

STATE OF CALIFORNIA

Report to the California State Legislature

PROPERTY TAX APPORTIONMENTS

Calendar Year 2010



JOHN CHIANG
California State Controller

March 2011



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California State Controller

March 6, 2011

To the Members of the State Legislature
and the People of California:

Re: Property Tax Apportionments Report to the Legislature for Calendar Year 2010

I am pleased to present the Property Tax Apportionments report for calendar year 2010. This report, prepared pursuant to Government Code section 12468, is intended to help mitigate problems associated with the counties' apportionment and allocation of property tax revenues.

The audits completed by the State Controller's Office in 2010 found the audited counties to be generally in compliance with the legal requirements for allocating property tax revenues. However, this report notes specific problem areas relative to individual counties.

I hope you find the report informative and useful for future policy decisions.

Sincerely,

Original signed by

JOHN CHIANG
California State Controller

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Executive Summary

This report summarizes the results of the State Controller's Office (SCO) audit of county property tax apportionments and allocations during the 2010 calendar year. After the passage of Proposition 13 in 1978, the California 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 agencies with a property tax base that would grow as assessed property values increase.

Property tax revenues that local governments receive each year are based on the amount received the prior year plus a share of the property tax growth within their boundaries. Property tax revenues are then allocated to local agencies and schools using prescribed formulas and methods defined in the Revenue and Taxation Code. This methodology is commonly referred to as the AB 8 process or the AB 8 system. The method has been further refined in subsequent laws passed by the Legislature.

The SCO's property tax audit program began on July 1, 1986, pursuant to Revenue and Taxation Code section 95.6 (now Government Code section 12468). The statute mandates that the SCO perform audits of the allocation and apportionment of property tax revenues by counties and make specific recommendations to counties concerning their property tax administration. The statute also specifies that the SCO is to prepare an annual report summarizing the results of its findings under this audit program.

We developed and implemented a comprehensive audit program that includes, but is not limited to, a detailed analysis of past and current requirements of property tax laws and an examination of property tax systems, processes, and records at the county level. Each audit encompasses an evaluation of a county's property tax apportionment methodology, allocation procedures, and compliance with applicable laws and regulations. We applied procedures considered necessary and appropriate to provide a basis for reporting on the areas examined.

Government Code section 12468 requires that audits be conducted periodically for each county according to a prescribed schedule based on county population. During 2010, the SCO completed audits of 14 counties' property tax apportionment and allocation systems, processes, and records. The 14 counties are Humboldt, Kern, Los Angeles, Mariposa, Merced, Monterey, Napa, San Diego, Santa Barbara, Sierra, Sonoma, Tehama, Tulare, and Tuolumne counties.

As a part of our audit, we performed follow-up reviews to ensure that the counties properly addressed the findings identified in our previous audit reports. We are pleased to note that 7 of the 14 counties have successfully resolved the prior audit findings and that 3 of the 14 counties had no prior audit findings.

Therefore, except for the findings and recommendations noted in this report, the processes used by the 14 counties audited during 2010 appear to comply with the requirements for the apportionment and allocation of property tax revenues. However, the auditors are particularly concerned about one county's failure to address prior audit findings that could adversely affect the ability of the county's property tax system to accurately apportion and allocate property tax revenues to the taxing agencies in the county.

Our audit report findings are broadly classified as follows:

Prior Audits

- Four counties have not resolved prior audit issues, which include:
 - Incorrect distribution of the 1978-79 base-year apportionment;
 - Factor adjustments for a new tax rate area (TRA); and
 - Inclusion of the Educational Revenue Augmentation Fund (ERAF) in the unitary and operating nonunitary tax apportionment calculations by two counties.

Current Audits

- One county used the net instead of gross amount for post-1994 redevelopment agency (RDA) pass-through calculations for RDA projects.
- Thirteen counties included the ERAF, a non-taxing jurisdiction, in the unitary and operating nonunitary apportionment calculations.
- One county's disaster relief amount in the ERAF fund did not receive growth from FY 1997-98 and all subsequent years.
- One county deposited a portion of the mandatory pass-through payments made by an RDA into the ERAF, a non-affected taxing entity.
- One county failed to comply with the setup requirements of Senate Bill 1096, as neither the Sales and Use Tax Compensation Fund nor the Vehicle License Fee Property Tax Compensation Fund were established in the county treasury.
- One county incorrectly distributed the cost of tax refunds to all agencies instead of to only the affected agencies.

We noted two pending legal issues which could have an impact on many counties:

- The first concerns the computation of administrative cost pro rata shares chargeable to local agencies and whether certain subvention revenues are to be included in the computation.
- The second concerns the computation of tax equity allocation amounts for low- and no-tax cities.

The counties generally agreed with most findings, except as noted in the findings of individual audits, and have stated that corrective action has been or will be taken to rectify the issues noted in our audit reports.

Overview

Introduction

This report presents the results of 14 audits of county property tax apportionments and allocations completed by the State Controller's Office (SCO) in calendar year 2010. The following counties were audited: Humboldt, Kern, Los Angeles, Mariposa, Merced, Monterey, Napa, San Diego, Santa Barbara, Sierra, Sonoma, Tehama, Tulare, and Tuolumne. Government Code section 12468 requires that such audits be conducted periodically for each county according to a prescribed schedule based on county population. The purpose of the audits is to help mitigate problems associated with property tax apportionment and allocation.

Except for the findings and recommendations noted in this report, the 14 audited counties complied with the requirements for the apportionment and allocation of property tax revenues.

The SCO is particularly concerned about one county's failure to address prior audit findings that could adversely affect the ability of the county's property tax system to accurately apportion and allocate property tax revenues to the taxing agencies in the county.

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 agencies with a property tax base that would grow as assessed property values increase. 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.

Property tax revenues that local governments receive each fiscal year are based on the amount received 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 process involved several steps, including the transfer of revenues from schools to local agencies and the development of the tax rate area annual tax increment growth (ATI) factors, which determine the amount of property tax revenues allocated to each entity (local agency and school). The total amount allocated to each entity is then divided by the total amount to be allocated to all entities to determine the AB 8 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 has removed revenue generated by unitary and operating nonunitary property and pipelines 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 ERAF. The fund is subsequently allocated and apportioned by the county auditor according to instructions received from the local superintendent of schools or chancellor of the California community colleges.

Taxable property includes land, improvements, and other properties that are accounted for on the property tax rolls, which are primarily maintained by the county assessor. Tax rolls contain an entry for each parcel of land, including parcel number, owner's name, and value. The types of property tax rolls are:

- *Secured Roll*—Property that, in the opinion of the assessor, has sufficient value to guarantee payment of the tax levies and that, if unpaid, can be satisfied by the sale of the property by the tax collector.
- *Unsecured Roll*—Property that, in the opinion of the assessor, does not constitute sufficient “permanence” or have other intrinsic qualities to guarantee payment of taxes levied against it.
- *State-Assessed Roll*—Utility properties, composed of unitary and nonunitary value, assessed by the State Board of Equalization.
- *Supplemental Roll*—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.

Audit Program

The property tax audit program began on July 1, 1986, under Revenue and Taxation Code section 95.6 (now Government Code section 12468). The statute mandates that the State Controller periodically perform audits of the allocation and apportionment of property tax revenues by counties and make specific recommendations to counties concerning their property tax administration. However, the State Controller's authority to compel resolution of its audit findings is limited to those findings involving an overpayment of state funds.

Overpayment of state general fund money is recoverable by the State under several provisions of law. In addition, the State Controller has broad authority to recover overpayments made from the State Treasury. If an audit finds overpayment of state funds, and the state agency that made or authorized the payment does not seek repayment, the SCO is authorized to pursue recovery through a variety of means (e.g., Government Code sections 12418–12419.5). The specific remedy employed by the SCO depends on the facts and circumstances of each situation.

The SCO developed and implemented a comprehensive audit program to carry out the mandated duties. The comprehensive audit program includes, but is not limited to, a detailed analysis of past and current requirements of property tax laws and an examination of property tax records, processes, and systems at the county level.

These property tax apportionment audits have identified and aided in the correction of property tax underpayments to public schools. The underallocation of property taxes by individual counties to their public schools results in a corresponding overpayment of state funds to those schools by the same amount. This, in turn, causes public schools in other counties to receive less state funding because the total funds available are limited. Subsequent legislation forgave some counties for underpayments to schools without requiring repayment or assessment of penalties. However, the legislation required that the cause of the underallocations, as identified by the audits, be corrected.

Audit Scope

Each audit encompasses an evaluation of a county's property tax apportionment methodology, allocation procedures, and compliance with applicable laws and regulations. The auditors used procedures considered necessary to provide a basis for reporting on the areas examined. In conducting the audits, the auditors focused on the following areas to determine if:

- The apportionment and allocation of the ATI was in accordance with Revenue and Taxation Code sections 96 through 96.5;
- The methodology for redevelopment agencies' base-year calculations and apportionment and allocation of the ATI was in accordance with Revenue and Taxation Code sections 96.4 and 96.6, and Health and Safety Code sections 33670 through 33679;
- The effect of jurisdictional changes on base-year tax revenues and the ATI was in accordance with Revenue and Taxation Code section 99;
- The apportionment and allocation of property tax revenues from supplemental assessments was in accordance with Revenue and Taxation Code sections 75.60 through 75.71;
- The apportionment and allocation of state-assessed unitary and operating nonunitary property taxes was in accordance with Revenue and Taxation Code section 100;
- The computation and apportionment of property tax revenues to low- and no-tax cities was in accordance with Revenue and Taxation Code section 98;
- The computation and collection of local jurisdictions' property tax administrative costs was in accordance with Revenue and Taxation Code sections 95.2 and 95.3;

- The computation and apportionment of property tax revenues to the ERAF was in accordance with Revenue and Taxation Code sections 97 through 97.3; and
- For eligible counties, the computation of the county credit against the county's ERAF shift was in accordance with Revenue and Taxation Code sections 97.3(a)(5) and 97.36.

Pending Litigation

Property Tax Administration Fees

A dispute has arisen between the counties and the cities regarding the application of Revenue and Taxation Code section 95.3 relating to the computation of Property Tax Administration Fees (PTAF). The counties generally contend that distribution factors for purposes of distributing PTAF to taxing agencies should be computed including amounts received by cities under Revenue and Taxation Code section 97.68, commonly known as the "Triple Flip," and section 97.70, commonly known as the "VLF Swap." The cities generally believe that the Triple Flip and the VLF (Vehicle License Fee) Swap should be excluded from the computation.

