

SACRAMENTO COUNTY

Audit Report

PROPERTY TAX ALLOCATION AND APPORTIONMENT SYSTEM

July 1, 2010, through June 30, 2015



BETTY T. YEE
California State Controller

December 2017



BETTY T. YEE
California State Controller

December 28, 2017

Ben Lamera, Director of Finance
Sacramento County
Department of Finance
700 H Street, Suite 3650
Sacramento, CA 95814

Dear Mr. Lamera:

The State Controller's Office audited the methods employed by Sacramento County to allocate and apportion property tax revenues for the period of July 1, 2010, through June 30, 2015. The audit was conducted pursuant to the requirements of Government Code section 12468.

The audit scope excluded a determination on the validity of 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.

Without consideration of this legal issue, our audit found that the county complied with California statutes, except that it incorrectly computed:

- Supplemental apportionment factors;
- Unitary and operating nonunitary apportionment factors;
- Regulated Railway apportionment factors;
- Property tax administrative fee factors; and
- The Vehicle License Fee growth computation.

If you have any questions, please contact Jim L. Spano, CPA, Assistant Division Chief, by telephone at (916) 323-5849.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/lis

Attachment

cc: Joyce Renison, Assistant Auditor-Controller
Sacramento County
Department of Finance
Jeff Emslie, Senior Accounting Manager
Sacramento County
Department of Finance
Shih-Der "Stephanie" Huang, Accounting Manager
Sacramento County
Department of Finance
Don Nottoli, Chair
Sacramento County Board of Supervisors

Contents

Audit Report

Summary	1
Background	1
Objective, Scope, and Methodology	2
Conclusion	4
Follow-up on Prior Audit Findings	4
Views of Responsible Officials	4
Restricted Use	4
Findings and Recommendations	5
Observation	9
Schedule 1—Summary of Misallocations to the Educational Revenue Augmentation Fund	10
Attachment—County’s Response to Draft Audit Report	

Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by Sacramento County to allocate and apportion property tax revenues for the period of July 1, 2010, through June 30, 2015.

The audit scope excluded 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.

Without consideration of this legal issue, our audit found that the county complied with California statutes for the allocation and apportionment of property tax revenues, except that it incorrectly computed:

- Supplemental apportionment factors;
- Unitary and operating nonunitary apportionment factors;
- Regulated Railway apportionment factors;
- Property tax administrative fee factors; and
- The Vehicle License Fee (VLF) growth computation.

Background

After the passage of Proposition 13 in 1978, the California State Legislature (Legislature) enacted new methods for allocating and apportionment property tax revenues to local government agencies, school districts, and community college districts. The main objective was to provide local government agencies with a property tax base that would grow as assessed property values increase. 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 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 then are 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.

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 now is 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 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 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 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 have other intrinsic qualities to guarantee payment of taxes levied against it.
- *State-Assessed Roll*—Utility properties composed of unitary and 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 was enacted in 1985 requiring the State Controller to audit counties' allocation and apportionment methods and report the results to the Legislature.

Objective, Scope, and Methodology

Our audit objective was to determine whether the county complied with Revenue and Taxation Code requirements pertaining to the allocation and apportionment of property taxes. The audit covered the period of July 1, 2010, through June 30, 2015.

To meet our objective, we:

- Interviewed key personnel to gain an understanding of the county's property tax allocation and apportionment processes;
- Reviewed the county's written procedures for allocating and apportioning 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 selected a non-statistical sample of five taxing jurisdictions within the county (errors found will not be projected to the intended population) and:
 - 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 are 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 computations used to develop apportionment factors;
 - Reviewed the RPTTF deposits and distributions;
 - Reviewed property tax administration cost reports and recomputed administrative costs associated with work performed for allocating and apportioning property tax 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 ERAF and, subsequently, to school and community college districts;
 - Reviewed Sales and Use Tax letter and recomputed VLF computations used to verify the amount of ERAF transferred to cities and counties 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.

