

MONTEREY COUNTY

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2003, through June 30, 2006



JOHN CHIANG
California State Controller

February 2008



JOHN CHIANG
California State Controller

February 27, 2008

The Honorable Michael J. Miller, CPA, CISA
Auditor-Controller
Monterey County
P.O. Box 390
Salinas, CA 93902

Dear Mr. Miller:

The State Controller's Office audited the methods employed by Monterey County to apportion and allocate property tax revenues for the period of July 1, 2003, through June 30, 2006. The audit was conducted pursuant to the requirements of *Government Code* Section 12468.

Our audit disclosed that the county complied with California statutes, except in the following instances:

- The AB 8 amounts did not reconcile to the assessor's assessed values.
- The jurisdictional revenue exchange was computed in error.
- The supplemental cost reimbursement was overstated.
- The unitary and operating non-unitary apportionment factors were computed in error.
- The base value for the City of Greenfield amended redevelopment agency (RDA) did not reconcile to the assessed parcel numbers.
- The county accepted a consolidated RDA Statement of Indebtedness report.

The county has disputed certain facts related to the conclusions and recommendations contained in this audit report. The State Controller's Office has an informal audit review process to resolve a dispute of facts. To request a review, the county should submit, in writing, a request for a review and all information pertinent to the disputed issues within 60 days after receiving the final report. The request and supporting documents should be submitted to Richard J. Chivaro, Chief Counsel, State Controller's Office, Post Office Box 942850, Sacramento, CA 94250-0001.

In addition, please provide a copy of the request letter to Steven Mar, Chief, Local Government Audits Bureau, State Controller's Office, Division of Audits, Post Office Box 942850, Sacramento, CA 95250-5874.

If you have any questions, please contact Mr. Mar at (916) 324-7226.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB/jj:sk:vb

cc: Peggy Collins, Chief Consultant
 Joint Legislative Budget Committee
 Peter Detwiler, Consultant
 Senate Local Government Committee
 Elvia Dias, Assistant
 Senate Local Government Committee
 Dixie Martineau-Petty, Secretary
 Assembly Local Government Committee
 Martin Helmke, Consultant
 Senate Revenue and Taxation Committee
 Kimberly Bott, Chief Consultant
 Assembly Revenue and Taxation Committee
 Diana L. Ducay, Chief
 Office of State Audits and Evaluations
 Department of Finance
 Catherine Smith, Executive Director
 California Special Districts Association
 Richard J. Chivaro, Chief Counsel
 State Controller's Office

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Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by Monterey County to apportion and allocate property tax revenues for the period of July 1, 2003, through June 30, 2006.

Our audit disclosed that the county complied with California statutes for the allocation and apportionment of property tax revenues, except in the following instances:

- The AB 8 amounts did not reconcile to the assessor's assessed values.
- The jurisdictional revenue exchange was computed in error.
- The supplemental cost reimbursement was overstated.
- The unitary and operating non-unitary apportionment factors were computed in error.
- The base value for the City of Greenfield amended redevelopment agency (RDA) did not reconcile to the assessed parcel numbers.
- The county accepted a consolidated RDA Statement of Indebtedness report.

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 8 (AB 8), 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 operating nonunitary property from the AB 8 system. This revenue is now 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 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 constitute sufficient “permanence” or have other intrinsic qualities to guarantee payment of taxes levied against it.
- *State-Assessed Roll*—This roll contains public utility and railroad 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, legislation (SB 418) was enacted in 1985 that requires 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 systems for apportioning and allocating property tax revenues used by the county auditor and the subsystems used by the tax collector and the assessor.

We performed the following procedures:

- Performed tests to determine whether there had been any incorrect apportionment and allocation of property tax.
- 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 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; and
- 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.

We performed our audit according to *Government Auditing Standards*, issued by the Comptroller General of the United States, and covered the period of July 1, 2003, through June 30, 2006. However, we did not audit the county's financial statements. 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.

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 disclosed that, except for the items discussed in the Findings and Recommendations section of this report, Monterey County complied with California statutes for the apportionment and allocation of property tax revenues for the period of July 1, 2003, through June 30, 2006. 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 December 7, 2005.

Views of Responsible Official

We issued a draft audit report on April 25, 2007. Michael Miller, Auditor-Controller, responded by letter dated July 11, 2007 (Attachment). He agreed with the audit results with the exception of Finding 2.

Restricted Use

This report is solely for the information and use of Monterey 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
Chief, Division of Audits

February 27, 2008

Findings and Recommendations

FINDING 1— Calculation and distribution of ATI

The AB 8 amounts could not be reconciled to the 1% of the Assessor's certified assessed values. The totals between systems appear to differ for each fiscal year.