We are aware of two legal actions that have been filed on this issue.

In the first action, 47 cities (petitioners) in Los Angeles County filed suit against the county (respondent). In the summary of facts included in the decision, a retired judge acting as referee, noted:

The financial consequences of RESPONDENTS' method of calculating the PTAF for PETITIONERS are that PETITIONERS' PTAF fees were, collectively, over \$4.8 million in fiscal year 2006-07 and \$5.3 million in fiscal year 2007-08, more than such fees would have been had the Triple Flip and the VLF Swap additional property tax revenues not been included in PETITIONERS' property tax share used for apportioning PTAF, [sic] the County's actual cost of incremental tax allocation/distribution duties required by the Triple Flip and VLF Swap was approximately \$35,000 per year.

On June 2, 2009, the referee determined that the above-described method used by Los Angeles County was correct.

In the second action, filed in Fresno County, seven cities (petitioners) filed suit against the county (respondent). In this action, the court ruled that the method used by Fresno County was not in accordance with statute. This is the same method approved by the referee in Los Angeles County. In relevant part, the court ruled:

Under the County's methodology, each city's allocation of property tax revenue is reduced by the amount of PTAF. In the first sentence of section 97.75, the Legislature prohibited counties from reducing the allocation in reimbursement for the services performed under the two swaps. But when the Legislature said what the counties can do to get reimbursed in the second sentence, it did not say that counties could reduce a city's property tax revenue allocation. But that is exactly the effect of the County's approach. . . .

Pursuant to section 97.75, Respondents are permitted to charge no more than their actual incremental costs in providing the services specified in Rev. & Tax Code §§ 97.68 and 97.70.

Currently, the SCO is not expressing an opinion on the computation of the PTAF until such time as appeals (if any) are resolved.

Tax Equity Allocation Computations

Some cities historically received little or no property tax allocations from the taxes generated in their jurisdictional boundaries. Legislation was subsequently enacted to increase 7% over a period of time. Some counties perform the tax equity allocation (TEA) calculation annually. Other counties have brought the TEA cities into the AB 8 process at 7% and do not perform the calculation annually. In the past, the SCO has accepted either methodology.

A dispute has arisen between a city and a county concerning the proper method of computing the minimum 7% share, commonly known as “tax equity allocation” or “TEA payment.” Among the items of contention is whether or not the TEA city’s ERAF shift, pursuant to Revenue and Taxation Code section 97.3, is restored through the TEA payment process, thus effectively making the TEA city exempt from the second shift. The first ERAF shift, under Revenue and Taxation Code section 97.2, requires that the TEA calculations be done “so that those computations do not result in the restoration of any reduction required pursuant to this section.” Revenue and Taxation Code section 97.3 does not have similar language.

Currently, the SCO is not expressing an opinion on the TEA process in any county with a TEA city until the legal issues are resolved.

Conclusion

The property tax allocation and apportionment system is generally operating as intended. In the interest of efficiency and cost control for both the counties and the State, we submit the Summary of Findings and Recommendations in this report to assist in initiating changes that will help improve the system.

Summary of Findings and Recommendations

Introduction

Except for the findings and recommendations cited in this report, the audit reports issued in 2010 indicated that the counties complied with the legal requirements for the apportionment and allocation of property tax revenues. However, problem areas were identified and are described below. Recommendations to resolve the problems are included with the individual county findings.

The SCO is particularly concerned about one county's failure to address prior audit findings that could adversely affect the ability of the county's property tax system to accurately apportion and allocate property tax revenues to the taxing agencies in the county.

Unresolved Prior Audit Findings

As part of the audit process, auditors review the prior audit reports to determine which issues, if any, require follow-up action. Auditors perform procedures to determine whether the county has resolved previously noted findings, and they restate in the current audit any unresolved prior audit findings.

One county has continuing unresolved issues that could adversely affect the ability of the county's property tax system to accurately apportion and allocate property tax revenues to the taxing agencies in the county.

One county has an unresolved issue relating to a factor adjustments for a new tax rate area (TRA) regarding a city annexation.

Two counties have a continuing unresolved issue regarding an Education Revenue Augmentation Fund (ERAF) contribution amount.

Computation of Annual Tax Increment Factors

The Revenue and Taxation Code requires that each jurisdiction in a TRA must be allocated property tax revenues in an amount equal to the property tax revenues allocated to it in the prior fiscal year. The difference between this amount and the total amount of property tax assessed in the current year is known as the annual tax increment (ATI). The computation of the annual tax increment results in a percentage that is used to allocate growth in assessed valuation to a county's local government jurisdictions and schools from the base year forward. Revenue and Taxation Code sections 96 through 96.5 prescribe this methodology. (Some exceptions to this allocation are contained in the Revenue and Taxation Code for specified TRAs.)

We noted one county that continued to have base year revenue and factor computation errors that have not been corrected.

Jurisdictional Changes

Revenue and Taxation Code section 99 prescribes the procedures the county must perform in order to make adjustments for the apportionment and allocation of property taxes resulting from changes in jurisdictional controls or changes in responsibilities of local government agencies and schools. The statute requires the county to prepare specific documentation that takes into consideration services and responsibilities.

One county has an unresolved issued relating to a factor adjustment for a new TRA regarding a city annexation.

**Supplemental
Property Tax
Apportionments**

When a revaluation of property occurs during the fiscal year due to changes in ownership or completion of new construction, supplemental taxes are usually levied on the property. Revenue and Taxation Code sections 75.70, 75.71, and 100.2 provide for the apportionment and allocation of these supplemental taxes.

No errors were noted in this area.

**Supplemental
Property Tax
Administrative Fees**

In addition to the fee allowed by Revenue and Taxation Code section 95.3 for the administration of the secured tax roll, Revenue and Taxation Code section 75.60 allows the charging of a fee for the administration of the supplemental tax roll. Once the counties adopt a method of identifying the actual administrative costs associated with the supplemental roll, they are allowed to charge an administrative fee for supplemental property tax collections. This fee is not to exceed 5% of the supplemental taxes collected.

No errors were noted in this area.

**Redevelopment
Agencies**

The legal requirements for the apportionment and allocation of property tax to redevelopment agencies (RDA) are found in Revenue and Taxation Code sections 96.4 and 96.6 and Health and Safety Code sections 33670 through 33679. California community redevelopment law entitles a community redevelopment agency to all of the property tax revenue realized from growth in values since the redevelopment project's inception, with specified exceptions.

One county used the net amount instead of the gross amount for post-1994 redevelopment pass-through calculations for RDA projects.

**Unitary and
Operating
Nonunitary
Property Taxes**

The process for allocating and apportioning property taxes from certain railroad and utility companies functions through the unitary and operating nonunitary tax system employed by the State Board of Equalization. Unitary properties are those properties on which the State Board of Equalization "may apply 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." Revenue and Taxation Code section 100 prescribes the procedures counties must perform to allocate unitary and operating nonunitary property taxes beginning in FY 1988-89.

Thirteen counties included the ERAF as a taxing jurisdiction in unitary and operating nonunitary apportionment calculations.

Property Tax Administrative Fees

Counties are allowed to collect from each appropriate jurisdiction, that jurisdiction's share of the cost of assessing, collecting, and apportioning property taxes. Revenue and Taxation Code section 95.3 prescribes the requirements for computing and allocating property tax administrative fees (PTAF). The assessor, tax collector, and auditor generally incur county property tax administrative costs. The county is generally allowed to be reimbursed for these costs.

For FY 2004-05 and FY 2005-06, the county is prohibited by Revenue and Taxation Code section 97.75 from charging a fee for the services provided under Revenue and Taxation Code sections 97.68 and 97.70.

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

A legal challenge has arisen regarding the method some counties have used to impose the fee for the services provided under Revenue and Taxation Code sections 97.68 and 97.70. Though none of the counties included in this report have used this method to impose the fee, an observation is noted until the legal issues are resolved. After all legal challenges are resolved, we will review the PTAF process again to determine if any adjustments are warranted and will modify reports accordingly; the counties will also be allowed to modify their method of imposing the fee. Currently, the SCO is not expressing an opinion on the computation of the PTAF until all legal issues are resolved.

Educational Revenue Augmentation Fund

The legal requirements for the local agency shift of property tax revenues to the Education Revenue Augmentation Fund (ERAF) are contained in Revenue and Taxation Code sections 97 through 97.3. Beginning in FY 1992-93, each local agency was required to shift an amount of property tax revenues to the ERAF using formulas prescribed by the Revenue and Taxation Code. The property tax revenues in the ERAF are subsequently allocated to schools and community colleges using factors supplied by the county superintendent of schools or chancellor of the California community colleges.

Since the passage of the ERAF shift requirements, the Legislature has enacted numerous bills that affect the shift requirements for various local government agencies. One bill was Assembly Bill (AB) 1589 (Chapter 290, Statutes of 1997). This bill primarily addressed three areas related to the ERAF shift: (1) ERAF shift requirements for certain county fire funds for FY 1992-93 (Revenue and Taxation Code section 97.2(c)(4)(B)); (2) a special provision for counties of the second class when computing the ERAF shift amount for county fire funds in FY 1993-94 (Revenue and Taxation Code section 97.3(c)(4)(A)(I)); and

(3) ERAF shift requirements for county libraries for FY 1994-95 and subsequent years. After the passage of AB 1589, the State Controller requested advice from the California Attorney General regarding the application of Chapter 290, Statutes of 1997. The Attorney General responded in May 1998.

The Attorney General advised that the amendment to Revenue and Taxation Code section 97.2(c)(4)(B) significantly narrowed the scope of the exemption granted by the code section and was to be given retroactive application. The result is that many counties and special fire protection districts that were able to claim an exemption under the section as it formerly read lost the exemption retroactive to FY 1992-93. Consequently, those counties and special districts were required to shift additional funds to the county ERAF.

In response to the advice by the Attorney General, and noting the severe fiscal impact the loss of the exemption would have on local government agencies, the SCO recommended that the Legislature consider restoring the exemption previously granted to fire protection districts and county fire funds that was eliminated as a result of AB 1589, Chapter 290, Statutes of 1997. Subsequently, the Legislature enacted AB 417 (Chapter 464, Statutes of 1999), restoring the exemption to fire districts.

