SAN JOAQUIN COUNTY

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2010, through June 30, 2015

BETTY T. YEE
California State Controller

July 2016

BETTY T. YEE
California State Controller

July 8, 2016

The Honorable Jerome Wilverding
Auditor-Controller
San Joaquin County
44 North San Joaquin Street, Suite 550
Stockton, CA 95202

Dear Mr. Wilverding:

The State Controller's Office (SCO) audited the methods employed by San Joaquin County to apportion and allocate property tax revenues for the period of July 1, 2010, 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/implemented jurisdictional changes in fiscal year (FY) 2011-12 through FY 2014-15
- Incorrectly computed the vehicle license fee growth in FY 2010-11 through FY 2014-15

However, the county corrected the errors above during the audit.

Additionally, we made the following observation: 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 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, Compliance Audits Bureau at (916) 324-0622.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/rg

Attachment

cc: Sandra Chan, Chief Deputy Auditor-Controller
San Joaquin County

Contents

Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by San Joaquin County to apportion and allocate property tax revenues for the period of July 1, 2010, 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/implemented jurisdictional changes in fiscal year (FY) 2011-12 through FY 2014-15
- Incorrectly computed the vehicle license fee growth in FY 2010-11 through FY 2014-15

However, the county corrected the errors above during the audit.

Additionally, we made the following observation: 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 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 California State 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.

Objectives, 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.
- 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 License 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, 2010, 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; 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, San Joaquin County complied with California statutes for the apportionment and allocation of property tax revenues for the period of July 1, 2010, through June 30, 2015.

Additionally, we made the following observation: 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 SCO cannot make a determination on the county's methodology at this time. We will follow up on this issue in the subsequent audit.

Follow-up on Prior Audit Findings

The county has satisfactorily resolved the findings noted in our prior audit report, issued July 13, 2011.

Views of Responsible Officials

We issued a draft audit report on April 27, 2016. Jerome C. Wilverding, Auditor-Controller, responded by letter dated May 4, 2016 (Attachment). He agreed with the audit results.

Restricted Use

This report is solely for the information and use of the San Joaquin County, 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 report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

July 8, 2016

Findings and Recommendations

FINDING 1— Jurisdictional changes

The county incorrectly computed/implemented jurisdictional changes in FY 2011-12 through FY 2014-15 because it did not adjust the base year assessed value. This resulted in a misstatement of TRA tax increments and gross revenues for the jurisdictional change year.

The legal requirements for jurisdictional changes are found in Revenue and Taxation (R&T) 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, 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.

Recommendation

The county should adjust the base-year assessed value for jurisdictional changes going forward. The overall amounts are immaterial. The county corrected all of the identified negative TRA revenue from FY 2011-12 through FY 2014-15 during the audit.

County's Response

The county concurs with the finding. The county stated:

> This error caused tax increments and gross revenues to be misstated by an immaterial amount in the jurisdictional change year. The misstated gross revenues that were negative for tax rate areas were identified and corrected during the audit. San Joaquin County will follow the recommendation of adjusting the base year assessed value for jurisdictional changes that become effective in and after fiscal year 2015-16.

SCO's Comment

The SCO agrees with the county's corrective action.

FINDING 2— Vehicle License Fee and Sales and Use Tax adjustments

The county incorrectly computed the VLF growth in FY 2010-11 through FY 2014-15 by adjusting prior year base assessed value instead of current year assessed value for the annexations.

Requirements for the ERAF adjustment for the VLF and SUT are found in R&T Code sections 97.68 through 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 TRAs 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 correct the VLF growth computation and use the corrected VLF amounts going forward. However, the county corrected the VLF error during the audit.

County's Response

The county concurs with the finding. The county stated:

> The calculation and VLF amounts were corrected during the audit. San Joaquin County will follow the recommendation of using the corrected VLF amounts and adjusting current base year assessed value for annexations for VLF growth in and after fiscal year 2015-16.

SCO's Comment

The SCO agrees with the county's corrective action.

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 SCO 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

JEROME C. WILVERDING
AUDITOR-CONTROLLER
SAN JOAQUIN COUNTY

ASSISTANT AUDITOR-CONTROLLER
Jeffery M. Woltkamp, CPA

CHIEF DEPUTIES
Tod Hill – Accounting
Sandra Chan – Property Tax
Tom Lanfranki – Internal Audit

PAYROLL MANAGER
Lori Rolleri

May 4, 2016

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

RE: Property Tax Apportionment and Allocation System Audit Report Draft
For the Period of July 1, 2010 through June 30, 2015

Dear Ms. González:

We agree with the first finding of jurisdictional changes not being calculated correctly in fiscal years 2011-12 through 2014-15 due to the base year assessed value not being adjusted. This error caused tax increments and gross revenues to be misstated by an immaterial amount in the jurisdictional change year. The misstated gross revenues that were negative for tax rate areas were identified and corrected during the audit. San Joaquin County will follow the recommendation of adjusting the base year assessed value for jurisdictional changes that become effective in and after fiscal year 2015-16.

We also agree with the second finding of the Vehicle Licensing Fee (VLF) growth not being calculated correctly in fiscal years 2011-12 through 2014-15 due to the prior year base assessed value being adjusted for annexations instead of adjusting the current year. The calculation and VLF amounts were corrected during the audit. San Joaquin County will follow the recommendation of using the corrected VLF amounts and adjusting current year base assessed values for annexations for VLF growth in and after fiscal year 2015-16.

Sincerely,

Jerome C. Wilverding

Jerome C. Wilverding
Auditor-Controller

44 N. San Joaquin Street, Suite 550, Stockton, CA 95202
Main (209) 468-3925, Main FAX (209) 468-3681 - Payroll (209) 468-3928, Payroll FAX (209) 468-0408
www.sjgov.org/auditor/

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

http://www.sco.ca.gov