LAKE COUNTY

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2001, through June 30, 2006

JOHN CHIANG
California State Controller

March 2007

JOHN CHIANG
California State Controller

March 30, 2007

The Honorable Pam Cochrane
County Clerk/Auditor-Controller
Lake County
255 North Forbes Street
Lakeport, CA 95453-4790

Dear Ms. Cochrane:

The State Controller's Office audited the methods employed by Lake County to apportion and allocate property tax revenues for the period of July 1, 2001, 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 county computed AB 8 factors incorrectly.
- The county did not adjust supplemental apportionment factors for ADA.
- The county incorrectly computed unitary and operating nonunitary factors.
- The county incorrectly computed an RDA pass-through.

If you have any questions, please contact Jerry McClain, Chief, Special Audits Bureau, at (916) 323-1573.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB/vb:ams

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

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Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by Lake County to apportion and allocate property tax revenues for the period of July 1, 2001, through June 30, 2006. The last day of fieldwork was September 26, 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 county computed AB 8 factors incorrectly.
- The county did not adjust supplemental apportionment factors for ADA.
- The county incorrectly computed unitary and operating nonunitary factors.
- The county incorrectly computed an RDA pass-through.

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, 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.

- 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, 2001, 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, Lake County complied with California statutes for the apportionment and allocation of property tax revenues for the period of July 1, 2001, 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 October 31, 2002.

Views of Responsible Official

We issued a draft report on January 26, 2007. Pam Cochrane, Auditor-Controller, responded by letter dated February 16, 2007 (Attachment). She agreed with the audit results.

Restricted Use

This report is solely for the information and use of Lake 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

Findings and Recommendations

FINDING 1—Calculation and distribution of ATI

Our audit disclosed the following issues.

1. The county adjusted the Highland redevelopment increment in the AB 8 system net of pass-through.

2. The list of tax rate areas (TRAs) in the county Auditor-Controller's Office did not reconcile to the list provided by the county Assessor's Office.

3. The assessed valuation the county used in computing the AB 8 system gross levy included airplane values.

4. In fiscal year (FY) 2005-06, the county used the individual TRA assessed valuation for prior year and current year to compute the prior year base revenues and current year gross levy for each jurisdiction.

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.

<u>Recommendation</u>

The county must correct the redevelopment increment adjustment in the AB 8 system from FY 2001-02 through FY 2005-06 to reflect the correct apportionment factors.

The county must reconcile the Auditor-Controller's tax rate area list with the list from the Assessor's Office and close out the non-existing TRAs. The non-existing TRA values should be consolidated into like-kind existing TRAs.

The county must exclude airplane values from the assessed valuation when computing the gross levy for the AB 8 system.

The county must correct the TRA base revenue for FY 2005-06 by using the prior year TRA property tax revenue per jurisdiction.

County's Response

1. The county concurs with this finding. Adjustments were made while the field audit was still in process.
2. The county concurs with this finding and has reconciled the Auditor-Controller's tax rate area list with the list of the Assessor's office. All TRA values have been consolidated into like-kind existing TRAs.
3. The county concurs with this finding and has excluded the aircraft values from future year values when computing the gross levy for the AB 8 system.
4. The county concurs with this finding and the corrections to the base tax revenue were made while the field audit was still in process.

FINDING 2—Supplemental property tax

The K-12 schools supplemental apportionment factors for FY 2002-03 and FY 2003-04 were not adjusted for ADA.

The legal requirements for supplemental roll property tax apportionment and allocation 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.

Recommendation

The county should re-examine the impact of the ADA error on the K–12 schools' revenues for FY 2002-03 and FY 2003-04. If the error is material and significant, the county must make the necessary revenue corrections.

County's Response

The county concurs with this finding and will re-examine the ADA error impact on the K-12 revenues for FY 2002-03 and FY 2003-04. The county will make the necessary corrections if the error is material and significant.

FINDING 3—Redevelopment agencies

The county included bond collection in the Northshore redevelopment area (RDA) property tax gross increment to compute the low-income housing set-aside and passes-through.

In FY 2003-04 and FY 2004-05, the county allocated a property tax revenue increment to the Northshore RDA that was greater than the total reported 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 growths in value since the redevelopment project's inception.

