LASSEN COUNTY

Audit Report

APPORTIONMENT AND ALLOCATION OF PROPERTY TAX REVENUES

July 1, 2012, through June 30, 2017

BETTY T. YEE
California State Controller

September 2019

BETTY T. YEE
California State Controller

September 26, 2019

Diana Wemple, Auditor
Lassen County
221 South Roop Street, Suite 1
Susanville, CA 96130

Dear Ms. Wemple:

The State Controller's Office audited the methods employed by Lassen County to apportion and allocate property tax revenues for the period of July 1, 2012, 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 Lassen County incorrectly calculated:

- Supplemental property tax administrative costs;
- Unitary and operating nonunitary apportionment and allocation;
- Unitary regulated railway apportionment and allocation;
- Negative Educational Revenue Augmentation Fund adjustments;
- Vehicle License Fee adjustments; and
- Negative bailout.

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

cc: Lori Pearce, Assistant Auditor
    Lassen County
  Taya Morrison, Accountant Auditor/Property Tax Manager
    Lassen County
  Jeff Hemphill, Chair
    Lassen 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 Lassen County to apportion and allocate property tax revenues for the period of July 1, 2012, 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 administrative costs;
- Unitary and operating nonunitary apportionment and allocation;
- Unitary regulated railway apportionment and allocations;
- Negative Educational Revenue Augmentation Fund (ERAF) adjustments;
- Vehicle License Fee (VLF) adjustments; and
- Negative bailout.

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 nonunitary properties, regulated railway companies, and qualified electric 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 (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.

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, 2012, 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 40 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 and unitary regulated railway 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 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 VLF 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 Lassen 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:

- Supplemental property tax administrative costs;
- Unitary and operating nonunitary apportionment and allocation;
- Unitary regulated railway apportionment and allocation;
- Negative ERAF adjustments;
- VLF adjustments; and
- Negative bailout.

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

Follow-up on Prior Audit Findings

Findings noted in our prior audit report for the period of July 1, 2004, through June 30, 2012, issued June 9, 2014, have been satisfactorily resolved by the county, with the exception of the unitary and operating nonunitary apportionment and allocation (see Finding 2), and the negative bailout (see Finding 6).

Views of Responsible Officials

We issued a draft audit report on June 28, 2019. Diana Wemple, Auditor, responded by letter dated April 2, 2019, received on July 15, 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 Lassen 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

September 26, 2019

Findings and Recommendations

FINDING 1— Supplemental Property Tax Administrative Costs

During testing of the supplemental administrative cost process, we found that the county does not have procedures in place to identify the actual costs associated with administration of the supplemental assessment rolls. As a result, the county cannot substantiate all of the fees that it collected during the audit period, totaling $35,285. The error occurred because the county misinterpreted the applicable statute.

RTC section 75.60 provides the legal requirements for supplemental property tax administrative costs reimbursements.

The statute allows a county to charge an administrative fee for supplemental property tax revenues collections. This fee is not to exceed five percent of the supplemental property tax revenues collected.

Recommendation

We recommend that the county review RTC section 75.60, and implement procedures to ensure compliance.

County's Response

The county agrees with the finding and stated that it is in the process of implementing corrections.

FINDING 2— Unitary and Operating Nonunitary Apportionment and Allocation (Repeat Finding)

In our prior audit report for the period of July 1, 2004, through June 30, 2012, we found that the county's corrections to the unitary and operating nonunitary apportionment factors were incorrect. The county carried forward an incorrect beginning balance in the first year, adversely affecting the subsequent years.

We could not determine the cause of the error, as the staff responsible for the correction no longer work for the county.

This is a repeat finding. See Finding 1 of our previous report on Lassen County's property tax apportionment and allocation system (S13-PTX-003) dated June 9, 2014.

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 implement policies and procedures for properly computing the unitary and operating nonunitary apportionment factors;
- Re-compute the unitary and operating nonunitary apportionment factors for FY 2004-05 through FY 2016-17; and
- Make monetary adjustments to the affected entities.

County's Response

The county agrees with the finding and stated that it is in the process of implementing corrections.

FINDING 3— Unitary Regulated Railway Apportionment and Allocation

During testing of the unitary regulated railway process, we found that the county:

- Did not use the correct grand total revenue for computing the FY 2014-15 factors; and
- Did not provide to the ERAF its revenue share ($23,935) for the December apportionment for FY 2015-16.

We could not determine the cause of these errors, as the staff responsible for the unitary regulated railway process no longer work for the county.

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.

Recommendation

We recommend that the county:

- Review RTC section 100.11, and implement policies and procedures to ensure compliance;
- Re-compute the unitary regulated railway factors beginning with FY 2014-15; and
- Make monetary adjustments between the affected entities.

County's Response

The county agrees with the finding and stated that it is in the process of implementing corrections.

FINDING 4— Negative Educational Revenue Augmentation Fund Adjustments

During testing of the negative ERAF process, we found that the county incorrectly reduced the County School Services' total property tax for FY 2012-13 through FY 2016-17. Based on documentation provided by the county, the monetary effect of the error is estimated to be $598,038 for FY 2014-15 through FY 2016-17.

