CITY AND COUNTY OF SAN FRANCISCO

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2012, through June 30, 2016

BETTY T. YEE
California State Controller

May 2017
May 23, 2017

The Honorable Ben Rosenfield, Controller
City and County of San Francisco
City Hall, Room 316
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Dear Mr. Rosenfield:

The State Controller’s Office audited the methods employed by the City and County of San Francisco (county) to apportion and allocate property tax revenues for the period of July 1, 2012, through June 30, 2016. 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:

- Unitary and operating nonunitary apportionment factors;
- Regulated railway apportionment factors; and
- Vehicle Licensing Fee revenue adjustment.

Additionally, we made the following observations:

**Qualified Electric Property Tax Revenue Allocation**

We are unable to make a determination on the qualified electric property tax revenue allocation due to differences of interpretation as to whether the Educational Revenue Augmentation Fund is entitled to a portion of the revenue. Therefore, we will follow up on this issue in the subsequent audit.

**Redevelopment Property Tax Trust Fund**

We are unable to make a determination on the county’s methodology for apportioning the residual balance from the Redevelopment Property Tax Trust Fund because of a pending appellate court decision, as described in the Observations section of this report. Therefore, we will follow up on this issue in the subsequent audit.
If you have any questions, please contact Elizabeth González, Bureau Chief, by telephone at (916) 324-0622.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA  
Chief, Division of Audits

JVB/rg

Attachment

cc: James Whitaker, Property Tax Manager  
City and County of San Francisco
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Summary

The State Controller’s Office (SCO) audited the methods employed by the City and County of San Francisco (county) to apportion and allocate property tax revenues for the period of July 1, 2012, through June 30, 2016.

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

- Unitary and operating nonunitary apportionment factors;
- Regulated railway apportionment factors; and
- Vehicle Licensing Fee (VLF) revenue adjustment.

Additionally, we made the following observations:

Qualified Electric Property Tax Revenue Allocation

We are unable to make a determination on the qualified electric (QE) property tax revenue allocation due to differences of interpretation as to whether the Educational Revenue Augmentation Fund (ERAF) is entitled to a portion of the revenue. Therefore, we will follow up on this issue in the subsequent audit.

Redevelopment Property Tax Trust Fund

We are unable to make a determination on the county’s methodology for apportioning the residual balance from the Redevelopment Property Tax Trust Fund (RPTTF) because of a pending appellate court decision, as described in the Observations section of this report. Therefore, 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 apportioning and allocating 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 California State Legislature.

One key law was Assembly Bill 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 involves numerous steps, including the transfer of revenues from schools to local agencies (AB 8 shift) and the development of the tax rate area (TRA) annual tax increment (ATI) apportionment 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 apportionment 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 apportionment factors.

Subsequent legislation removed from the AB 8 process revenues generated by unitary and nonunitary properties, regulated railway companies, and qualified electric properties. These revenues are now apportioned and allocated under separate processes.

Other legislation established 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, regulated railway, and qualified electric properties assessed as either unitary or nonunitary property by the Board of Equalization (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.
Objectives, Scope, and Methodology

Our audit objective was to determine whether the county complied with Revenue and Taxation Code requirements pertaining to the apportionment and allocation of property taxes. The audit covered the period of July 1, 2012, through June 30, 2016.

To meet our objective, we performed the following procedures:

- Interviewed key personnel to gain an understanding of the county’s property tax apportionment and allocation processes;
- Reviewed the county’s written procedures for apportioning and allocating property tax revenues;
- Performed a walkthrough to validate the county’s procedures;
- Performed analytical reviews to assess the reasonableness of property tax revenues; and
- Judgmentally sampled five taxing jurisdictions within the county (errors found will not be projected to the population) and:
  - Recomputed apportionment and allocation reports to verify computations used to develop property tax distribution factors;
  - Tested TRA reports to verify that the correct TRA factors are used in the computation of the ATI;
  - Verified computations used to develop unitary and operating nonunitary tax distribution factors;
  - Recomputed unitary and operating nonunitary reports and BOE reports, and verified computations used to develop unitary and operating nonunitary distribution factors;
  - Reviewed redevelopment agency (RDA) reports and verified computations used to develop the project base amount and the tax increment distributed to the RDA;
  - Reviewed Successor Agency Recognized Obligation Payment Schedules and apportionment and allocation reports addressing the RPTTF;
  - Reviewed ERAF reports and verified computations used to determine the shift of property taxes from local agencies to ERAF and, subsequently, to public schools; and
  - Reviewed Sales and Use Tax (SUT) and 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 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.
Our review of the county’s internal controls was limited 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 relevant to the apportionment and allocation of property taxes. We did not audit the county’s financial statements.

