YOLO COUNTY

Audit Report

APPORTIONMENT AND ALLOCATION OF PROPERTY TAX REVENUES

July 1, 2014, through June 30, 2017

BETTY T. YEE
California State Controller

March 2019

BETTY T. YEE
California State Controller

March 13, 2019

Chad Rinde, CPA, Chief Financial Officer
Yolo County
625 Court Street, Room 102
Woodland, CA 95695

Dear Mr. Rinde:

The State Controller's Office audited the methods employed by Yolo County to apportion and allocate property tax revenues for the period of July 1, 2014, through June 30, 2017. We conducted the audit pursuant to the requirements of Government Code section 12468.

Our audit found instances of noncompliance with California statutes for the apportionment and allocation of property tax revenues for the audit period. We determined that Yolo County incorrectly calculated its:

- Computation and distribution of property tax revenues;
- Unitary and operating nonunitary apportionment and allocation;
- Unitary regulated railway apportionment and allocation; and
- Redevelopment Property Tax Trust Fund (RPTTF) administration.

As stated in the Supplemental Information section of this audit report, we did not make a determination on the validity of the county's methodology for apportioning the residual balance from the RPTTF due to a pending appellate court decision.

If you have any questions, please contact Lisa Kurokawa, Chief, Compliance Audits Bureau, by telephone at (916) 327-3138.

Sincerely,

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

JLS/hf

cc: Don Saylor, Chair
Yolo County Board of Supervisors
Sheryl Hardy-Salgado, Property Tax Supervisor
Yolo County
Chris Hill, Principal Program Budget Analyst
Local Government Unit
California Department of Finance

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Audit Report

Summary

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Our audit found instances of noncompliance with California statutes for the apportionment and allocation of property tax revenues for the audit period. We determined that the county incorrectly calculated its:

- Computation and distribution of property tax revenues;
- Unitary and operating nonunitary apportionment and allocation;
- Unitary regulated railway apportionment and allocation; and
- RPTTF administration.

As stated in the Supplemental Information section of this audit report, we did not make a determination on the validity of the county's methodology for apportioning the residual balance from the Redevelopment Property Tax Trust Fund (RPTTF) due to a pending appellate court decision.

Background

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

One key law was Assembly Bill (AB) 8, Chapter 282, Statutes of 1979, which established the method of allocating property taxes for fiscal year (FY) 1979-80 (base year) and subsequent fiscal years. The methodology is commonly referred to as the AB 8 process or the AB 8 system.

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

The AB 8 process involves several steps, including the transfer of revenues from school and community college districts to local government agencies (AB 8 shift) and the development of the tax rate area (TRA) annual tax increment (ATI) apportionment factors, which determine the amount of property tax revenues to be allocated to each jurisdiction.

The total amount to be allocated to each jurisdiction is then divided by the total amount to be allocated to all entities to determine the AB 8 factor (percentage share) for each entity for the year. The AB 8 factors are computed each year for all entities using the revenue amounts established in the prior year. These amounts are adjusted for growth annually using ATI factors.

Subsequent legislation removed from the AB 8 process revenue generated by unitary and operating nonunitary properties, pipelines, regulated railway companies, and qualified electric (QE) properties. These revenues are now apportioned and allocated under separate process.

Other legislation established an Educational Revenue Augmentation Fund (ERAF) in each county. Most local government agencies are required to transfer a portion of their property tax revenues to the fund. The fund is subsequently apportioned and allocated to school and community college districts by the county auditor according to instructions received from the county superintendent of schools or the chancellor of the California community colleges.

Revenues generated by the different types of property tax are apportioned and allocated to local government agencies, school districts, and community college districts using prescribed formulas and methods, as defined in the Revenue and Taxation Code. Taxable property includes land, improvements, and other properties that are accounted for on the property tax rolls, 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 the taxes are unpaid, the obligation 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 have sufficient "permanence" or other intrinsic qualities to guarantee payment of taxes levied against it.
- *State-Assessed Roll*—Utility properties composed of unitary and operating nonunitary value assessed by the State Board of Equalization (BOE).
- *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.

