SAN MATEO COUNTY

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2006, through June 30, 2013

JOHN CHIANG
California State Controller

March 2014

JOHN CHIANG
California State Controller

March 21, 2014

The Honorable Bob Adler, Controller
555 County Center, 4th Floor
Redwood City, CA 94063

Dear Mr. Adler:

The State Controller's Office audited the methods employed by San Mateo County to apportion and allocate property tax revenues for the period of July 1, 2006, through June 30, 2013. 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:

- Included the Educational Revenue Augmentation Fund (ERAF) in the unitary and operating nonunitary apportionment.
- Included redevelopment agencies and excluded ERAF in the base unitary railroad allocation.
- Used base year factors for the apportionment of unitary railroad revenues up to 102% of prior year for fiscal years 2009-10 through 2012-13.

If you have any questions, please contact Elizabeth Gonzalez, Chief, Local Government Compliance Bureau, by phone at (916) 324-0622.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/kw

cc: Dave Pine, Chairperson
San Mateo County Board of Supervisors
Jody Martin, Principal Consultant
Joint Legislative Budget Committee
Peter Detwiler, Staff Director
Senate Local Government Committee

Elvia Dias, Committee Assistant
Senate Local Government Committee
Dixie Martineau-Petty, Secretary
Assembly Local Government Committee
Gayle Miller, Staff Director
Senate Revenue and Taxation Committee
Oksana Jaffe, Chief Consultant
Assembly Revenue and Taxation Committee
Neil McCormick, Executive Director
California Special Districts Association

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Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by San Mateo County to apportion and allocate property tax revenues for the period of July 1, 2006, through June 30, 2013.

Our audit found that the county complied with California statutes for the allocation and apportionment of property tax revenues, except that it:

- Included the Educational Revenue Augmentation Fund (ERAF) in the unitary and operating nonunitary apportionment.
- Included redevelopment agencies and excluded ERAF in the base unitary railroad allocation.
- Used base year factors for the apportionment of unitary railroad revenues up to 102% of prior year for fiscal years 2009-10 through 2012-13.

Background

After the passage of Proposition 13 in 1978, the California State Legislature enacted new methods for allocating and apportioning 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 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.

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 involved numerous steps, including the transfer of revenues from schools to local agencies (AB 8 shift) and the development of the tax rate area annual tax increment apportionment factors (ATI 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 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 revenues generated by unitary and nonunitary properties, regulated railway companies, and qualified electric properties from the AB 8 process. These revenues are now allocated and apportioned 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, railroad, and qualified electric properties, assessed as either unitary or nonunitary property by the State Board of Equalization.

- *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.

Objective, Scope, and Methodology

Our audit objective was to review the county's apportionment and allocation of property tax revenues to local government agencies and public schools within its jurisdiction to determine whether the county complied with Revenue and Taxation Code requirements.

To meet the objective, we reviewed the county's procedures for apportioning and allocating property tax revenues used by the county auditor and the processes used by the tax collector and the assessor.

We performed the following procedures:

- Conducted tests to determine whether the county correctly apportioned and allocated property tax revenue.
- Interviewed key personnel and reviewed supporting documentation to gain an understanding of the county's property tax apportionment and allocation processes.
- Reviewed apportionment and allocation reports prepared by the county showing the computations used to develop the property tax distribution factors.
- Reviewed tax rate area (TRA) reports to verify that the annual tax increment was computed properly.
- Reviewed county unitary and operating nonunitary reports and Board of Equalization reports and verified the computations used by the county to develop the unitary and operating nonunitary property tax distribution factors.
- Reviewed redevelopment agency (RDA) reports prepared by the county and verified the computations used to develop the project base amount and the tax increment distributed to the RDA.
- Reviewed successor agency Recognized Obligation Payment Schedules (ROPS) and county apportionment and allocation reports addressing the Redevelopment Property Tax Trust fund (RPTTF).
- Reviewed property tax administration cost reports prepared by the county and verified administrative costs associated with procedures used for apportioning and allocating property tax to local government agencies and school districts.
- Reviewed ERAF reports prepared by the county and verified the computations used to determine the shift of property taxes from local agencies to the ERAF and, subsequently, to public schools.
- Reviewed reports and computations prepared by the county to determine any increases in property tax revenues due cities having low or non-existent property tax amounts.

We conducted this performance audit under the authority of Government Code sections 12468 and 12410. 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The audit covered the period of July 1, 2006, through June 30, 2013. Our audit scope was limited to:

- Reviewing operational procedures and significant applicable controls over the apportionment and allocation process;

- Examining selected property tax apportionment and allocation records; and
- Reviewing related property tax revenue data used to determine the apportionment and allocation computation process.

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 services 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.

We limited our review of the county's internal controls 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.

In addition, we tested transactions used to apportion and allocate property taxes and performed other procedures deemed necessary. This report relates solely to the method used by the county to apportion and allocate property taxes.

Conclusion

Our audit found that, except for the items discussed in the Findings and Recommendations section of this report, San Mateo County complied with California statutes for the apportionment and allocation of property tax revenues for the period of July 1, 2006, through June 30, 2013. The county should correct the items discussed in the Findings and Recommendations section.

Follow-up on Prior Audit Findings

Findings noted in our prior audit, issued February 13, 2009, have been satisfactorily resolved by the county, with the exception of the inclusion of the ERAF in unitary and operating nonunitary apportionments.