This audit was conducted under the authority of Government Code section 12410 and section 12468, which requires the SCO to audit the apportionment and allocation of property taxes. 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 service 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.

Conclusion

Our audit found that, except for the items discussed in the Findings and Recommendations section of this report, the City and County of San Francisco complied with California statutes for the apportionment and allocation of property tax revenues for the period of July 1, 2012, through June 30, 2016. The county should correct the items discussed in the Findings and Recommendations section.

Additionally, we made observations related to the QE property tax revenue allocation and the RPTTF, as discussed in the Observations section of this report.

Follow-up on Prior Audit Findings

The county has satisfactorily resolved the findings noted in our prior audit report, issued April 29, 2014.

Views of Responsible Officials

We issued a draft audit report on April 25, 2017. Ben Rosenfield, Controller, responded by letter dated May 9, 2017, agreeing with the audit results. The response is included as an attachment to this report.

Restricted Use

This report is solely for the information and use of the City and County of San Francisco, the California State 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 final report, which is a matter of public record and is available on the SCO website at www.sco.ca.gov.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

May 23, 2017
Findings and Recommendations

FINDING 1—Unitary and operating nonunitary apportionment

The county made the following errors in its computation of unitary and operating nonunitary apportionment factors:

- In FY 2012-13, the county did not use the calculated factors for revenue apportionment.
- In FY 2012-13 through 2015-16, the county used incorrect excess allocation factors.
- In FY 2015-16, the county used the incorrect unitary and pipeline assessed value and excess 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 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 California State Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The California State 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 county should correct the errors and use the corrected unitary apportionment factors going forward.

County’s Response

The County agrees with this finding. For FY 2016-17, the County corrected the above errors and will use the corrected unitary and operating nonunitary apportionment factors going forward.

SCO Comment

The SCO will review the implementation of the corrections in the next audit.
FINDING 2—
Regulated railway apportionment

The county made the following errors in its computation of regulated railway apportionments factors:

- In FY 2012-13, 2014-15, and 2015-16, the county used incorrect excess allocation factors.
- In FY 2014-15 and 2015-16, the county used incorrect computed revenue.

The process for apportioning and allocating property taxes from certain regulated railway companies functions through the unitary railway tax system employed by BOE. Unitary railway properties are defined in Revenue and Taxation Code section 723. Revenue and Taxation Code section 100.11 prescribes the procedures counties must perform to allocate unitary railway property taxes beginning in FY 2007-08.

Recommendation

The county should correct the errors and use the corrected regulated railway apportionment factors going forward.

County’s Response

The County agrees with this finding. For FY 2016-17, the County corrected the above errors and will use the corrected unitary railroad apportionment factors going forward.

SCO Comment

The SCO will review the implementation of the corrections in the next audit.

FINDING 3—
Vehicle Licensing Fee and Sales and Use Tax adjustments

The county incorrectly calculated and distributed the VLF revenue adjustment to the General Fund from ERAF. The error caused a misallocation to the General Fund in the amount of $3,197,686.

Requirements for the ERAF adjustment for the VLF and 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 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 on unincorporated parcels only. The growth for each city’s VLF should be based on the growth of all incorporated parcels in all TRAs within the city.

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

The county computed the corrections during the audit and should implement them going forward. We will review the corrections in the next audit.

County’s Response

The County agrees with this finding. The City and County's Property Tax Unit will more carefully review the VLF revenue adjustment calculation to avoid a similar error in the future. During the audit, the County computed the corrected values and provided the SCO with FY 2016-17 accounting journal entries to reflect the $3,197,686 adjustment to the Educational Revenue Augmentation Fund (ERAF). The County will use the corrected VLF amounts going forward.
Observations

OBSERVATION 1—Qualified Electric Property Tax Revenue Allocation

In FY 2007-2008 the California State Legislature enacted a new type of property tax for QE property. The SCO and the California State Association of County Auditors, Property Tax Managers’ Sub-Committee (Sub-Committee) is currently discussing the interpretation of Revenue and Taxation Code section 100.95, which governs the tax revenue allocation for QE property.

