CITY AND COUNTY OF SAN FRANCISCO

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2004, through June 30, 2007

JOHN CHIANG
California State Controller

December 2008

JOHN CHIANG
California State Controller

December 12, 2008

Ben Rosenfield, Controller
City and County of San Francisco
City Hall, Room 316
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102-4694

Dear Mr. Rosenfield:

The State Controller's Office audited the methods employed by the City and County of San Francisco to apportion and allocate property tax revenues for the period of July 1, 2004, through June 30, 2007. 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 properly apportion supplemental property taxes to K-12 schools in fiscal year 2004-05; and
- Included the Educational Revenue Augmentation Fund in the unitary apportionment process as a taxing entity.

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/sk: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
David Botelho, Chief
Office of State Audits and Evaluations
Department of Finance
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 the City and County of San Francisco to apportion and allocate property tax revenues for the period of July 1, 2004, through June 30, 2007.

Our audit disclosed that the county complied with California statutes for the allocation and apportionment of property tax revenues, except in the following instances.

- The county did not properly apportion supplemental property taxes to K-12 schools in fiscal year (FY) 2004-05; and
- The Educational Revenue Augmentation Fund was included in the unitary apportionment process as a taxing entity.

Background

After the passage of Proposition 13 in 1978, the California State Legislature enacted new methods for allocating and apportioning property tax revenues to local government agencies and public schools. The main objective was to provide local government agencies with a property tax base that would grow as assessed property values increased. These methods have been further refined in subsequent laws passed by the Legislature.

One key law was Assembly Bill 8, which established the method of allocating property taxes for fiscal year (FY) 1979-80 (base year) and subsequent fiscal years. The methodology is commonly referred to as the AB 8 process or the AB 8 system.

The property tax revenues that local government agencies receive each fiscal year are based on the amount received in the prior year, plus a share of the property tax growth within their boundaries. Property tax revenues are then apportioned and allocated to local agencies and schools using prescribed formulas and methods defined in the Revenue and Taxation Code.

The AB 8 base process 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 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, 2004, through June 30, 2007. 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 Findings and Recommendations section of this report, San Francisco City and County complied with California statutes for the apportionment and allocation of property tax revenues for the period of July 1, 2004, through June 30, 2007. The county should review and correct the items discussed in the Findings and Recommendations section.

Follow-up on Prior Audit Findings

Our prior audit report, issued October 6, 2006, included no findings related to the apportionment and allocation of property tax revenues by the county.

Views of Responsible Official

We issued a draft audit report on September 19, 2008. Ben Rosenfield, Controller, responded by letter dated October 30, 2008 (Attachment), agreeing with the audit results.

Restricted Use

This report is solely for the information and use of the City and County of San Francisco, 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

December 12, 2008

Findings and Recommendations

FINDING 1—Supplemental property tax

The county did not apportion supplemental property taxes to the San Francisco Unified School District (SFUSD) in fiscal year (FY) 2004-05 because the information available to the county indicated that the average daily attendance (ADA) was zero for that year. The county reapportioned all supplemental property taxes that would have gone to the district to all other taxing jurisdictions proportionately.

The county subsequently learned that the zero ADA was incorrect and the revenue should have been apportioned to the district. In addition, no statutory provision permits the reallocation of supplemental property taxes in situations of this type.

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

The county must recover the revenue incorrectly distributed to non-school entities and distribute it to the district.

City and County's Response

> The county concurs with this finding and has allocated the supplemental property taxes to San Francisco Unified School District. Please refer to attached supporting document.

FINDING 2—Unitary and operating nonunitary apportionment

The county included the Educational Revenue Augmentation Fund (ERAF) as a taxing entity in the unitary apportionment process. The ERAF is a fund, not a taxing entity, and therefore should not be included in the unitary apportionment process.

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 unitary amounts paid to the ERAF for this audit period may be recovered from the ERAF and distributed to the local agencies from which it was diverted.

City and County's Response

> The county agrees with this finding. Adjustments were made to exclude ERAF while the field audit was still in process and will continue to do this in future unitary apportionment.

