HUMBOLDT COUNTY

Audit Report

APPORTIONMENT AND ALLOCATION OF PROPERTY TAX REVENUES

July 1, 2015, through June 30, 2021

BETTY T. YEE
California State Controller

December 2022

BETTY T. YEE
California State Controller

December 5, 2022

The Honorable Cheryl Dillingham, Auditor-Controller
Humboldt County
825 5th Street, Room 126
Eureka, CA 95501

Dear Ms. Dillingham:

The State Controller's Office audited Humboldt County's process for apportioning and allocating property tax revenues for the period of July 1, 2015, through June 30, 2021. We conducted the audit pursuant to the requirements of Government Code section 12468.

Our audit found instances that the county incorrectly calculated the:

- Annual tax increment revenue;
- Jurisdictional changes;
- Unitary and operating nonunitary apportionment;
- Educational Revenue Augmentation Fund shift; and
- Vehicle license fee shifts.

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/ac

cc: Tabatha Miller, Chief Financial Officer
Humboldt County
Virginia Bass, Chair
Humboldt 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 Humboldt County's process for apportioning and allocating property tax revenues for the period of July 1, 2015, through June 30, 2021.

Our audit found that the county incorrectly calculated the:

- Annual tax increment (ATI) revenue;
- Jurisdictional changes;
- Unitary and operating nonunitary apportionment;
- Educational Revenue Augmentation Fund (ERAF) shift; and
- Vehicle License Fee (VLF) shifts.

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 and subsequent fiscal years. The methodology is commonly referred to as the "AB 8 process."

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 that 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 boundaries.

The AB 8 process involves several steps, including the transfer of revenues from school and community college districts to local government agencies and the development of the tax rate area (TRA) 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 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 apportionment 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 ERAF in each county. Most local government agencies and special districts 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.

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 California 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. The 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 (e.g. funds intended for the ERAF, school districts, or community college districts). The 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 SCO with broad authority to "superintend the fiscal concerns of the state." GC section 12418 provides the SCO 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 SCO 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 SCO.

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 on a one-, three-, or five-year cycle, depending on the county's population. The audit results are reported annually to the Legislature along with any recommendations for corrective action.

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.

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 was 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.

The audit period was July 1, 2015, through June 30, 2021.

To achieve our objective, we performed the following procedures:

- We gained an understanding of the county's process for apportioning and allocating property tax revenues by interviewing key personnel.
- We reviewed the county's written procedures for apportioning and allocating property tax revenues.
- We reviewed documents supporting the transaction flow for apportioning and allocating property tax revenues.
- We judgmentally selected a non-statistical sample of five from approximately 100 taxing jurisdictions within the county for all fiscal years in the audit period.[1] Then, we:
    - Reviewed apportionment and allocation reports to verify computations used to develop property tax apportionment factors;

[1] The actual number of taxing jurisdictions can vary from year to year based on jurisdictional changes. For testing purposes, we included the ERAF in our sample of taxing jurisdictions. We also tested a special district, a school district, a city, and the county. 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.

- 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 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 verified VLF computations used to determine the amount transferred from the ERAF to counties and cities to compensate for the diversion of these revenues; and
- Reviewed California State Board of Equalization 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 did not audit the county’s financial statements.

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.

Conclusion

Our audit found that Humboldt 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 the:

- ATI revenue;
- Jurisdictional changes;
- Unitary and operating nonunitary apportionment;
- ERAF shift; and
- VLF shifts.

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

Follow-up on Prior Audit Findings

The county has satisfactorily resolved the findings noted in our prior audit report, for the period of July 1, 2008, through June 30, 2015, issued on May 3, 2016.

Views of Responsible Officials

We issued a draft audit report on October 21, 2022. Cheryl Dillingham, Auditor-Controller, responded by email on November 9, 2022, stating that the county intends to implement all of the recommendations.

Restricted Use

This audit report is solely for the information and use of Humboldt 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

KIMBERLY TARVIN, CPA
Chief, Division of Audits

December 5, 2022

Findings and Recommendations

FINDING 1—Computation and distribution of property tax revenue

During our testing of the computation and distribution of property tax revenue, we found that the county incorrectly calculated ATI revenue. The calculations were incorrect because the TRA factors totaled less than 100% for FY 2019-20 and FY 2020-21. The miscalculation was due to a clerical error.

We also found that the TRA factors for Eureka High School, which are in TRA 003, were removed from ATI calculations for all TRAs-003; and the TRA factors for Rohnerville Elementary, which are in TRA 005, were removed from ATI calculations for all TRAs-005. The error resulted in a misallocation of ATIs to all affected taxing entities. We did not quantify the monetary impact for each affected taxing entity due to various errors affecting the computation and allocation.

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.