We noted that, in one county, the disaster relief amount in the ERAF fund did not receive growth from FY 1997-98 and all subsequent years.

In another county, a portion of the mandatory pass-through payments made by a city RDA were deposited by the county in the ERAF, a non-affected taxing entity.

Finally, one county did not comply with Senate Bill 1099 setup requirements.

Tax Equity Allocation

Revenue and Taxation Code section 98 and the Guidelines for County Property Tax Administration Charges and “No/Low Property Tax Cities” Adjustment, provided by the County Accounting Standards and Procedures Committee, provide a formula for increasing the amount of property tax allocated to a city that had either no- or low-property tax revenues.

In the past, SCO auditors have accepted the tax equity allocation formula computations completed by the counties. However, a legal challenge has raised the possibility that the methods used may not be in compliance with the Revenue and Taxation Code. At this time, this issue is noted as an observation until the legal issues are addressed. After all legal challenges are resolved, the SCO will review the no- or low-property tax revenue procedures again to determine if any adjustments or corrections are warranted, and we will modify any reports accordingly.

Currently, the SCO is not expressing an opinion on the TEA process in any county with a TEA city until the legal issues are resolved.

**Property Tax
Refunds and
Assessment Appeals**

Revenue and Taxation Code section 4707 prescribes the procedures for apportioning refunds. A formula is set out in the Revenue and Taxation Code for determining and allocating real property tax revenues assessed in a county that will be apportioned to each taxing agency located in the particular county. The formula is based or contingent on the situs of the assessed parcels of realty located in each of the tax rate areas.

One county incorrectly distributed the cost of tax refunds to all agencies instead of to only the affected agencies.

Findings of Individual County Audits

Introduction

The findings and recommendations included below are presented as they were stated in the County Property Tax Apportionment and Allocation reports issued by the State Controller's Office (SCO) in calendar year 2010. Unless otherwise indicated, the counties agreed with the findings and recommendations.

The findings and recommendations listed below are solely for the information and use of the California Legislature, the respective counties, the Department of Finance, and the SCO; they are not intended to be and should not be used by anyone other than those specified parties. This restriction is not intended to limit distribution of this report or the respective audit reports, which are a matter of public record.

Humboldt County (July 1, 2003, through June 30, 2008)

Follow-up on Prior Audit Findings

Findings noted in our prior audit, issued October 18, 2005, have been satisfactorily resolved by the county, with the exception of one finding related to the factor adjustments for a new tax rate area (TRA) involved in the City of Trinidad annexation. This finding is described in the Findings and Recommendations section of this report under Finding 1.

FINDING 1— Jurisdictional changes

The county failed to satisfactorily resolve one finding related to the factor adjustments for a new tax rate area (TRA) involved in the City of Trinidad annexation; this finding was noted in the prior SCO audit, dated October 18, 2005.

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 make the proper factor adjustments for the new TRA to complete the annexation.

County's Response

We concur with the finding and have made the necessary corrections.

**FINDING 2—
ERAF included in
unitary and operating
nonunitary
apportionment**

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

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in Revenue and Taxation Code section 100.

Unitary properties are those properties on which the Board of Equalization “may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee” (i.e., public utilities and railroads). The Revenue and Taxation Code further states, “Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee.”

In fiscal year 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The Legislature established the unitary and operating nonunitary base year and developed formulas to compute the distribution factors for the fiscal years that followed.

Recommendation

The county should not include the ERAF in future unitary and operating nonunitary tax apportionment computations, as the ERAF does not qualify as a “taxing jurisdiction” under Revenue and Taxation Code section 100. Thus, the ERAF is not eligible to share and its amount should be distributed proportionately among all taxing jurisdictions that contributed to the fund.

County’s Response

The County of Humboldt did not include ERAF in unitary tax apportionment calculations until 2004-05 when we were specifically directed to do so by SCO staff as part of the SB 1096 implementation. The reasons for the Controller’s change of opinion on this matter are irrelevant to us but the fact remains that clear and unambiguous guidance on this aspect of the property tax apportionment process is not present in the law.

The County of Humboldt is indifferent as to whether or not ERAF should be included in unitary apportionments – the dollar amounts involved in this County are immaterial. We recommend that the SCO work with the State Association of County Auditors to promulgate some uniform standards on this issue that all the counties can follow rather than use audit findings to promote unwritten policies on a county-by-county basis. Once uniform printed standards are worked out we will comply with whatever guidance those standards provide.

SCO’s Comment

Our finding and recommendation remain unchanged.

The response states that Humboldt County is indifferent as to whether or not the ERAF should be included in unitary apportionments. However, the ERAF is a fund, an accounting entity, and not a taxing jurisdiction. Revenue and Taxation Code section 100 requires that taxes from unitary and operating nonunitary property be allocated to taxing jurisdictions. As the ERAF is not a taxing jurisdiction, it is not eligible to receive unitary and operating nonunitary taxes.

**FINDING 3—
Property tax refunds
and assessment appeals**

A taxpayer may appeal the taxes levied against property owned if the taxpayer feels that the assessment is in error and has resulted in the taxpayer paying too much property tax. It has been the policy of Humboldt County, when there is a successful assessment appeal by a taxpayer, to require the resulting property tax refund to be paid proportionately by all agencies in the county, including redevelopment agencies that receive property taxes through the county's AB 8 tax allocation process. The result is that agencies that did not receive property taxes from the tax rate area where the successful appellant resided must repay a share of the refund from taxes levied and collected from other tax rate areas.

During this audit period, there were two large assessment appeals that were resolved in the taxpayers' favor, resulting in a refund of property taxes to the taxpayers. Several redevelopment agencies in the county did not believe that it was proper for the county to "charge" them for a portion of the refund, as they did not receive property taxes from the tax rate areas where the successful appellants were located. They consequently requested that the SCO review the matter.

Upon completion of the review, we concluded that only agencies within the tax rate areas of the successful appellants should be charged for the refund. Nevertheless, the county still charged all agencies a share of the refund. County personnel stated that its refund methodology has since been changed to exclude redevelopment agencies, but that it will still charge all other agencies for a share of the refund. We believe this methodology is still incorrect.

The basis of the property tax system is *situs*, that is, where the property is located. Property is assessed by its location and local agencies receive a share of the taxes generated if services are provided to that location. By charging agencies outside the taxpayer's area in order to repay a portion of the taxes levied in the taxpayer's area, the county is essentially transferring property taxes levied for, and paid to, agencies outside the taxpayer's area to agencies within the taxpayer's area. We are unaware of any statute that would allow such a transfer.

County personnel also stated that the redevelopment agencies had agreed to this methodology during this audit period after the county informed them that they had been paid too much property tax for certain years, and that if they wanted to be excluded from the refund, they would also have to pay back the overpayment. County personnel stated that this overpayment resulted because the county had collected more taxes than was used in the computations. It is unclear how the redevelopment agencies could be overpaid if the county is a "Teeter" county, in which all agencies essentially receive their proportionate share of taxes levied,

not taxes collected. In addition, redevelopment agencies are to receive the taxes only from the tax increment generated within its area. If the redevelopment agency received more than the generated tax increment, then other agencies within the county did not receive enough property taxes. Again, the county may have transferred property taxes between areas and agencies within the county.

Revenue and Taxation Code section 4701 et seq. provides an alternative for the distribution of property tax levies on the secured roll made by the counties. In the event of a change in any tax or assessment by correction, cancellation, or refund, section 4707 expressly provides for a “pro rata adjustment for the amount of such change . . . in each of the funds to which apportionment previously has been made.”

Recommendation

The county should change its methodology for distributing the cost of the tax refunds by making the appropriate adjustments only to the affected agencies, rather than all agencies. These agencies were charged a share of the tax refund regardless of the situs of the property.

County’s Response

We are guided by Revenue and Taxation Code Section 4707, which requires that any refunding adjustment to the tax roll be apportioned in the same manner that the tax revenue was originally apportioned, i.e. create a negative apportionment to adjust the earlier positive apportionment of tax revenues. In Humboldt County all \$1.00 property tax apportionments are distributed to every taxing agency in the County, not just to the agencies in the tax rate areas where the tax dollars originate. Therefore, our policy has been to allocate the cost of any refund to the entire tax pool when we are required to adjust the rolls.

However, we do understand the nature of the Controller’s recommendation and it presents some concerns for us. Our primary concern is that the schools’ ERAF fund exists only at the jurisdictional level in this County. If we were to allocate the cost of refunds at the TRA level we would have to create a methodology for recouping overpaid tax revenue from the ERAF fund. If we did not recoup tax refunds from ERAF we would violate R&T 4707. ERAF takes about twenty percent of the tax revenue from the countywide AB8 distribution but its impact varies among the different agencies. ERAF takes forty-three percent of the County General fund’s revenue but much less from other agencies so any calculation taking ERAF down to the TRA level would have to accommodate those disparities.

Another concern is for the complexity of administering a TRA-based refunding system. We probably couldn’t justify the staff time involved in performing the calculations described above for every little refund, so we would have to set a dollar threshold above which we employ the TRA-based system. By contrast, our current system of applying refunds to the entire AB8 pool is very simple and makes no distinction for the size of the refund.

Resolving these concerns requires that we do more research before we can commit to changing our current policy. We will consult with other

counties to see what they are doing with refunds and what systems they have in place to accurately allocate the cost of refunds. We will keep the Controller informed as to what our future policy is going to be regarding this matter.

SCO's Comment

Our finding and recommendation remain unchanged.

A property tax concept is that property taxes on real property are determined by the situs of the property. Under the county's procedure of adjusting apportionments of all taxing agencies, the intent is to spread the refund burden to all agencies. The effect, however, is to force agencies that did not receive revenues from the erroneously assessed properties to subsidize the other taxing agencies that did benefit from the excessive assessments. This result is inconsistent with the provisions and intent of Revenue and Taxation Code section 4707, and with the statutory formula governing the allocation of property taxes.

If an apportionment was made to a taxing agency that included a portion of revenues derived from an incorrect assessment valuation, then a pro rata adjustment should be made in the agency's apportionment. But if a taxing agency did not receive revenues attributable to the erroneous valuation assessments, then there is no purpose or reason for adjusting its allocation of property tax revenues.

Kern County (July 1, 2005, through June 30, 2009)

Follow-up on Prior Audit Findings

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

FINDING 1— ERAF included in unitary and operating nonunitary apportionment

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

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in Revenue and Taxation Code section 100.

