MARIN COUNTY

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2004, through June 30, 2011

JOHN CHIANG
California State Controller

April 2014

JOHN CHIANG
California State Controller

April 29, 2014

Roy Given
Director of Finance
County of Marin
3501 Civic Center Drive, Room 225
San Rafael, CA 94903

Dear Mr. Given:

The State Controller's Office audited the methods employed by Marin County to apportion and allocate property tax revenues for the period of July 1, 2004, through June 30, 2011. 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:

- Made inappropriate factor adjustments in the completion of jurisdictional changes.
- Included the Educational Revenue Augmentation Fund (ERAF) in the apportionment and allocation of unitary and operating non-unitary property taxes.
- Included Sales and Use Tax (SUT) and Vehicle License Fee (VLF) revenues received by cities in the computation of SB 2557 Administrative Cost share (PTAF) for cities.

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

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/mh

cc: Kathrin Sears, President
Marin 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
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Senate Revenue and Taxation Committee
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Assembly Revenue and Taxation Committee
Neil McCormick, Executive Director
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Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by Marin County to apportion and allocate property tax revenues for the period of July 1, 2004, through June 30, 2011.

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

- Made inappropriate factor adjustments in the completion of jurisdictional changes.
- Included the Educational Revenue Augmentation Fund (ERAF) in the apportionment and allocation of unitary and operating non-unitary property taxes.
- Included Sales and Use Tax (SUT) and Vehicle License Fee (VLF) revenues received by cities in the computation of SB 2557 Administrative Cost share (PTAF) for cities.

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 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 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, 2004, through June 30, 2011 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, Marin County complied with California statutes for the apportionment and allocation of property tax revenues for the period of July 1, 2004, through June 30, 2011. The county should correct the items discussed in the Findings and Recommendations section.

Follow-up on Prior Audit Findings

Our prior audit report, issued October 15, 2005, included no findings related to the apportionment and allocation of property tax revenues by the county.

Views of Responsible Official

We issued a draft audit report on March 20, 2014. Roy Given, Director of Finance, responded by letter dated April 9, 2014 (Attachment). He agreed with the audit results.

Restricted Use

This report is solely for the information and use of Marin 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

April 29, 2014

Findings and Recommendations

FINDING 1— Jurisdictional changes

The county computed new tax rate area (TRA) factors for all entities following jurisdictional changes.

The legal requirements for jurisdictional changes are found in Revenue and Taxation Code section 99. A jurisdictional change involves a change in the organization or boundaries of a local government agency or school district. 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 increased receives additional annual tax increment, and the base property tax revenues are adjusted according to the negotiated agreements.

<u>Recommendation</u>

The county must review and correct all jurisdictional changes to ensure that only entities whose service responsibilities were changed have adjustments to their TRA factors.

<u>County Response</u>

The county agreed with the finding and made the appropriate corrections.

FINDING 2— Unitary and operating nonunitary apportionment

The county included the Educational Revenue Augmentation Fund (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 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 fiscal year 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 ERAF must be removed from the unitary apportionment and allocation and the ERAF revenue base distributed to all appropriate taxing jurisdictions.

County Response

The county agreed with the finding and made the appropriate corrections.

FINDING 3— Property tax administrative costs

The county included the Sales and Tax (SUT) and Vehicle License Fee (VLF) revenues received by cities in the calculation of SB2557 Administrative Cost computations.

Requirements for the reimbursement of county property tax administrative costs are found in Revenue and Taxation Code section 95.3. County property tax administrative costs are incurred by the assessor, the tax collector, the assessment appeals board, and the auditor. The county is allowed, depending on the fiscal year and any corresponding exclusions, to be reimbursed by local agencies and public schools for these administrative costs.

Recommendation

The County must recalculate the administrative costs for all years that included the SUT and/or VLF for cities and reimburse the cities for any amounts charged in excess of the corrected amounts without SUT and VLF.

County Response

The county agreed with the finding and made the appropriate corrections.

Attachment— County's Response to Draft Audit Report

COUNTY OF MARIN
DEPARTMENT OF FINANCE
Excellent and responsive fiscal leadership.

Roy Given, CPA
DIRECTOR

Cristine Alilovich
ASSISTANT DIRECTOR

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April 9, 2014

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

Re: Property Tax Audit (FY 2005-FY 2011)

Dear Ms. Gonzalez:

The following information provides the County of Marin's response to the California State Controller's audit report titled, "Marin County – Property Tax Apportionment and Allocation System".

SCO Finding #1: Made inappropriate tax rate area (TRA) factor adjustments in the completion of jurisdictional changes.

SCO Recommendation: The County must review and correct all jurisdictional changes to ensure that only entities whose service responsibilities were changed have adjustments to their TRA factors. As a result, the nonparticipating agencies revenues are understated every fiscal year thereafter in the resulting TRA.

- County of Marin Response: The County of Marin's property tax system erroneously recalculated its fixed increment factors using the new base revenues. We have determined that this error occurred primarily in the fourth decimal place and only affected jurisdictional changes that created *new* TRAs. The impact on actual jurisdictional tax revenue distribution was deemed to be immaterial based on three factors: 1) the limited number of new TRAs created during the period, 2) the associated value/increment of each jurisdictional change, and 3) the de minimis effect on the TRA increment factors. In January 2012, the County reprogrammed its property tax software system to ensure that increment factors are accurate for those entities, whose service responsibilities are not altered as a result of jurisdictional changes.

SCO Finding #2: Included the Educational Revenue Augmentation Fund (ERAF) in the apportionment and allocation of unitary and operating non-unitary property taxes.

- SCO Recommendation: The County should reallocate the ERAF revenues to all participating taxing entities.

- County of Marin Response: The County has removed ERAF from the Unitary calculation effective as of fiscal year 2013/14. Based on State Controller's directive to the California Counties' Property Tax Managers' sub-committee on 10/28/2013, prior periods are not required to be retroactively recalculated. In addition, the County of Marin is an Excess ERAF County. As such, any additional ERAF contributed to the ERAF fund from the Unitary calculation would be redistributed back to the contributing agencies based on their overall contribution to the ERAF fund as excess ERAF.

SCO Finding #3: Included Sales and Use Tax (SUT) and Vehicle License Fee (VLF) revenues received by cities in the computation of SB2557 Administrative Cost share (PTAF) for cities.

- SCO Recommendation: The County must recalculate the administrative costs for all years that included the SUT and/or VLF for cities and reimburse cities for any amounts charged in excess of the corrected amounts without SUT and VLF.

- County of Marin Response The County recalculated and reimbursed the cities for the administrative costs for fiscal year 2008/09 through fiscal year 2011/12 to exclude Sales and Use Tax (SUT) and Vehicle License Fees (VLF). We corrected the calculation removing the SUT and VLF in our administrative costs calculations for fiscal year 2012/13 and have corrected the calculation moving forward.

Please let me know if you have any additional questions or need further information. We look forward to receiving your final audit report.

Sincerely,

Roy Given

Roy Given, CPA
Director of Finance
County of Marin

cc email: Mr. Scott Freefmeier (freefmeier@sco.ca.gov)

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