MENDOCINO COUNTY

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2001, through June 30, 2008

JOHN CHIANG
California State Controller

November 2009

JOHN CHIANG
California State Controller

November 25, 2009

The Honorable Meredith Ford
Auditor-Controller
Mendocino County
501 Low Gap Road, Room 1080
Ukiah, CA 95482

Dear Ms. Ford:

The State Controller's Office audited the methods employed by Mendocino County to apportion and allocate property tax revenues for the period of July 1, 2001, 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 did not correct prior audit issues, included the Educational Revenue Augmentation Fund (ERAF) in the unitary tax apportionment computation during this audit period, incorrectly computed the 2002-03 fiscal year unitary apportionment factors, did not compute a separate apportionment factors for the unitary railroad, allocated the unitary bond collection to the redevelopment agencies, and allocated excess increment to a redevelopment agency.

Prior to fiscal year 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 services performed by the county under Revenue and Taxation Code sections 97.68 and 97.70. Pursuant to Revenue and Taxation Code 97.75, beginning with fiscal year 2006-07, a county may impose fee, charge, or other levy on a city for these services, but the fee, charge, or other levy can not 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 section Code 97.68 and 97.70. Mendocino County has used this method to impose the fee. Therefore, at this time we have noted an observation until the legal issues are resolved. After all legal challenges are resolved, we will review this process again to determine if any adjustments are warranted and modify the report accordingly.

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: 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
Richard J. Chivaro, Chief Counsel
State Controller's Office

Contents

Audit Report

Summary 1

Background 1

Objective, Scope, and Methodology 3

Conclusion 4

Follow-Up on Prior Audit Findings 5

Views of Responsible Official 5

Restricted Use 5

Findings and Recommendations 6

Attachment—County's Response to Draft Audit Report

Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by Mendocino County to apportion and allocate property tax revenues for the period of July 1, 2001, 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 did not correct prior audit issues, included the Educational Revenue Augmentation Fund (ERAF) in the unitary tax apportionment computation during this audit period, incorrectly computed the 2002-03 fiscal year unitary apportionment factors, did not compute a separate apportionment factor for the unitary railroad, allocated the unitary bond collection to the redevelopment agencies, and allocated excess increment to a redevelopment agency.

Prior to fiscal year 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 services performed by the county under Revenue and Taxation Code sections 97.68 and 97.70. Pursuant to Revenue and Taxation Code 97.75, beginning with fiscal year 2006-07, a county may impose fee, charge, or other levy on a city for these services, but the fee, charge, or other levy can not 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 section Code 97.68 and 97.70. Mendocino County has used this method to impose the fee. Therefore, at this time we have noted an observation until the legal issues are resolved. After all legal challenges are resolved, we will review this process again to determine if any adjustments are warranted and modify the report 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 (AB 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 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.

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 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, 2001, 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

The audit identifies procedural changes necessary to ensure that Mendocino County complies with the legislative requirements for the apportionment and allocation of property tax revenues. The auditors are particularly concerned about the county's failure to resolve all prior audit findings that could adversely affect the ability of the Mendocino County property tax system to accurately apportion and allocate property tax revenues to the taxing agencies in the county. The county should correct all prior and current audit findings as stated in the items discussed in the findings and recommendations section.

The county did not correct prior errors in the AB 8 system. In FY 1997-98, the county froze the TRA factors but did not correct the prior year base revenues and TRA factors for the following errors:

- The county recomputed the annual tax increment (ATI) TRA factors annually up to FY 1996-97;
- The annual recomputation up to FY 1993-94 included a Special District Augmentation Fund (SDAF) revenue adjustment in the TRA factors; and
- The unitary and operating nonunitary base revenue, computed in 1987-88, was included in the AB 8 process up to FY 1996-97.