Attachment—
City and County's Response to Draft Audit Report

CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

Ben Rosenfield
Controller

Monique Zmuda
Deputy Controller

October 30, 2008

Mr. Steven Mar
Chief, Division of Audits
Local Government Audits Bureau
State Controller's Office
P.O. Box 942850
Sacramento, CA 94250-5874

Dear Mr. Mar:

We have reviewed your draft audit report on property tax apportionment and allocation system for the period of July 1, 2004, through June 30, 2007, for the purposes of determining the county's compliance with the California *Revenue and Taxation Code* and applicable rules and regulations. Below are our comments regarding your audit findings:

Finding 1:

- The county did not apportion Supplemental Property Taxes to K-12 schools in FY 2004-05.

Response:

The county concurs with this finding and has allocated the supplemental property taxes to San Francisco Unified School District. Please refer to attached supporting document.

Finding 2:

- The county included the Educational Revenue Augmentation Fund (ERAF) as a taxing entity in the unitary apportionment process.

Response:

The county agrees with this finding. Adjustments were made to exclude ERAF while the field audit was still in process and will continue to do this in future unitary apportionment.

We appreciate the State Controller's Office assistance during this audit. Please let us know if you have any questions.

Sincerely,

Ben Rosenfield
Controller

Encls:

415-554-7500 City Hall • 1 Dr. Carlton B. Goodlett Place • Room 316 • San Francisco CA 94102-4694 FAX 415-554-7466

FAML4010 V5.1 CITY AND COUNTY OF SAN FRANCISCO--NFAMIS 10/23/2008
DOCUMENT HEADER 2:26 PM

NOTEPAD : Y

DOCUMENT CATEGORY	: RE RIMS JOURNAL ENTRY		
ENTERED BY	: MERCADO, ROBERTO		
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INPUT PERIOD (MM YYYY)	: 10 2008 OCTOBER	RIMS CODE	: J5035AUD
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VENDOR NAME	:		
VENDOR ADDRESS	:		
STREET	:		
CITY / STATE / ZIP	:		COUNTRY:
DBA NAME	:		
BANK NUMBER	:	TREAS NO	:
DUE DATE	:	SINGLE CHECK	:
DOCUMENT AMOUNT	: 7,087,537.58	CURRENCY CODE	:
NUMBER OF LINES	: 14	RESPONSIBLE UNIT	:
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F1-HELP F2-SELECT F3-DELETE F6-DTL ENTRY
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G014 - RECORD FOUND

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FAML4760 V5.1 CITY AND COUNTY OF SAN FRANCISCO--NFAMIS 10/23/2008
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DOCUMENT : JEC009013022 INPUT PERIOD : 10 2008 AMT : 7,087,537.58

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01 407		995031	10410				N
GENL FUND-PY SECURED SUPP-FY04/05 STATE AUD ADJUST						2,076,015.27	
02 407		USDCOE	10410				N
CNTY SUPT-PY SEC SUP - FY2004/05 STATE AUDIT ADJ						3,290.81	
03 407		230001	10410				N
CHLDN'S FUND-PY SEC SUP-FY2004/05 STATE AUDIT ADJ						101,427.43	
04 407		415006	10410				N
LIB PRES FD-PY SEC SUP-FY2004/05 STATE AUDIT ADJ						84,522.86	
05 407		REC047217	10410				N
OSP FD-PY SEC SUP - FY2004/05 STATE AUDIT ADJUSTMT						84,522.86	
06 407		970005	10410				N
DEBT SERV FD-PY SEC SUP-FY2004/05 STATE AUDIT ADJT						396,942.31	
07 407		145001	10410				N
SFCCD GEN FD-PY SEC SUP-FY2004/05 STATE AUDIT ADJT						48,834.67	

