

# **SANTA CRUZ COUNTY**

Final Audit Report

## **PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM**

*July 1, 2001, through June 30, 2006*



**JOHN CHIANG**  
California State Controller

July 2008



**JOHN CHIANG**  
**California State Controller**

July 1, 2008

The Honorable Mary Jo Walker  
Auditor-Controller  
Santa Cruz County  
P.O. Box 1804  
Santa Cruz, CA 95061

Dear Ms. Walker:

The State Controller's Office audited the methods employed by Santa Cruz County to apportion and allocate property tax revenues for the period of July 1, 2001, through June 30, 2006. The audit was conducted pursuant to the requirements of Government Code section 12468.

Except for the effects, if any, of the matter discussed below, our audit disclosed that the county complied with California statutes for the allocation and apportionment of property tax revenues for the period audited.

In the past, SCO auditors have accepted the County's Tax Equity Allocation (TEA) formula computation. However, the legal challenge in your county has raised the possibility that it may not be in compliance with the Revenue and Taxation Code. At this time, this finding does not warrant a reportable condition, but is only an observation until the legal issues are resolved. After all legal challenges are resolved, this process will be reviewed again to determine if any adjustments or corrections are warranted and the report will be modified accordingly.

It is our understanding that Special Counsel for the County has demanded a Final Audit Report. Therefore, we are issuing this report without the normal draft process and comment period.

The county has disputed certain facts related to the conclusions and recommendations contained in this audit report. The State Controller's Office has an informal audit review process to resolve a dispute of facts. To request a review, the county should submit, in writing, a request for a review and all information pertinent to the disputed issues within 60 days after receiving the final report. The request and supporting documents should be submitted to Richard J. Chivaro, Chief Counsel, State Controller's Office, Post Office Box 942850, Sacramento, CA 94250-0001. In addition, please provide a copy of the request letter to Steven Mar, Chief, Local Government Audits Bureau, State Controller's Office, Division of Audits, Post Office Box 942850, Sacramento, CA 95250-5874.

If you have any questions, please contact Steven Mar, Chief, Local Government Audits Bureau, at (916) 324-7226.

Sincerely,

*Original signed by*

**JEFFREY V. BROWNFIELD**  
Chief, Division of Audits

JVB/vb

cc: Peggy Collins, Chief Consultant  
    Joint Legislative Budget Committee  
Peter Detwiler, Consultant  
    Senate Local Government Committee  
Elvia Dias, Assistant  
    Senate Local Government Committee  
Dixie Martineau-Petty, Secretary  
    Assembly Local Government Committee  
Martin Helmke, Consultant  
    Senate Revenue and Taxation Committee  
Kimberly Bott, Chief Consultant  
    Assembly Revenue and Taxation Committee  
David Botelho, Chief  
    Office of State Audits and Evaluations  
    Department of Finance  
Catherine Smith, Executive Director  
    California Special Districts Association  
Richard J. Chivaro, Chief Counsel  
    State Controller's Office

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# Audit Report

## Summary

The State Controller's Office (SCO) audited the methods employed by Santa Cruz County to apportion and allocate property tax revenues for the period of July 1, 2001, through June 30, 2006.

Except for the effects, if any, of the matter discussed below, our audit disclosed that the county complied with California statutes for the allocation and apportionment of property tax revenues for the period audited.

**Tax Equity Allocation (TEA):** In the past, SCO auditors have accepted the county's TEA formula computation. However, the legal challenge in the county has raised the possibility that it may not be in compliance with the Revenue and Taxation Code. At this time, this finding does not warrant a reportable condition, but is only an observation until the legal issues are resolved. After all legal challenges are resolved, this process will be reviewed again to determine if any adjustments or corrections are warranted and the report will be modified accordingly.

## 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 8, 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 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 operating nonunitary property from the AB 8 system. This revenue is now allocated and apportioned under a separate system.

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 and railroad 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, legislation (SB 418) was enacted in 1985 that requires 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 systems for apportioning and allocating property tax revenues used by the county auditor and the subsystems used by the tax collector and the assessor.

We performed the following procedures.

- Performed 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.
- 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 performed our audit according to *Government Auditing Standards*, issued by the Comptroller General of the United States. The audit covered the period of July 1, 2001, through June 30, 2006. However, we did not audit the county's financial statements. 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.

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**

Except for the effects, if any, of the matter discussed below, our audit disclosed that the county complied with California statutes for the allocation and apportionment of property tax revenues for the period audited.

Tax Equity Allocation (TEA): In the past, SCO auditors have accepted the County's TEA formula computation. However, the legal challenge in the County has raised the possibility that it may not be in compliance with the Revenue and Taxation Code. At this time, this finding does not warrant a reportable condition, but is only an observation until the legal issues are resolved. After all legal challenges are resolved, this process will be reviewed again to determine if any adjustments or corrections are warranted and the report will be modified accordingly.

## **Follow-up on Prior Audit Findings**

Our prior audit report, issued May 2002, included no findings related to the apportionment and allocation of property tax revenues by the county.

## **Views of Responsible Officials**

At an exit conference held on December 28, 2006, we discussed the audit results with Mary Jo Walker, Auditor-Controller, Santa Cruz County, and Kathleen Hammons, Tax Manager, Santa Cruz County. Subsequent to that meeting, it is our understanding that Special Counsel for the County demanded a Final Audit Report. Therefore, we are issuing this report without the normal draft process and comment period.

## **Restricted Use**

This report is solely for the information and use of Santa Cruz 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  
Chief, Division of Audits

July 1, 2008

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

**<http://www.sco.ca.gov>**