MONTEREY COUNTY

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2009, through June 30, 2015

BETTY T. YEE
California State Controller

August 2016

BETTY T. YEE
California State Controller

August 26, 2016

The Honorable Michael J. Miller
Auditor-Controller
Monterey County
168 West Alisal Street, 3rd Floor
Monterey, CA 93901

Dear Mr. Miller:

The State Controller's Office (SCO) audited the methods employed by Monterey County to apportion and allocate property tax revenues for the period of July 1, 2009, 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 did not complete jurisdictional changes pursuant to the Board of Equalization change notice, and made errors in calculating the following items:

- Supplemental apportionment factors;
- Unitary and operating nonunitary debt service rates and apportionment factors;
- Unitary regulated railway apportionment factors;
- Vehicle license fee adjustments; and
- Former redevelopment agencies' annual tax increments.

Additionally, 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 Observation section of this report.

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

cc: Gary Giboney, Division Chief Deputy
Property Taxes, Monterey County
Julie Aguero, A/C Analyst II
Property Taxes, Monterey County

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Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by Monterey County to apportion and allocate property tax revenues for the period of July 1, 2009, through June 30, 2015.

Our audit found that the county complied with California statutes, except that it did not complete jurisdictional changes pursuant to the Board of Equalization (BOE) change notice, and made errors in calculating the following items:

- Supplemental apportionment factors;
- Unitary and operating nonunitary debt service rates and apportionment factors;
- Unitary regulated railway apportionment factors;
- Vehicle license fee adjustments; and
- Former redevelopment agencies' annual tax increments.

Additionally, 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 Observation section of this report.

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 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.

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 BOE reports and verified the computations used by the county to develop the unitary and operating nonunitary property tax distribution factors.
- Reviewed 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 and county apportionment and allocation reports addressing the 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 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, 2009, 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, Monterey County complied with California statutes for the apportionment and allocation of property tax revenues for the period of July 1, 2009, through June 30, 2015. The county should correct the items discussed in the Findings and Recommendations section.

Additionally, we are unable to make a determination on the county’s methodology for apportioning the residual balance from the RPTTF because of a pending appellate court decision, as described in the Observation section of this report.

Follow-up on Prior Audit Findings

The county has satisfactorily resolved the findings noted in our prior audit report, issued September 10, 2010.

Views of Responsible Officials

We issued a draft audit report on April 29, 2016. Michael J. Miller, Auditor-Controller, responded by letter dated May 13, 2016 (Attachment). He agreed with the audit results.

Restricted Use

This report is solely for the information and use of Monterey 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

August 26, 2016

Findings and Recommendations

FINDING 1— Jurisdictional changes

The county did not complete jurisdictional changes pursuant to BOE change notice No. 2012-009 because parcels were not properly transferred by the Assessor's Office and the TRA was not dissolved/inactivated by the Auditor-Controller's Office.

The legal requirements for jurisdictional changes are found in Revenue and Taxation 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, the local government agencies are required to negotiate any exchange of base-year property tax revenue and ATI. After the jurisdictional change, the local agency whose responsibility increased receives additional ATI, and the base property tax revenues are adjusted according to the negotiated agreements.

Recommendation

We recommend that the county review annual BOE change notices and ensure that the jurisdictional changes are promptly and completely implemented in accordance to Revenue and Taxation Code section 99.

County's Response

> The Auditor-Controller's Office cannot inactivate a tax rate area until the Assessor's Office has completely transferred all affected parcels to the new tax rate area. All remaining parcels have subsequently been reassigned and the tax rate area will be inactivated for the coming fiscal year.

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.

FINDING 2— Supplemental property tax

The county's supplemental apportionment factors are incorrect because the AB 8 factors were adjusted erroneously for RDAs during the computation.

The legal requirements for supplemental roll property tax apportionment and allocation are found in Revenue and Taxation Code sections 75.60 through 75.71, and 100.2. When there is a change in assessed property value due to changes in ownership or completion of new construction, the property owner is charged a supplemental property tax. This process enables the counties to retroactively tax property for the period when changes in ownership or completion of new construction occurred, rather than at the time the secured roll is developed.

Recommendation

We recommend that the county recalculate the supplemental apportionment factors with the correct AB 8 factors.

County's Response

> The County is in agreement and has recalculated the current year factors and will apply the change in the future.

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.

FINDING 3— Redevelopment agencies

The county's ATI computation is incorrect because it erroneously included or excluded certain frozen base-year values.

Requirements for the apportionment and allocation of property tax to RDAs are found in Revenue and Taxation Code sections 96.4 and 96.5. California Community Redevelopment Law generally entitles a community RDA to all of the property tax revenues that are realized from growth in values since the redevelopment project's inception.

Recommendation

We recommend that the county ensure that there are no changes in frozen base-year assessed values from year to year.

County's Response

> The County discovered and corrected these errors prior to the audit.

SCO's Comment

The SCO will continue to review frozen base-year assessed values in future audits.

FINDING 4— Unitary and operating nonunitary apportionment

There were errors in the county's unitary and operating nonunitary section due to the following:

- Annual debt service rates' calculations were not in accordance with Revenue and Taxation Code section 100(2)(A) and (B).
- Transposition of total revenue amount used in calculating the in-excess of 102% revenue in FY 2009-2010, which caused the error in apportionment factors.