Recommendation

The county should exclude bond revenues from the RDA property tax revenue when computing the low-income set-aside and pass-through.

The county must refund the excess property tax revenue received by the RDA back to the participating jurisdictions within the RDA area.

County's Response

> The county concurs with this finding and has excluded bond revenues from the RDA property tax revenue from the calculations beginning with FY 2006-07 and will continue to do this in future calculations.
>
> The county concurs with this finding that in FY 2003-04 and 2004-05 the county allocated a property tax revenue increment to the Northshore RDA that was greater than the total reported debt. Subsequent to the audit the statements of indebtness for these years have been amended. If the revenue increment is still greater after review of these amendments, the county will refund the excess revenue to the participating districts.

FINDING 4—
Unitary and operating nonunitary apportionment

Our audit disclosed the following issues.

1. In FY 2002-03, the unitary and operating nonunitary assessed valuation exceeded 102%. The excess of 102% was adjusted using an incorrect apportionment factor derived from the AB 8 system.

2. The apportionment factors for FY 2004-05 did not reconcile to that of the prior year.

3. In FY 2004-05, the county did not adjust the vehicle license fee amount in the AB 8 system. These incorrect AB 8 factors were used in FY 2005-06 to adjust the unitary and operating nonunitary assessed valuation in excess of 102%.

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 correct the apportionment factors for the unitary and operating nonunitary factors from FY 2002-03 through FY 2005-06.

County's Response

> The county concurs with this finding and the corrections to the unitary and operating nonunitary apportionment factors were made while the field audit was still in process.

Attachment—
County's Response to
Draft Audit Report

COUNTY OF LAKE
Office of the County Clerk/Auditor-Controller
Courthouse-255 North Forbes Street
Lakeport, CA 95453
Telephone (707) 263-2311
FAX (707) 263-2310
Email: pam_c@co.lake.ca.us
cathy_s@co.lake.ca.us

Pam Cochrane
County Clerk/Auditor-Controller
Cathy Saderlund
Chief Deputy Auditor-Controller

Ref. No. 07L-170

February 16, 2007

State Controller's Office
Mr. Jerry McClain
PO Box 942850
Sacramento CA 94250-5874

Dear Mr. McClain:

Thank you for the draft audit report pertaining to our property tax allocation and apportionment methods for the period of July 1, 2001 through June 30, 2006. We received the draft report on February 5, 2007. Our response is as follows:

Finding 1—Calculation and distribution of ATI

1. The county concurs with this finding. Adjustments were made while the field audit was still in process.

2. The county concurs with this finding and has reconciled the Auditor-Controller's tax rate area list with the list of the Assessor's office. All TRA values have been consolidated into like-kind existing TRAs.

3. The county concurs with this finding and has excluded the aircraft values from future year values when computing the gross levy for the AB 8 system.

4. The county concurs with this finding and the corrections to the base tax revenue were made while the field audit was still in process.

Finding 2—Supplemental property tax

The county concurs with this finding and will re-examine the ADA error impact on the K-12 revenues for FY 2002-03 and FY 2003-04. The county will make the necessary corrections if the error is material and significant.

Finding 3—Redevelopment agencies

The county concurs with this finding and has excluded bond revenues from the RDA property tax revenue from the calculations beginning with FY 2006-07 and will continue to do this in future calculations.

The county concurs with this finding that in FY 2003-04 and 2004-05 the county allocated a property tax revenue increment to the Northshore RDA that was greater than the total reported debt. Subsequent to the audit the statements of indebtedness for these years have been amended. If the revenue increment is still greater after review of these amendments, the county will refund the excess revenue to the participating districts.

Finding 4—Unitary and operating non-unitary apportionment

The county concurs with this finding and the corrections to the unitary and operating nonunitary apportionment factors were made while the field audit was still in process.

We would like to extend our appreciation to your staff auditor, Moises Laurel, for his cooperative and conscientious manner during the performance of this audit. We also appreciate the extra help he provided staff to correct some of the findings.

Sincerely,

Pam Cochrane

Pam Cochrane
Auditor-Controller

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

http://www.sco.ca.gov

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