To mitigate problems associated with the apportionment and allocation of property tax revenues, Senate Bill 418, which requires the State Controller to audit the counties' apportionment and allocation methods and report the results to the Legislature, was enacted in 1985.

Apportionment and allocation of property tax revenues can result in revenues to an agency or agencies being overstated, understated, or misstated. Misstated revenues occur when at least one taxing agency receives more revenue than it was entitled to, while at least one taxing agency receives less revenue than it was entitled to.

The agency that received less tax revenue than its statutory entitlement would have standing to require that adjustments be made by the county, either on a retroactive or prospective basis. SCO does not have enforcement authority or standing to require the county to take corrective action with respect to misallocation of tax revenues, unless the misallocation resulted in overpaid state funds (funds intended for the ERAF, school districts, or community college districts). SCO has authority to recover misallocations resulting in overpaid state funds pursuant to Government Code (GC) sections 12410, 12418, and 12419.5.

GC section 12410 provides the State Controller with broad authority to "superintend the fiscal concerns of the state." GC section 12418 provides the State Controller with the authority to "direct and superintend the collection of all money due the State, and institute suits in its name" against all debtors of the State. GC section 12419.5 provides the State Controller with the authority to offset any amounts due the State against any amounts owing the debtor by the State.

Revenue and Taxation Code (RTC) section 96.1(b) allows a reallocation of current audit findings and unresolved prior audit findings.

RTC section 96.1(c)(3) limits a cumulative reallocation or adjustment to one percent of the total amount levied at a one-percent rate of the current year's original secured tax roll. For reallocation to the ERAF, school districts, or community college districts, a reallocation must be completed in equal increments within the following three fiscal years, or as negotiated with the State Controller.

Objective, Scope, and Methodology

The objective of our audit was to determine whether the county complied with Revenue and Taxation Code, Health and Safety Code, and Government Code requirements pertaining to the apportionment and allocation of property tax revenues.

The audit period was July 1, 2014, through June 30, 2017.

To achieve our objective, we:

- Interviewed key personnel to gain an understanding of the county's process for apportioning and allocating property tax revenues;
- Reviewed the county's written procedures for apportioning and allocating property tax revenues;
- Performed analytical reviews to assess the reasonableness of property tax revenues;
- Judgmentally selected a non-statistical sample of five from approximately 64 taxing jurisdictions within the county for all fiscal years in the audit period (the actual number of taxing jurisdictions, which include the ERAF, can vary from year to year based on jurisdictional changes). Errors found were not projected to the intended population. Then, we:
    - o Recomputed apportionment and allocation reports to verify computations used to develop property tax apportionment factors;

- Tested TRA reports to verify that the correct TRA factors were used in the computation of the ATI;
- Reviewed supplemental property tax administrative costs and fees to determine whether recovery costs associated with administering supplemental taxes were based on actual costs and did not exceed five percent of revenues collected, as prescribed in statute;
- Verified computations used to develop supplemental property tax apportionment factors;
- Verified unitary and operating nonunitary, unitary regulated railway, and QE property computations used to develop apportionment factors;
- Reviewed RPTTF deposits and distributions. As stated in the Supplemental Information section of this audit report, we did not make a determination on the validity of the county's methodology for apportioning the residual balance from the RPTTF due to a pending appellate court decision;
- Reviewed property tax administration cost reports and recomputed administrative costs associated with work performed for apportioning and allocating property tax revenues to local government agencies, school districts, and community college districts;
- Reviewed ERAF reports and verified computations used to determine the shift of property taxes from local government agencies to the ERAF and, subsequently, to school and community college districts;
- Reviewed the Sales and Use Tax letter and recomputed Vehicle License Fee computations used to verify the amount transferred from the ERAF to counties and cities to compensate for the diversion of these revenues;
- Reviewed reports to determine any increases in property tax revenues due cities having low or nonexistent property tax amounts; and
- Reviewed BOE jurisdictional change filing logs and their impact on the tax apportionment and allocation system.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

We limited our review of the county's internal controls to gaining an understanding of the transaction flow to develop appropriate auditing procedures. We did not evaluate the effectiveness of internal controls relevant to the apportionment and allocation of property tax revenues. We did not audit the county's financial statements.

