HUMBOLDT COUNTY

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2008, through June 30, 2015

BETTY T. YEE

California State Controller

May 2016

BETTY T. YEE
California State Controller

May 3, 2016

Joseph Mellett, Auditor-Controller
Humboldt County
825 5th Street, Room 126
Eureka, CA 95501

Dear Mr. Mellett:

The State Controller's Office (SCO) audited the methods employed by Humboldt County to apportion and allocate property tax revenues for the period of July 1, 2008, through June 30, 2015. 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:

- Incorrectly computed the annual tax increment amount used in AB 8 factor calculations for fiscal year (FY) 2010-11, FY 2011-12, and FY 2012-13.
- Used incorrect assessed values when calculating the vehicle license fee growth.
- Did not apportion unitary revenue in-excess of 102% to redevelopment agencies.
- Did not document actual supplemental administrative costs.

Additionally, we made the following observation:

In May 2015, a court case between the cities of Chula Vista, El Cajon, Escondido, Poway, San Diego, San Marcos, and Vista versus the County of San Diego challenged the methodology for apportioning the residual balance from the redevelopment property tax trust fund. Therefore, the SCO cannot make a determination on the county's methodology at this time. We will follow up on this issue in the subsequent audit.

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

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/rg

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Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by Humboldt County to apportion and allocate property tax revenues for the period of July 1, 2008, through June 30, 2015.

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

- Incorrectly computed the annual tax increment amount used in AB 8 factor calculations for fiscal year (FY) 2010-11, FY 2011-12, and FY 2012-13.
- Used incorrect assessed values when calculating the vehicle license fee growth.
- Did not apportion unitary revenue in-excess of 102% to redevelopment agencies.
- Did not document actual supplemental administrative costs.

Additionally, we made the following observation:

In May 2015, a court case between the cities of Chula Vista, El Cajon, Escondido, Poway, San Diego, San Marcos, and Vista versus the County of San Diego challenged the methodology for apportioning the residual balance from the redevelopment property tax trust fund. Therefore, the SCO cannot make a determination on the county's methodology at this time. We will follow up on this issue in the subsequent audit.

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 successor agency Recognized Obligation Payment Schedules (ROPS) and county apportionment and allocation reports addressing the Redevelopment Property Tax Trust fund (RPTTF).
- 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 Sales and Use Tax (SUT) and Vehicle Licensing Fee (VLF) reports and computations used to verify the amount of ERAF transferred to counties and cities to compensate for the diversion of these revenues.

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, 2008, through June 30, 2015. 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.
- 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, Humboldt County complied with California statutes for the apportionment and allocation of property tax revenues for the period of July 1, 2008, through June 30, 2015. The county should correct the items discussed in the Findings and Recommendations section.

Additionally, we made an observation related to the redevelopment property tax trust fund.

Follow-up on Prior Audit Findings

The county has satisfactorily resolved the findings noted in our prior audit report, issued June 30, 2010.

Views of Responsible Officials

We issued a draft audit report on February 17, 2016. Joseph Mellett, CPA, Auditor-Controller, responded by letter dated March 14, 2016 (Attachment). He agreed with the audit results.

Restricted Use

This report is solely for the information and use of Humboldt 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

May 3, 2016

Findings and Recommendations

FINDING 1— Calculation and distribution of annual tax increment

In fiscal year (FY) 2010-11, FY 2011-12, and FY 2012-13, the county's Annual Tax Increment (ATI) calculation was incorrect.

Requirements for the apportionment and allocation of the 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 ATI 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 manually calculate the ATI and reconcile with the county's property tax system (Megabyte) report to ensure accuracy.

<u>County's Response</u>

The county agreed with the finding.

FINDING 2— Supplemental property tax – administrative costs

In reviewing the county's Supplemental Tax Administrative Fee, we noted that the county does not document actual supplemental administrative costs as required by statute.

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.

<u>Recommendation</u>

The county should implement a system to assist in documenting actual costs for administration of supplemental tax allocation and apportionment.

<u>County's Response</u>

The county agreed with the finding, and will take reasonable measures to reliably capture and document supplemental administrative costs beginning fiscal year 2016-2017.

<u>SCO's Comment</u>

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

FINDING 3—
Unitary apportionment

In reviewing the county's unitary apportionment, we noted that the redevelopment agencies (RDAs) did not receive a portion of the unitary in-excess of 102% revenue.

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.

<u>Recommendation</u>

The county should recalculate its unitary apportionment by creating an AB 8 factor adjusted for RDAs to use in apportioning their unitary excess calculation beginning FY 2015-16. The county should recalculate to arrive at corrected values to be carried forward for future years.

<u>County's Response</u>

The county agreed with the finding and changed its methodology for FY 2015-2016 and for future fiscal years until the dissolution process is complete.

<u>SCO's Comment</u>

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

FINDING 4—
Vehicle licensing fee and Sales and Use Tax adjustments

In reviewing the county's vehicle licensing fee (VLF) growth calculation for FY 2011-12, we determined that the county used incorrect prior year (FY 2010-11) assessed value for the county's portion. Therefore, the county's portion of VLF was underpaid for FY 2011-2012 and forward.

Requirements for the Educational Revenue Augmentation Fund (ERAF) adjustment for the VLF and Sales and Use Tax (SUT) are found in Revenue and Taxation Code sections 97.68-97.70.

In FY 2004-05, the county was given a VLF estimate that was to be transferred from the ERAF to the VLF Property Tax Compensation Fund, and eventually to the county and cities. In FY 2005-06, the county was given another estimate, including true-ups. In FY 2006-07 and subsequent years, the county calculated the VLF adjustment based on the prior-year VLF adjusted for growth. The growth for the county's VLF should be based on countywide growth, not only on unincorporated parcels. The growth for each city's VLF should be based on the growth of all incorporated parcels in all Tax Rate Areas within the city.