Requirements for the apportionment and allocation of the annual tax increment (ATI) are found in Revenue and Taxation Code sections 96 through 96.5. The annual increment of property tax, which is the change in assessed value from one year to the next, is allocated to TRAs on the basis of each TRA's share of the incremental growth in assessed valuations. The tax increment is then multiplied by the jurisdiction's annual tax increment apportionment factors for each TRA. These factors were developed in the 1979-80 base year and are adjusted for jurisdictional changes. The tax increment is then added to the tax computed for the prior fiscal year to develop the apportionment for the current fiscal year.

Recommendation

Once the annual tax increment is added to the AB 8 system, the county should reconcile the AB 8 balances to the Assessor's certified values.

County's Response

Beginning with the 2007-08 fiscal year, Monterey County will reconcile the AB 8 amounts with the Assessor's certified assessed values.

FINDING 2— Jurisdictional changes

The county computed revenue exchange amounts for jurisdictional changes in the AB 8 system using effective date values rather than effective roll year. In addition, the Assessor's Office was untimely in moving the existing TRA Assessor's Parcel Numbers (APN) to the resulting TRA's.

The legal requirements for jurisdictional changes are found in Revenue and Taxation Code section 99. A jurisdictional change involves a change in organization or boundaries of local government agencies and school districts. Normally, these are service area or responsibility changes between the local jurisdictions. As part of the jurisdictional change, the local government agencies are required to negotiate any exchange of base year property tax revenue and annual tax increment. After the jurisdictional change, the local agency whose responsibility has increased receives additional annual tax increment, and the base property tax revenues are adjusted according to the negotiated agreements.

Recommendation

Unless wording to the contrary appears in the revenue exchange agreement, the revenue exchange calculation for the AB 8 system to be used by the county should be the approved roll year. The Assessor's Office must move existing TRA APNs to the resulting TRAs in a timely manner.

County's Response

Monterey County feels that the use of the effective date for computing revenue exchange is a County policy and should not be an audit finding. This policy has been in effect before the prior two State audits and the agency most affected is the County itself in that it gives up its own revenue.

SCO's Comment

In accordance with the Revenue and Taxation Code section 99, local government agencies are required to negotiate any exchange of base year property tax revenue and annual tax increment. The jurisdictional change agreement reviewed in this audit specifically states, "the following formulas for property tax base and increment distribution within Tax Rate Area 126-011 *after change of organization/reorganization.*" (Emphasis added). We understand this to mean the roll year approved by the State Board of Equalization and not the effective date of the resolution. The finding remains unchanged.

**FINDING 3—
Supplemental
property tax-
administrative costs**

The county was reimbursed for actual supplemental administrative costs rather than the maximum allowed of 5% of supplemental revenue collection.

Revenue and Taxation Code section 75.60 allows a county to charge an administrative fee for supplemental property tax collections. This fee is not to exceed 5% of the supplemental property taxes collected.

Recommendation

Since the county includes supplemental administrative costs in the SB 2557 reimbursement system, the maximum allowed for supplemental administrative costs reimbursement in the supplemental system is a maximum of 5% of supplemental revenue collection. The county was over-reimbursed by \$117,645. This amount must be returned to all paying entities in the supplemental apportionment system.

County's Response

The \$117,465 was allocated back to the paying entities in 2006-07.

**FINDING 4—
Redevelopment
agencies**

The revenue base value for the City of Greenfield amended redevelopment agency (RDA) did not reconcile to the list of APNs provided by the Assessor's Office to the RDA.

The county accepted a consolidated Statement of Indebtedness (SOI) report from the City of Greenfield RDA and apportioned the increment without verifying the total debt.

Requirements for the apportionment and allocation of property tax to RDAs are found in Revenue and Taxation Code sections 96.4 and 96.5. California Community Redevelopment Law generally entitles a community redevelopment agency to all of the property tax revenues that are realized from growth in values since the redevelopment project's inception.

Recommendation

The County Assessor's Office must reconcile the mapped APNs for all jurisdictional changes to the values in the TRAs prior to shifting values. In addition, all resulting TRAs identified by the State Board of Equalization must be accounted for in the property tax systems. Furthermore, the shift of APNs must be done on a timely basis so that the County Controller's Office computes revenue correctly and in a timely manner.

The County Controller should not apportion property taxes impacted by jurisdictional changes unless assured that the value to be used is correct.

The County Controller should examine each RDA project's SOI and apportion property tax increments only for those projects that report debts. The purpose of the SOI is to determine the maximum amount of increment an RDA project can receive for each fiscal year.

County's Response**Auditor-Controller**

Monterey County was unaware that an amendment to an existing RDA project required a separate SOI and will review them more carefully. Also, please see the attached memo from the Assessor.