We conducted this audit under the authority of GC section 12468, which requires the SCO to audit the apportionment and allocation of property tax revenues. A property tax bill contains the property tax levied at a one percent tax rate pursuant to the requirement of Proposition 13. A bill may also contain special taxes, debt service levies on voter-approved debt, fees, and assessments levied by the county or a city. The scope of our audit is concerned with the distribution of the one percent tax levy. Special taxes, debt service levies on voter-approved debt, fees, and assessments levied by the county or a city are beyond the scope of our audit and were not reviewed or audited.

Conclusion

Without consideration of the legal issue described in the Supplemental Information section of this audit report, our audit found that Yolo County did not comply with California statutes for the apportionment and allocation of property tax revenues for the audit period, as it incorrectly calculated its:

- Computation and distribution of property tax revenues;
- Unitary and operating nonunitary apportionment and allocation;
- Unitary regulated railway apportionment and allocation; and
- RPTTF administration.

These instances of noncompliance are described in the Findings and Recommendations section of this audit report.

Follow-up on Prior Audit Findings

Our prior audit report, issued March 24, 2015, for the period of July 1, 2007, through June 30, 2014, included no findings related to the apportionment and allocation of property tax revenues by the county.

Views of Responsible Officials

We issued a draft audit report on December 17, 2018. Chad Rinde, CPA, Chief Financial Officer, responded by letter dated January 11, 2019 (Attachment), agreeing with the audit results. This final audit report includes the county’s response.

Restricted Use

This audit report is solely for the information and use of Yolo County, the Legislature, the California Department of Finance, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this audit report, which is a matter of public record and is available on the SCO website at www.sco.ca.gov.

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

March 13, 2019

Findings and Recommendations

FINDING 1—Computation and Distribution of Property Tax Revenues

During testing of the county's property tax revenue computation and distribution process, we found that the county made several errors that resulted in the misallocation of property tax revenues to affected entities in the county. Specifically, we found that the county:

- Incorrectly included unsecured aircraft assessed values in its computations of the ATI for each fiscal year in the audit period;
- Incorrectly computed current-year AB 8 revenue for FY 2014-15;
- Used incorrect prior-year base revenue when computing the current-year increment for FY 2014-15 and FY 2015-16;
- Did not use the updated unitary revenue amount in the tax distribution factors schedule for FY 2014-15 and FY 2015-16, and did not use the updated tax increment for redevelopment agencies (RDAs) in the FY 2014-15 tax distribution factors schedule; and
- Did not apportion homeowner property tax revenue using the computed factors for FY 2014-15 and FY 2015-16.

The error occurred because the county has always included unsecured aircraft in the ATI, and was unaware that unsecured aircraft should be excluded from the ATI. In addition, other errors related to incorrect formulas and factors occurred because the county does not have established policies and procedures to ensure that computation worksheets are accurate.

We are unable to quantify the monetary impact due to various errors affecting the calculation.

RTC sections 96 through 96.5 provide the legal requirements for the computation of ATI and the apportionment and allocation of property tax revenues.

ATI is the difference between the total amount of property tax revenues computed each year using the equalized assessment roll and the sum of the amounts allocated pursuant to RTC section 96.1(a). Each TRA will receive an increment based on its share of the incremental growth in assessed valuations. ATI added to the tax computed for the prior fiscal year will develop the apportionments for the current fiscal year.

<u>Recommendation</u>

We recommend that the county:

- Review the aforementioned Revenue and Taxation Code sections and update its procedures to exclude unsecured aircraft assessed values from its ATI calculations;
- Establish and implement policies and procedures to ensure that computation worksheets are properly supported and reviewed in detail for accuracy;
- Recalculate the ATI computation for each fiscal year in the audit period; and

- Make monetary adjustments as necessary to affected entities.

County's Response

The county concurs with the audit finding and will make necessary adjustments, if they are material.

FINDING 2— Unitary and Operating Nonunitary Allocation and Apportionment

During testing of the county's unitary and operating nonunitary apportionment and allocation process, we found the county did not use the correct prior-year worksheet to compute the unitary revenues for FY 2015-16, which resulted in the misallocation of unitary revenues to entities in the county.

