SAN BERNARDINO COUNTY

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2006, through June 30, 2013

BETTY T. YEE
California State Controller

March 2015

BETTY T. YEE
California State Controller

March 26, 2015

The Honorable Larry Walker
Auditor-Controller
San Bernardino County
222 W. Hospitality Lane, 4th Floor
San Bernardino, CA 92415

Dear Mr. Walker:

The State Controller's Office audited the methods employed by San Bernardino 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:

I. Incorrectly allocated unitary, pipeline, and qualified electric property tax revenues by making the following errors:

   1. In fiscal year (FY) 2006-07 through FY 2012-13, the County did not allocate pipeline revenues up to 102% of prior year revenues using prior year factors. The County also did not allocate pipeline revenues in excess of 102% of prior year revenues using Assembly Bill (AB) 8 factors. All pipeline revenues were instead apportioned using unitary factors.
   2. In FY 2006-07 and FY 2007-08, the County did not include the state assessed pipeline in its unitary/pipeline calculations.
   3. In FY 2009-10 and FY 2010-11, the unitary values used in the County's calculations did not match the Board of Equalization unitary roll.
   4. In FY 2010-11, the County did not calculate factors for the qualified electric properties.
   5. In FY 2011-12 and FY 2012-13, the County included qualified electric properties in the unitary/operating nonunitary calculations.
   6. In FY 2006-07 through FY 2012-13, the County included the Educational Revenue Augmentation Fund in the unitary apportionment.

II. Incorrectly calculated the base year unitary railroad factors in FY 2007-08, by combining assessed values by each tax rate area (TRA) primary number, then distributing base year assessed value using factors in the first TRA with the designated primary number.

III. Apportioned unitary railroad revenues using AB 8 factors in FY 2008-09 through FY 2010-11.

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

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/kw

cc: 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
Richard J. Chivaro, Chief Counsel
State Controller's Office
James C. Ramos, Chair
Board of Supervisors, San Bernadino County

Contents

Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by San Bernardino 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:

I. Incorrectly allocated unitary, pipeline, and qualified electric property tax revenues by making the following errors:

   1. In FY 2006-07 through FY 2012-13, the County did not allocate pipeline revenues up to 102% of prior year revenues using prior year factors. The County also did not allocate pipeline revenues in excess of 102% of prior year revenues using Assembly Bill (AB) 8 factors. All pipeline revenues were instead apportioned using unitary factors.

   2. In FY 2006-07 and FY 2007-08, the County did not include the state-assessed pipeline in its unitary/pipeline calculations.

   3. In FY 2009-10 and FY 2010-11, the unitary values used in the County's calculations did not match the Board of Equalization (BOE) unitary roll.

   4. In FY 2010-11, the County did not calculate factors for the qualified electric properties.

   5. In FY 2011-12 and FY 2012-13, the County included qualified electric properties in the unitary/operating nonunitary calculations.

   6. In FY 2006-07 through FY 2012-13, the County included the Educational Revenue Augmentation Fund (ERAF) in the unitary apportionment.

II. Incorrectly calculated the base year unitary railroad factors in FY 2007-08, by combining assessed values by each tax rate area (TRA) primary number, then distributing base year assessed value (AV) using factors in the first TRA with the designated primary number.

III. Apportioned unitary railroad revenues using AB 8 factors in FY 2008-09 through FY 2010-11.

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 AB 8, Chapter 282, Statutes of 1979, which established the method of allocating property taxes for 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 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 BOE.

- *Supplemental Roll*—This roll contains property that has been reassessed due to a change in ownership or the completion of new construction, where the resulting change in assessed value is not reflected in other tax rolls.

To mitigate problems associated with the apportionment and allocation of property taxes, Senate Bill 418 was enacted in 1985 requiring the State Controller to audit the counties' apportionment and allocation methods and report the results to the California State Legislature.

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 TRA reports to verify that the annual tax increment was computed properly.

- Reviewed County unitary and operating nonunitary reports and BOE 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 and County apportionment and allocation reports addressing the Redevelopment Property Tax Trust Fund.

- 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 Bernardino 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

The County has satisfactorily resolved the findings noted in our prior audit report, issued January 2007.

Views of Responsible Officials

We issued a draft audit report on May 30, 2014. Oscar Valdez, Assistant Auditor-Controller/Treasurer/Tax Collector, responded by letter dated September 22, 2014, agreeing with the audit results. The County's response is included in this final audit report as an attachment.