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 allocation and apportionment 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 SCO to audit the allocation and apportionment of property taxes. 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 discussed in the Observation section of this report, Sacramento County complied with California statutes for the allocation and apportionment of property tax revenues for the period of July 1, 2010, through June 30, 2015, except for the items described in the Findings and Recommendations section of this report. The county should correct the items discussed 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, issued June 10, 2011.

Views of Responsible Officials

We issued a draft audit report on September 1, 2017. Ben Lamera, Director of Finance, responded by letter dated September 15, 2017, agreeing with the audit results. The county's response is included as an attachment to this report.

Restricted Use

This report is solely for the information and use of Sacramento 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 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

December 28, 2017

Findings and Recommendations

FINDING 1— Supplemental Property Tax Apportionment

In FY 2014-15 and FY 2015-16, the county incorrectly computed the supplemental allocation factors by including the VLF adjustment. As a result, the county underallocated \$7,988,822 to the ERAF (Schedule 1).

The legal requirements for supplemental roll property tax allocation and apportionment are found in Revenue and Taxation Code sections 75.60 through 75.71, and 100.2. When there is a change in assessed property value due to changes in ownership or completion of new construction, the property owner is charged a supplemental property tax. This process enables the counties to retroactively tax property for the period when changes in ownership or completion of new construction occurred, rather than at the time the secured roll is developed.

The county computed the corrections for FY 2014-15 and FY 2015-16 during the current audit. We will review the corrections in our next audit.

Recommendation

We recommend that the county:

- Reallocate \$7,988,822 to the ERAF for FY 2014-15 and FY 2015-16; and
- Correctly compute the supplemental factor in subsequent years by excluding the VLF adjustment.

County's Response

The county concurs with the finding and has made the recommended changes. The county also requested that it be allowed to repay the ERAF over a five-year period, as permitted by Revenue and Taxation Code section 96.1(c)(3).

SCO Comment

We will review the correction in the next audit.

Revenue and Taxation Code section 96.1(c)(3) requires that the reallocation be completed in equal increments within the following three fiscal years, or as negotiated with the Controller. The county's request to repay the ERAF in equal installment over a five-year period, commencing in FY 2017-18, is approved.

FINDING 2— Unitary and Operating Nonunitary Apportionment

In FY 2015-16, the county incorrectly apportioned unitary and operating nonunitary revenues to the ERAF. As a result, the county misallocated revenues to taxing entities.

Requirements for the allocation and apportionment 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 Legislature established a separate system for allocating and apportioning the unitary and operating nonunitary property taxes. The Legislature established 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:

- Correct the unitary and operating nonunitary apportionment factors;
- Make necessary adjustments to affected entities; and
- Use the corrected factors going forward.

County’s Response

The county concurs with the finding and will work on recommended changes.

SCO Comment

We will review the correction in the next audit.

FINDING 3— Regulated Railway Apportionment

In FY 2010-11 through FY 2015-16, the county made the following errors in the computation of the Regulated Railway apportionment factors:

- Used incorrect prior-year railway revenues to compute for current-year factors;
- Used incorrect prior-year AB 8 revenues to compute for in-excess factors; and
- Apportioned in-excess revenues separately.

In addition, in FY 2014-15 and FY 2015-16, the county incorrectly adjusted for VLF. As a result, the county misallocated revenues to taxing authorities.

The process for allocating and apportioning 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

We recommend that the county:

- Correct the Regulated Railway apportionment factors;
- Use the corrected factors going forward; and
- Make necessary adjustments to affected entities.

County's Response

The county concurs with the finding and will work on recommended changes.

SCO Comment

We will review the correction in the next audit.

**FINDING 4—
Property Tax
Administrative Factor**

In FY 2012-13 through FY 2014-15, the county incorrectly used prior-year unitary and operating nonunitary, and Regulated Railway revenues for the computation of the property tax administrative fee factors. As a result, the county did not receive the allowable reimbursable cost from affected entities.

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 government agencies and school districts for these administrative costs.

Recommendation

We recommend that the county correct the property tax administrative fee factors and make necessary adjustments to affected entities.

County's Response

The county concurs with the finding and will work on recommended changes.