The SUT amounts for each county and cities within the county are provided by the Department of Finance, on or before September 1 of each fiscal year. These amounts are to be transferred from the ERAF to the SUT Compensation Fund, and eventually to each designated county and cities within each county.

Recommendation

The county should recalculate its VLF growth beginning FY 2011-12. Should the recalculation have a significant impact, the county is to appropriately make necessary monetary adjustments to ERAF and other affected taxing jurisdictions.

County's Response

The county agreed with the finding and recalculated the VLF and booked a correction for $22,716. The corrected VLF amount will be used for all future calculations.

SCO's Comment

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

Observation

OBSERVATION—Redevelopment Property Tax Trust Fund

In May 2015, a recent court case between the cities of Chula Vista, El Cajon, Escondido, Poway, San Diego, San Marcos, and Vista versus the County of San Diego challenged the methodology in apportioning the residual balance from the redevelopment property tax trust fund. Therefore, the State Controller's Office cannot make a determination on the county's methodology at this time. We will follow up on this issue in the subsequent audit.

Attachment—
County's Response to Draft Audit Report

AUDITOR-CONTROLLER
COUNTY OF HUMBOLDT
825 FIFTH STREET, ROOM 126
EUREKA, CALIFORNIA 95501
PHONE (707) 476-2452

March 14, 2016

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

Dear Ms. Gonzalez,

The following are the County of Humboldt's responses to the findings of our recent property tax audit:

Finding 1 – Calculation and distribution of annual tax increment

County Response – The County agrees with the finding.

Our computerized property tax system is in essence an enormous database, with some 77,000 secured parcels and hundreds of attributes (tax codes) that could potentially be linked to those parcels. Each year during the tax year rollover every data element in the database is refreshed for the new tax year, and the possibility of erroneous linkages forming in the database does exist. To compound the risk of having data errors that go undetected, the County of Humboldt has historically had only one person in the organization reviewing the integrity of the new tax year setup - the Auditor-Controller. This has been a matter of staffing rather than organizational design. No matter how skilled and diligent that person is, it is impossible for a single reviewer to be provide complete assurance that every error in such a complex system has been identified and corrected.

As the Controller's finding notes, there were errors in the increment calculations in 2010-11, 2011-12 and 2012-13. The dollar value of any potential impacts on taxing agencies has not been estimated but is considered likely to be minimal if they exist at all. These errors have not reoccurred since that period. It is likely that the software has improved due to the continual updates provided by the software vendor, and also the sole reviewer of the tax system output has improved his knowledge and methods for detecting and preventing such errors.

The Auditor-Controller's office has received an ongoing budget allocation for a new Senior Accountant who will concentrate on property taxation beginning with the 2015-16 fiscal year. This position will provide the department with a second reviewer for the tax system and should strengthen the integrity of our tax processes.

Finding 2 – Supplemental property tax administrative costs

County Response – The County agrees with the finding.

The County of Humboldt has not been specifically tracking staff time spent on administration of the supplemental rolls. In past years it was estimated that the costs incurred in administering the supplemental tax rolls far exceeded the five percent administrative fee received by the County general fund. In fiscal year 2014-15 the County received $92,678.64 in supplemental administration fees. That amount would not cover the salary and benefits of one upper-level employee in the Assessor's office, and given that much of the activity of the Assessor's office (outside of their main lien date work and audits) involves transactions on the supplemental rolls, it seems unlikely that any accurate time study would show that the County's costs in that office alone did not greatly exceed supplemental administrative revenues. Given that the Auditor-Controller and Treasurer-Tax Collector also have significant costs in calculating and billing the supplemental rolls, it has long been assumed that further support justifying that revenue was unnecessary.

As the Controller's finding notes however, Revenue and Taxation Code Section 75.60 states that counties can be reimbursed only for "actual administrative costs" as defined below:

(1) "Actual administrative costs" includes only those direct costs for administration, data processing, collection, and appeal that are incurred by county auditors, assessors, and tax collectors. "Actual administrative costs" also includes those indirect costs for administration, data processing, collections, and appeal that are incurred by county auditors, assessors, and tax collectors and are allowed by state and federal audit standards pursuant to the A-87 Cost Allocation Program.

We have for years been fully confident that we were spending more to administer the supplemental tax program than we received in administrative fee revenue, however the

County has not performed actual time studies to verify that. The Assessor, Auditor-Controller and Treasurer-Tax Collector shall take reasonable measures to reliably capture and document this cost information beginning with the 2016-17 fiscal year.

Finding 3 – Unitary apportionment

County Response – the County agrees with the finding.

We have changed our methodology for allocating $1.00 rate unitary revenues to give the dissolved redevelopment agencies and their successor agencies their share of the unitary revenue in excess of 102% growth for the 2015-16 fiscal year and for future fiscal years until the dissolution process is complete.

Finding 4 – Vehicle license fee and Sales and Use tax adjustments

County Response – the County agrees with the finding.

This finding relates to the database issues discussed in Finding 1 – some data links were compromised in the tax year setup for 2010-11 causing a slightly lower figure to be used in calculating the County's share of the VLF shift. That lower figure skewed the calculations going forward through 2015-16. The only agencies affected were the County general fund and the State of California through the VLF shift, with a small annual advantage going to the State's share. We have recalculated those years and booked a correction for $22,716 that recoups the County's losses over that period. The calculations are now correct for future years.

In conclusion, we would like to thank your office for these audit services, and we commend your pleasant and professional staff.

Sincerely,

M. J. Mellett

Joseph Mellett, CPA
Auditor-Controller

State Controller's Office
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http://www.sco.ca.gov