MODOC COUNTY

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2004, through June 30, 2012

JOHN CHIANG
California State Controller

April 2014

JOHN CHIANG
California State Controller

April 14, 2014

The Honorable Darcy Locken
Auditor-Recorder
108 East Modoc Street
Alturas, CA 96101

Dear Ms. Locken:

The State Controller's Office audited the methods employed by Modoc County to apportion and allocate property tax revenues for the period of July 1, 2004, through June 30, 2012. The audit was conducted pursuant to the requirements of Government Code section 12468.

Our audit disclosed that the county complied with California statutes, except that it incorrectly computed:

- The secured assessed value in fiscal year (FY) 2006-07, and FY 2008-09 through FY 2011-12.

- Two jurisdictional changes.

- The supplemental apportionment factors in FY 2004-05 through FY 2011-12.

- Unitary, pipeline, and railroad apportionments in FY 2007-08 through FY 2011-12.

- The Vehicle Licensing Fee growth computation for FY 2006-07 through FY 2011-12.

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/kw

cc: Geri Byrne, Chairperson
Modoc County
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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Assembly Revenue and Taxation Committee
Neil McCormick, Executive Director
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Contents

Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by Modoc County to apportion and allocate property tax revenues for the period of July 1, 2004, through June 30, 2012.

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

- The secured assessed value in fiscal year (FY) 2006-07, and FY 2008-09 through FY 2011-12.
- Two jurisdictional changes.
- The supplemental apportionment factors in FY 2004-05 through FY 2011-12.
- Unitary, pipeline, and railroad apportionments in FY 2007-08 through FY 2011-12.
- The Vehicle Licensing Fee growth computation for FY 2006-07 through FY 2011-12.

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 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 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, 2012. 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 disclosed that, except for the items discussed in the Findings and Recommendations section of this report, Modoc County complied with California statutes for the apportionment and allocation of property tax revenues for the period of July 1, 2004, through June 30, 2012. The county should correct the items discussed in the Findings and Recommendations section.

Follow-up on Prior Audit Findings

Findings noted in our prior audit, issued September 2005, have been satisfactorily resolved by the county, except that the county continues to exclude the state-assessed local utility roll from the increment calculations.

Views of Responsible Official

We issued a draft audit report on February 7, 2014. Darcy Locken, Auditor/Clerk/Recorder, responded by letter dated April 9, 2014 (Attachment).

Restricted Use

This report is solely for the information and use of Modoc 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 14, 2014

Findings and Recommendations

FINDING 1— Calculation and distribution of ATI

The county's secured assessed value does not include the local utility value in fiscal year (FY) 2006-07, and FY 2008-09 through FY 2011-12.

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 tax rate areas (TRA) 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 should include local utility assessed value with the secured value.

FINDING 2— Jurisdictional changes

The county included the Cedarville Water District annexation in the FY 2011-12 AB-8 allocation prior to authorization. The State Board of Equalization (BOE) change notice stated the change was to be implemented in FY 2013-14.

In addition, the county did not implement a jurisdictional change for adding Last Frontier Healthcare District to its AB-8 calculations in FY 2011-12.

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 assessed value changes for the Cedarville Water District were made only to the districts that were addressed in the exchange agreement. Even though this exchange was completed early, there will be no material impact to any districts addressed by the exchange.

Additionally, the county should add the Last Frontier Healthcare District to its AB-8 calculations as directed by the BOE. The county should develop controls to ensure that directives from the BOE are implemented in a timely manner.

FINDING 3— Supplemental property tax

In verifying the supplemental property tax allocations, we noted that prior to FY 2011-12 the county did not adjust AB-8 factors for Average Daily Attendance (ADA) revenue.

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 use AB-8 factors adjusted for ADA in the allocation of supplemental property tax revenue.

FINDING 4— Unitary, operating nonunitary, pipeline, and railroad apportionments

The county apportioned pipeline property tax revenues in FY 2010-11 and FY 2011-12 using AB-8 factors.

