

STANISLAUS COUNTY

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2003, through June 30, 2006



JOHN CHIANG
California State Controller

December 2008



JOHN CHIANG
California State Controller

December 23, 2008

Larry D. Haugh
Auditor-Controller
Stanislaus County
1010 10th Street, Suite 5100
Modesto, CA 95354

Dear Mr. Haugh:

The State Controller's Office audited the methods employed by Stanislaus County to apportion and allocate property tax revenues for the period of July 1, 2003, through June 30, 2006. The audit was conducted pursuant to the requirements of Government Code section 12468.

Our audit disclosed that the county complied with California statutes for the allocation and apportionment of property tax revenues for the period audited, except that it included the Educational Revenue Augmentation Fund in the unitary and operating nonunitary apportionment process.

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

cc: Jody Martin

Joint Legislative Budget Committee
Peter Detwiler, Consultant
Senate Local Government Committee
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Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by Stanislaus County to apportion and allocate property tax revenues for the period of July 1, 2003, through June 30, 2006.

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 in the unitary and operating nonunitary apportionment process.

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 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, 2003, through June 30, 2006. 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 item discussed in the Finding and Recommendation section of this report, Stanislaus County complied with California statutes for the apportionment and allocation of property tax revenues for the period of July 1, 2003, through June 30, 2006. The county should correct the item discussed in the Finding and Recommendation section.

Follow-up on Prior Audit Findings

The county has satisfactorily resolved the findings noted in our prior audit report, issued September 2005.

Views of Responsible Official

We issued a draft audit report on August 8, 2008. Larry D. Haugh, Auditor-Controller, responded by letter dated October 6, 2008 (Attachment). He disagreed with the audit results.

Restricted Use

This report is solely for the information and use of Stanislaus 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

December 23, 2008

Finding and Recommendation

FINDING— Unitary and operating nonunitary apportionment

The county complied with California statutes, except that it included the Educational Revenue Augmentation Fund (ERAF) in the unitary and operating nonunitary 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 county should remove the ERAF from the unitary and operating nonunitary process and distribute the revenue to the agencies contributing to the ERAF.

County’s Response

Revenue & Taxation Code Section 100 governs the distribution of unitary and operating nonunitary taxes. This section as evidenced below, defines the distribution of taxes to “taxing jurisdictions”

(3) If the amount of property tax revenue available for allocation to all taxing jurisdictions in the current fiscal year from unitary and operating nonunitary property, exclusive of revenue attributable to qualified property under Section 100.95 and levies for debt service, exceeds 102 percent of the property tax revenue received by all taxing jurisdictions from all unitary and operating nonunitary property in the prior fiscal year, exclusive of revenue attributable to qualified property under Section 100.95 and levies for debt service, **the amount of revenue in excess of 102 percent shall be allocated to all taxing jurisdictions in the county by a ratio determined by dividing each taxing jurisdiction’s share of the county’s total ad valorem tax levies for the secured roll for the prior year, exclusive of levies for qualified property under Section 100.95 and levies for debt service, by the county’s total ad valorem tax levies for the secured roll for the prior year, exclusive of levies for qualified property under Section 100.95 and levies for debt service.**

The underlying foundation for the State Controller's opinion seems to be that ERAF is not a taxing jurisdiction. Unfortunately, in the chapter that governs the distribution of taxes from the unitary and operating nonunitary roll, the term "taxing jurisdiction" is not clearly defined. The general construction for the chapter is found in section 95 of the Revenue and Taxation code. That section (95 (b)) does define the term "Jurisdiction" as "a local agency, school district, community college district, or county superintendent of schools. . ." We also find in section 100 (e) (3) that "Taxing Jurisdiction" includes a redevelopment agency". The State Controller has opined that ERAF is not entitled to distribution of unitary and operating nonunitary taxes because linking R&T 100 (e) (3) with R&T 95 (b) eliminates the possibility of ERAF meeting the criteria of being a taxing jurisdiction.

