocation;
- Regulated railway apportionment and allocation;
- QE property apportionment and allocation; and
- Property tax administrative costs.

These instances of noncompliance are described in the 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, 2006, through June 30, 2013, issued March 26, 2015.

## Views of Responsible Officials

We issued a draft audit report on December 19, 2018. Ensen Mason, Auditor-Controller/Treasurer/Tax Collector, responded by letter dated May 2, 2019 (Attachment), agreeing with the audit results. The county's response is included as an attachment to this audit report.

## Restricted Use

This audit report is solely for the information and use of San Bernardino 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

# Findings and Recommendations

**FINDING 1— Supplemental Property Tax Apportionment and Allocation**

During testing of the county's supplemental apportionment and allocation process, we found that it incorrectly included VLF revenues in the FY 2014-15 calculation. This resulted in an understatement of approximately $3.9 million to the ERAF. The error occurred because the county misinterpreted the requirements outlined in statute.

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 in which 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 for proper implementation of supplemental apportionment and allocation computations;
- Recalculate the FY 2014-15 supplemental apportionment and allocation factor;
- Reallocate approximately $3.9 million in supplemental revenue to the ERAF; and
- Ensure that all subsequent supplemental apportionment and allocation factor computations exclude any VLF revenue adjustments.

County's Response

> The County concurs with this finding. The County is in the process of recalculating the supplemental allocation and apportionment factors for FY 2014-15 and reallocating approximately $3.9 million in supplemental revenue to the ERAF. Procedures were implemented in FY 2015-16 to exclude any VLF revenue adjustments [from] the calculation.

**FINDING 2— Unitary Regulated Railway Apportionment and Allocation**

During testing of the county's regulated railway apportionment and allocation process, we found that it incorrectly:

- Included VLF adjustments for excess factors' computation for FY 2014-15; and
- Computed the wrong base revenue from prior audit corrections for FY 2015-16.

These errors occurred because the county misinterpreted the requirements outlined in statute, which resulted in the county's misallocation of revenues to the affected taxing entities. However, due to the complexity of the re-computation process, we did not quantify the effect.

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.

<u>Recommendation</u>

We recommend that the county:

- Review RTC section 100.11 and update its procedures for proper implementation of unitary regulated railway apportionment and allocation computations;
- Recalculate the FY 2014-15 through FY 2016-17 unitary regulated railway apportionment and allocation factors;
- Make monetary adjustments to the affected entities, if significant; and
- Use the corrected factors in subsequent fiscal years.

<u>County's Response</u>

> The County concurs with this finding. The County made the necessary corrections to the computations during the fieldwork phase, will make the necessary adjustments to the affected entities, and will ensure the corrected factors are utilized going forward.

**FINDING 3— Qualified Electric Property Apportionment and Allocation**

During testing of the county's QE property apportionment and allocation process, we found that it made the following errors:

- Allocated QE property revenue to enterprise special districts for FY 2015-16; and
- Allocated QE property revenue to special districts based on enterprise and non-enterprise ratios for FY 2016-17.

These errors occurred because the county misinterpreted the requirements outlined in statute, which resulted in the county's misallocation of revenues to the affected taxing entities. However, due to the complexity of the re-computation process, we did not quantify the effect.

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 RTC section 100.95 and update its procedures for proper implementation of the QE property apportionment and allocation;
- Recalculate the QE apportionment and allocation factors for FY 2015-16 and FY 2016-17; and
- Make monetary adjustments to the affected entities, if significant.

County's Response

> The County concurs with this finding. The County made the necessary corrections to the computations during the fieldwork phase and will make the necessary adjustments to the affected entities.

**FINDING 4— Reimbursement of Property Tax Administrative Costs**

During testing of the county's reimbursement of property tax administrative costs, we found that the county did not offset supplemental administrative fee revenues for each fiscal year in the audit period, which resulted in an overstatement of property tax administrative costs totaling approximately $8.6 million. The error occurred because the county misinterpreted the requirements outlined in statute.

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 for reimbursement of property tax administrative costs; and
- Ensure that all future property tax administrative cost computations include the proper supplemental administrative fee revenue offsets.

County's Response

> The County concurs with this finding. A meeting was held with staff responsible for calculating the property tax administrative cost to identify offsetting revenue that should be included and procedures were implemented accordingly to ensure [that] future computations include the supplemental administrative fee revenue.

# Schedule— Summary of Misallocations to the Educational Revenue Augmentation Fund July 1, 2013, through June 30, 2017

| Finding No. | Fiscal Year Affected | Amount Due to the ERAF |
|---|---|---|
| 1 | 2014-15 | $ ~3,900,000 |
| Total | | $ ~3,900,000 |

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

County of San Bernardino

**Auditor–Controller/Treasurer/Tax Collector**

**Ensen Mason, MBA, CPA, CFA**
*Auditor–Controller/Treasurer/Tax Collector*

**Douglas R. Boyd, Sr., ESQ.**
*Assistant Auditor–Controller/Treasurer/Tax Collector*

May 2, 2019

Lisa Kurokawa, Chief, Compliance Audits Bureau
Division of Audits
State Controller's Office
P.O. Box 942850
Sacramento, CA 94250-5874

RE: **Amended Response to Draft Audit Report**
San Bernardino County Allocation and Apportionment of Property Tax Revenues
July 1, 2013, through June 30, 2017

Dear Ms. Kurokawa:

Per our review of the Allocation and Apportionment of Property Tax Revenues draft audit report, please find our amended responses to the identified findings below:

**FINDING 1 – Supplemental Property Tax Allocation and Apportionment**

County Response
The County concurs with this finding. The County is in the process of recalculating the supplemental allocation and apportionment factors for FY 2014-15 and reallocating approximately $3.9 million in supplemental revenue to the ERAF. Procedures were implemented in FY 2015-16 to exclude any VLF revenue adjustments in the calculation.

**FINDING 2 – Unitary Regulated Railway Allocation and Apportionment**

County Response
The County concurs with this finding. The County made the necessary corrections to the computations during the fieldwork phase, will make the necessary adjustments to the affected entities, and will ensure the corrected factors are utilized going forward.

**FINDING 3 – Qualified Electric Allocation and Apportionment**

County Response
The County concurs with this finding. The County made the necessary corrections to the computations during the fieldwork phase and will make the necessary adjustments to the affected entities.

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**FINDING 4 – Reimbursement of Property Tax Administrative Costs**

County Response
The County concurs with this finding. A meeting was held with staff responsible for calculating the property tax administrative cost to identify offsetting revenue that should be included and procedures were implemented accordingly to ensure future computations include the supplemental administrative fee revenue.

We appreciate the State Controller's Office consideration of our heavy workload periods, the extension granted during the transition period of the new administration in our office, and the professionalism displayed by the field auditors. If you have any questions, please contact Linda Santillano, Chief Deputy, Property Tax, at (909) 382-3189.

Sincerely,

Ensen Mason CPA, CFA
Auditor-Controller/Treasurer/Tax Collector
San Bernardino County

By: ______________________
Douglas R. Boyd Sr., Esq.
Assistant Auditor-Controller/Treasurer/Tax Collector

EM:DRB:LS:aeg

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