

SAN DIEGO COUNTY

Audit Report

APPORTIONMENT AND ALLOCATION OF PROPERTY TAX REVENUES

July 1, 2009, through June 30, 2018



BETTY T. YEE
California State Controller

June 2019



BETTY T. YEE
California State Controller

June 24, 2019

The Honorable Tracy Sandoval, Deputy Chief Administrative Officer/Auditor and Controller
San Diego County
1600 Pacific Highway, Room 166
San Diego, CA 92101

Dear Ms. Sandoval:

The State Controller's Office audited the methods employed by San Diego County to apportion and allocate property tax revenues for the period of July 1, 2009, through June 30, 2018. We conducted the audit pursuant to the requirements of Government Code section 12468.

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 determined that San Diego County incorrectly included enterprise special districts within the Tier 1 allocation of the qualified electric property apportionment and allocation process for fiscal year (FY) 2015-16 through FY 2017-18.

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

Sincerely,

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

JLS/hf

Attachment

cc: Jon Baker, Manager of Property Tax Services
San Diego County Auditor/Controller's Office
The Honorable Dianne Jacob, Chair
San Diego 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 San Diego County to apportion and allocate property tax revenues for the period of July 1, 2009, through June 30, 2018.

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 determined that the county incorrectly included enterprise special districts within the Tier 1 allocation of the qualified electric (QE) property apportionment and allocation process for fiscal year (FY) 2015-16 through FY 2017-18.

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 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, 2009, through June 30, 2018.

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 199 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 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 San Diego County did not comply with the California statutes for the apportionment and allocation of property tax revenues for the audit period. Specifically, we determined that the county incorrectly

included enterprise special districts within the Tier 1 allocation of the QE property apportionment and allocation process for FY 2015-16 through FY 2017-18. This instance of noncompliance is described in the Finding and Recommendation section of this audit report.

Follow-up on Prior Audit Findings

The findings noted in our prior audit report for the period of July 1, 2003, through June 30, 2009, issued September 16, 2010, have been resolved.

Views of Responsible Officials

We issued a draft audit report on April 25, 2019. Tracy M. Sandoval, Deputy Chief Administrative Officer/Auditor and Controller, responded by letter dated May 3, 2019 (Attachment), agreeing with the audit results. The county's response is included as an attachment to this final audit report.

Restricted Use

This audit report is solely for the information and use of San Diego 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 24, 2019

Finding and Recommendation

FINDING— Qualified Electric Property Apportionment and Allocation

During testing of the QE property apportionment and allocation process, we found that the county incorrectly included enterprise special districts within the Tier 1 allocation for FY 2015-16 through FY 2017-18, resulting in a misallocation of QE revenue to the affected taxing entities, excluding schools and the ERAF. We did not quantify the monetary impact due to various components involved in the calculation. The error occurred because the county misinterpreted applicable statutes.

RTC section 100.95 provides the legal requirements for the apportionment and allocation of QE property tax revenues.

Qualified property is “all plant and associated equipment, including substation facilities and fee-owned land and easements, placed in service by the public utility on or after January 1, 2007.”

Recommendation

We recommend that the county:

- Review RTC section 100.95;
- Update its procedures to exclude all enterprise special districts within the Tier 1 allocation of the QE property apportionment and allocation process; and
- Make the necessary adjustments, if significant.

County’s Response

We concur with this finding and the necessary adjustments have been made to correct this error starting in FY 2018-19.

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



County of San Diego

TRACY M. SANDOVAL
DEPUTY CHIEF ADMINISTRATIVE OFFICER/
AUDITOR AND CONTROLLER
(619) 531-5413
FAX: (619) 531-5219

FINANCE & GENERAL GOVERNMENT GROUP
1800 PACIFIC HIGHWAY, SUITE 166, SAN DIEGO, CA 92101-2422

May 3, 2019

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

Dear Ms. Kurokawa:

COUNTY OF SAN DIEGO AUDIT REPORT: APPORTIONMENT AND ALLOCATION OF
PROPERTY TAX REVENUES JULY 1, 2009 THROUGH JUNE 30, 2018 ("APRIL 2019 DRAFT
AUDIT")

Thank you for allowing the County of San Diego (County) the opportunity to review and reply to
this draft audit report of the County's property tax system for the period of July 1, 2009 to June
30, 2018. Below is the County's response:

Finding: Qualified Electric Apportionment & Allocation

The County incorrectly included enterprise special districts within the Tier 1 allocation for
FY 2015-16 through FY 2017-18.

It is recommended that the County review Revenue and Taxation Code section 100.95
and update its procedures to exclude all enterprise special districts in the QE Tier 1
allocation.

Response:

We concur with this finding and the necessary adjustments have been made to correct
this error starting in FY 2018-19.

ASSESSOR/RECORDER/COUNTY CLERK
AUDITOR AND CONTROLLER
CHIEF ADMINISTRATIVE OFFICE
CIVIL SERVICE COMMISSION

CLERK OF THE BOARD
COUNTY COMMUNICATIONS OFFICE
COUNTY COUNSEL
COUNTY TECHNOLOGY OFFICE

GRAND JURY
HUMAN RESOURCES
RETIREMENT ASSOCIATION
TREASURER-TAX COLLECTOR

County of San Diego Audit Report: Apportionment and Allocation of Property Tax Revenues
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May 3, 2019

If you have any questions, please contact Tracy Drager, Assistant Auditor and Controller, at (858) 694-2324 or Jon Baker, Manager of Property Tax Services, at (858) 694-2290.

Sincerely,

A handwritten signature in black ink, appearing to read "Tracy M. Sandoval". The signature is fluid and cursive, with the first name "Tracy" being the most prominent.

TRACY M. SANDOVAL
Deputy Chief Administrative Officer/Auditor and Controller

PTS:JB:tw

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