However, R&T 100 also calls for the distribution of unitary and operating nonunitary taxes attributable to any growth over 2% in any given year to be apportioned using the prior year's allocation formula for the secured roll. The allocation of taxes for the Secured Roll is found in R&T 95 et seq. which clearly provides for apportionment of taxes to ERAF and defines ERAF as a school entity eligible to receive tax distributions R&T 95 (f):

(f) "School entities" means school districts, community college districts, the Educational Revenue Augmentation Fund, and county superintendents of schools.

Given the provision for inclusion of ERAF as part of the secured roll tax allocation formula, it also would be reasonable to conclude that, under the provisions of R&T 100 (c) (3), that ERAF should be a part of the distribution of unitary and operating nonunitary taxes the first year, and each year there after, that the assessed valuation of unitary and operating nonunitary properties increase by a magnitude of greater than 2%.

Given these two reasonable, albeit contradictory positions, as to the inclusion of ERAF in unitary and operating nonunitary tax distributions, we need to see what the legislative intent was. R&T 100 was added by Stats. 1997, c.1167. The historical and statutory notes state, "It is the intent of the Legislature in enacting this act only to clarify and reorganize those statutes with respect to the allocation of property tax revenues, and to eliminate portions of those statutes that have been fully implemented or are no longer applicable. ***This act shall not be construed to invalidate or otherwise affect any otherwise proper action taken under the authority of Chapter 6 (commencing with Section 95) of Part 0.5 of Division 1 of the Revenue and Taxation Code*** prior to the operative date of this act, or any requirements of that chapter as the chapter read prior to the operative date of this act.

In our opinion, the intent of the legislature was that the allocation of unitary and operating nonunitary tax revenues attributable to the increase over 2% should strictly follow the allocation practices and procedures for the Secured Roll found in R&T 95 et seq., that includes ERAF as part of the distribution of taxes. In addition, we find it difficult to believe the State intentionally enacted legislation that would negatively impact State revenue by excluding ERAF from the distribution process. We therefore disagree with this finding and will continue with our current practice of including ERAF as part of the distribution of unitary and operating nonunitary taxes.

SCO's Comment

The ERAF is a fund—an accounting entity, not a taxing jurisdiction—and with respect to the allocation and apportionment of unitary and operating nonunitary taxes, the Legislature has not defined the ERAF as a taxing jurisdiction.

The county points out that Revenue and Taxation (R&T) Code section 95(b) defines a jurisdiction as a “local agency, school district, community college district, or county superintendent of schools. . . .” The county further points out that R&T Code section 95(f) includes the ERAF in the definition of school entities. “School entities” means school districts, community college districts, the Educational Revenue Augmentation Fund, and county superintendent of schools.” However, the definition of “jurisdiction” does not include the ERAF but does include all defined school entities *except* the ERAF. Defining the ERAF as a school entity does not make it a jurisdiction.

In addition, the county points out that R&T Code section 100(e)(3) includes a redevelopment agency as a taxing jurisdiction. The county is trying to show that the Legislature, in enacting the section, is including a non-taxing entity in the definition of a taxing jurisdiction. We concur. This demonstrates that the Legislature can include non-taxing entities in the definition of taxing jurisdiction. In this case, it omitted the ERAF from the definition of taxing jurisdiction.

The finding remains as written.

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



AUDITOR-CONTROLLER

Larry D. Haugh
Auditor - Controller

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October 6, 2008

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

**SUBJECT: PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM AUDIT
REPORT JULY 1, 2003 THROUGH JUNE 30, 2006**

Dear Mr. Mar:

Thank you for the opportunity to respond to the audit finding. While we do not agree with this specific finding, we do appreciate the work of the State Controller's Office and your dedicated staff.

Finding by the State Controller:

"The county complied with California statutes, except that it includes the Educational Revenue Augmentation Fund (ERAF) in the unitary and operating nonunitary apportionment process."

Recommendation by the State Controller:

"The county should remove the ERAF from the unitary and operating nonunitary process and distribute the revenue to the agencies contributing to the ERAF."

