

KINGS COUNTY

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2002, through June 30, 2008



JOHN CHIANG
California State Controller

August 2009



JOHN CHIANG
California State Controller

August 14, 2009

Doil O'Steen
Director of Finance
Kings County Government Center
1400 West Lacey Boulevard
Hanford, CA 93230

Dear Mr. O'Steen:

The State Controller's Office audited the methods employed by Kings County to apportion and allocate property tax revenues for the period of July 1, 2002, through June 30, 2008. 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 included the Educational Revenue Augmentation Fund (ERAF) in the unitary tax apportionment computation during this audit period.

In addition, prior to fiscal year (FY) 2006-07, counties could not impose a fee, charge, or other levy on a city, nor reduce a city's allocation of ad valorem property tax revenues in reimbursement for the services performed by the county under Revenue and Taxation Code sections 97.68 and 97.70. Pursuant to Revenue and Taxation Code section 97.75, beginning with FY 2006-07, a county may impose a fee, charge, or other levy on a city for these services, but the fee, charge, or other levy cannot exceed the actual cost of providing the services.

A legal challenge has arisen regarding the method a county has used to impose the fee for the services provided under Revenue and Taxation Code sections 97.68 and 97.70. Kings County has used the same method to impose the fee. The legal challenge has raised the possibility that the county 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.

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: Jody Martin

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
Catherine Smith, Executive Director
California Special Districts Association

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Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by Kings County to apportion and allocate property tax revenues for the period of July 1, 2002, through June 30, 2008.

Our audit disclosed that the county complied with California statutes for the allocation and apportionment of property tax revenues, except that it included the Educational Revenue Augmentation Fund (ERAF) in the unitary tax apportionment computation during this audit period.

Prior to fiscal year (FY) 2006-07, counties could not impose a fee, charge, or other levy on a city, nor reduce a city's allocation of ad valorem property tax revenue in reimbursement for the services performed by the county under Revenue and Taxation Code section 97.75. Beginning with FY 2006-07, a county may impose a fee, charge, or other levy on a city for these services, but the fee, charge, or other levy cannot exceed the actual cost of providing the services.

A legal challenge has arisen regarding the method a county has used to impose the fee for the services provided under Revenue and Taxation Code sections 97.68 and 97.70. Kings County has used the same method to impose the fee. Therefore, at this time, an observation is noted 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, including allowing the county to modify its method of imposing the fee.

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 (AB 8), 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 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.

**Objective, Scope,
and Methodology**

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.

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.

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, 2002, through June 30, 2008. 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

Our audit disclosed that, except for the items discussed in the Finding and Recommendation section of this report, Kings County complied with California statutes for the apportionment and allocation of property tax revenues for the period of July 1, 2002, through June 30, 2008. The county should correct the item discussed in the Finding and Recommendation section.

Prior to FY 2006-07, counties could not impose a fee, charge, or other levy on a city, nor could they reduce a city's allocation of ad valorem property tax revenue in reimbursement for the services performed by the county under Revenue and Taxation Code section 97.75. Beginning with fiscal year 2006-07, a county may impose a fee, charge, or other levy on a city for these services, but the fee, charge, or other levy cannot exceed the actual cost of providing the services.

A legal challenge has arisen regarding the method a county has used to impose the fee for the services provided under Revenue and Taxation Code sections 97.68 and 97.70. Kings County has used the same method to impose the fee. Therefore, at this time, an observation is noted 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; the report will be modified accordingly, and the county will be allowed to modify its method of imposing the fee.

**Follow-up on Prior
Audit Findings**

The county has satisfactorily resolved the findings noted in our prior audit report, issued in December 2003.

**Views of
Responsible
Official**

We issued a draft audit report on March 20, 2009. Harold Nikoghosian, Acting Director of Finance, responded through a telephone conversation on June 18, 2009. He agreed with the audit results.

Restricted Use

This report is solely for the information and use of Kings 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

August 14, 2009

Finding and Recommendation

**FINDING—
Unitary and operating
nonunitary
apportionment**

The county included the Educational Revenue Augmentation Fund (ERAF) in the unitary tax apportionment computation during this audit period.

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 and railroads).

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 fiscal year 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

For all future unitary tax apportionment computations, the county should not include the ERAF as it does not qualify as a “taxing jurisdiction under the Revenue and Taxation Code section 100.” The county should distribute the ERAF’s share proportionately among all taxing jurisdictions that contributed to the fund.

County’s Response

On June 18, 2009, Harold Nikoghosian, Acting Finance Director, responded by e-mail stating, “Per our telephone conversation of this afternoon regarding the Property Tax Audit Report dated March 20, 2009, please be advised that we agree with your findings and recommendation and you may proceed with finalizing that report. Thank you.”

**Attachment—
County’s Response to
Draft Audit Report**

Rose, Don

From: Nikoghosian, Harold [Harold.Nikoghosian@co.kings.ca.us]

Sent: Thursday, June 18, 2009 01:49 PM

To: Rose, Don

Cc: Dorna, Ute

Subject: Property Tax Audit

Per our telephone conversation of this afternoon regarding the Property Tax Audit Report dated March 20, 2009, please be advised that we agree with your findings and recommendation and you may proceed with finalizing that report. Thank you.

06/18/2009

**State Controller's Office
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