Unitary properties are those properties on which the Board of Equalization "may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee" (i.e., public utilities and railroads). The Revenue and Taxation Code further states, "Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee."

In fiscal year (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

For all future unitary and operating nonunitary tax apportionment computations, the county should not include the ERAF, as the ERAF does not qualify as a “taxing jurisdiction” under Revenue and Taxation Code section 100. Thus, the ERAF is not eligible to share and its amount should be distributed proportionately among all taxing jurisdictions that contributed to the fund.

County’s Response

The county did include ERAF in the unitary and operating nonunitary apportionments in accordance with unitary and operating nonunitary allocation guidelines. Allocation factors have been audited previously and were found to be correct. In response to questions on this issue, in May of 2007, the State Auditor’s Association recommended that County Auditors make no changes to their allocation methodology and stay consistent in following the Property Tax Manager’s Reference Manual. Until the legislature clarifies this issue, we will not change our position.

SCO’s Comment

Our finding and recommendation remain unchanged.

The ERAF is a fund—an accounting entity, not a taxing jurisdiction. Revenue and Taxation Code section 100 requires that taxes from unitary and operating nonunitary property be allocated to taxing jurisdictions. As the ERAF is not a taxing jurisdiction, it is not eligible to receive unitary and operating nonunitary taxes.

FINDING 2— Educational Revenue Augmentation Fund

The disaster relief amount in the ERAF fund did not receive growth from FY 1997-98 and all subsequent fiscal years.

The roll value used by the county to compute the vehicle license fee (VLF) growth and reimbursed by the ERAF excluded the values assessed by the State Board of Equalization.

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 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 was 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 must correct the ERAF system so that growth is added for the disaster relief amount for each fiscal year beginning with FY 1997-98. The corrected values must be used beginning with FY 2009-10.

The VLF growth formula must use the gross taxable assessed valuation within the jurisdiction of the entity as reflected in the equalized assessment roll for those fiscal years.

County's Response

We concur regarding the VLF growth formula and have corrected the formula to include state assessed values. However, we do not concur with respect to disaster relief. Based on the introductory language in R&T 97.2 and subsection (e)(1), an adjustment is required in the 1997-98 fiscal year, to be carried over into fiscal year 1998-99 per subsection (e)(3). Not only is there no authorization for subsequent growth, a review conducted as a result of your audit indicates that the disaster relief adjustment should be removed from the formula in subsequent years. Therefore, we will journalize the correcting adjustment in the current fiscal year, and make a corresponding adjustment in the 2010/2011 AB8 calculation.

SCO's Comment

Our finding and recommendation remain unchanged.

Revenue and Taxation Code section 97.2 states, in part: "... the computations and allocations made by each county pursuant to section 96.1 or its predecessor section shall be modified for the 1992-93 fiscal year pursuant to subdivisions (a) to (d), inclusive, and for the 1997-98 and 1998-99 fiscal years pursuant to subdivision (e), as follows:"

Revenue and Taxation Code section 97.2 (e) states, in part:

(e)(1) For the 1997-98 fiscal year:

(A) The amount of property tax revenue deemed allocated in the prior fiscal year to any city subject to the reduction specified in paragraph (2) of subdivision (b) shall be reduced by an amount that is equal to the difference between the amount determined for the city pursuant to paragraph (1) of subdivision (b) and the amount of the reduction determined for the city pursuant to paragraph (2) of subdivision (b).

Revenue and Taxation Code section 96.1 states, in part:

(a) Except as otherwise provided in Article 3 (commencing with section 97), and in Article 4 (commencing with section 98), for the 1980-81 fiscal year and each fiscal year thereafter, property tax revenues shall be apportioned to each jurisdiction pursuant to this section and section 96.2 by the county auditor, subject to allocation and payment of funds as provided for in subdivision (b) of section 33670 of the Health and Safety Code, to each jurisdiction in the following manner:

- (1) For each tax rate area, each jurisdiction shall be allocated an amount of property tax revenue equal to the amount of property tax revenue allocated pursuant to this chapter to each jurisdiction in the prior fiscal year, modified by any adjustments required by section 99 or 99.02.

In the code cited above it can be seen that, pursuant to section 97.2, the amounts computed by section 96.1 are modified by section 97.2(e) in FY 1997-98. Section 96.1 then requires these adjusted amounts to be carried forward into the next fiscal year. Other sections of the Revenue and Taxation Code specify that the tax increment is then added to these amounts carried forward to determine the amount of property tax for the current year.

**FINDING 3—
Redevelopment
agencies**

The county computed and provided post-1994 redevelopment agency (RDA) pass-through calculations for RDA projects. The revenue used in the formula was net of SB 2557 cost.

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 must use the gross amount in the formula for pass-through calculations.

County's Response

We concur and have changed out internal processes in order to allocate pass-through prior to the allocation of SB2557.

Los Angeles County (July 1, 2007, through June 30, 2009)

**Follow-up on Prior
Audit Findings**

The finding noted in our prior audit, issued February 2009, has not been satisfactorily resolved by the county.

**FINDING—
ERAF included in
unitary and operating
nonunitary
apportionment**

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

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in Revenue and Taxation Code section 100.

Unitary properties are those properties on which the Board of Equalization "may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee" (i.e., public utilities and railroads). The

Revenue and Taxation Code further states, “Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee.”

In 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 not include the ERAF in future unitary and operating nonunitary tax apportionment computations, as the ERAF does not qualify as a “taxing jurisdiction” under Revenue and Taxation Code section 100. Thus, the ERAF is not eligible to share and its amount should be distributed proportionately among all taxing jurisdictions that contributed to the fund.

County’s Response

My office agrees that ERAF is not a taxing entity but disagrees that ERAF is improperly included in the unitary apportionment computation.

The audit report states the requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in Revenue and Taxation Code Section 100. Revenue and Taxation Code Section 100 (c) (3) provides:

If the amount of property tax revenues 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 services, 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.

“Taxing jurisdiction” is defined in §100 (e) as including a redevelopment agency; but redevelopment agencies have no taxing power. Thus the term “taxing jurisdiction” in §100 is not necessarily confined to “jurisdictions” as defined in §95.

In the 2006-07 legislative session, §100.95 was added to change the allocation of new public utility construction after 2007. §100.95 holds harmless, (with counties and non-enterprise special districts) the allocations made to “school entities”. However, there would be no need to protect school entities’ allocations if such entities, including ERAF, were not entitled to any under §100.

Our view is that the term “taxing jurisdiction” in §100 was intended to broadly capture both jurisdictions (as defined in §95) and ERAF as entities, which receive defined property tax share under part 0.5, Chapter 6 of the Revenue and Taxation Code.

The Statewide Property Tax Manager’s Reference Manual is consistent with this approach and illustrates the calculation as including ERAF. Further, the State Association of County Auditors (SACA) recommends that tax managers follow the Reference Manual procedures as standard practice for the county auditors throughout the State.

Representatives from your office have verbally discussed this matter with the SACA and the Statewide Property Tax Managers Subcommittee. Your staff has indicated your position is based on an unpublished State Attorney General Opinion that states ERAF is not a taxing jurisdiction and should be excluded in the unitary calculation. The SACA and the Statewide Property Tax Managers Subcommittee has requested a copy of the opinion on many occasions, however, your office has declined to provide it.

Since we consider that our current method is not inconsistent with the Revenue and Taxation Code and the computation is a statewide standard practice, the County of Los Angeles respectfully declines to exclude ERAF in the unitary calculation. Absent further legislative clarification, my office will continue to apportion and allocate the unitary property tax revenue according to the Statewide Property Tax Manager’s Reference Manual.

SCO’s Comment

Our finding and recommendation remain unchanged.

The ERAF is a fund—an accounting entity, not a taxing jurisdiction.

The county points out that Revenue and Taxation Code section 100, subsection (e), includes redevelopment agencies as a taxing jurisdiction even though redevelopment agencies do not have taxing power. The county then concludes that the term “taxing jurisdiction” in Revenue and Taxation Code section 100 is “not necessarily confined to ‘jurisdictions’ as defined in §95.” We do not find anything in statute that would support this conclusion. Rather, by including redevelopment agencies as taxing jurisdictions in Revenue and Taxation Code section 100, subsection (e), the Legislature has shown that it can include a non-taxing jurisdiction in the definition of taxing jurisdictions. In this case, the Legislature included redevelopment agencies and did not include the ERAF.

The county further notes that Revenue and Taxation Code section 100.95 “. . . holds harmless . . . the allocations made to ‘school entities.’” The county concludes that there would be no need to “protect school entities’ allocations if such entities, including ERAF, were not entitled to any under §100.” The county also states its view that “. . . the term ‘taxing jurisdiction’ in §100 was intended to broadly capture both jurisdictions (as defined in §95) and ERAF as entities, which receive defined property tax share under Part 0.5, Chapter 6 of the Revenue and Taxation Code.”

The county is referring to Revenue and Taxation Code section 100.95, subdivisions (a)(3) and (a)(3)(A)(i), which state:

The county auditor shall allocate the property tax revenues derived from applying the tax rate described in paragraph (1) of subdivision (b) of Section 100 to the qualified property described in this section as follows:

School entities, as defined in subdivision (f) of Section 95, shall be allocated an amount equivalent to the same percentage the school entities received in the prior fiscal year from the property tax revenues paid by the utility in the county in which the qualified property is located.

The section does not hold harmless or protect the allocations made to school entities. The section defines the percentage of property taxes the school entities are to receive from the property taxes generated from the qualified property, not a dollar amount. Revenue and Taxation section 100.95, subsections (3)(A)(ii) and (iii), contain similar wording for the county and specified special districts.

Similarly, Revenue and Taxation Code section 100.95, subdivisions (a)(4) and (a)(5), provides:

(4) The county auditor shall allocate the property tax revenues derived from applying the tax rate described in paragraph (2) of subdivision (b) of Section 100 to the qualified property described in this section in accordance with subdivision (d) of Section 100, except that school entities, as defined in subdivision (f) of Section 95, shall be allocated an amount equivalent to the same percentage the school entities received in the prior fiscal year from the property tax revenues paid by the utility in the county in which the qualified property is located.