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RE95 - THIS DOCUMENT IS IN APPROVAL, NO UPDATE ALLOWED

FAML4760 V5.1 CITY AND COUNTY OF SAN FRANCISCO--NFAMIS 10/23/2008
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08 407		144001	10410				N
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09 408		USD0100	10410				N
	SFUSD GEN FD-PY SEC SUP-FY2004/05 STATE AUDIT ADJT					3,543,768.79	
10 407		070001	10410				N
	SFUSD BOND FD-PY SEC SUP-FY2004/05 STATE AUDIT ADJ					6,334.04	
11 407		USD53	10410				N
	SFUSD STATE LOAN FD-PY SEC SUP-FY04/05 STATE AUDIT					499.15	
12 407		CON7AZAFAQM	10410				N
	BAAQ-PY SEC SUP-FY2004/05 STATE AUDIT ADJUSTMENT					7,050.52	
13 407		CON7ATRFBRT	10410				N
	BART-PY SEC SUP-FY2004/05 STATE AUDIT ADJUSTMENT					21,385.23	
14 407		990005	10410				N
	ERAF-PY SEC SUP-FY2004/05 STATE AUDIT ADJUSTMENT					693,572.86	

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ATTACHED TO : DOC TYPE - RE INITIATING DEPT - CON01 RIMS CODE - J5035AUD
PAGE : 01 OF 01

TO REDISTRIBUTE SECURED SUPPLEMENTAL TAXES COLLECTED FOR FY 2004/05 AS RECOMMENDED PER STATE AUDIT FINDING LETTER DATED 09/19/08. SUPPLEMENTAL PROPERTY TAXES WERE NOT APPORTIONED DUE TO INFORMATION AVAILABLE INDICATED THAT THE SCHOOL HAS A ZERO ADA (AVERAGE DAILY ATTENDANCE) OR BASIC AID. IT WAS LATER DETERMINED THAT THE SAID INFORMATION WAS INCORRECT AND THE REVENUE SHOULD HAVE BEEN APPORTIONED TO THE SCHOOL DISTRICT.

FY 2004-05 - SB-813 SUPPLEMENTAL TAX COLLECTIONS

ALLOCATION OF SUPPLEMENTAL COLLECTIONS TO SF UNIFIED SCHOOL DISTRICT

	FY 2004-05 Tax Rate	[illegible]	FY 2003-04 Tax Rate	[illegible]	TOTAL APPORTIONMENT
	Allocation Factors	[illegible]	Allocation Factors	[illegible]	(A)
GENERAL FUND	0.66401471	[illegible]	0.56688206	[illegible]	(2,076,015.27)
COUNTY SUPERINTENDENT OF SCHOOLS	0.00097335	[illegible]	0.00097335	[illegible]	(3,290.81)
SUB - TOTAL GENERAL FUND	0.66498806	[illegible]	0.56685541	[illegible]	(2,079,306.08)
CHILDRENS' FUND	0.03000000	[illegible]	0.03000000	[illegible]	(101,427.43)
LIBRARY PRESERVATION FUND	0.02500000	[illegible]	0.02500000	[illegible]	(84,522.86)
OPEN SPACE ACQUISITION FUND	0.02500000	[illegible]	0.02500000	[illegible]	(84,522.86)
GENERAL CITY BOND DEBT FUND	0.12838968	[illegible]	0.10682335	[illegible]	(396,942.31)
SUB - TOTAL	0.87337774	[illegible]	0.75367876	[illegible]	(2,746,721.53)
S.F. COMMUNITY COLLEGE DISTRICT GENERAL FUND	0.01444422	[illegible]	0.01444422	[illegible]	(48,834.67)
S.F. COMMUNITY COLLEGE DISTRICT BOND FUND	0.01167514	[illegible]	-	[illegible]	(19,370.78)
SUB - TOTAL	0.02611936	[illegible]	0.01444422	[illegible]	(68,205.45)
S.F. UNIFIED SCHOOL DIST. GENERAL FUND	0.07698857	1,770,329.38	0.07698857	1,773,439.41	3,543,768.79
S.F. UNIFIED SCHOOL DIST. BOND FUND	0.00381765	[illegible]	-	0.00	(6,334.04)
S.F. UNIFIED SCHOOL STATE LOAN FUND	0.00011753	[illegible]	0.00017665	[illegible]	(499.15)
SUB - TOTAL	0.08092375	[illegible]	0.07716522	[illegible]	3,536,935.60
BAY AREA AIR QUALITY MANAGEMENT DIST.	0.00208539	[illegible]	0.00208539	[illegible]	(7,050.52)
BAY AREA RAPID TRANSIT DIST. GENERAL FD.	0.00632528	[illegible]	0.00632528	[illegible]	(21,385.23)
BAY AREA RAPID TRANSIT DIST. BOND FUND	-	[illegible]	-	[illegible]	0.00
SUB - TOTAL	0.00632528	[illegible]	0.00632528	[illegible]	(21,385.23)
EDUCATIONAL REVENUE AUGMENTATION FUND	0.15516848	(257,447.40)	0.25330113	(436,125.46)	(693,572.86)
TOTAL APPORTIONED	1.14400000	0.00	1.10700000	[illegible]	0.00
NEGATIVE TAXES - GL 211		0.00		0.00	0.00
5% ADMINISTRATIVE COSTS					
TOTAL APPORTIONED - NET TOTAL	1.14400000	0.00	1.10700000	0.00	0.00

