DEL NORTE COUNTY

Audit Report

APPORTIONMENT AND ALLOCATION OF PROPERTY TAX REVENUES

July 1, 2014, through June 30, 2020

BETTY T. YEE

California State Controller

October 2021

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California State Controller

October 1, 2021

The Honorable Clinton Schaad, Auditor-Controller
Del Norte County
981 H Street, Suite 140
Crescent City, CA 95531

Dear Mr. Schaad:

The State Controller's Office audited Del Norte County's process for apportioning and allocating property tax revenues to determine whether the county complied with California statutes for the period of July 1, 2014, through June 30, 2020. We conducted the audit pursuant to the requirements of Government Code section 12468.

Our audit found that the county incorrectly calculated the:

- Computation and distribution of property tax revenue; and
- Vehicle License Fee adjustment.

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

Sincerely,

Original signed by

KIMBERLY TARVIN, CPA
Chief, Division of Audits

KT/ls

cc: Chris Howard, Chair, Board of Supervisors
  Del Norte County
 Sherrik Cron, Assistant Auditor-Controller
  Del Norte County
 Heather Bays, Property Tax Manager
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Audit Report

Summary

The State Controller's Office (SCO) audited Del Norte County's process for apportioning and allocating property tax revenues to determine whether the county complied with California statutes for the period of July 1, 2014, through June 30, 2020.

Our audit found that the county incorrectly calculated the:

- Computation and distribution of property tax revenue; and
- Vehicle License Fee (VLF) adjustment.

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 these agencies and 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 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 are 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. In general, the amount of revenue an agency or district receives is based on the amount received in the prior year plus a share of the property tax growth within its boundary.

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 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.
- *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 owed to 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.

Audit Authority

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 tax 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.

Objective, Scope, and Methodology

Our audit objective 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, 2014, through June 30, 2020.

To achieve our objective, we:

- Gained an understanding of the county's process for apportioning and allocating property tax revenues, and of the relevant criteria;
- 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;
- Reviewed documents supporting the transaction flow for apportioning and allocating property tax revenues;

- Judgmentally selected a non-statistical sample of five from approximately 23 taxing jurisdictions within the county for all fiscal years in the audit period.[1] 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 (see Finding 1);
    - 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 computations used to develop apportionment factors;
    - Reviewed redevelopment agency reports and verified computations used to develop the project base amount and the tax increment distributed to the redevelopment agency;
    - 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 VLF computations used to verify the amount transferred from the ERAF to counties and cities to compensate for the diversion of these revenues (see Finding 2); and
    - Reviewed the State Board of Equalization's jurisdictional change filing logs and their impact on the tax apportionment and allocation system.

  Errors found were not projected to the intended (total) population.

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

[1] The actual number of taxing jurisdictions, which include the ERAF, can vary from year to year based on jurisdictional changes. The five sampled taxing jurisdictions include a special district, a school district, a city, the county, and the ERAF. We selected only one of each type of local agency because when the apportionment and allocation for one jurisdiction is incorrect, the error affects every other taxing jurisdiction.

reasonable basis for our findings and conclusions based on our audit objective.

We did not audit the county's financial statements.

Conclusion

Our audit found that Del Norte 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:

- Computation and distribution of property tax revenue; and
- VLF adjustment.

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, 2005, through June 30, 2014, issued on August 29, 2014, 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 August 12, 2021. Clinton Schaad, Auditor-Controller, responded by email on August 27, 2021, agreeing with the audit results.

Restricted Use

This audit report is solely for the information and use of Del Norte County, the Legislature, the California Department of Finance, 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

KIMBERLY TARVIN, CPA
Chief, Division of Audits

October 1, 2021

Schedule— Summary of Misallocations to the Educational Revenue Augmentation Fund July 1, 2014, through June 30, 2020

Finding	Fiscal Years Affected	Amount Owed from the ERAF[1]
Finding 2 - VLF Adjustments	FY 2014-15 through FY 2019-20	$ 2,555,483
Total		$ 2,555,483

[1] RTC section 96.1(c)(3) limits the maximum amount of cumulative reallocation to one percent of the one-percent tax levied on the current fiscal year (FY 2020-21) secured assessed value, which is $177,577.

Findings and Recommendations

FINDING 1— Computation and Distribution of Property Tax Revenue

During testing of the computation and distribution of property tax revenue process, we found that the county incorrectly calculated the ATI by using the incorrect assessed values for certain TRAs for FY 2014-15 through FY 2019-20. This error resulted in a misallocation of property tax revenue to all affected entities in the county. We could not quantify the monetary impact for each affected taxing entity due to the cumulative effect of the various errors affecting the computation and allocation. The error occurred because the county incorrectly implemented RTC section 96.5 and 96.5(d), which provides the legal requirement for the computation and distribution of property tax revenue.

RTC sections 96 through 96.5 provide the legal requirements for the computation of ATI and the apportionment and allocation of property tax revenues.

ATI is the difference between the total amount of property tax revenues computed each year using the equalized assessment roll and the sum of the amounts allocated pursuant to RTC section 96.1(a). Each TRA will receive an increment based on its share of the incremental growth in assessed valuations. ATI added to the tax computed for the prior fiscal year will develop the apportionments for the current fiscal year.

<u>Recommendation</u>

We recommend that the county:

- Review RTC section 96.5 and 96.5(d) and update its procedures to include the correct assessed values from the computation and distribution of property tax revenue process;
- Recalculate its property tax revenues for FY 2014-15 through FY 2019-20; and
- Make monetary adjustments to school districts and the ERAF. (Monetary adjustments to all other affected taxing entities will be necessary, if the error is significant).

<u>County’s Response</u>

> The County recognizes and agrees with this finding and will implement the recommendations. The County was unaware of this oversight and has put controls in place to prevent this from happening in the future. The County is requesting to have an audit completed on a more regular basis by the State to help prevent these types of issues [from] happening.

FINDING 2— Vehicle License Fee Adjustments

During testing of the VLF adjustment process, we found that the county incorrectly calculated the VLF adjustment by using the incorrect assessed values for FY 2014-15 through FY 2019-20. This error resulted in a net over-allocation of $2,555,483 to the ERAF (an under-allocation of $2,790,002 to the county and an over-allocation of $234,519 to the City of Crescent City). The error occurred because the county incorrectly implemented RTC sections 97.69 and 97.70, which provide the legal requirement for the VLF adjustment (Schedule).

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:

- Review RTC section 97.69 and 97.70 and update its procedures to include the correct assessed values from the VLF adjustment process;
- Recalculate its VLF adjustment for FY 2014-15 through FY 2019-20; and
- Make monetary adjustments from the City of Crescent City to the ERAF and from the ERAF to the county[1].

County's Response

> The County recognizes and agrees with this finding and will implement the recommendations. The County was unaware of this oversight and has put controls in place to prevent this from happening in the future. The County is requesting to have an audit completed on a more regular basis by the State to help prevent these types of issues [from] happening.

[1] RTC section 96.1(c)(3) limits the maximum amount of cumulative reallocation to one percent of the one-percent tax levied on the current fiscal year (FY 2020-21) secured assessed value, which is $177,577.

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