There is a difference of interpretation as to whether the ERAF is entitled to a portion of the QE property tax revenue. The Sub-Committee contends that if QE property tax revenue is allocated to ERAF, the State is essentially in violation of Proposition 1A. However, the SCO believes that ERAF should be entitled to QE property tax revenue pursuant to the Revenue and Taxation Code section 100.95 (a)(3)(A)(i).

Revenue and Taxation Code section 100.95 (a)(3)(A)(i) states:

School entities, as defined in subdivision (f) of Section 95, shall be allocated an amount equivalent to the same percentage the school entities received in the prior fiscal year from the property tax revenues paid by the utility in the county in which the qualified property is located.

Revenue and Taxation Code section 95 (f) states:

“School entities” means school districts, community college districts, the Educational Revenue Augmentation Fund, and county superintendents of schools.

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.

OBSERVATION 2—Redevelopment Property Tax Trust Fund

On May 26, 2015, the Sacramento County Superior Court ruled in the case between the cities of Chula Vista, El Cajon, Escondido, Poway, San Diego, San Marcos, and Vista (petitioners) and the San Diego County Auditor-Controller (respondent) regarding the methodology in apportioning the residual balance from the RPTTF.

The Court stated, in part:

(1) that a cap on the residual amount each entity can receive be imposed in an amount proportionate to its share of property tax revenue in the tax area; and (2) the calculation of the residual share an entity is entitled to receive must be done by considering the property tax available in the Redevelopment Property Tax Trust Fund after deducting only the amount of any distributions under paragraphs (2) and (3) of subdivision (a) of Section 34183.

The SCO is currently assessing the impact the ruling has on the county’s methodology. On September 17, 2015, the respondent appealed the ruling to the Court of Appeal of the State of California. As the appellate court has not decided on the case, we will follow up on this issue in the subsequent audit.
Schedule 1—
Summary of Misallocations to the
Educational Revenue Augmentation Fund
July 1, 2012, through June 30, 2016

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<th>Years Affected</th>
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<td>FY 2012/13 - 2015/16</td>
<td>$3,197,686</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>$3,197,686</td>
</tr>
</tbody>
</table>
Attachment—
County’s Response to
Draft Audit Report
May 9, 2017

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

Dear Ms. González,

We have reviewed the State Controller’s Office’s (SCO’s) draft audit report on the City and County of San Francisco’s (County’s) property tax apportionment and allocation system for the period of July 1, 2012 through June 30, 2016 for the purposes of determining the County’s compliance with the California Revenue and Taxation (R&T) Code and applicable rules and regulations.

Below are our comments regarding SCO’s audit findings:

Finding 1:
- The County made the following errors in its computation of unitary and operating nonunitary apportionment factors:
  - In FY 2012-13, did not use the calculated factors for revenue apportionment.
  - In FY 2012-13 through 2015-16, used incorrect excess allocation factors.
  - In FY 2015-16, overestimated the unitary and pipeline assessed value and excess revenue.

Response: The County agrees with this finding. For FY 2016-17, the County corrected the above errors and will use the corrected unitary and operating nonunitary apportionment factors going forward.

Finding 2:
- The County made the following errors in its computation of unitary railroad apportionment factors:
  - In FY 2014-15 and 2015-16, used incorrect computed revenue.

Response: The County agrees with this finding. For FY 2016-17, the County corrected the above errors and will use the corrected unitary railroad apportionment factors going forward.
Finding 3:

- The County incorrectly calculated and distributed the VLF revenue adjustment to the General Fund from the ERAF. The error caused a misallocation to the General Fund in the amount of $3,197,686.

Response: The County agrees with this finding. The City and County’s Property Tax Unit will more carefully review the VLF revenue adjustment calculation to avoid a similar error in the future. During the audit, the County computed the corrected values and provided the SCO with FY 2016-17 accounting journal entries to reflect the $3,197,686 adjustment to the Educational Revenue Augmentation Fund (ERAF). The County will use the corrected VLF amounts going forward.

We appreciate the State Controller’s Office’s assistance during this audit. Please let us know if you have any questions.

Sincerely,

[Signature]

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

http://www.sco.ca.gov