Restricted Use

This report is solely for the information and use of San Bernardino 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 26, 2015

Findings and Recommendations

FINDING 1— Unitary and operating nonunitary, pipeline, and qualified electric apportionment

The County incorrectly allocated unitary, pipeline, and qualified electric property tax revenues by making the following errors:

1. In FY 2006-07 through FY 2012-13, the County did not allocate pipeline revenues up to 102% of prior year revenues using prior year factors. The County also did not allocate pipeline revenues in excess of 102% of prior year revenues using AB 8 factors. All pipeline revenues were instead apportioned using unitary factors.
2. In FY 2006-07 and FY 2007-08, the County did not include the state-assessed pipeline in its unitary/pipeline calculations.
3. In FY 2009-10 and FY 2010-11, the unitary values used in the County's calculations did match the BOE unitary roll.
4. In FY 2010-11, the County did not calculate factors for the qualified electric properties.
5. In FY 2011-12 and FY 2012-13, the County included qualified electric properties in the unitary/operating nonunitary calculations.
6. In FY 2006-07 through FY 2012-13, the County included ERAF in the unitary apportionment.

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

Unitary properties are those properties on which the BOE "may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee" (i.e., public utilities, railroads, or qualified electric properties). The Revenue and Taxation Code further states, "Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee."

In FY 1988-89, the 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.

<u>Recommendation</u>

The County should recalculate the unitary, pipeline, and qualified electric property tax allocation factors beginning with FY 2006-07, correcting all errors noted above, with the exception of including ERAF in the unitary apportionment.

The County should remove ERAF in the FY 2014-15 unitary calculations using the method described in the Accounting Standards and Procedures for Counties, published by the SCO (updated version to be released in April/May 2014).

The County should use these corrected factors in all subsequent unitary calculations and apportionments.

County's Response

> The County concurs with this finding. The County is in the process of recalculating the unitary, pipeline and qualified electric property tax allocation factors beginning with FY 2006-07 addressing all the errors identified above, with exception to ERAF, so the correct factors are reflected on future apportionments. The County will remove ERAF in the unitary calculation commencing in FY14-15.

SCO Comment

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

FINDING 2— Unitary railroad apportionment

In FY 2007-08, the County incorrectly calculated the base year unitary railroad factors. The County combined assessed values by each TRA primary number, then distributed base year AV using factors in the first TRA with the designated primary number.

Furthermore, in FY 2008-09 through FY 2010-11, the County used AB 8 factors to apportion unitary railroad 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 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 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

In FY 2011-12 and FY 2012-13, it appears the County's process for calculating unitary railroad factors was corrected. However, because there were errors in the base year calculations, the County should recalculate the base year factors and all subsequent apportionments correcting the errors noted above. The County should use the corrected calculations in subsequent years.

County's Response

> The County concurs with the finding. The County is in the process of recalculating the railroad base year factors and all subsequent apportionments so the correct factors are reflected on future apportionments.

SCO Comment

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

Attachment— County's Response to Draft Audit Report

AUDITOR-CONTROLLER/
TREASURER/TAX COLLECTOR

COUNTY OF SAN BERNARDINO

☑ 222 West Hospitality Lane, Fourth Floor
San Bernardino, CA 92415-0018 • (909) 387-8322 • Fax (909) 386-8830

☐ 172 West Third Street, First Floor
San Bernardino, CA 92415-0360 • (909) 387-8308 • Fax (909) 387-6716

LARRY WALKER
Auditor-Controller/
Treasurer/Tax Collector

September 22, 2014

Ms. Elizabeth Gonzalez, Chief,
Local Government Compliance Bureau
Division of Audits
State Controller's Office
P.O. Box 942850
Sacramento, CA 94250-5874

Subject: Audit of San Bernardino County Property Tax Apportionment and Allocation System
July 1, 2006 to June 30, 2013

Dear Ms. Gonzalez:

In response to our review of the Property Tax Apportionment and Allocation System draft audit report, please find our responses to the identified findings below:

FINDING 1 – Unitary and operating nonunitary, pipeline, and qualified electric apportionment

County's Response
The County concurs with this finding. The County is in the process of recalculating the unitary, pipeline and qualified electric property tax allocation factors beginning with FY 2006-07 addressing all the errors identified above, with exception to ERAF, so the correct factors are reflected on future apportionments. The County will remove ERAF in the unitary calculation commencing in FY14-15.

FINDING 2 – Unitary railroad apportionment

County's Response
The County concurs with this finding. The County is in the process of recalculating the railroad base year factors and all subsequent apportionments so the correct factors are reflected on future apportionments.

Our office appreciates the Controller's office's consideration of our heavy workload periods and the professionalism displayed by the field auditors. Feel free to call Linda Santillano, Property Tax Manager, at (909) 386-8829 if you have any questions.

Sincerely,

Larry Walker
Auditor-Controller/Treasurer/Tax Collector
San Bernardino County

By:
Oscar Valdez
Assistant Auditor-Controller/Treasurer/Tax Collector

LDW:OV:SH:LS:tr

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

http://www.sco.ca.gov

S14-PTX-002