Views of Responsible Officials

We issued a draft audit report on February 7, 2014. Bob Alder, Auditor-Controller, responded by letter dated March 5, 2014 (Attachment).

Restricted Use

This report is solely for the information and use of San Mateo County, the California 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 report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

March 21, 2014

Findings and Recommendations

FINDING 1— Unitary and operating nonunitary apportionment

The county's unitary allocation system includes ERAF. This calculation resulted in an under-apportionment to all agencies receiving unitary property tax revenues.

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 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). 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 apportioning and allocating 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

The county should not include ERAF in unitary apportionments.

County's Response

> Whether or not to include ERAF in the unitary and operating nonunitary apportionments is an unsettled question across the State. Our understanding is that the California Property Tax Managers Group has been working closely with the SCO to develop a revised methodology for apportioning unitary property tax revenues. We intend to revise our unitary apportionment methodology as needed once that process is complete and further guidance has been issued.

SCO Comment

The SCO agrees with the County's corrective action and will review the corrections in the next audit.

FINDING 2— Unitary railroad apportionment

The county included redevelopment agencies (RDAs) and excluded ERAF in the base unitary railroad allocation, instead of excluding RDAs and including ERAF.

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 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). 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 apportioning and allocating 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.

During fieldwork the county recalculated the 2007-08 base year unitary railroad allocations to include ERAF and exclude RDAs. The county also recalculated subsequent allocations to reflect the changes made to the base year factors.

Recommendation

The county should apportion unitary railroad revenues based on the corrected factors.

County's Response

> The County Controller's Office identified that the redevelopment agencies were incorrectly included in the FY 2007-08 base year unitary railroad allocations and accordingly made a prior period adjustment in FY 2008-09. The County has provided SCO staff with the supporting documentation showing the correction was made in FY 2008-09.
>
> We agree that ERAF should have been included in the FY 2007-08 base year unitary railroad allocations. Based on the recommendations provided by the SCO, the County had taken steps to ensure our calculations are correct going forward.

SCO Comment

The SCO has reviewed the corrections to railroad apportionments to RDAs and agrees with the County's corrective actions. The SCO will review additional corrections in the next audit.

FINDING 3—Unitary railroad apportionment

In the fiscal years 2009-10 through 2012-13, the county apportioned unitary railroad revenues up to 102% of prior year revenues using base year factors, instead of the prior year unitary railroad factors.

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 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). 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 apportioning and allocating 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.

During fieldwork the county recalculated the 2009-10 through 2012-13 apportionments. The county used the prior year unitary railroad factors for the apportionment of up to 102% in accordance with the Revenue and Taxation Code.

Recommendation

The county should apportion unitary railroad revenues up to 102% of prior year revenues based on prior year unitary railroad factors.

County's Response

> We agree that the unitary railroad revenues up to 102% of the prior year amount should be apportioned based on the prior year unitary railroad factors rather that base year factors. Based on recommendations provided by the SCO, the County has taken steps to ensure our calculations are correct going forward.

SCO Comment

The SCO agrees with the County's corrective action and will review the corrections in the next audit.

Attachment—
County's Response to Draft Audit Report

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County of San Mateo
Office of the Controller

Bob Adler
Controller

Juan Raigoza
Assistant Controller

Shirley Tourel
Deputy Controller

March 5, 2014

Elizabeth Gonzalez, Chief
State Controller's Office
Division of Audits - Local Government Compliance Bureau
PO Box 942850
Sacramento, California 94250-5874

Dear Elizabeth,

We received San Mateo County's Property Tax Apportionment and Allocation System DRAFT report for the period July 1, 2006 through June 30, 2013. The enclosed attachment provides our response to the findings and recommendations identified in the report. We would like to express our appreciation for the cooperation and courtesy by the State Controller's Office (SCO) management and staff during the course of the review.

If you have any questions or concerns, please contact Shirley Tourel, Deputy Controller at 650 599 1149. Thank you.

Very Truly Yours,

Shirley Tourel for Bob Adler

Bob Adler

County of San Mateo Controller

Cc: Jeffrey Brownfield, Chief, Division of Audits

Attachment

1. FINDING 1 – Unitary and Operating Nonunitary Apportionment

   Whether or not to include ERAF in the unitary and operating nonunitary apportionments is an unsettled question across the State. Our understanding is that the California Property Tax Managers Group has been working closely with the SCO to develop a revised methodology for apportioning unitary property tax revenues. We intend to revise our unitary apportionment methodology as needed once that process is complete and further guidance has been issued.

2. FINDING 2 – Unitary Railroad Apportionment

   The County Controller's Office identified that the redevelopment agencies were incorrectly included in the FY 2007-08 base year unitary railroad allocations and accordingly made a prior period adjustment in FY 2008-09. The County has provided SCO staff with the supporting documentation showing the correction was made in FY 2008-09.

   We agree that ERAF should have been included in the FY 2007-08 base year unitary railroad allocations. Based on the recommendations provided by the SCO, the County has taken steps to ensure our calculations are correct going forward.

3. FINDING 3 – Unitary Railroad Apportionment

   We agree that the unitary railroad revenues up to 102% of the prior year amount should be apportioned based on the prior year unitary railroad factors rather than base year factors. Based on the recommendations provided by the SCO, the County has taken steps to ensure our calculations are correct going forward.

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http://www.sco.ca.gov