Prior to fiscal year 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 services performed by the county under Revenue and Taxation Code sections 97.68 and 97.70. Pursuant to Revenue and Taxation Code 97.75, beginning with fiscal year 2006-07, a county may impose fee, charge, or other levy on a city for these services, but the fee, charge, or other levy can not 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 section Code 97.68 and 97.70. Mendocino County has used this method to impose the fee. Therefore, at this time we have noted an observation until the legal issues are resolved. After all legal challenges are resolved, we will review this process again to determine if any adjustments are warranted and modify the report accordingly.

Follow-up on Prior Audit Findings

Findings noted in our prior audit, issued December 31, 2002, have not been satisfactorily resolved by the county.

Views of Responsible Official

We issued a draft audit report on June 26, 2009. Meredith Ford, Auditor-Controller, responded by letter dated July 20, 2009 (Attachment). She disagreed with Findings 1, 2, and 6; agreed with Findings 3 and 4; and partially agreed with Finding 5.

Restricted Use

This report is solely for the information and use of Mendocino 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

November 25, 2009

Findings and Recommendations

FINDING 1—Calculation and distribution of ATI

The county did not correct prior errors in the AB 8 system. In fiscal year (FY) 1997-98, the county froze the Tax Rate Area (TRA) factors but did not correct the prior-year base revenues and TRA factors for the following errors:

- The county recomputed the annual tax increment (ATI) TRA factors annually up to FY 1996-97;
- The annual recomputation up to FY 1993-94 included a Special District Augmentation Fund (SDAF) revenue adjustment in the TRA factors; and
- The unitary and operating nonunitary base revenue, computed in 1987-88, was included in the AB 8 process up to FY 1996-97.

Requirements for the apportionment and allocation of the annual tax increment are found in Revenue and Taxation Code sections 96 through 96.5. The annual increment of property tax, which is the change in assessed value from one year to the next, is allocated to TRAs on the basis of each TRA's share of the incremental growth in assessed valuations. The tax increment is then multiplied by the jurisdiction's annual tax increment apportionment factors for each TRA. These factors were developed in the 1979-80 base year and are adjusted for jurisdictional changes. The tax increment is then added to the tax computed for the prior fiscal year to develop the apportionment for the current fiscal year.

Recommendation

The county should correct the above errors and recompute the base revenues and TRA factors from FY 1978-79 to present. The county should implement procedures to correct errors in the property tax system in a timely manner and in conformance with the Revenue and Taxation Code.

County's Response

> We reiterate our position from the prior audit report comments that the county did not err in re-computing the annual tax increment. Our approach was based upon your approved 1987 audit findings and recommendations. We further believe that the County of Mendocino is in compliance with state statute on a prospective basis commencing in fiscal year 1997-98.

SCO's Comment

We reiterate our position from the previous audit. The fact remains that the county did not comply with the provisions of the Revenue and Taxation Code. The county has the ultimate responsibility to ensure that the allocation and apportionment of property tax revenues are in accordance with statutory requirements. The statutes require that ATI factors remain constant except for the effects of jurisdictional changes.

The finding remains as written.

FINDING 2—
Jurisdictional changes

The county failed to correct jurisdictional change errors identified in the previous SCO audits. In those audits, the SCO noted, "The county does not include TRA factor exchange negotiations in the jurisdictional exchange process." The county continues to process jurisdictional changes in the same manner.

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 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 review all jurisdictional changes and the correct the TRA factors of jurisdictions that were improperly changed. These corrections must be completed in conjunction with the corrections recommended in Finding 1. The county should implement procedures to correct errors in the property tax system in a timely manner and in conformance with the Revenue and Taxation Code.

County's Response

> We reiterate our position from the prior audit report comments that the county did not err in re-computing the annual tax increment. Our approach was based upon your approved 1987 audit findings and recommendations. We further believe that the County of Mendocino is in compliance with state statute on a prospective basis commencing in fiscal year 1997-98.

