

STANISLAUS COUNTY

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2013, through June 30, 2016



BETTY T. YEE
California State Controller

June 2017



BETTY T. YEE
California State Controller

June 12, 2017

Lauren Klein, CPA, Auditor-Controller
Stanislaus County
1010 10th Street, Suite 5100
Modesto, CA 95354

Dear Ms. Klein:

The State Controller's Office audited the methods employed by Stanislaus County to apportion and allocate property tax revenues for the period of July 1, 2013, through June 30, 2016. The audit was conducted pursuant to the requirements of Government Code section 12468.

Our audit found that the county complied with California statutes, except that it incorrectly computed:

- Unitary and operating nonunitary apportionment factors;
- Railway apportionment factors;
- Property tax administrative fee factors; and
- Vehicle Licensing Fee growth.

Additionally, we are unable to make a determination on the county's methodology for apportioning the residual balance from the Redevelopment Property Tax Trust Fund because of a pending appellate court decision, as described in the Observation section of this report. Therefore, we will follow up on this issue in the subsequent audit.

If you have any questions, please contact Elizabeth González, Bureau Chief, by telephone at (916) 324-0622.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/as

cc: Todd Filgas, Property Tax Manager
Stanislaus County

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Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by Stanislaus County to apportion and allocate property tax revenues for the period of July 1, 2013, through June 30, 2016.

Our audit found that the county complied with California statutes, except that it incorrectly computed:

- Unitary and operating nonunitary apportionment factors;
- Railway apportionment factors;
- Property tax administrative fee factors; and
- Vehicle Licensing Fee (VLF) growth.

Additionally, we are unable to make a determination on the county's methodology for apportioning the residual balance from the Redevelopment Property Tax Trust Fund (RPTTF) because of a pending appellate court decision, as described in the Observation section of this report. Therefore, we will follow up on this issue in the subsequent audit.

Background

After the passage of Proposition 13 in 1978, the California State Legislature enacted new methods for apportioning and allocating property tax revenues to local government agencies and public schools. The main objective was to provide local government agencies with a property tax base that would grow as assessed property values increased. These methods have been further refined in subsequent laws passed by the California State 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.

The 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 agencies and schools using prescribed formulas and methods defined in the Revenue and Taxation Code.

The AB 8 base process involves numerous steps, including the transfer of revenues from schools to local 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 apportionment factor (percentage share) for each entity for the year. The AB 8 apportionment 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 nonunitary properties; 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 allocated and apportioned to schools by the county auditor according to instructions received from the county superintendent of schools or the State Chancellor of Community Colleges.

Revenues generated by the different types of property tax are apportioned and allocated to local agencies and schools 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 maintained primarily by the county assessor. Tax rolls contain an entry for each parcel of land, including the parcel number, the owner's name, and the value. Following are the types of property tax rolls:

- *Secured Roll*—This roll contains property that, in the opinion of the assessor, has sufficient value to guarantee payment of the tax levies and that, if necessary, can be sold by the tax collector to satisfy unpaid tax levies.
- *Unsecured Roll*—This roll contains property that, in the opinion of the assessor, does not have sufficient “permanence” or have other intrinsic qualities to guarantee payment of taxes levied against it.
- *State-Assessed Roll*—This roll contains public utility, regulated railway, and qualified electric properties assessed as either unitary or nonunitary property by the Board of Equalization (BOE).
- *Supplemental Roll*—This roll contains 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 taxes, Senate Bill 418 was enacted in 1985 requiring the State Controller to audit the counties' apportionment and allocation methods and report the results to the California State Legislature.

Objectives, Scope, and Methodology

Our audit objective was to determine whether the county complied with Revenue and Taxation Code requirements pertaining to the apportionment and allocation of property taxes. The audit covered the period of July 1, 2013, through June 30, 2016.