(5) In order to provide the allocations required by paragraphs (3) and (4), the county auditor shall make any necessary pro rata reductions in allocations of property taxes attributable to the qualified property to jurisdictions other than those receiving an allocation under paragraphs (3) and (4).

The reference to Revenue and Taxation Code section 95, subdivision (f), would indicate that the ERAF may receive an allocation from the revenues generated from the specified qualified property in Revenue and Taxation Code section 100.95, but it does not guarantee it. There is no such reference to Revenue and Taxation Code section 95, subdivision (f), in Revenue and Taxation Code section 100, only a statement related to taxing jurisdictions.

Mariposa County (July 1, 2003, through June 30, 2008)

Follow-up on Prior Audit Findings

The county has satisfactorily resolved the findings noted in our prior audit report, issued April 16, 2004.

FINDING— ERAF included in unitary and operating nonunitary apportionment

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

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in Revenue and Taxation Code section 100.

Unitary properties are those properties on which the Board of Equalization “may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee” (i.e., public utilities and railroads). The Revenue and Taxation Code further states, “Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee.”

In fiscal year 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The Legislature established the unitary and operating nonunitary base year and developed formulas to compute the distribution factors for the fiscal years that followed.

Recommendation

For all future unitary tax apportionment computations, the ERAF should not be included since it does not qualify as a “taxing jurisdiction” under Revenue and Taxation Code section 100. Thus, an ERAF is not eligible to share and its amount should be distributed proportionately among all taxing jurisdictions that contributed to the fund.

Auditor-Controller’s Response

Christopher Ebie, Mariposa County Auditor-Controller, responded by e-mail on December 8, 2009, agreeing with our finding and recommendation.

Merced County (July 1, 2005, through June 30, 2009)

Follow-up on Prior Audit Findings

The county has satisfactorily resolved the findings noted in our prior audit report, issued March 2006.

FINDING— ERAF included in unitary and operating nonunitary apportionment

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

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in Revenue and Taxation Code section 100.

Unitary properties are those properties on which the Board of Equalization “may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee” (i.e., public utilities and railroads). The Revenue and Taxation Code further states, “Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee.”

In 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 not include the ERAF in future unitary and operating nonunitary tax apportionment computations, as the ERAF does not qualify as a “taxing jurisdiction” under Revenue and Taxation Code section 100. Thus, the ERAF is not eligible to share and its amount should be distributed proportionately among all taxing jurisdictions that contributed to the fund.

County’s Response

The county agrees with the finding.

Monterey County (July 1, 2006, through June 30, 2009)

Follow-up on Prior Audit Findings

The county has satisfactorily resolved the findings noted in our prior audit report, issued February 27, 2008.

FINDING— ERAF included in unitary and operating nonunitary apportionment

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

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in Revenue and Taxation Code section 100.

Unitary properties are those properties on which the Board of Equalization “may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee” (i.e., public utilities and railroads). The Revenue and Taxation Code further states, “Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee.”

In fiscal year 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The Legislature established the unitary and operating nonunitary base year and developed formulas to compute the distribution factors for the fiscal years that followed.

Recommendation

The county should not include the ERAF in future unitary and operating nonunitary tax apportionment computations, as the ERAF does not qualify as a “taxing jurisdiction” under Revenue and Taxation Code section 100. Thus, the ERAF is not eligible to share and its amount should be distributed proportionately among all taxing jurisdictions that contributed to the fund.

County’s Response

Monterey County will continue to follow the Property Tax Manual which includes ERAF in the computation of unitary and operating non-unitary apportionments.

SCO’s Comment

Our finding and recommendation remain unchanged.

The ERAF is a fund—an accounting entity, not a taxing jurisdiction. Revenue and Taxation Code section 100 requires that taxes from unitary and operating nonunitary property be allocated to taxing jurisdictions. As the ERAF is not a taxing jurisdiction, it is not eligible to receive unitary and operating nonunitary taxes.

The county's statement that "Monterey County will continue to follow the Property Tax Manual" is not relevant. The SCO is not bound by the Property Tax Manager's Reference Manual. We audit to applicable statutes.

The Revenue and Taxation Code section 100(d)(1) states, "an amount shall be computed for each taxing jurisdiction" while section 100(e)(3) states, "taxing jurisdiction includes Redevelopment Agencies." The statute does not include the ERAF as a taxing jurisdiction.

Napa County (July 1, 2003, through June 30, 2009)

Follow-up on Prior Audit Findings

The county has satisfactorily resolved the findings noted in our prior audit report, issued October 24, 2005.

FINDING— ERAF included in unitary and operating nonunitary apportionment

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

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in Revenue and Taxation Code section 100.

Unitary properties are those properties on which the Board of Equalization "may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee" (i.e., public utilities and railroads). The Revenue and Taxation Code further states, "Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee."

In fiscal year 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The Legislature established the unitary and operating nonunitary base year and developed formulas to compute the distribution factors for the fiscal years that followed.

Recommendation

The county should not include the ERAF in future unitary and operating nonunitary tax apportionment computations, as the ERAF does not qualify as a "taxing jurisdiction" under Revenue and Taxation Code section 100. Thus, the ERAF is not eligible to share and its amount should be distributed proportionately among all taxing jurisdictions that contributed to the fund.

County's Response

We respectfully disagree with the finding stating that Napa County has incorrectly included the Educational Revenue Augmentation Fund (ERAF) in the unitary and operating nonunitary tax apportionment.

Pursuant to the California Property Tax Managers' Reference Manual, the County of Napa is in full compliance with the methodology regarding including the ERAF in our unitary calculations. We fully understand the State Controller's Office has treated the inclusion of ERAF in the unitary apportionment inconsistently throughout the years with findings written for not including ERAF in the unitary apportionment calculations noted in the State Controller's Office report to the Legislature for calendar year 2003. However, until the issue is addressed by the California State Legislature, Napa County will continue to follow the California Property Tax Managers' Reference Manual and include the ERAF in our unitary calculations.

SCO's Comment

Our finding and recommendation remain unchanged.

The ERAF is a fund—an accounting entity, not a taxing jurisdiction. Revenue and Taxation Code section 100 requires that taxes from unitary and operating nonunitary property be allocated to taxing jurisdictions. As the ERAF is not a taxing jurisdiction, it is not eligible to receive unitary and operating nonunitary taxes.

The county's statement that "Napa County will continue to follow to follow the California Property Tax Managers' Reference Manual" is not relevant. The SCO is not bound by the Property Tax Managers' Reference Manual. We audit to applicable statutes.

Revenue and Taxation Code section 100(d)(1) states, "... an amount shall be computed for each taxing jurisdiction" while section 100(e)(3) states, "Taxing jurisdiction' includes a redevelopment agency." The statute does not include the ERAF as a taxing jurisdiction.

San Diego County (July 1, 2003, through June 30, 2009)

Follow-up on Prior Audit Findings

Findings noted in our prior audit, issued June 9, 2004, have been satisfactorily resolved by the county, with the exception of Finding 1 in this report. This finding was also noted in our three previous audit reports (September 20, 1991; May 30, 1997; and June 9, 2004).

FINDING 1— Distribution of the 1978-79 base-year apportionments (SB 154 split)

As noted in the three previous SCO audits (issued on September 20, 1991; May 30, 1997; and June 9, 2004), the county computed the Fiscal Year (FY) 1978-79 base-year apportionment (SB 154 Split) in error, thus overstating the General Fund revenue base.

The county did not use the correct "split" factor (percent of local agencies vs. public schools) and apportionment factors computed from the FY 1977-78 revenues to apportion the FY 1978-79 property tax revenues. Our initial audit, dated September 20, 1991, disclosed that in FY 1978-79 the county General Fund received approximately \$694,500 more revenues, while public schools and special districts received approximately \$644,500 and \$50,000 less, respectively.

For FY 2008-09, based on the county's own assessed valuation reports used to calculate its countywide growth rates, our calculation indicates that, for public schools, this amount has increased to \$8,314,033 (see Table 1 [of original report]). The cumulative effect of this finding is that the county's General Fund received approximately \$109,379,259 more in revenues, while the public schools and special districts received approximately \$101,504,582 and \$7,874,677 less, respectively (see Table 2 [of original report]).

Requirements for the apportionment and allocation of the annual tax increment (ATI) 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 tax rate area (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 base-year amounts in the property tax system and reimburse all entities that have been impacted by this error.

County's Response

Finding 1 of the 2010 Draft Audit is a finding that has been carried over for a number of audit periods since its inception. Finding 1 was first reported for the audit period covering fiscal years 1978-79 through 1989-90, in a report issued in 1991 ("1991 Audit"). It was carried over again for the audit period covering fiscal years 1990-91 through 1994-95 in a report issued in 1997 ("1997 Audit"), and the audit period that covered fiscal years 1995-96 through 2002-03 in an audit report issued in 2004 ("2004 Audit"). Finding 1 was again carried over for the current audit period covering fiscal years 2003-04 through 2008-09 in the 2010 Draft Audit. The County has consistently disputed Finding 1 each time it was re-issued in the aforementioned audits. The basis for the County's continued dispute is outlined below.

First, the Department of Finance audited the County and issued a report on March 25, 1982, and a follow-up report dated April 9, 1982 ("1982 Audit"), both of which are attached and we have previously provided, approving the County's calculation and distribution method. As noted in the March 25th letter, "[a] variety of information was reviewed on topics such as computation of the AB 8 adjusted tax base 1979/80 revenues" and "distribution of property tax revenue increment. . . ." The 1982 Audit concluded, "the information which was reviewed indicated that San Diego County's apportionment and allocation methods are generally in compliance with our interpretation of legal requirements." In its follow-up April 9th letter, the Department of Finance, having again reviewed its audit findings, confirmed that the County used a correct tax base. The County therefore continued to apply this approved methodology.

The SCO then audited the County's property tax revenue apportionment and allocation procedures for the period of July 1, 1978 through June 30, 1990 ("1990 Audit"). Concerning the 1978-1979 base year apportionment, the 1990 Audit noted,

"Many of the following issues have been noted in other counties and in some instances indicate a need for clarifying legislation. The type or quantity of issues presented do not necessarily indicate a good or bad processing system, but merely demonstrate the complexity of property tax allocation and apportionment. . . . The County did not use the correct "split" factor (percent of local agencies vs. school entities) and apportionment factors computed from the 1977/78 revenue to apportion the 1978/79 Property Tax Revenue. The split and apportionment factors were not off by a large amount, but the County General Fund received approximately \$694,500 more revenue and all other local agencies and schools received slightly less revenue than they should have."