We have determined that the error, while procedurally incorrect, is not material. The error occurred because the county was engaged in system implementation and undergoing high staff turnover, which constrained resources dedicated to tax administration. Only one staff member performed the computation with limited review; as a result, the county did not detect the errors.

RTC section 100 provides the legal requirements for the apportionment and allocation of the unitary and operating nonunitary property tax revenues.

Unitary properties are those properties on which BOE "may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee" (i.e., public utilities, railroads, or QE properties). RTC section 723.1 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 tax revenues. The system created the unitary and operating nonunitary base year, and developed formulas to compute the distribution factors for the fiscal years that followed.

Recommendation

We recommend that the county:

- Establish and implement policies and procedures to ensure that computation worksheets are properly supported and reviewed in detail for accuracy;
- Recalculate the unitary and operating nonunitary allocation factors beginning with FY 2015-16; and
- Make monetary adjustments as necessary to affected entities.

County's Response

The county concurs with the audit finding and will make necessary adjustments, if they are material.

FINDING 3— Unitary Regulated Railway Allocation and Apportionment

During testing of the county's unitary regulated railway apportionment and allocation process, we found that, for FY 2015-16, the county's apportionment factors for revenues over 102% of prior year (excess factors) did not reconcile to supporting documentation. This resulted in the misallocation of unitary regulated railway revenues to entities in the county.

We have determined that the error, while procedurally incorrect, is not material. The error occurred because the county was engaged in system implementation and undergoing high staff turnover, which constrained resources dedicated to tax administration. Only one staff member performed the computation with limited review; as a result, the county did not detect the errors.

RTC section 100.11 provides the legal requirements for the apportionment and allocation of unitary regulated railway property tax revenues.

Unitary regulated railway properties are facilities that were completely constructed and placed in service after January 1, 2007. RTC section 723 defines unit valuation of a property that is operated as a unit in a primary function of the assesse.

<u>Recommendation</u>

We recommend that the county:

- Establish and implement policies and procedures to ensure that computation worksheets are properly supported and reviewed in detail for accuracy;
- Recalculate the unitary regulated railway allocation factors beginning with FY 2015-16; and
- Make monetary adjustments as necessary to affected entities.

<u>County's Response</u>

The county concurs with the audit finding and will make necessary adjustments, if they are material.

FINDING 4— Redevelopment Property Tax Trust Fund Administration

During testing of the RPTTF administration process, we found that the county made several errors which resulted in misallocation of the tax increment to the City of Winters' Redevelopment Successor Agency and of pass-through payments to various affected entities in the project area. Specifically, we found that the county:

- Distributed an incorrect amount for Recognized Obligation Payment Schedule 14-15B to the City of Winters' Redevelopment Successor Agency for FY 2014-15;
- Incorrectly computed the tax increment for the City of Winters' Redevelopment Successor Agency for FY 2015-16 and FY 2016-17; and

- Incorrectly computed the contractual pass-through payments to the county's funds (the General Fund, the ACO Fund, and the Library Fund), the Winters Cemetery District, and the Solano County Community College District for each fiscal year in the audit period.

The error occurred because the county was engaged in system implementation and undergoing high staff turnover, which constrained resources dedicated to tax administration. Only one staff member performed the calculation and distribution of the RPTTF with limited review; as a result, the county did not detect the errors.

We are unable to quantify the monetary impact due to various errors affecting the calculation.

RTC section 97.401 and Health and Safety Code sections 34182 through 34188 provide the legal requirements for administration of the RPTTF.

In 2012, the Legislature passed a law dissolving the previously established RDAs. Provision of the law included the creation of successor agencies (SAs) and oversight boards to oversee the winding-down of the defunct agencies' affairs.

Under the applicable Health and Safety Code sections, SAs will receive the ATI previously given to RDAs to fund payments of their obligations, including, but not limited to, administrative costs, pass-through payments, and debts.

<u>Recommendation</u>

We recommended that the county establish and implement policies and procedures to:

- Ensure that it correctly administers RPTTF deposits and fund activities (allocations and disbursements) in accordance with applicable statutes and pass-through agreements; and

- Ensure that computation worksheets are properly supported and reviewed for accuracy.