SCO's Comment

We reiterate our position from the previous audit. The fact remains that the county did not comply with the provisions of the Revenue and Taxation Code. The county has the ultimate responsibility to ensure that the allocation and apportionment of property tax revenues are in accordance with statutory requirements. The statutes require that ATI factors remain constant except for the effects of jurisdictional changes. The methodology used by the county changes all ATI factors annually, regardless of whether or not an entity was party to a jurisdictional change.

The finding remains as written.

FINDING 3—Supplemental property tax-administrative costs

The county again failed to correct errors noted in the prior two audit findings in identifying costs associated with the supplemental property tax administrative cost reimbursement. The county documented the Auditor-Controller's accountant salary but excluded all other costs. As a result, the allocation reimbursement exceeded 5% of collected revenue.

Revenue and Taxation Code section 75.60 allows a county to charge an administrative fee for supplemental property tax collections. This fee is not to exceed 5% of the supplemental property taxes collected.

Recommendation

The county should document and identify all costs associated with administering the supplemental property tax revenues. The county should implement procedures to correct errors in the property tax system in a timely manner and in conformance with the Revenue and Taxation Code.

County's Response

> We concur with your findings and have implemented a process that will ensure full documentation of all costs associated with administering the supplemental property tax revenue program in a more timely manner.

FINDING 4—Redevelopment agencies

The county allocated increments in excess of the net required amount reported by the redevelopment agency in the Statement of Indebtedness.

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 redevelopment agency to all of the property tax revenues that are realized from growth in values since the redevelopment project's inception.

Recommendation

The county should request a reimbursement of the excess and reallocate that excess back to all participating entities.

County's Response

> We concur with your finding and have corrected the allocations.

FINDING 5—
Unitary and operating nonunitary apportionment

The county failed to correct prior errors in the unitary and operating nonunitary apportionment factors. The base revenue and apportionment factors were corrected, but no adjustment was made for fiscal years when revenue exceeded 102%. In addition, in this current audit, we observed the following issues:

- The county included the ERAF in the apportionment system.
- In FY 2002-03, the county process to compute revenue in excess of 102% excluded the RDAs.
- In FY 2007-08, the county process included railroad revenues in the allocation.
- The county allocated bond collections to the redevelopment agencies.

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 FY 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

The county should adjust the base revenue for all fiscal years in which revenue exceeded 102%. This correction must be completed in conjunction with the corrections recommended in Finding 1. The county must also incorporate the current audit findings.

County's Response

> We reiterate our position from the prior audit report comments that the county did not err in re-computing the annual tax factors. Our approach was based upon your approved 1987 audit findings and recommendations. We further believe that the County of Mendocino is in compliance with state stature [sic] on a prospective basis commencing in fiscal year 1997-98.
>
> Unitary – Failure to include RDA
>
> We concur with the finding, and the allocations are being corrected.

Unitary – Railroad revenues

We concur with the finding, and the allocations are being corrected.

Unitary – Debt Service allocations

We concur with the finding, and the allocations are being corrected.

SCO's Comment

We reiterate our position from the previous audits. The fact remains that the county did not comply with the provisions of the Revenue and Taxation Code. The county has the ultimate responsibility to ensure that allocation and apportionment of property tax revenues are in accordance with statutory requirements. The county used an inappropriate methodology to develop the base amounts for the unitary and operating nonunitary system. Rather than developing factors based upon the proportionate share of unitary and operating nonunitary revenue received by local jurisdictions, the county inappropriately applied a countywide AB 8 factor. In addition, when the Legislature abolished the SDAF in FY 1993-94, the county inappropriately distributed the SDAF factor within the unitary and operating nonunitary system to the county general fund and cities in the county rather than solely to the entities that had made SDAF contributions in the development of the SDAF factor. The finding remains as written.

