

SOLANO COUNTY

Audit Report

ALLOCATION AND APPORTIONMENT OF PROPERTY TAX REVENUES

July 1, 2014, through June 30, 2017



BETTY T. YEE
California State Controller

September 2018



BETTY T. YEE
California State Controller

September 17, 2018

The Honorable Simona Padilla-Scholtens, CPA, Auditor-Controller
Solano County
675 Texas Street, Suite 2800
Fairfield, CA 94533

Dear Ms. Padilla-Scholtens:

The State Controller's Office audited the methods employed by Solano County to allocate and apportion property tax revenues for the period of July 1, 2014, through June 30, 2017. 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 allocation and apportionment of property tax revenues for the audit period. We determined that the county incorrectly included unsecured aircraft assessed values in its computation of the annual tax increment for fiscal year (FY) 2014-15 through FY 2016-17.

Due to a pending appellate court decision, our audit scope excluded making a determination on the validity of the county's methodology for apportioning the residual balance from the Redevelopment Property Tax Trust Fund, as described in the Observation section of this audit report.

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

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/ls

cc: Phyllis Taynton, CPA, Assistant Auditor-Controller
Solano County
Rosemary Bettencourt, Deputy Auditor-Controller
Solano County
John Vasquez, Chair
Solano County Board of Supervisors
Chris Hill, Principal Program Budget Analyst
Local Government Unit
California Department of Finance

Contents

Audit Report

Summary	1
Background	1
Objective, Scope, and Methodology	3
Conclusion	4
Follow-up on Prior Audit Findings	5
Views of Responsible Officials	5
Restricted Use	5
Finding and Recommendation	6
Observation	7
Attachment—County’s Response to Draft Audit Report	

Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by Solano County to allocate and apportion property tax revenues for the period of July 1, 2014, through June 30, 2017.

Our audit found an instance of noncompliance with California statutes for the allocation and apportionment of property tax revenues for the audit period. We determined that the county incorrectly included unsecured aircraft assessed values in its computation of the annual tax increment (ATI) for fiscal year (FY) 2014-15 through FY 2016-17.

Due to a pending appellate court decision, our audit scope excluded making a determination on the validity of the county's methodology for apportioning the residual balance from the Redevelopment Property Tax Trust Fund (RPTTF), as described in the Observation section of this audit report.

Background

After the passage of Proposition 13 in 1978, the California State Legislature (Legislature) enacted new methods for allocating and apportioning 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 allocated and apportioned to local government agencies, school districts, and community college districts using prescribed formulas and methods defined in the Revenue and Taxation Code (RTC).

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 revenue generated by unitary and nonunitary property and pipelines from the AB 8 system. This revenue is now allocated and apportioned under a separate system.

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 allocated and apportioned 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 allocated and apportioned to local government agencies, school districts, and community college districts using prescribed formulas and methods, as defined in the RTC. 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 allocation and apportionment of property taxes, Senate Bill 418, which requires the State Controller to audit the counties' allocation and apportionment methods and report the results to the Legislature, was enacted in 1985.

Allocation and apportionment of property taxes 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.

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 RTC requirements pertaining to the allocation and apportionment of property tax revenues.

The audit period was July 1, 2014, through June 30, 2017.

To achieve our objective, we:

- Interviewed key personnel to gain an understanding of the county’s process for allocating and apportioning property tax revenues;
- Reviewed the county’s written procedures for allocating and apportioning property tax revenues;
- Performed analytical reviews to assess the reasonableness of property tax revenues;
- Judgmentally selected a non-statistical sample of five from approximately 69 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 allocation and apportionment 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;
 - Verified computations used to develop supplemental property tax apportionment factors;

- Verified unitary and operating nonunitary, regulated railway, and qualified electric property computations used to develop apportionment factors;
- Reviewed RPTTF deposits and distributions;
- Reviewed property tax administration cost reports and recomputed administrative costs associated with work performed for allocating and apportioning 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 allocation and apportionment 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 allocation and apportionment of property tax revenues. We did not audit the county's financial statements.

We conducted this audit under the authority of GC sections 12410 and 12468, which require SCO to audit the allocation and apportionment 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

Without consideration of the legal issue described in the Observation section of this audit report, our audit found an instance of noncompliance with California statutes for the allocation and apportionment of property tax revenues for the audit period. We determined that the county incorrectly included unsecured aircraft assessed values in its computation

of the ATI for FY 2014-15 through FY 2016-17. This instance of noncompliance is described in the Finding and Recommendation section of this audit report.