To meet our objective, we performed the following procedures:

- Interviewed key personnel to gain an understanding of the county's property tax apportionment and allocation processes;
- Reviewed the county's written procedures for apportioning and allocating property tax revenues;
- Performed a walkthrough to validate the county's procedures;
- Performed analytical reviews to assess the reasonableness of property tax revenues; and
- Judgmentally sampled five taxing jurisdictions within the county (errors found will not be projected to the population) and:
 - 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 are used in the computation of the ATI;
 - Verified computations used to develop unitary and operating nonunitary tax apportionment factors;
 - Recomputed unitary and operating nonunitary reports and BOE reports, and verified computations used to develop unitary and operating nonunitary distribution factors;
 - Reviewed Successor Agency Recognized Obligation Payment Schedules and apportionment and allocation reports addressing the RPTTF deposits and distributions;
 - Reviewed property tax administration cost reports and verified administrative costs associated with procedures used for apportioning and allocating property tax to local government agencies and school districts;
 - Reviewed ERAF reports and verified computations used to determine the shift of property taxes from local agencies to ERAF and, subsequently, to public schools; and
 - Reviewed Sales and Use Tax (SUT) and VLF reports and computations used to verify the amount of ERAF transferred to counties and cities to compensate for the diversion of these revenues.

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.

Our review of the county's internal controls was limited to gaining an understanding of the transaction flow in order to develop appropriate auditing procedures. We did not evaluate the effectiveness of all internal controls relevant to the apportionment and allocation of property taxes. We did not audit the county's financial statements.

This audit was conducted under the authority of Government Code section 12410 and section 12468, which requires the SCO to audit the apportionment and allocation of property taxes. A property tax bill contains the property tax levied at a 1% 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 1% 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, except for the items discussed in the Findings and Recommendations section of this report, Stanislaus County complied with California statutes for the apportionment and allocation of property tax revenues for the period of July 1, 2013, through June 30, 2016. The county should correct the items discussed in the Findings and Recommendations section.

Additionally, we made an observation related to the methodology for apportioning the residual balance from the RPTTF, as discussed in the Observation section of this report.

Follow-up on Prior Audit Findings

The county has satisfactorily resolved the findings noted in our prior audit report, issued July 18, 2014.

Views of Responsible Officials

We issued a draft audit report on May 3, 2017. Lauren Klein, CPA, Auditor-Controller, responded by letter dated May 19, 2017, agreeing with the audit results. The response is included as an attachment to this report.

Restricted Use

This report is solely for the information and use of Stanislaus County, the California State Legislature, 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 final 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

June 12, 2017

Findings and Recommendations

FINDING 1— Unitary and Operating Nonunitary Apportionment

The county incorrectly computed the unitary and operating nonunitary apportionment factors by using incorrect prior-year AB 8 apportionment factors in the excess revenue computation.

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in Revenue and Taxation Code section 100.

Unitary properties are those properties on which the 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 qualified electric properties). The Revenue and Taxation Code further 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 California State Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The California State Legislature established the unitary and operating nonunitary base year and developed formulas to compute the distribution factors for the fiscal years that followed.

Recommendation

The county should correct the unitary and operating nonunitary apportionment factors and use the corrected factors going forward.

County’s Response

The County concurs with the finding and will use corrected unitary and operating nonunitary factors moving forward.

SCO Comment

The SCO will review the implementation of the corrections in the next audit.

FINDING 2— Regulated Railway Apportionment

In computing the regulated railway apportionment factors, the county made the following errors:

- In FY 2013-14, used incorrect prior year factors; and
- In FY 2013-14 through FY 2015-16, used incorrect prior year AB 8 apportionment factors in the excess computation by included redevelopment pass-through revenue.

The process for apportioning and allocating property taxes from certain regulated railway companies functions through the unitary railway tax system employed by BOE. Unitary railway properties are defined in

Revenue and Taxation Code section 723. Revenue and Taxation Code section 100.11 prescribes the procedures counties must perform to allocate unitary railway property taxes beginning in FY 2007-08.

Recommendation

The county should correct the regulated railway apportionment factors and use the corrected factors going forward.

County's Response

The County concurs with the finding and will use corrected regulated railway unitary factors moving forward.

SCO Comment

The SCO will review the implementation of the corrections in the next audit.

**FINDING 3—
Property Tax
Administrative Costs**

The county incorrectly computed proportionate shares of administrative costs for FY 2013-14 through FY 2015-16 by including redevelopment pass-through payments.