The error occurred because the county misinterpreted the applicable statutes.

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, subsequently annually adjusted for growth, of property tax revenues to the ERAF using formulas detailed in the Revenue and Taxation Code.

Recommendation

We recommend that the county:

- Review RTC sections 96.1 through 96.5 and 97 through 97.3;
- Implement updated policies and procedures to exclude County School Services from the negative ERAF computation; and
- Make monetary adjustments to affected entities beginning with FY 2012-13.

County's Response

The county agrees with the finding and stated that it is in the process of implementing corrections.

FINDING 5— Vehicle License Fee Adjustments

During testing of the VLF adjustment process, we found that the county used an incorrect assessed value in the computation of City of Susanville's VLF. This error resulted in an understatement of $79,365 for the city's FY 2016-17 VLF adjustment from the ERAF. The understatement was due to a clerical error.

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:

- Implement policies and procedures to ensure that correct assessed values are used in the computation of the VLF adjustment;
- Re-compute VLF growth beginning with FY 2016-17; and
- Make monetary adjustments to affected entities.

County's Response

The county agrees with the finding and stated that it is in the process of implementing corrections.

**FINDING 6—
Negative Bailout (SB 85)
(Repeat Finding)**

In our prior audit report for the period of July 1, 2004, through June 30, 2012, we found that the county had incorrectly calculated and applied the negative bailout amount of $57,935 in FY 2011-12. During our review of the prior audit finding, we concluded that the county did not take corrective action to address the error. The county stated that it did not implement the prior audit recommendation because it experienced staff turnover, and the new staff were unfamiliar with this complex calculation.

In addition to the uncorrected prior audit finding, we also found that the county made the following errors during the current audit period:

- Incorrectly adjusted for negative bailout in FY 2012-13 ($57,218) and in FY 2013-14 ($57,218);
- Incorrectly made adjustments to the ERAF instead of to non-basic aid K-14 schools; and
- Did not compute the negative bailout amount from FY 2014-15 through FY 2016-17 ($116,635).

As a result of these errors, the ERAF is owed $114,436 from the county General Fund, and the county General Fund is owed $116,635 from all non-basic aid K-14 schools. In discussing the errors, we concluded that the county does not have policies and procedures in place because of its misinterpretation of the applicable statute for computing the negative bailout amount.

This is a repeat finding. See Finding 6 of our previous report on Lassen County's property tax apportionment and allocation system (S13-PTX-003) dated June 9, 2014.

RTC section 96.11 provides the legal requirements for calculation of the negative bailout amount.

After the passage of Proposition 13, the Legislature passed SB 154 (Chapter 292, Statutes of 1978), which provided for the distribution of state assistance, or bailout, to partially mitigate property tax losses. The relief for counties was $436 million in cash grants plus the State's assumption of $1 billion associated with mandated health and welfare programs.

In the second year following the passage of Proposition 13, the Legislature passed AB 8 (Chapter 282, Statutes of 1979), which provided a long-term solution for the bailout program consisting of a one-time adjustment (shift) that created a new property tax base for each local agency. Counties received all of their SB 154 block grants and a small adjustment for Aid to Families with Dependent Children, minus the amount of the indigent health block grant. For some counties, the value of the indigent health block grant was so great that it exceeded the value of the SB 154 block grant. In those cases, the AB 8 shift resulted in a reduction of the property tax base instead of an increase; this created negative bailout counties. Consequently, the negative bailout amount received by the counties has grown each year as the assessed value of property in the counties has grown.

Recommendation

We recommend that the county:

- Review RTC section 96.11, and establish and implement policies and procedures to ensure compliance;
- Re-compute the negative bailout amount for FY 2011-12 through FY 2016-17; and
- Make monetary adjustments to affected entities.

County's Response

The county agrees with the finding and stated that it is in the process of implementing corrections.

Schedule— Summary of Misallocations to the Educational Revenue Augmentation Fund July 1, 2011[1], through June 30, 2017

Finding No.	Fiscal Year Affected	Amount Due to (Due from) the ERAF
3	2015-16	$ 23,935
5	2016-17	(79,365)
6	2011-12[1]	57,935
6	2012-13 and 2013-14	114,436
		$ 116,941

[1] In our prior audit, the county had a $57,935 finding that was not corrected.

Attachment—
County's Response to Draft Audit Report

County of Lassen

Auditor

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April 2, 2019

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

Dear Ms. Kurokawa:

Please accept this response from the County of Lassen regarding the draft audit of the apportionment and allocation of property tax revenues for the period of July 1, 2012 through June 30, 2017.

After reviewing the findings, I am in agreement with them. We are in the process of implementing corrections and we will be working on in-house procedures to minimize errors in the future.

The County of Lassen, like other small counties, has minimal staffing for property tax apportionment and allocation. In 2015 and 2017, the county's experienced property tax staff retired leaving new staff to handle the audit. This has been a great learning experience for the staff and I want to thank the State Controller's Office staff for their assistance and education provided to our county staff.

Sincerely,

Diana Wemple

Diana Wemple
Lassen County Auditor

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