"Josie Cruz"
<CruzJ1@sfusd.edu>
12/19/2007 12:02 PM

To <edel.antiniw@sfgov.org>
cc "Medhavan,Reeta" <MadhavanR@sfusd.edu>
bcc
Subject FW: CDE Re: 2004-05 Advance Apportionment Average Daily Attendancefor Allocation of Supplemental Taxes

History: This message has been forwarded

Hi Edel,

Please read CDE's response about SFUSD on 2004-05, (Basic Aid or Not Basic Aid)?

I will e-mail Hermie Briones at CDE to request for an official letter of confirmation that SFUSD is not Basic Aid. For the meantime, you may want to share this information with your auditors.

Thanks,
Josie

From: Cindy Chan [mailto:CChan@cde.ca.gov]
Sent: Wednesday, December 19, 2007 11:02 AM
To: Josie Cruz
Cc: Caryn Moore; Hermie Briones; Peter Fogglato; Scott Hannan; Grazioli,Joseph Charles; Madhavan,Reeta
Subject: CDE Re: 2004-05 Advance Apportionment Average Daily Attendancefor Allocation of Supplemental Taxes
Importance: High

Hi Josie,
Our final records indicate that San Francisco Unified School District was not an excess tax district for the 2004-05 fiscal year. At a point in time, SFUSD may have appeared as an excess tax district based on the data used to calculate the district's revenue limit. **I don't believe that the district fell into the definition of 'basic aid',** which is a different formula than comparing the total revenue limit to taxes...I'll need to run that calculation; however, the 'basic aid' determination is pretty much limited for the certification of ADA used to allocate supplemental taxes.

I can finish looking at the numbers on Thursday. Hermie Briones is the main contact for this...he can be reached at 916-324-4541 or by e-mail at hbriones@cde.ca.gov.

Cindy

<<<Josie Cruz" <CruzJ1@sfusd.edu> 12/18/2007 3:19 PM >>>
Hello Cindy,

Your letter on above referenced subject dated November 5, 2004, indicated that San Francisco Unified School District was Basic Aid in 2004-05. The City and County of San Francisco is being audited by the State Controller's Office and is using that information that could lead to the adjustment of Taxes/ERAF allocated to SFUSD. In 2004-05, our Revenue Limit funding amounted to $273, 285,091 and Taxes including ERAF came at $206,130,444 only.

The auditors require a letter from your office, as soon as possible, to verify and establish that SFUSD was not Basic Aid in 2004-05. Please e-mail me the letter on your letterhead to meet the auditor's timelines and requirements.

Thank you so much for your assistance.

Josie Cruz
(510) 305-5305
Cindy S. Chan, Administrator
Charter Schools Fiscal Office
School Fiscal Services Division
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(916) 324-4541 (tel)
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S08-PTX-001