Requirements for the reimbursement of county property tax administrative costs are found in Revenue and Taxation Code section 95.3. County property tax administrative costs are incurred by the assessor, the tax collector, the assessment appeals board, and the auditor. The county is allowed, depending on the fiscal year and any corresponding exclusions, to be reimbursed by local agencies and public schools for these administrative costs.

Recommendation

The county computed the corrections for FY 2016-17 during the audit and should implement the corrected methodology going forward. The corrections will be reviewed in the next audit.

County's Response

The County concurs with the finding. As stated in the report, the corrections were made in FY 2016-17. The methodology was also changed in FY 2016-17. All changes will remain for future periods.

**FINDING 4—
Vehicle Licensing Fee
and Sales and Use Tax
Adjustments**

The county incorrectly computed the VLF growth by not including the local utility assessed values.

Requirements for the ERAF adjustment for the VLF and SUT are found in Revenue and Taxation Code sections 97.68-97.70.

In FY 2004-05, the county was given a VLF estimate that was to be transferred from ERAF to the VLF Property Tax Compensation Fund, and eventually to the county and cities. In FY 2005-06, the county was given

another estimate, including true-ups. In FY 2006-07 and subsequent years, the county calculated the VLF adjustment based on the prior-year VLF adjusted for growth. The growth for the county's VLF should be based on countywide growth, not only on unincorporated parcels. The growth for each city's VLF should be based on the growth of all incorporated parcels in all TRAs within the city.

The SUT amounts for each county and cities within each county are provided by the Department of Finance, on or before September 1 of each fiscal year. These amounts are to be transferred from ERAF to the SUT Compensation Fund, and eventually to each designated county and cities within each county.

Recommendation

The county computed the corrections for FY 2016-17 during the audit and should implement them going forward. The corrections will be reviewed in the next audit.

County's Response

The County concurs with the finding. As stated in the report, the corrections were made in FY 2016-17. All changes will remain for future periods.

Observation

OBSERVATION— Redevelopment Property Tax Trust Fund

On May 26, 2015, the Sacramento County Superior Court ruled in the case 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 in 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.

The SCO is currently assessing the impact the ruling has on the county's methodology. On September 17, 2015, the respondent appealed the ruling to the Court of Appeal of the State of California. As the appellate court has not decided on the case, we will follow up on this issue in the subsequent audit.

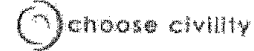
**Attachment—
County’s Response to
Draft Audit Report**



AUDITOR-CONTROLLER

Lauren Klein, CPA
Auditor-Controller

1010 10th Street, Suite 5100, Modesto, CA 95354
PO Box 770, Modesto, CA 95353-0770
Phone: 209.525.6398 Fax: 209.525.7507



May 19, 2017

Elizabeth Gonzalez, Bureau Chief
State Controller's Office
Division of Audits
PO Box 942850
Sacramento, CA. 94250-5874

Ms. Gonzalez,

In response to the draft State Controller's Office audit report dated May 3, 2017 regarding Stanislaus County's property tax apportionments for the period July 1, 2013 through June 30, 2016 please see our responses to the findings noted in the report:

Finding 1 – Unitary and Operating Nonunitary Apportionment

The County concurs with the finding and will use corrected unitary and operating nonunitary factors moving forward.

Finding 2 – Regulated Railway Apportionment

The County concurs with the finding and will use corrected regulated railway unitary factors moving forward.

Finding 3 – Property Tax Administrative Costs

The County concurs with the finding. As stated in the report, the corrections were made in FY 2016-17. The methodology was also changed in FY 2016-17. All changes will remain for future periods.

Finding 4 – Vehicle Licensing Fee and Sales and Use Tax Adjustments

The County concurs with the finding. As stated in the report, the corrections were made in FY 2016-17. All changes will remain for future periods.

If you should have any questions please contact Todd Filgas, Property Tax Manager, at filgast@stancounty.com or (209) 525-6597.

Thank-you,

Lauren Klein, CPA

**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874**

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