SCO Comment

We will review the correction in the next audit.

**FINDING 5—
Vehicle Licensing Fee
Adjustments**

In FY 2013-14, the county incorrectly computed the VLF growth and shift amount for the City of Folsom by including current-year annexation assessed values. As a result, the county underallocated \$94,485 to the ERAF (Schedule 1).

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 the 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.

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 the ERAF to the SUT Compensation Fund, and eventually to each designated county and cities within each county.

The county computed the corrections for FY 2013-14 during our fieldwork. We will review the corrections in our next audit.

Recommendation

We recommend that the county:

- Reallocate \$94,485 to the ERAF for FY 2013-14; and
- Correctly compute the VLF growth and shift amounts for the City of Folsom in subsequent years by excluding current-year annexation assessed values.

County's Response

The county concurs with the finding and has made the recommended changes.

SCO Comment

We will review the correction in the 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 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.

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.

**Schedule 1—
Summary of Misallocations to the
Educational Revenue Augmentation Fund
July 1, 2010, through June 30, 2011**

<u>Finding No.</u>	<u>Years Affected</u>	<u>Amount Due to the Educational Revenue Augmentation Fund</u>
1	FY 2014-15 through FY 2015-16	\$ 7,988,822 ¹
5	FY 2013-14 through FY 2015-16	<u>94,485</u>
		<u><u>\$ 8,083,307</u></u>

¹This amount was based on current year secured and unsecured apportionments only.

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

Department of Finance
Ben Lamera
Director



Auditor-Controller Division
Joyce Renison
Assistant Auditor-Controller

County of Sacramento

September 15, 2017

Jim L. Spano, CPA
Assistant Division Chief
State Controller's Office
Division of Audits
P.O. Box 942850
Sacramento, CA 94250-5874

Dear Mr. Spano,

Please find below our responses to your draft audit report dated September 2017:

FINDING 1 – SUPPLEMENTAL PROPERTY TAX APPORTIONMENT

Auditee's Response

The County concurs with this finding. The County has corrected the supplemental apportionment factors by excluding the VLF adjustment for fiscal years 2014-15, 2015-16 and 2016-17. For fiscal year 2016-17, supplemental revenue distributions were made using the corrected apportionment factors. We have calculated the amount of the corrections for the prior fiscal years of 2014-15 and 2015-16 during fieldwork by the SCO auditor. The County hereby requests that these corrections be made over a period of 5 fiscal years in accordance with Revenue and Taxation Code Section 96.1(c)(3).

FINDING 2 – UNITARY AND OPERATING NONUNITARY APPORTIONMENT

Auditee's Response

The County concurs with this finding. The County has corrected the unitary and nonunitary apportionment factors and has made the necessary adjustments to the affected entities during fieldwork by the SCO auditor.

FINDING 3 – REGULATED RAILWAY APPORTIONMENT

Auditee's Response

The County concurs with this finding. The County has corrected the Regulated Railway apportionment factors and has made the necessary adjustments to the affected entities during fieldwork by the SCO auditor.

FINDING 4 – PROPERTY TAX ADMINISTRATIVE FACTOR

Auditee's Response

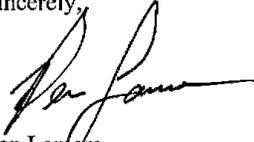
The County concurs with this finding. The County has corrected the property tax administrative fee factors and has made the necessary adjustments to the affected entities.

FINDING 5 – VEHICLE LICENSING FEE ADJUSTMENT

Auditee's Response

The County concurs with this finding. The County has corrected the VLF growth and shift amounts for the City of Folsom and has made the necessary adjustments to the City of Folsom. In addition, the County has forwarded these corrections to the California State Controller, Division of Accounting and Reporting.

Sincerely,

A handwritten signature in black ink, appearing to read "Ben Lantera", written over a horizontal line.

Ben Lantera
Director of Finance

cc: Joyce Renison, Assistant Auditor-Controller
Jeffrey A. Emslie, Senior Accounting Manager
Shih-Der "Stephanie" Huang, Accounting Manager

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

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