FINDING 6—Educational Revenue Augmentation Fund (ERAF)

The county again failed to take full corrective action for prior errors in the ERAF shift. The prior fiscal year ERAF shift included the following errors:

- The FY 1992-93 ERAF (9%) of revenue computation for one city was overstated because the prior revenue amount the county used was different from the city revenue amount used in the prior-year AB 8 reports.
- The FY 1993-94 special district ERAF computations did not include the SDAF participation adjustment required.
- The county included the ERAF in the TRA factor computation each fiscal year up to FY 1996-97. Recomputing the TRA factors annually causes the growth share of the ERAF to be shared by all jurisdictions, rather than just the local agencies that are required to contribute to ERAF.
- The county reversed the cities' disaster relief amounts in fiscal year 2002-03 instead of fiscal year 1997-98.

As the errors encompass numerous fiscal years and many complex computations, we were unable to determine and report the total error in the ERAF shift.

Requirements for the local agency shift of property tax revenues to the ERAF are primarily found in Revenue and Taxation Code sections 97.1 through 97.3. Beginning in FY 1992-93, most local agencies were required to shift an amount of property tax revenues to the ERAF using formulas detailed in the code. The property tax revenues in the ERAF are subsequently allocated to the public schools using factors supplied by the county superintendent of schools.

For FY 1992-93, the ERAF shift amount for cities was determined by adding a per capita amount to a percentage of property tax revenues received by each city. The amount for counties was determined by adding a flat amount, adjusted for growth, to a per capita amount. The amount for special districts was generally determined by shifting the lesser of 10% of that district's total annual revenues as shown in the FY 1989-90 edition of the State Controller's *Report on Financial Transactions Concerning Special Districts* or 40% of the FY 1991-92 property tax revenues received, adjusted for growth. Specified special districts were exempted from the shift.

For FY 1993-94, the ERAF shift for cities and counties was generally determined by:

- Reducing the FY 1992-93 ERAF shift by the FY 1992-93 per capita shift;
- Adjusting the result for growth; and
- Adding the result to a flat amount and a per capita amount determined by the Department of Finance, adjusted for growth.

The FY 1993-94 ERAF shift for special districts, other than fire districts, was generally determined by:

- Multiplying the property tax allocation for FY 1992-93, pre-ERAF, by the Special District Augmentation Fund (SDAF) factor for the district effective on June 15, 1993;
- Adjusting this amount by subtracting the FY 1992-93 shift to the ERAF;
- If the above amount is greater than zero, adjusting this amount for FY 1993-94 growth (zero is used for negative amounts); and
- Adding this amount to the FY 1992-93 ERAF shift, adjusting for growth.

For fire districts, the FY 1993-94 ERAF shift was generally determined by:

- Deducting the FY 1992-93 ERAF shift for the district from the FY 1992-93 property tax allocation;
- Multiplying the result by the SDAF factor for the district effective on June 13, 1993 (net current-year bailout equivalent);

- For a district governed by a board of supervisors, deducting the amount received from the SDAF in FY 1992-93 from the net current-year bailout equivalent; or, for an independent district, deducting the amount received from the SDAF and the difference between the net current-year bailout equivalent and the amount contributed to the SDAF from the net current-year bailout equivalent;

- Adjusting this amount for growth; and

- Adding this amount to the FY 1992-93 ERAF shift, adjusted for growth.

For fiscal years subsequent to FY 1993-94, the amounts determined are adjusted for growth annually to determine the ERAF shift amounts for that year.

Recommendation

The county should correct the ERAF shift amount in conjunction with all of the other findings in this report. Once the shift amount has been corrected, the ERAF revenue must be adjusted accordingly. The county should implement procedures to correct errors in the property tax system in a timely manner and in conformance with the Revenue and Taxation Codes.

County's Response

> We reiterate our position from the prior audit report comments that the county did not err in re-computing the appropriate ERAF amount. Our approach was based upon your approved 1987 audit findings and recommendations. We further believe that the County of Mendocino is in compliance with state stature on a prospective basis commencing in fiscal year 1997-98.