Assessor

The Assessor's Office agrees with this recommendation and makes every effort to reconcile mapped APNs for all jurisdictional changes to values in the TRAs prior to shifting values. The Assessor's Office does not know why the AB 8 amounts did not reconcile to the assessor's assessed values. Although it is possible for a mistake to occur the assessor's office makes every effort possible to ensure that resulting TRAs identified by the State Board of Equalization are accounted for in the property tax system in a timely manner.

**FINDING 5—Unitary
and operating
nonunitary
apportionment**

The county incorrectly computed the unitary and operating nonunitary apportionment factors in FY 2005-06. Computing and apportioning the excess of 102% of assessed valuation using AB 8 system factors unadjusted for, VLF revenues caused the error. In addition, for FY 2005-06, the County Assessor’s Office did not account for pipeline AV in the correct TRA.

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 apply 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 and railroads). 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 unitary and operating nonunitary base year was established and formulas were developed to compute the distribution factors for the fiscal years that followed.

Recommendation

The county must recompute the apportionment factors by adjusting the FY 2004-05 AB 8 for VLF revenues and include pipeline AV in the correct TRA.

County’s Response

Monterey County has made the VLF revenue adjustments to the unitary apportionment factors in 2006-07.

**FINDING 6—
Educational Revenue
Augmentation Fund
(ERAF)**

The county computed the ERAF shift growth using gross AB 8 jurisdiction revenues. The jurisdiction revenues should be net of RDA gross increment.

Requirements for the local agency shift of property tax revenues to the ERAF are generally found in Revenue and Taxation Code sections 97.1 through 97.3. Beginning in FY 1992-93, each local agency was generally required to shift an amount of property tax revenues to the ERAF using formulas detailed in the code. The property tax revenues in the ERAF are subsequently allocated to the public schools using factors supplied by the county superintendent of schools.

For FY 1992-93, the ERAF shift amount for cities was generally determined by adding a per capita amount to a percentage of property tax revenues received by each city. The amount for counties was generally determined by adding a flat amount, adjusted for growth, to a per capita

amount. The amount for special districts was generally determined by shifting the lesser of 10% of that district's total annual revenues as shown in the FY 1989-90 edition of the State Controller's Report on Financial Transactions Concerning Special Districts or 40% of the FY 1991-92 property tax revenues received, adjusted for growth. Specified special districts were exempted from the shift.

For FY 1993-94, the ERAF shift for cities and counties was generally determined by:

- Reducing the FY 1992-93 ERAF shift by the FY 1992-93 per capita shift;
- Adjusting the result for growth; and
- Adding the result to a flat amount and a per capita amount determined by the Department of Finance, adjusted for growth.

The FY 1993-94 ERAF shift for special districts, other than fire districts, was generally determined by:

- Multiplying the property tax allocation for FY 1992-93, pre-ERAF, by the Special District Augmentation Fund (SDAF) factor for the district effective on June 15, 1993;
- Adjusting this amount by subtracting the FY 1992-93 shift to the ERAF;
- If the above amount is greater than zero, adjusting this amount for FY 1993-94 growth (zero is used for negative amounts); and
- Adding this amount to the FY 1992-93 ERAF shift, adjusting for growth.

For fire districts, the FY 1993-94 ERAF shift was generally determined by:

- Deducting the FY 1992-93 ERAF shift for the district from the FY 1992-93 property tax allocation;
- Multiplying the result by the SDAF factor for the district effective on June 13, 1993 (net current-year bailout equivalent);
- For a district governed by a board of supervisors, deducting the amount received from the SDAF in FY 1992-93 from the net current-year bailout equivalent; or, for an independent district, deducting the amount received from the SDAF and the difference between the net current-year bailout equivalent and the amount contributed to the SDAF from the net current-year bailout equivalent;
- Adjusting this amount for growth; and
- Adding this amount to the FY 1992-93 ERAF shift, adjusted for growth.

For fiscal years subsequent to FY 1993-94, the amounts determined are adjusted for growth annually to determine the ERAF shift amounts for that year.

Recommendation

The county must revise the AB 8 system by removing RDA gross increments from participating jurisdictions' prior revenues before calculating the ERAF shift growth. To properly correct the system, the revision should begin with the 1993-94 fiscal year.

County's Response

Monterey County will adjust the ERAF shift growth and go forward starting in 2007-08.

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

MONTEREY COUNTY



AUDITOR - CONTROLLER

(831) 755-5040 • FAX (831) 755-5098 • P.O. BOX 390 • SALINAS, CALIFORNIA 93902

MICHAEL J. MILLER, CPA, CISA
AUDITOR-CONTROLLER

ALFRED R. FRIEDRICH, CGFM
ASSISTANT AUDITOR-CONTROLLER

July 11, 2007

Mr. Steven Fujimori, Acting Chief
Special Audits Bureau
Division of Audits
State Controller's Office
P.O. Box 942850
Sacramento, CA 94250-5874

Dear Mr. Fujimori:

We have received your draft audit report in May 2007 of the Monterey County Property Tax Apportionment and Allocation System for July 1, 2003 through June 30, 2006. Here is our response to your findings:

Finding #1: The AB 8 amounts did not reconcile to the assessor's assessed values.