County Response to Finding:

Revenue & Taxation Code Section 100 governs the distribution of unitary and operating nonunitary taxes. This section as evidenced below, defines the distribution of taxes to "taxing jurisdictions"

(3) If the amount of property tax revenue available for allocation to all taxing jurisdictions in the current fiscal year from unitary and operating nonunitary property, exclusive of revenue attributable to qualified property under Section 100.95 and levies for debt service, exceeds 102 percent of the property tax revenue received by all taxing jurisdictions from all unitary and operating nonunitary property in the prior fiscal year, exclusive of revenue attributable to qualified property under Section 100.95 and levies for debt service, the amount of revenue in excess of 102 percent shall be allocated to all taxing jurisdictions in the county by a ratio determined by dividing each taxing jurisdiction's share of the county's total ad valorem

tax levies for the secured roll for the prior year, exclusive of levies for qualified property under Section 100.95 and levies for debt service, by the county's total ad valorem tax levies for the secured roll for the prior year, exclusive of levies for qualified property under Section 100.95 and levies for debt service.

The underlying foundation for the State Controller's opinion seems to be that ERAF is not a taxing jurisdiction. Unfortunately, in the chapter that governs the distribution of taxes from the unitary and operating nonunitary roll, the term "taxing jurisdiction" is not clearly defined. The general construction for the chapter is found in section 95 of the Revenue and Taxation code. That section (95 (b)) does define the term "Jurisdiction" as "a local agency, school district, community college district, or county superintendent of schools..." We also find in section 100 (e) (3) that "Taxing Jurisdiction" includes a redevelopment agency". The State Controller has opined that ERAF is not entitled to distribution of unitary and operating nonunitary taxes because linking R&T 100 (e) (3) with R&T 95 (b) eliminates the possibility of ERAF meeting the criteria of being a taxing jurisdiction.

However, R&T 100 also calls for the distribution of unitary and operating nonunitary taxes attributable to any growth over 2% in any given year to be apportioned using the prior year's allocation formula for the secured roll. The allocation of taxes for the Secured Roll is found in R&T 95 et seq. which clearly provides for apportionment of taxes to ERAF and defines ERAF as a school entity eligible to receive tax distributions R&T 95 (f):

(f) "School entities" means school districts, community college districts, the Educational Revenue Augmentation Fund, and county superintendents of schools.

Given the provision for inclusion of ERAF as part of the secured roll tax allocation formula, it also would be reasonable to conclude that, under the provisions of R&T 100 (c) (3), that ERAF should be a part of the distribution of unitary and operating nonunitary taxes the first year, and each year thereafter, that the assessed valuation of unitary and operating nonunitary properties increase by a magnitude of greater than 2%.

Given these two reasonable, albeit contradictory positions, as to the inclusion of ERAF in unitary and operating nonunitary tax distributions, we need to see what the legislative intent was. R&T 100 was added by Stats. 1994, c.1167. The historical and statutory notes state, "It is the intent of the Legislature in enacting this act only to clarify and reorganize those statutes with respect to the allocation of property tax revenues, and to eliminate portions of those statutes that have been fully implemented or are no longer applicable. ***This act shall not be construed to invalidate or otherwise affect any otherwise proper action taken under the authority of Chapter 6 (commencing with Section 95) of Part 0.5 of Division 1 of the Revenue and Taxation Code*** prior to the operative date of this act, or any requirements of that chapter as the chapter read prior to the operative date of this act."

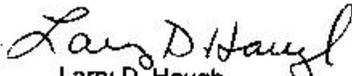
In our opinion, the intent of the legislature was that the allocation of unitary and operating nonunitary tax revenues attributable to the increase over 2% should strictly follow the allocation practices and procedures for the Secured Roll found in R&T 95 et seq., that includes ERAF as part of the distribution of taxes. In addition, we find it difficult to believe the State intentionally enacted legislation that would negatively impact State revenue by excluding ERAF from the

October 6, 2008,
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distribution process. We therefore disagree with this finding and will continue with our current practice of including ERAF as part of the distribution of unitary and operating nonunitary taxes.

Please let us know if you would like additional information regarding our response.

Sincerely,


Larry D. Haugh
Auditor-Controller

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