SCO's Comment

As stated in Finding 1, we reiterate our position that it was inappropriate to recalculate apportionment factors, including ERAF apportionment factors. We acknowledge that the county's disaster relief amount was reve*-rsed. However, when the county froze the factors, the disaster relief amount was inadvertently omitted from the computation.

The finding remains as written.

Attachment—
County's Response to
Draft Audit Report

MEREDITH J. FORD
Auditor-Controller

LLOYD B. WEER
Assistant
Auditor-Controller

COUNTY OF MENDOCINO
AUDITOR-CONTROLLER
501 LOW GAP RD., RM. 1080
UKIAH, CALIFORNIA 95482
PH: (707) 463-4388
FAX: (707) 467-2503
E-mail: auditor@co.mendocino.ca.us

July 20, 2009

Jeffrey V. Brownfield, Chief
Division of Audits
State Controllers Office
P.O. Box 942850
Sacramento, CA 94250-5874

Dear Mr. Brownfield:

The purpose of this letter is to respond with comment in a timely manner to your letter/draft report dated June 26, 2009 and received by my office on July 6, 2009 concerning your staff's compliance audit findings of the methods employed by the County of Mendocino in apportioning and allocating property tax revenues for the period of July 1, 2001, through June 30, 2008 pursuant to Government Code Section 12468.

I have reviewed your draft report and have prepared the following statements as to the degree of accuracy to your draft findings:

Summary of major issues:

Your audit report references six (6) specific findings in which you indicate the County of Mendocino did not comply with California statutes during the audit period referenced above. Those areas of noncompliance in your report were as follows:

- Finding #1: The county did not correct prior errors in the AB 8 system.
- Finding #2: The county failed to correct jurisdictional change errors identified in the previous SCO audit.
- Finding #3: The county again failed to correct errors noted in the prior two audit findings in identifying costs associated with the supplemental property tax administrative cost reimbursement.
- Finding #4: The county allocated increments in excess of the net required amount reported by the redevelopment agency in the Statement of Indebtedness.
- Finding #5: The county failed to correct prior errors in the unitary and operating non-unitary apportionment factors.

- Finding #6: The county again failed to take full corrective action for prior errors in the ERAF shift.

County Position:

After having thoroughly reviewed the comments made within your report, we have concluded, as noted below, that we do **not** concur with a number of your findings and strongly believe them to be an inaccurate reflection of the past tax allocation practices employed by the County of Mendocino. We again submit to you, as we have in a previous audit report dated March 14, 2003, that the County of Mendocino did, in fact, **fully** comply with California statutes in this regard and reject in the strongest possible terms the implication(s) that we knowingly acted in disregard of existing statute.and in our interpretation of same.

Basis:

Since the passage of Proposition in June 1978, the County of Mendocino has been audited on four (4) separate occasions by the State Controller's Office for compliance purposes in the allocation and apportionment of local property taxes.

The initial audit was performed in 1988 by a team of three auditors covering the period July 1, 1978 through June 30, 1987. In its report issued on August 12, 1988, the consensus of the auditors was that the methodology and procedures employed by the County of Mendocino in the allocation and apportionment of property taxes was found to be in substantial compliance with state statute. In complete reliance upon that acknowledgement from three individual auditors, the county continued to employ the same methodology and practices for the ensuing nine (9) years.

In 1997, we were audited a second time by one individual auditor who concluded that the County of Mendocino did not, in fact, comply with state statute. The auditor further disclosed that "the fact that the noncompliance issues were not disclosed the previously issued SCO report does not mitigate the need for the county to follow state laws and conform its current procedures with statutory requirements."

At the time of that exit conference and at subsequent discussions the previous Auditor-Controller, Dennis Huey, had with your bureau chief, Patricia Ramos, he stated his position that the County of Mendocino should not be held in a position of double jeopardy, after having relied in good faith for over eighteen (18) years that the process we were following was correct and proper and had the blessing of the SCO. He further indicated that he would comply with state statute but only on a time-forward basis. From that time forward, it is our stated position that we have complied fully with state statute.