The County disagreed and responded to the 1990 Audit as follows:

"I disagree with the statement that the County did not use the correct split factor to apportion the 1978/79 property tax revenue. The County of San Diego allocated the 1978/79 property tax pursuant to SB154 in that a three-year average was determined for local agencies and the prior year revenue was used for schools. Because of the amount of time that has elapsed from implementation to the audit, some of the microfilm records had deteriorated to the point of being unreadable¹. I feel it is inappropriate for a specific finding of this nature to be included in the audit findings when the evidence is so circumstantial in light of the whole balancing process. I am also concerned with the fact that when the Department of Finance audit was done in 1982, no findings in this area were noted. As noted in their audit report, a review of the allocation system as well as internal audit working papers indicated that the methods used to allocate property tax revenues were in compliance with their interpretation of legal requirements. At that time, the hard copies of the reports were available and reviewed by the audit staff. I am requesting that finding either be deleted from the audit report or be modified to one with no revenue impact to the County.

The Auditor's Reply to the County's Response was, in its entirety, as follows:

"The above audit finding was achieved using the Countys' [sic] own computations, reports, and workpapers that clearly indicate that the amount apportioned to the County General Fund in the 1978-79 fiscal year was not accurately derived from the "split percentage" and 3 year average revenue ratio."

Government Auditing Standards require that when an auditee's comments are inconsistent with the reports findings and the auditor disagrees with the auditee's comments that the auditor should explain their reasons for the disagreement and modify the report as necessary with sufficient and appropriate evidence. See GAO-07-162G, Section 5.37, 6.49 and 8.36. If there was evidence of any specific error, this was the opportunity to provide the appropriate evidence and explain the SCO's finding. Instead, the SCO simply denied the County's request to delete this finding from the 1990 Audit report and

maintained its position regarding the finding despite the Department of Finance's earlier written confirmation asserting that the County's methods were in compliance with legal requirements.

The SCO then audited the County's property tax revenue apportionment and allocation procedures for the period of July 1, 1990 through June 30, 1995 ("1997 Audit"). Finding 1 was carried over without additional comment except a note related to growth. Similar to the 1990 Audit, the 1997 Audit does not identify any specific error in the split factors used by the County, nor does it articulate how the SCO believes things should have been done differently. The County continued to disagree with Finding 1. The SCO then audited the County's property tax revenue apportionment and allocation procedures for the period of July 1, 1995 through June 30, 2003 ("2004 Audit"). Finding 1 was again carried over. The 2004 Audit recommended that the County "correct the base year amounts in the system and reimburse all entities that have been impacted by this error." While the SCO continues to state the County general fund received approximately \$694,500 more in revenues than they should have received, at no time has the SCO pointed to the specific evidence of the alleged error.

The County's response in the 2004 Audit remained consistent with previous responses to the Finding. However, the County also raised the issue of the statute of limitations, which is three years. Civ. Proc. § 338, subd. (a). The 2004 Audit contends that this is a "legal issue" and that "the Legislature did not require the SCO to start performing the audits until after the (county-proposed) statute of limitations would have expired. The State would have had no chance to discover the error until the statute had expired, thus precluding the State from seeking a remedy."

The County continues to disagree with the SCO's Finding 1. The State, through its Department of Finance, had the opportunity to discover the alleged error during their audit in 1982, yet noted no such error. Further, the 2004 Audit implies that the statute of limitations runs anew if a different department within the State undertakes an audit concerning the same issue. We are unaware of any legal authority in support of this contention.

Given the lengthy history of Finding 1, the continuing lack of specifics with regard to any error, and the inability of either the SCO or the County to reconstruct what took place in 1978, the County has no basis to "correct" or change the apportionment factors even on a "going forward" basis. Although the 2010 Draft Audit attempts to quantify the amounts of the alleged error, the SCO amounts provided are based on sheer speculation as there is no evidence to show what different split factors might have been used or what the impact was on individual school districts and other agencies which may or may not have existed in 1978, not to mention jurisdictional changes of the districts and other agencies since 1978. The SCO has continued to carry over Finding 1 based on documentation which was reviewed in 1990 from records back in 1978. Even in 1991, the 1978 records were unreadable. The Department of Finance audit in 1982 was performed closest in time to the alleged error and, as indicated previously, the Department of Finance found the County's apportionment and allocation methods "generally in compliance with our interpretation of legal requirements."

As the alleged error occurred in 1978, the County's concern raised in response to the 2004 Audit as to the statute of limitations is particularly compelling and therefore must be given considerable weight in determining whether Finding 1 should even be included in the 2010 Audit Report. Additionally, as stated in the 2004 Audit, the SCO has conducted their audits outside the timeframe described in Government Code section 12468. Government Code section 12468, subdivision (b), requires the Controller to regularly audit counties' apportionment and allocation of property tax revenue on a three-year cycle for counties with a population greater than 200, 000 and less than 5,000,000. The 2004 Audit was on a nine-year cycle. The 2010 Draft Audit is on a six-year cycle. The County should have the opportunity to address any issues raised by the SCO within the three-year time frame.

Given the facts and circumstances provided and recognized Government Auditing Standards, unless the SCO can identify and support with "sufficient and appropriate evidence" the underlying basis for the original Finding 1 from the 1990 Audit, we believe the SCO has no choice but to remove Finding 1 from the 2010 Draft Audit Report.

¹ The importance of this statement is that the \$694,500 figure, which was a figure determined by the SCO and not the County, could not be proved or disproved in 1990 due to the condition of the County's records.

SCO's Comment

Our finding and recommendation remain unchanged.

The county, in its response, has provided the history of this finding, one that stretches back over 20 years and relates to the county's actions more than 30 years ago.

The county notes in its response that it was audited by the Department of Finance (DOF) and that the DOF issued a report on March 25, 1982, and a follow-up report on April 9, 1982. However, the county does not state that the reports were draft reports and not final reports. The March 25, 1982, report states "If you like, your office may prepare a written response to the audit exception. This response should be received by May 1st to allow for reference or incorporation into the final report." The April 9, 1982, report dropped the exception noted in the earlier letter. It also included specific suggestions for the county. As the intended date for the final report appears to be after May 1, 1982, the reports referred to can only be considered drafts. In addition, while the county provided copies of the draft reports, it has not provided a copy of the final report.

On a related note, the March 25, 1982 report referred to above states, in part, "A variety of information was reviewed on topics such as computation of the AB8 adjusted base 1979-80 revenues, distribution of property tax revenue increment. . . ." No date earlier than 1979-80 is mentioned in the draft report. However, the audit finding is concerned with the fiscal year 1978-79 split factors. Our finding from the first audit states, in part, "**The County did not use the correct "split" factor (percent of local agencies vs. school entities) and apportionment factors computed from the 1977/78 revenue to apportion the 1978/79 Property Tax Revenue** [emphasis added]." There is nothing in the DOF

draft audit reports to indicate the DOF considered the computation of the 1978-79 split factors.

We acknowledge that the March 25, 1982 draft report states, “Again, the information which was reviewed indicated that San Diego County’s allocation methods are generally in compliance with our interpretation of legal requirements.” However, while the methods may be correct, if the revenue data being used is flawed, then the results emanating from the system will also be flawed.

The county further notes that in its response to the 2004 audit, in addition to its consistency with prior responses, it raised the issue of the statute of limitations. The county notes that the SCO responded that this was “a ‘legal issue’ and that ‘the Legislature did not require the SCO to start performing the audits until after the (county-proposed) statute of limitations would have expired. . . . [and that] the State would have had no chance to discover the error . . . thus precluding the State from seeking a remedy.’ ” The county continues, “The State, through its Department of Finance, had the opportunity to discover the alleged error during their audit in 1982, yet noted no such error. Further, the 2004 Audit implies that the statute of limitations runs anew if a different department within the State undertakes an audit concerning the same issue. We are unaware of any legal authority in support of this contention. . . . As the alleged error occurred in 1978, the County’s concern raised in response to the 2004 Audit as to the statute of limitations is particularly compelling and therefore must be given considerable weight in determining whether Finding 1 should even be included in the 2010 Audit Report.” We believe that more compelling is the fact that there is nothing in the 1982 DOF draft audit report to indicate that the DOF ever considered the issue, even though the county continues to hold out the draft audit report as justification for its position.

The county further states there is no basis to correct or change the apportionment factors even on a prospective basis, indicating that the quantification of the “alleged error” is based on sheer speculation because “there is no evidence to show what different split factors might have been used or what the impact was on individual school districts and other agencies which may or may not have existed in 1978, not to mention jurisdictional changes of the districts and other agencies since 1978.”

The amount is not speculation. Our finding is based on documentation reviewed during the first audit that determined that the county made an error in the computation of the split factor. The error resulted in the County receiving more property tax revenue than it was entitled to at the expense of schools and special districts. The computation of the amount currently due is based on the original documented error and adjusted by growth percentages taken from the county’s own records. The county’s responsibility is not negated by subsequent jurisdictional changes. The county has a fiduciary responsibility to allocate and apportion property tax revenues correctly.

**FINDING 2—
ERAF included in
unitary and operating
nonunitary
apportionment**

The county included the Educational Revenue Augmentation Fund (ERAF) in the unitary and operating nonunitary tax apportionment computation.

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 not include the ERAF in future unitary and operating nonunitary tax apportionment computations, as the ERAF does not qualify as a “taxing jurisdiction” under Revenue and Taxation Code section 100. Thus, the ERAF is not eligible to share and its amount should be distributed proportionately among all taxing jurisdictions that contributed to the fund.

County’s Response

With regard to Finding 2, consistent with the majority of counties in the State, the County did include ERAF in the unitary and operating nonunitary apportionments in accordance with unitary and nonunitary allocation guidelines. The State Auditor’s Association recommended that County Auditors make no changes in their allocation methodology and stay consistent in following the Property Tax Manager’s Reference Manual. Until the legislature clarifies this issue, we do not intend to change our position.

SCO’s Comment

Our finding and recommendation remain unchanged.

The ERAF is a fund—an accounting entity, not a taxing jurisdiction. Revenue and Taxation Code section 100 requires that taxes from unitary and operating nonunitary property be allocated to taxing jurisdictions. As the ERAF is not a taxing jurisdiction, it is not eligible to receive unitary and operating nonunitary taxes.