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). 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

We recommend that the county follow Revenue and Taxation Code section 100(2)(A) and (B), which includes immediate prior and second prior fiscal years' debt service levies' percentage differences within the debt service calculation.

We further recommend that the county recalculate the apportionment factor from FY 2009-10 with the correct total revenue amount and carry that correct factor forward for FY 2015-16.

County's Response

> The County concurs with the finding on the debt service rate calculation and will correct its methodology. The County has fixed the transposition error and recalculated each affected year and reapportioned collections for FY 2015-16.

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.

FINDING 5— Unitary regulated railway apportionment

The county's railway apportionment factors are incorrect because it transposed total revenue amount used in the in-excess of 102% revenue in FY 2009-10.

The process for allocating and apportioning property taxes from certain regulated railway companies functions through the unitary railway tax system employed by the State 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

We recommend that the county recalculate the railway apportionment factor from FY 2009-10 with the correct total revenue amount and carry that correct factor forward for FY 2015-16.

County's Response

> The County has fixed the transposition error and recalculated each affected year and reapportioned collections for FY 2015-16.

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.

FINDING 6— Vehicle licensing fee and sales and use tax adjustments

The county did not calculate the VLF adjustments correctly, due to the exclusion of utilities' assessed values during the growth computation.

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 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 calculates 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

We recommend that the county includes utilities' assessed values within the computation of VLF growth for all future VLF adjustments.

County's Response

> The County concurs and will adjust its calculation worksheet to included utility values beginning with FY 2016-17.

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

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.

Attachment—
County's Response to Draft Audit Report

MONTEREY COUNTY

AUDITOR - CONTROLLER
(831) 755-5040 • FAX (831) 755-5098 • P.O. BOX 390 • SALINAS, CALIFORNIA 93902

MICHAEL J. MILLER, CPA
AUDITOR - CONTROLLER

May 13, 2016

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

Dear Ms. González:

We have received the draft audit report dated April 29, 2016 of the Monterey County Property Tax Apportionment and Allocation System for July 1, 2009 through June 30, 2015. Here is our response to the audit finding:

> **Finding 1:** The county did not complete jurisdictional changes pursuant to Board of Equalization (BOE) change notice #2012-009 because parcels were not properly transferred by the Assessor's Office and the tax rate area was not dissolved/inactivated by the Auditor-Controller's Office.
>
> **Recommendation:** We recommend that the county review annual BOE change notices and ensure that the jurisdictional changes are promptly and completely implemented in accordance to Revenue and Taxation Code section 99.
>
> **Response:** The Auditor-Controller's Office cannot inactivate a tax rate area until the Assessor's Office has completely transferred all affected parcels to the new tax rate area. All remaining parcels have subsequently been reassigned and the tax rate area will be inactivated for the coming fiscal year.
>
> **Finding 2:** The county's supplemental apportionment factors are incorrect because the AB 8 factors were adjusted erroneously for redevelopment agencies during the computation.
>
> **Recommendation:** We recommend that the county recalculate the supplemental apportionment factors with the correct AT 8 factors.

Response: The County is in agreement and has recalculated the current year factors and will apply the change in the future.

Finding 3: The county's annual tax increment computation is incorrect because it erroneously included or excluded certain frozen base-year values.

Recommendation: We recommend that the county ensure that there are no changes in frozen base-year assessed values from year to year.

Response: The County discovered and corrected these errors prior to the audit.

Finding 4: There were errors in the county's unitary and operating nonunitary section due to the following:

- Annual debt service rates' calculations were not in accordance with Revenue and Taxation Code section 100(2)(A) and (B).
- Transposition of total revenue amount used in calculating the in-excess of 102% revenue in fiscal year (FY) 2009-2010, which caused the error in apportionment factors.

Recommendation: We recommend that the county follow Revenue & Taxation Code section 100(2)(A) and (B), which includes immediate prior and second prior fiscal years' debt service levies' percentage differences within the debt service calculation. We further recommend that the county recalculate the apportionment factor from FY 2009-2010 with the correct total revenue amount and carry that factor forward for FY 2015-16.

Response: The County concurs with the finding on the debt service rate calculation and will correct its methodology. The County has fixed the transposition error and recalculated each affected year and reapportioned collections for FY 2015-16.

Finding 5: The county's railway apportionment factors are incorrect because it transposed total revenue amount used in the in-excess of 102% revenue in FY 2009-2010.

Recommendation: We recommend that the county recalculate the railway apportionment factor from FY 2009-2010 with the current total revenue amount and carry that correct factor forward for FY 2015-2016.

Response: The County has fixed the transposition error and recalculated each affected year and reapportioned collections for FY 2015-16.

Finding 6: The county did not calculate the vehicle license fee (VLF) adjustments correctly, due to the exclusion of utilities' assessed values during the growth computation.

Recommendation: We recommend that the county includes Utilities' assessed values within the computation of VLF growth for all future VLF adjustments.

Response: The County concurs and will adjust its calculation worksheet to include utility values beginning with FY 2016-17.

We look forward to working with you in the future. If you have any questions or additional comments, please call me at (831) 755-5040.

Sincerely,

Michael J. Miller

Michael J. Miller, CPA, CISA

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