With that as a prologue, what follows are your audit findings along with our point-by-point response:

Response to Specific Audit Findings:

Finding #1: Correction of prior errors in AB8 system

- We reiterate our position from the prior audit report comments that the county did not err in re-computing the annual tax increment. Our approach was based upon your approved 1987 audit findings and recommendations. We further believe that the County of Mendocino is in compliance with state statute on a prospective basis commencing in fiscal year 1997-98.

Finding #2: Jurisdictional changes

- We reiterate our position from the prior audit report comments that the county did not err in re-computing the annual tax factors. Our approach was based upon your approved 1987 audit findings and recommendations. We further believe that the County of Mendocino is in compliance with state statute on a prospective basis commencing in fiscal year 1997-98.

Finding #3: Supplemental property taxes – administrative costs

- We concur with your findings and have implemented a process that will ensure full documentation of all costs associated with administering the supplemental property tax revenue program in a more timely manner.

Finding #4: Redevelopment Agency over-allocation

- We concur with your finding and have corrected the allocations.

Finding #5: Unitary and operating non-unitary apportionment, prior

- We reiterate our position from the prior audit report comments that the county did not err in re-computing the annual tax factors. Our approach was based upon your approved 1987 audit findings and recommendations. We further believe that the County of Mendocino is in compliance with state stature on a prospective basis commencing in fiscal year 1997-98.

Finding #5 (cont) Unitary - Failure to include RDA

- We concur with the finding, and the allocations are being corrected.

Finding #5 (cont) Unitary – Railroad revenues

- We concur with the finding, and the allocations have been corrected.

Finding #5 (cont) Unitary – Debt Service allocations

- We concur with the finding, and the allocations are being corrected.

Finding #6: Educational Revenue Augmentation Fund (ERAF)

- We reiterate our position from the prior audit report comments that the county did not err in re-computing the appropriate ERAF amount. Our approach was based upon your approved 1987 audit findings and recommendations. We further believe that the County of Mendocino is in compliance with state statute on a prospective basis commencing in fiscal year 1997-98.

Final Comments

Our position in this matter is that believe we have been operating in substantial compliance with California statutes with regard to the apportionment methodologies used in allocating property tax revenues in Mendocino County.

As was indicated in comments, which were made in your previous audit of the county in 1997, our position remains steadfast. For over eighteen (18) years, covering the period of July 1, 1978 through June 30, 1997, the County of Mendocino relied on the audit findings of members of your agency who approved of our original methodology. In doing so, we acted in good faith in continuing to use that methodology, which we were led to believe, was a correct and appropriate methodology.

At the time of our exit conference for our prior audit in 1997, Dennis Huey informed your office that it would be virtually impossible for us to go back and recalculate eighteen years of history in light of the fact that (1) we are short-staffed in this office and therefore do not have the human resources to perform this Herculean task and (2) most importantly it is not our fault that we find ourselves in this position. In this case, we believe that the State Controller's Office has some degree of culpability in this matter.

Since our last audit review, we have continued under a plan focused on transitioning Mendocino County's tax apportionment and allocation process to the methodology required under state statute. We believe that, to-date we have been successful in that endeavor, however, with the recognition that the base year values are not those as would have been determined in 1978. While we

understand fully that following this course of action does not provide us with the optimum result we all want, it is, in my opinion, a reasonable alternative under the circumstances.

Before finalizing your draft report, we request that you respond to us in writing with regard to the aforementioned issued which either need clarification or correction. In addition, it is our desire that our comments to your draft audit document be incorporated in your final published report.

Thank you for your time and consideration in this matter.

Sincerely,

Meredith Ford

Meredith Ford
Auditor-Controller

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

http://www.sco.ca.gov

S09-PTX-001