In the apportionment of unitary property taxes, the county made the following computations:

- In FY 2011-12, the county used AB-8 factors instead of unitary factors.
- In FY 2004-05 through FY 2011-12, the county included ERAF.
- In FY 2007-08 through FY 2011-12, the county included Railroad Property Taxes.

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

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

In FY 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The Legislature established the unitary and operating nonunitary base year and developed formulas to compute the distribution factors for the fiscal years that followed.

Recommendation

During fieldwork, the county corrected the findings by recomputing the pipeline, unitary, and railroad property tax apportionments. In subsequent years, the county should allocate unitary, pipeline, and railroad property tax revenues in accordance with Revenue and Taxation Code 100.

County Response

2. On page 8, under Recommendation for Finding 4, the report states: "The county should transfer funds to correct any mis-allocated amounts." The first paragraph on page 7 (under finding 4) refers to the inclusion of ERAF in the pipeline allocation, and the second bullet item on page 7 refers to the removal of ERAF from the unitary. These were not mis-allocations as stated in the recommendation section. It's up to the County to determine whether the SCO's recent opinion will be applied to years before 2012/13. Please specify this in the recommendation section, or clarify on page 7 that the inclusion of ERAF was not a mis-allocation.

SCO's Comment

The finding and recommendation has been modified to reflect the county's concern, noting that the ERAF was included.

FINDING 5— Educational Revenue Augmentation Fund

The county incorrectly calculated Vehicle Licensing Fee (VLF) for FY 2006-07 through FY 2011-12, and could not substantiate the assessed values used in the growth computations for FY 2006-07 through FY 2009-10.

Requirements for the local agency shift of property tax revenues to the ERAF are primarily found in Revenue and Taxation Code sections 97.1 through 97.3. Beginning in FY 1992-93, most local agencies were 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 determined by adding a per capita amount to a percentage of property tax revenues received by each city. The amount for counties was 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 should recompute the VLF adjustment for FY 2006-07 through FY 2011-12, using the correct assessed values, and adjust any misapportioned property tax revenues.

During the SCO review in FY 2006 and FY 2009, we noted several errors in the Sales and Use Tax and VLF computations and apportionments. The county made correcting adjustments during the audits. Therefore, any reapportionments required by the current audit are limited to FY 2010-11 and FY 2011-12.

The County and SCO recalculated VLF in the current audit and found an under allocation of $65,694 to the county and $15,225 to the City of Alturas, pertaining to FY 2010-11 and FY 2011-12.

Attachment— County's Response to Draft Audit Report

COUNTY OF MODOC

Auditor/Clerk/Recorder
108 E. Modoc Street
ALTURAS, CALIFORNIA 96101

(530) 233-6204 Office
(530) 233-6666 Fax

DARCY LOCKEN
Auditor, Clerk, Recorder & Registrar of Voters

April 9, 2014

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

Re: Draft Audit Report, Property Tax Apportionment and Allocation System

Dear Ms. Gonzalez:

I am in receipt of the above-referenced audit report and have the following questions/concerns:

1. On page 8, under Recommendation for Finding 4, the report states: "The county should transfer funds to correct any mis-allocated amounts." The first paragraph on page 7 (under finding 4) refers to the inclusion of ERAF in the pipeline allocation, and the second bullet item on page 7 refers to the removal of ERAF from the unitary. These were not mis-allocations as stated in the recommendation section. It's up to the County to determine whether the SCO's recent opinion will be applied to years before 2012/13. Please specify this in the recommendation section, or clarify on page 7 that the inclusion of ERAF was not a mis-allocation.
2. On page 10, Finding 5, the values owed to the County and City are $65,694 and $15,225, respectively. I've provided my revised calculations to SCO staff.

If you have any questions please do not hesitate to contact me at the phone number above, or by using my direct line at (530) 233-6207. I can also be reached by email at darcylocken@co.modoc.ca.us.

Sincerely,

Darcy Locken

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http://www.sco.ca.gov