**Follow-up on Prior
Audit Findings**

The county has satisfactorily resolved the findings noted in our prior audit report, issued June 23, 2016.

**Views of
Responsible
Officials**

We issued a draft audit report on August 2, 2018. Simona Padilla-Scholtens, Auditor-Controller, responded by letter dated August 7, 2018 (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 Solano County, the Legislature, 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

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

September 17, 2018

Finding and Recommendation

FINDING— Computation and Distribution of Annual Tax Increment

During our audit of the county’s ATI computation process, we found that for FY 2014-15 through FY 2016-17, the county incorrectly included unsecured aircraft assessed values in its computations of the ATI, resulting in overstated AB 8 revenues as follows:

Fiscal Year	Amount
2014-15	\$ 60,934
2015-16	56,066
2016-17	58,757
Total	<u>\$175,757</u> ¹

¹ Amount is based on one percent of unsecured assessed values.

This error affected all entities’ ATI computations in the county. Our discussion with the county regarding the error revealed that the county was not aware of the separate RTC sections 5451 through 5456 governing the allocation and apportionment of aircraft property tax revenues.

RTC sections 96 through 96.5 identify the requirements for the allocation and apportionment of the ATI, which does not address the requirements for unsecured aircraft values. These code sections require the county to:

- Allocate the annual increment of property tax (change in assessed value from one year to the next) to TRAs on the basis of each TRA’s share of the incremental growth in assessed valuations;
- Multiply the tax increment by the jurisdiction’s ATI apportionment factors for each TRA; and
- Add the tax increment to the tax computed for the prior fiscal year to develop the apportionment for the current fiscal year.

Recommendation

We recommend that the county:

- Establish and implement policies and procedures to exclude unsecured aircraft assessed values from its computation of the ATI calculation, and allocate and apportion aircraft property tax revenues in the manner prescribed by RTC sections 5451 through 5456; and
- Recalculate the ATI computation to exclude unsecured aircraft values for FY 2014-15 through FY 2016-17 and make adjustments as necessary.

County’s Response

The County concurs with the audit finding. The annual tax increment for FYs 2014-15 through 2016-17 has been corrected to exclude the unsecured aircraft assessed values.

SCO Comment

We will review the correction in our next audit.

Observation

OBSERVATION— Redevelopment Property Tax Trust Fund

On May 26, 2015, the Sacramento County Superior Court ruled in Case No. 34-2014-80001723-CU-WM-GDS between the cities of Chula Vista, El Cajon, Escondido, Poway, San Diego, San Marcos, and Vista (petitioners) and the San Diego County Auditor-Controller (respondent) regarding the methodology for apportioning the residual balance from the RPTTF.

The Court stated, in part:

(1) that a cap on the residual amount each entity can receive be imposed in an amount proportionate to its share of property tax revenue in the tax area; and (2) the calculation of the residual share an entity is entitled to receive must be done by considering the property tax available in the Redevelopment Property Tax Trust Fund after deducting only the amount of any distributions under paragraphs (2) and (3) of subdivision (a) of Section 34183.

On September 17, 2015, the respondent appealed the ruling to the Court of Appeal of the State of California, Third Appellate District.

As the appellate court has not decided on the case, we will follow up on this issue in a subsequent audit.

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

OFFICE OF THE AUDITOR-CONTROLLER

SIMONA PADILLA-SCHOLTENS, CPA
Auditor-Controller

PHYLLIS TAYNTON, CPA
Assistant Auditor-Controller



**SOLANO
COUNTY**

675 Texas Street, Suite 2800
Fairfield, CA 94533-6338
(707) 784-6280
Fax (707) 784-3553

www.solanocounty.com

SENT VIA EMAIL: lkurokawa@sco.ca.gov

August 7, 2018

Ms. Lisa Kurokawa
State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874

Dear Ms. Kurokawa:

We have reviewed the State Controller's draft report dated August 2, 2018 on the methods employed by Solano County to apportion and allocate property tax revenues for the period of July 1, 2014 through June 30, 2017. The following is our response to your finding:

Finding: Unsecured aircraft assessed values incorrectly included in computation of annual tax increment

The County concurs with the finding. The annual tax increment for FYs 2014-15 through 2016-17 has been corrected to exclude the unsecured aircraft assessed values.

I want to thank you for your efforts in completing our audit.

Sincerely,


Simona Padilla-Scholtens, CPA
Auditor-Controller

**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250**

<http://www.sco.ca.gov>