Revenue and Taxation Code section 100(c) states, “The property tax revenue derived from the assessed value assigned to the countywide tax rate area pursuant to subdivision (a) and pursuant to paragraph (2) of subdivision (a) of Section 100.1 by the use of the tax rate determined in paragraph (1) of subdivision (b) shall be allocated as follows: (1) For the 1988-89 fiscal year and each fiscal year thereafter, each taxing jurisdiction shall be allocated an amount of property tax revenue. . . .”

Revenue and Taxation Code section 95 (a) defines a local agency as a “city, county, and special district.” In addition, Revenue and Taxation Code section 95(b) defines a jurisdiction as a “local agency, school district, community college district, or county superintendent of schools. A jurisdiction as defined in this subdivision is a ‘district’ for purposes of section 1 of Article XIII A of the California Constitution.” Furthermore, Revenue and Taxation Code section 100(e)(3) includes a redevelopment agency as a taxing jurisdiction, demonstrating that the Legislature knows how to include non-taxing entities in the definition of a taxing jurisdiction. In this case, it omitted the ERAF from the definition of taxing jurisdiction.

Finally, the Property Tax Manager’s Reference Manual is a guide, not a statute. The SCO performs audits according to applicable statutes. The ERAF is a fund, an accounting entity, and not a taxing jurisdiction. Revenue and Taxation Code section 100 requires that taxes from unitary and operating nonunitary property be allocated to taxing jurisdictions. Since the ERAF is not a taxing jurisdiction, it is not eligible to receive unitary and operating nonunitary taxes.

Santa Barbara County (July 1, 2005, through June 30, 2009)

Follow-up on Prior Audit Findings

The county has satisfactorily resolved the findings noted in our prior audit report, issued October 31, 2006.

FINDING 1— ERAF included in unitary and operating nonunitary

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

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in Revenue and Taxation Code section 100.

Unitary properties are those properties on which the Board of Equalization “may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee” (i.e., public utilities and railroads). The Revenue and Taxation Code further states, “Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee.”

In 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 not include the ERAF in future unitary and operating nonunitary tax apportionment computations, as the ERAF does not qualify as a “taxing jurisdiction” under Revenue and Taxation Code section 100. Thus, the ERAF is not eligible to share and its amount should be distributed proportionately among all taxing jurisdictions that contributed to the fund.

County’s Response

We realize the current position of the SCO is that the ERAF is not to receive Unitary apportionments. We also note that this position is contrary to the SCO’s previous position published in the February 2001 audit report to Marin County in which the SCO required that county to include the ERAF in the Unitary apportionment.

We understand that the basis for the SCO’s current position is that the ERAF is not a taxing jurisdiction. However, the courts were asked in 1994 whether the ERAF was allowed to receive annual tax increments as the ERAF was not defined as a taxing jurisdiction. The courts opined in *San Miguel Consolidated Fire Protection Dist. v. Davis* 25 Cal.App.4th 134 (1994) that since school districts (which are defined as jurisdictions) are beneficiaries of the ERAF monies that it was proper to allocate annual tax increments to the ERAF.

“FN 19. Petitioners also contend annual tax increments may only be allocated to “jurisdictions”-a term which petitioners contend does not encompass the Educational Revenue Augmentation Funds Section 95, subdivision (b), includes cities, counties, special districts, school districts, community college districts, and county superintendents of schools within the definition of “jurisdiction.” The beneficiaries of the Educational Revenue Augmentation Funds are school districts, county offices of education, and community college districts. (§97.03, subd.(d)(1).) Annual tax increments are initially allocated to the special districts, which are specifically included within the “jurisdiction” definition, and a percentage is then subsequently reallocated by the county auditors to the Educational Revenue Augmentation Funds for the benefit of the school districts. We find no statutory prohibition to this procedure.”

We believe this court decision has merit in the analysis of this issue, but as we requested but were denied copies of the SCO legal analysis on their position, we are unable to learn how this point was addressed. Accordingly, until this court decision has been addressed and in addition to the other arguments presented by other counties in their audit report responses, we believe that our current method which is described in the *Property Tax Managers’ Reference Manual* published by the County Auditor’s Association of California is correct and allowed by law. We will implement any changes to our process should the *Property Tax Managers’ Reference Manual* be revised in the future.

SCO's Comment

Our finding and recommendation remain unchanged.

The ERAF is a fund—an accounting entity, not a taxing jurisdiction. Revenue and Taxation Code section 100 requires that taxes from unitary and operating nonunitary property be allocated to taxing jurisdictions. As the ERAF is not a taxing jurisdiction, it is not eligible to receive unitary and operating nonunitary taxes.

Revenue and Taxation Code section 100(c) states:

The property tax revenue derived from the assessed value assigned to the countywide tax rate area pursuant to subdivision (a) and pursuant to paragraph (2) of subdivision (a) of Section 100.1 by the use of the tax rate determined in paragraph (1) of subdivision (b) shall be allocated as follows:

(1) For the 1988-89 fiscal year and each fiscal year thereafter, each taxing jurisdiction shall be allocated an amount of property tax revenue. . . .

Revenue and Taxation Code section 95 (a) defines a local agency as a “city, county, and special district.” In addition, Revenue and Taxation Code section 95(b) defines a jurisdiction as a “local agency, school district, community college district, or county superintendent of schools. A jurisdiction as defined in this subdivision is a ‘district’ for purposes of Section 1 of Article XIII A of the California Constitution.” Furthermore, Revenue and Taxation Code section 100(e)(3) includes a redevelopment agency as a taxing jurisdiction. This section demonstrates that the Legislature knows how to include non-taxing entities in the definition of taxing jurisdiction if it so desires. In this case, the Legislature omitted the ERAF from the definition of taxing jurisdiction.

In its response to the finding, the county includes, and places reliance on, footnote 19 from *San Miguel Consolidated Fire Protection District v. Davis* 25 Cal. App. 4th 134 (1994). The county states that the court opined in the case “that since school districts (which are defined as jurisdictions) are beneficiaries of the ERAF monies that it was proper to allocate annual tax increments to the ERAF.”

The court stated in the above footnote: “. . . Annual tax increments are initially allocated to the special districts, which are specifically included within the ‘jurisdiction’ definition, and a percentage is then subsequently ***reallocated*** [emphasis added] by the county auditors to the Educational Revenue Augmentation Fund for the benefit of the school districts.” We find no statutory prohibition to this procedure.

We acknowledge that, in our audit reports issued prior to FY 2004-05, we stated that the ERAF should receive unitary and operating nonunitary revenues. However, at the request of another county, the SCO revisited the issue and determined that because the ERAF was not a taxing jurisdiction, it was not eligible to receive unitary and operating nonunitary revenues.

Finally, the Property Tax Manager's Reference Manual is a guide, not a statute. We perform audits according to applicable statutes. The ERAF is a fund—an accounting entity, not a taxing jurisdiction. Revenue and Taxation Code section 100 requires that taxes from unitary and operating nonunitary property be allocated to taxing jurisdictions. As the ERAF is not a taxing jurisdiction, it is not eligible to receive unitary and operating nonunitary taxes.

**FINDING 2—
Educational Revenue
Augmentation Fund**

A portion of the mandatory pass-through payments made by the City of Goleta Redevelopment Agency were deposited by the county in the ERAF, a non-affected taxing entity.

In addition to making required payments to the Sales and Use Tax Compensation Fund (SUT) and Vehicle License Fee Property Tax Compensation Fund (VLF), the county made interest payments to these funds from the ERAF.

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 not deposit in the ERAF pass-through payments from any redevelopment agency, as the ERAF does not meet the definition of an affected taxing entity.

Additionally, the county should not make payments in excess of the required amounts to the SUT and VLF funds.

County's Response

ERAF Deposits for Pass-through Payments

We believe this finding is directed incorrectly to the Auditor-Controller rather than to the RDA that submitted the pass-through payment, as the RDAs themselves not this office are responsible for the calculation of any statutory RDA pass-through payments.

As previously reported to the SCO under the AB1389 reporting process, our office noted that RDAs within the county were treating the ERAF differently for purposes of pass-through payment calculations, with one RDA making pass-through payments to the ERAF and the other reallocating the ERAF's share proportionally to the other affected taxing entities. As part of the AB1389 process we asked the SCO whether this was appropriate and were told that the SCO did not have an answer on how to address the ERAF share, that this was also noted at other counties and that to report it as an observation rather than a

finding due to the uncertainty of the correct treatment. During the audit we were also told that SCO did not have an answer as to the correct treatment of the ERAF's share other than the ERAF was not to receive a pass-through payment.

We also note that the *Los Angeles Unified School District v. County of Los Angeles* 181 Cal. App. 4th 414 (2010) case may impact the distribution of statutory pass-through payments in many counties. Accordingly, we believe that this comment should be redirected to the RDAs once the SCO can provide guidance on how to treat the ERAF's share taking into consideration the impacts of the *Los Angeles Unified School District v. County of Los Angeles* case noted above.

Interest payments to SUT and VLF fund

We concur that interest [sic] earned on the SUT and VLF transfers while in the ERAF should be retained in the ERAF and not distributed to the SUT and VLF. Corrections to our process were made during the course of the audit.

SCO's Comment

Our finding and recommendation remain unchanged.

We concur that the redevelopment agency is responsible for making the statutory pass-through payments. However, it is the county's responsibility to ensure the proper accounting for and distribution of funds received by the ERAF. The ERAF is a fund, not an affected taxing agency. The county noted in its response that some redevelopment agencies in the county were treating the pass-through payments differently. The county should have returned the ERAF pass-through payment to the redevelopment agency to be held in trust or should have held the money in trust in the county treasury until the matter is resolved.

The county quoted *Los Angeles Unified School District v. County of Los Angeles* 181 Cal. App. 4th 414 (2010). However, this case does not appear to address whether the ERAF is to receive a share of the pass-through payments. The court held that the redevelopment agency must, with noted exceptions, include as property taxes received the amount of the ERAF the local education agency received when it is computing pass-through shares. This increases the share of pass-through revenue the local education agency receives while decreasing the pass-through for all other affected taxing agencies.

As the ERAF does not meet the definition of an affected taxing agency, the county should not deposit in the ERAF pass-through payments from any redevelopment agency.