Recommendation

We recommend that the county:

- Review RTC section 96.5 and 96.5(d) and update its procedures;
- Review all TRA factors and correct any TRA factors under 100% for FY 2019-20 and forward; and
- Make monetary adjustments for all affected taxing entities.

County's Response

The county stated that it intends to implement all of the recommendations.

FINDING 2—Jurisdictional changes

During our testing of jurisdictional changes, we found that the county incorrectly implemented the City of Eureka – Brainard Site annexation.

The error resulted in misallocations of revenue to all affected taxing entities. We did not quantify the monetary impact for each affected taxing entity due to various errors affecting the computation and allocation. The error occurred due to clerical mistakes.

RTC section 99 provides the legal requirements for jurisdictional changes.

A jurisdictional change involves a change in the organization or boundaries of a local agency or school district. Typically, these are service-area or responsibility changes between the local jurisdictions. As part of the jurisdictional change, local agencies are required to negotiate any exchange of base-year property tax revenues and ATIs. Consequently, a local agency whose responsibility increased receives additional ATI, and negotiated agreements adjust the base property tax revenues accordingly.

Recommendation

We recommend that the county:

- Review RTC section 95(e) and 99, and update its procedures for jurisdictional changes;
- Review all jurisdictional changes for the audit period to correct any errors; and
- Make monetary adjustments to affected entities, if the error is significant.

County's Response

The county stated that it intends to implement all of the recommendations.

FINDING 3— Unitary and operating nonunitary apportionment and allocation

During our testing of the unitary and operating nonunitary apportionment and allocation, we found that the county incorrectly calculated unitary excess factors. The calculations were incorrect because the county incorrectly adjusted the RDA increment for FY 2015-16 through FY 2018-19, and for FY 2020-21.

The error resulted in misallocations to all affected taxing entities. We did not quantify the monetary impact for each affected taxing entity due to various errors affecting the computation and allocation. The error occurred because the county did not correctly implement procedures for RTC section 100, which 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 the California State Board of Equalization "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 qualified electric 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 update its procedures;
- Recalculate the unitary excess factors to correct the RDA increment adjustment for FY 2015-16 through FY 2020-21; and
- Make monetary adjustments to affected taxing entities.

County's Response

The county stated that it intends to implement all of the recommendations.

FINDING 4— Educational Revenue Augmentation Fund shift

During our testing of the ERAF shift, we found that the county incorrectly calculated the ERAF shift by including the RDA increment for FY 2015-16 through FY 2020-21.

The error resulted in misallocation to all affected taxing entities for FY 2015-16 through FY 2020-21. We did not quantify the monetary impact for each affected taxing entity due to various errors affecting the computation and allocation. The error occurred because the county did not correctly implement procedures for RTC section 97.2 and 97.3, which provide the legal requirements for calculation of the ERAF shift.

In FY 1992-93 and FY 1993-94, some local government agencies and special districts were required to shift an amount, of property tax revenues to the ERAF using formulas detailed in the Revenue and Taxation Code. Since FY 1993-94, the amount has been annually adjusted for growth.

Recommendation

We recommend that the county:

- Review RTC section 97.2 and 97.3 and update its procedures;
- Recalculate the ERAF shift for FY 2015-16 through FY 2020-21 to exclude the RDA increment; and
- Make monetary adjustments to affected taxing entities.

County's Response

The county stated that it intends to implement all of the recommendations.

FINDING 5— Vehicle License Fee Adjustments

During our testing of the county's VLF adjustment process, we found that the county made the following errors in calculating the VLF shift adjustment:

- Used the incorrect assessed values for the city of Arcata in FY 2018-19; and
- Did not adjust the assessed values for annexation for FY 2018-19 through FY 2020-21.

The errors resulted in misallocations to all affected cities for FY 2018-19 through FY 2020-21. We did not quantify the monetary impact for each affected taxing entity due to various errors affecting the computation and allocation. The errors occurred because the county incorrectly implemented RTC section 97.70, which provides the legal requirements for the VLF adjustment process.

Recommendation

We recommend that the county:

- Review RTC section 97.70 and update its procedures;
- Recalculate its VLF adjustments for FY 2018-19 through FY 2020-21; and
- Make monetary adjustments to the ERAF.

County's Response

The county stated that it intends to implement all of the recommendations.

Appendix— Summary of Prior Audit Findings

The following table shows the implementation status of Humboldt County's corrective actions related to the findings contained in the county's prior audit report, dated May 3, 2016:

Prior Audit Finding Number	Prior Audit Finding Title	Status
1	Calculation and distribution of annual tax increment	Fully implemented
2	Supplemental property tax administrative costs	Fully implemented
3	Unitary apportionment	Fully implemented
4	Vehicle licensing fee and Sales and Use Tax adjustments	Fully implemented

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