TULARE COUNTY

Audit Report

APPORTIONMENT AND ALLOCATION OF PROPERTY TAX REVENUES

July 1, 2015, through June 30, 2018

BETTY T. YEE

California State Controller

July 2019

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California State Controller

July 1, 2019

The Honorable Cass Cook, Auditor-Controller
Tulare County
221 South Mooney Boulevard, Room 101 E
Visalia, CA 93291

Dear Mr. Cook:

The State Controller's Office audited the methods employed by Tulare County to apportion and allocate property tax revenues for the period of July 1, 2015, through June 30, 2018. 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 Tulare County incorrectly calculated the:

- Unitary and operating nonunitary apportionment and allocation; and
- Educational Revenue Augmentation Fund shift.

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: Sue Copeland, Chief Accountant – Property Tax
  Tulare County Auditor-Controller's Office
 Kuyler Crocker, Chairman
  Tulare County Board of Supervisors
 Chris Hill, Principal Program Budget Analyst
  Local Government Unit
  California Department of Finance

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Audit Report

Summary

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- Unitary and operating nonunitary apportionment and allocation; and
- Educational Revenue Augmentation Fund (ERAF) shift.

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 qualified electric (QE) properties. These revenues are now apportioned and allocated under separate processes.

Other legislation established an 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, 2015, 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 178 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, unitary regulated railway, QE property 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 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 Tulare 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 unitary and operating nonunitary excess allocation factors; and

- Incorrectly calculated the ERAF shift.

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

Follow-up on Prior Audit Findings

Our prior audit report, for the period of July 1, 2009, through June 30, 2015, issued September 19, 2016, included no findings related to the apportionment and allocation of property tax revenues by the county.

Views of Responsible Officials

We issued a draft audit report on April 18, 2019. Cass Cook, Auditor-Controller, responded by letter dated April 29, 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 Tulare 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

July 1, 2019

Findings and Recommendations

FINDING 1— Unitary and Operating Nonunitary Apportionment and Allocation

During testing of the unitary and operating nonunitary (unitary) apportionment process, we found that the county incorrectly calculated the unitary excess allocation factors because it excluded the Porterville Redevelopment Agency Amended 2010 Project Area (Porterville RDA Amended 2010) for FY 2016-17. This error resulted in a misstatement of unitary revenue allocated to all taxing jurisdictions for all subsequent years. The largest affected jurisdiction, the Porterville RDA Amended 2010, was understated by approximately $616 for FY 2016-17. The miscalculation occurred because the county made a clerical error.

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.

<u>Recommendation</u>

We recommend that the county:

- Update its procedures to properly compute the unitary and operating nonunitary excess allocation factors;
- Recalculate the allocation factors for FY 2016-17 forward; and
- Make appropriate monetary adjustments to all affected entities, if significant.

<u>County's Response</u>

The recommended changes have been completed.

FINDING 2— Educational Revenue Augmentation Fund

During testing of the ERAF shift process, we found that the county incorrectly computed the ERAF shift amount, as it:

- Used the wrong prior-year revenue amount from an old Excel file for FY 2015-16; and
- Included the RDA increment amount for the City of Exeter Fire Department's ERAF shift for FY 2016-17.

The miscalculation occurred because the county made a clerical error. We did not quantify the monetary impact for each affected taxing entity due to various errors affecting the computation and allocation.

RTC sections 96.1 through 96.5 and 97 through 97.3 provide the legal requirements for calculation of the ERAF shift.

In FY 1992-93 and FY 1993-94, some local agencies were required to shift an amount of property tax revenues to the ERAF using formulas specified in the aforementioned Revenue and Taxation Code sections. The amount shifted to the ERAF is adjusted annually for growth.

Recommendation

We recommend that the county:

- Update its procedures to properly compute the ERAF shift;
- Recalculate the ERAF shift for FY 2015-16 forward; and
- Make appropriate monetary adjustments to all affected entities, if significant.

County's Response

The recommended changes have been completed.

Attachment—
County's Response to Draft Audit Report

County of Tulare
221 S. Mooney Blvd. Room 101-E
Visalia, CA 93291
Cass Cook CFIP · Auditor-Controller
Paul Sampietro CPA, Chief Deputy Treasurer-Tax Collector
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Fax: (559) 730-2532

April 29, 2019

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

Dear Ms Kurokawa:

The Auditor's response to the Audit Findings and Recommendations are as follows:

Finding 1) Unitary and Operating Nonunitary Apportionment and Allocation.
Response – The recommended changes have been completed.

Finding 2) Educational Revenue Augmentation Fund.
Response – The recommended changes have been completed.

If you have any questions or need additional information, please contact me at (559) 636-5280.

Sincerely,

Cass Cook CFIP
Auditor-Controller

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http://www.sco.ca.gov

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