In addition, we recommend that the county:

- Recalculate the tax increment for the City of Winters' Redevelopment Successor Agency for FY 2015-16 and FY 2016-17;
- Recalculate the contractual pass-through payments for the City of Winters' Redevelopment Successor Agency for FY 2014-15 through FY 2016-17; and
- Make monetary adjustments as necessary to affected entities.

<u>County's Response</u>

The county concurs with the audit finding and will make necessary adjustments, if they are material.

Supplemental Information

Redevelopment Property Tax Trust Fund

On May 26, 2015, the Sacramento County Superior Court ruled in Case No. 34-2014-80001723-CU-WM-GDS between the cities of Chula Vista, El Cajon, Escondido, Poway, San Diego, San Marcos, and Vista (petitioners) and the San Diego County Auditor-Controller (respondent) regarding the methodology for apportioning the residual balance from the RPTTF.

The Court stated, in part:

> (1) that a cap on the residual amount each entity can receive be imposed in an amount proportionate to its share of property tax revenue in the tax area; and (2) the calculation of the residual share an entity is entitled to receive must be done by considering the property tax available in the Redevelopment Property Tax Trust Fund after deducting only the amount of any distributions under paragraphs (2) and (3) of subdivision (a) of Section 34183.

On September 17, 2015, the respondent appealed the ruling to the Court of Appeal of the State of California, Third Appellate District.

As the appellate court has not decided on the case, we will follow up on this issue in a subsequent audit.

Attachment—
County's Response to Draft Audit Report

County of Yolo

www.yolocounty.org

CHAD RINDE, CPA
Chief Financial Officer

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- Financial Leadership
- Budget & Financial Planning
- Treasury & Finance
- Tax & Revenue Collection
- Financial Systems Oversight
- Accounting & Financial Reporting
- Internal Audit
- Procurement

January 11, 2019

Jeffrey V. Brownfield, CPA
Chief
State Controller's Office
Division of Audits
P.O. Box 942850
Sacramento, CA 94250

Dear Mr. Brownfield,

Please find our responses below to your audit report dated December 17, 2018:

FINDING 1 – COMPUTATION AND DISTRIBUTION OF PROPERTY TAX REVENUES

The County agrees with this finding. The County has reviewed the applicable Revenue and Taxation Codes and updated procedures to exclude unsecured aircraft assessed values from Annual Tax Increment (ATI) calculations. The County has established policies and procedures to ensure property tax computation worksheets are properly reviewed to ensure accuracy and adequate supporting documentation. The County will recalculate the ATI for the fiscal years in the audit period and will make monetary adjustments to affected entities, if material.

FINDING 2 – UNITARY AND OPERATING NON-UNITARY ALLOCATION AND APPORTIONMENT

The County agrees with this finding. The County has established policies and procedures to ensure property tax computation worksheets are properly reviewed to ensure accuracy and adequate supporting documentation. The County will recalculate the unitary and operating non-unitary allocation factors with the 2015-16 fiscal year identified and will make monetary adjustments to affected entities, if material.

FINDING 3 – UNITARY REGULATED RAILWAY ALLOCATION AND APPORTIONMENT

The County agrees with this finding. The County has established policies and procedures to ensure property tax computation worksheets are properly reviewed to ensure accuracy and adequate supporting documentation. The County will recalculate the unitary regulated railway allocation factors with the 2015-16 fiscal year identified and will make monetary adjustments to affected entities, if material.

FINDING 4 – REDEVELOPMENT PROPERTY TAX TRUST FUND ADMINISTRATION

The County agrees with this finding. The County has established policies and procedures to ensure redevelopment property tax trust fund computation worksheets are properly reviewed to ensure accuracy and adequate supporting documentation. The County will correct the 14-15B Recognized Obligation Payment to the City of Winters, recompute tax increment factors for the 2015-16 and 2016-17 fiscal years, recompute the contractual pass-through payments identified and will make monetary adjustments to affected entities, if material.

Sincerely,

Chad Rinde, CPA
Chief Financial Officer

Cc: Sheryl Hardy-Salgado, Property Tax Supervisor

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