Recommendation: Once the annual tax increment is added to the AB 8 system, the county should reconcile the AB 8 balances to the Assessor's certified values.

Response: Beginning with the 2007-08 fiscal year, Monterey County will reconcile the AB 8 amounts with the Assessor's certified assessed values.

Finding #2: The jurisdictional revenue exchange was computed in error.

Recommendation: Unless wording to the contrary appears in the revenue exchange agreement, the revenue exchange calculation for the AB 8 system to be used by the county should be the approved roll year.

Response: Monterey County feels that the use of the effective date for computing revenue exchange is a County policy and should not be an audit finding. This policy has been in effect before the prior two State audits and the agency most affected is the County itself in that it gives up its own revenue.

Finding #3: The supplemental cost reimbursement was overstated.

Recommendation: Since the county includes supplemental administrative costs in the SB 2557 reimbursement system, the maximum allowed for supplemental administrative costs reimbursement in the supplemental system is a maximum of 5% of supplemental revenue collection. The county was over-reimbursed by \$117,465. This amount must be returned to all paying entities in the supplemental apportionment system.

Response: The \$117,465 was allocated back to the paying entities in 2006-07.

Finding #4: The County accepted a consolidated RDA Statement of Indebtedness report.

Recommendation: The County Controller should examine each RDA project's SOI and apportion property tax increments only for those projects that report debts. The purpose of the SOI is to determine the maximum amount of increment an RDA project can receive for each fiscal year.

Response: Monterey County was unaware that an amendment to an existing RDA project required a separate SOI and will review them more carefully. Also, please see attached memo from the Assessor.

Finding #5: The County incorrectly computed the unitary and operating non-unitary apportionment factors in 2005-06. Computing and apportioning the excess of 102% of assessed values valuation using AB 8 system factors unadjusted for, VLF revenues caused the addition.

Recommendation: The County must recompute the apportionment factors by adjusting the FY 2004-05 AB 8 for VLF revenues.

Response: Monterey County has made the VLF revenue adjustments to the unitary apportionment factors in 2006-07.

Finding #6: The County computed the ERAF shift growth using gross AB 8 jurisdiction revenues. The jurisdiction revenues should be net of RDA gross Increment.

Recommendation: the county must revise the AB 8 system by removing RDA gross increments from participating jurisdictions' prior revenues before calculating the ERAF shift growth. To properly correct the system, the revision should begin with the 1993-94 fiscal year.

Response: Monterey County will adjust the ERAF shift growth and go forward starting in 2007-08.

We look forward to working with you in the future. If you have any questions or additional comments, please call me at (831) 755-5040.

Sincerely,

A handwritten signature in black ink that reads "Michael J. Miller". The signature is written in a cursive style with a large, stylized initial "M".

Michael J. Miller, CPA, CISA
Auditor-Controller
County of Monterey

Attach.

MONTEREY COUNTY ASSESSOR
STEPHEN L. VAGNINI
PO BOX 570, SALINAS, CA 93902
(831) 755-5035 – from Monterey (831) 647-7719

MEMORANDUM

DATE: July 9, 2007
TO: Mike Miller, Monterey County Auditor
FROM: Stephen L. Vagnini, Monterey County Assessor *SLV*
SUBJECT: Monterey County Audit Report: Property Tax And Allocation System

Finding 4 –
Redevelopment Agencies

The Revenue base value for the City of Greenfield amended redevelopment agency (RDA) did not Reconcile to the list of APNs provided by the Assessor's Office to the RDA.

Recommendation

The County Assessor's Office must reconcile the mapped APNs for all jurisdictional changes to values in the TRAs prior to shifting values. In addition, all resulting TRAs identified by the State Board of Equalization must be accounted for in the property tax systems. Furthermore, the shift of APNs must be done on a timely basis so that the County Controller's Office computes revenue correctly and in a timely manner.

Response

The Assessor's Office agrees with this recommendation and makes every effort to reconcile mapped APNs for all jurisdictional changes to values in the TRAs prior to shifting values. The Assessor's Office does not know why the AB 8 amounts did not reconcile to the assessor's assessed values. Although it is possible for a mistake to occur the assessor's office makes every effort possible to ensure that resulting TRAs identified by the State Board of Equalization are accounted for in the property tax system in a timely manner.

**State Controller's Office
Division of Audits
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