Sierra County (July 1, 2003, through June 30, 2009)

Follow-up on Prior Audit Findings

The county has satisfactorily resolved the findings noted in our prior audit report, issued December 17, 2003.

FINDING— SB 1096: Sales and Use Tax, Vehicle License Fee, and ERAF III

The county failed to comply with the setup requirements of SB 1096, as neither the Sales and Use Tax Compensation Fund nor the Vehicle License Fee Property Tax Compensation Fund were established in the county treasury. The revenue adjustments were made directly to the AB 8 apportionment system.

Requirements for the establishment of both funds are found in Revenue and Taxation Code sections 97.68(a)(2) and 97.70(a)(2). A county's Educational Revenue Augmentation Fund is to be reduced by the "countywide adjustment amount," which shall be deposited in a Sales and Use Tax Compensation Fund that is established in the treasury of each county. The countywide vehicle license fee adjustment amount shall be allocated to the Vehicle License Fee Property Tax Compensation Fund that shall be established in the treasury of each county.

Recommendation

The Sales and Use Tax Compensation Fund and the Vehicle License Fee Property Tax Compensation Fund shall be established in the county treasury, in accordance with Revenue and Taxation Code sections 97.68 and 97.70.

Sonoma County (July 1, 2005, through June 30, 2009)

Follow-up on Prior Audit Findings

Our prior audit report, issued July 14, 2006, included no findings related to the apportionment and allocation of property tax revenues by the county.

FINDING— ERAF included in unitary and operating nonunitary apportionment

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

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in Revenue and Taxation Code section 100.

Unitary properties are those properties on which the Board of Equalization "may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee" (i.e., public utilities and railroads). The Revenue and Taxation Code further states, "Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee."

In fiscal year 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The Legislature established the unitary and operating

nonunitary base year and developed formulas to compute the distribution factors for the fiscal years that followed.

Recommendation

The county should not include the ERAF in future unitary and operating nonunitary tax apportionment computations, as the ERAF does not qualify as a “taxing jurisdiction” under Revenue and Taxation Code section 100. Thus, the ERAF is not eligible to share and its amount should be distributed proportionately among all taxing jurisdictions that contributed to the fund.

County’s Response

Respectfully, Sonoma County disagrees with this recommendation. Also, while this issue is in dispute, in our opinion, the recommendation should be classified as an observation in the Audit Report and not a finding.

The audit report states the requirements for the apportionment and allocation of unitary and operating non-unitary property taxes are found in Revenue and Taxation Code section 100. However, to help understand other codes sections should be referenced.

After reviewing the Revenue and Taxation code sections there is insufficient language to unquestionably state that ERAF should not participate in property tax revenues allocations from Unitary. Revenue and Taxation code 97 does indicate that when ERAF was established R&T Section 96.1 was to be modified to include ERAF in the allocation of property tax revenues. Essentially, the reallocation was among taxing jurisdictions (including school districts which created ERAF).

R&T Section 95 subdivision (f) defines ERAF is defined as a “school entity”. R&T Section 100(k)(2)(A) states, “an amount of property tax revenues to school entities, as defined in subdivision (f) of Section 95. Therefore, it is our opinion that ERAF should be included in the Unitary code sections.

Revenues and Taxation code section 100 (c)(3) describes how to allocate the property revenues from Unitary in excess of 102 percent by using as a denominator “the county’s total ad valorem tax levies from the secured roll” which refers back to R&T Section 96.1. ERAF became a part of the calculation in fiscal year 1993/94, as referenced in R&T Section 97.

It is our opinion that revenues and taxation code provides sufficient support for the inclusion of ERAF in the Unitary tax revenue allocation.

Furthermore, I recommend that this issue is presented to the Department of Finance informing them that, if ERAF is excluded from the Unitary calculation, it will result in a statewide reallocation of millions of dollars from school districts to other taxing jurisdictions.

SCO's Comment

Our finding and recommendation remain unchanged.

The ERAF is a fund—an accounting entity, not a taxing jurisdiction. Revenue and Taxation Code section 100 requires that taxes from unitary and operating nonunitary property be allocated to taxing jurisdictions. As the ERAF is not a taxing jurisdiction, it is not eligible to receive unitary and operating nonunitary taxes.

Revenue and Taxation Code section 100(c) states “The property tax revenue derived from the assessed value assigned to the countywide tax rate area pursuant to subdivision (a) and pursuant to paragraph (2) of subdivision (a) of section 100.1 by the use of the tax rate determined in paragraph (1) of subdivision (b) shall be allocated as follows:

- (1) For the 1988-89 fiscal year and each fiscal year thereafter, each taxing jurisdiction shall be allocated an amount of property tax revenue. . . .”

Revenue and Taxation Code section 95(a) defines a local agency as a “city, county, and special district.” In addition, section 95(b) defines a jurisdiction as a “local agency, school district, community college district or county superintendent of schools. A jurisdiction as defined in this subdivision is a ‘district’ for purposes of section 1 of Article XIII A of the California Constitution.” Furthermore, Revenue and Taxation Code section 100(e)(3) includes a development agency as a taxing jurisdiction.

Tehama County (July 1, 2004, through June 30, 2009)

Follow-up on Prior Audit Findings

Our prior audit report, issued January 19, 2005, included no findings related to the apportionment and allocation of property tax revenues by the county.

FINDING— ERAF included in unitary and operating nonunitary apportionment

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

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in Revenue and Taxation Code section 100.

Unitary properties are those properties on which the Board of Equalization “may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee” (i.e., public utilities and railroads). The Revenue and Taxation Code further states, “Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee.”

In fiscal year 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary

property taxes. The Legislature established the unitary and operating nonunitary base year and developed formulas to compute the distribution factors for the fiscal years that followed.

Recommendation

The county should not include the ERAF in future unitary and operating nonunitary tax apportionment computations, as the ERAF does not qualify as a “taxing jurisdiction” under Revenue and Taxation Code section 100. Thus, the ERAF is not eligible to share and its amount should be distributed proportionately among all taxing jurisdictions that contributed to the fund.

County’s Response

I concur with the finding that ERAF is not a taxing jurisdiction and should not be included in the unitary and operating nonunitary tax apportionment computations. Historically, the county had excluded ERAF in this computation. The practice changed after the State Controller’s Office completed a property tax audit for the period of July 1, 1994, through June 30, 1999, resulting in a finding that the county had excluded ERAF in the unitary and operating nonunitary allocations. At that time, the State Controller’s Office opined that ERAF was a taxing jurisdiction and was to be included in the unitary and operating nonunitary allocations when those property tax values increased more than 2% between fiscal years.

As a result of the current audit finding, I have established procedures to adhere to your recommendation and exclude ERAF from future unitary allocations.

Tulare County (July 1, 2006, through June 30, 2009)

Follow-up on Prior Audit Findings

Findings noted in our prior audit, issued December 10, 2008, have been satisfactorily resolved by the county, with the exception that the county included the ERAF in the unitary and operating nonunitary tax apportionment computation during the audit period.

FINDING— ERAF included in unitary and operating nonunitary apportionment

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

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in Revenue and Taxation Code section 100.

Unitary properties are those properties on which the Board of Equalization “may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee” (i.e., public utilities and railroads). The Revenue and Taxation Code further states, “Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee.”

In fiscal year 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The Legislature established the unitary and operating nonunitary base year and developed formulas to compute the distribution factors for the fiscal years that followed.

Recommendation

The county should not include the ERAF in future unitary and operating nonunitary tax apportionment computations, as the ERAF does not qualify as a “taxing jurisdiction” under Revenue and Taxation Code section 100. Thus, the ERAF is not eligible to share and its amount should be distributed proportionately amount all taxing jurisdictions that contributed to the fund.

County’s Response

This issue is an ongoing debate statewide as the law is inconsistent. In May of 2007 the State Auditor’s Association recommended all County Auditors make no changes and stay consistent in following the Property Tax Manager’s Reference Manual. We will follow this recommendation until the issue is resolved by the State Legislature and there are clear, consistent codes and guidelines.

SCO’s Comment

Our finding and recommendation remain unchanged.

The ERAF is a fund – an accounting entity, not a taxing jurisdiction. Revenue and Taxation Code section 100 requires that taxes from unitary and operating nonunitary property be allocated to taxing jurisdictions. As the ERAF is not a taxing jurisdiction, it is not eligible to receive unitary and operating nonunitary taxes.

The county’s statement that “in May of 2007 the State Auditor’s Association recommended all County Auditors make no changes and stay consistent in following the Property Tax Manager’s Reference Manual” is without merit, as the SCO is not bound by the Property Tax Manager’s Reference Manual. It is bound by statutes.

The Revenue and Taxation Code section 100(d)(1) states, “an amount shall be computed for each taxing jurisdiction. . . .” while section 100(e)(3) states, “taxing jurisdiction includes Redevelopment Agencies.” The statute does not include the ERAF as a taxing jurisdiction. This demonstrates that the Legislature knows how to include non-taxing entities in the definition of taxing jurisdiction if it so desires. However, in this case, it omitted the ERAF from the definition of taxing jurisdiction.

Tuolumne County (July 1, 2004, through June 30, 2009)

Follow-up on Prior Audit Findings

The county has satisfactorily resolved the findings noted in our prior audit report, issued February 10, 2006.

FINDING— ERAF included in unitary and operating nonunitary apportionment

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

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in Revenue and Taxation Code section 100.

Unitary properties are those properties on which the Board of Equalization “may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee” (i.e., public utilities and railroads). The Revenue and Taxation Code further states, “Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee.”

In fiscal year 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The Legislature established the unitary and operating nonunitary base year and developed formulas to compute the distribution factors for the fiscal years that followed.

Recommendation

For all future unitary tax apportionment computations, the ERAF should not be included since it does not qualify as a “taxing jurisdiction” under Revenue and Taxation Code section 100. Thus, the ERAF is not eligible to share and its amount should be distributed proportionately among all taxing jurisdictions that contributed to the fund.

Auditor-Controller’s Response

The county disagreed with the recommendation.

SCO’s Comment

The ERAF is a fund, an accounting entity, not a taxing jurisdiction. Revenue and Taxation Code section 100 limits the allocation of unitary and operating nonunitary tax revenue to taxing jurisdictions. Therefore, as the ERAF is not a taxing jurisdiction, it cannot be allocated unitary and operating nonunitary tax revenue. The finding remains as written.

Copies of the audit reports referred to in this report may be obtained by contacting:

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