

STATE OF CALIFORNIA

Report to the California State Legislature

PROPERTY TAX APPORTIONMENTS

Calendar Year 2009



JOHN CHIANG
California State Controller

March 2010



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California State Controller

March 12, 2010

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

Re: Property Tax Apportionments Report to the Legislature for Calendar Year 2009

I am pleased to present the Property Tax Apportionments report for calendar year 2009. 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 2009 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 2009 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 2009, the SCO completed audits of 16 counties' property tax apportionment and allocation systems, processes, and records. The 16 counties include Amador, Butte, Contra Costa, Glenn, Imperial, Kings, Los Angeles, Mendocino, Mono, Orange, Placer, San Benito, San Mateo, Santa Clara, Sutter, and Yolo 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 seven of the 16 counties have successfully resolved the prior audit findings and that seven of the 16 counties had no prior audit findings. In addition, we had no reportable audit findings or conditions in 1 of the 16 counties audited during 2009.

Therefore, except for the findings and recommendations noted in this report, the processes used by the 16 counties audited during 2009 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:

- One county has not resolved a prior audit issue regarding the underfunding of an ERAF contribution.
- One county underfunded an ERAF contribution by the county library's share.
- One county incorrectly computed unitary and operating nonunitary apportionment factors.
- One county did not compute a separate railroad apportionment factor.
- One county allocated unitary bond collections to redevelopment agencies.
- One county allocated tax increment to a redevelopment agency in an amount greater than the Statement of Indebtedness justified.
- One county incorrectly included a taxing agency in a tax rate area thereby incorrectly computing and distributing annual tax increment.
- 14 counties included the ERAF in unitary and operating nonunitary apportionment calculations.

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 16 audits of county property tax apportionments and allocations completed by the State Controller's Office (SCO) in calendar year 2009. The following counties were audited: Amador, Butte, Contra Costa, Glenn, Imperial, Kings, Los Angeles, Mendocino, Mono, Orange, Placer, San Benito, San Mateo, Santa Clara, Sutter, and Yolo. 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, 16 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 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 factors (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 revenues 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 (e.g., Education Code section 42237.7 et seq., and Government Code section 12420 et seq.). 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 annual tax increment (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 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 percent 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 percent 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 percent share, commonly known as “tax equity allocation” or “TEA payment.” A number of issues are in contention. 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 2009 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 a continuing unresolved issue regarding an Education Revenue Augmentation Fund (ERAF) contribution amount.

One county has several 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.

Computation of Annual Tax Increment Factors

The Revenue and Taxation Code requires that each jurisdiction in a tax rate area (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.)

One county incorrectly included a taxing agency in a tax rate area thereby incorrectly computing and distributing annual tax increment.

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.

No errors were noted in this area.

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 they adopt a method of identifying the actual administrative costs associated with the supplemental roll, counties 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 allocated tax increment to a redevelopment agency in an amount greater than the Statement of Indebtedness justified and allocated unitary bond collections to redevelopment agencies.

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.

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

One county incorrectly computed unitary and operating nonunitary apportionment factors because of unresolved prior findings, the inclusion of the ERAF, and railroad revenues, and the exclusion of redevelopment agencies when growth exceeded 2% over the prior year. In addition, the county did not compute a separate railroad apportionment factor.

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 can 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, this process will be reviewed again to determine if any adjustments are warranted and reports will be modified accordingly, including allowing the counties 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 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 State Controller 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 Chapter 290, Statutes of 1997. Subsequently, the Legislature enacted AB 417 (Chapter 464, Statutes of 1999), restoring the exemption to fire districts.

One county underfunded an ERAF contribution by the county library's share.

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 is noted as an observation until the legal issues are addressed. After all legal challenges are resolved, these procedures will be reviewed again to determine if any adjustments or corrections are warranted and any reports will be modified 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.

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 SCO in calendar year 2009. 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.

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

Follow-up on Prior Audit Findings

Our prior audit report, issued November 15, 2004, included no findings related to the apportionment and allocation of property tax revenues by the county.

FINDING— 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 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 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, ERAF is not eligible to share in the unitary apportionment and its amount should be distributed proportionately among all taxing jurisdictions that contributed to the fund.

Butte County (July 1, 2005, through June 30, 2008)

Follow-up on Prior Audit Findings

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

FINDING— 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 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 tax apportionment computations, the ERAF should not be included in the calculation because the ERAF does not qualify as an affected taxing agency under the Revenue and Taxation Code. Thus, the ERAF is not eligible to share in the unitary apportionment. Any amount calculated for the ERAF should be proportionately shared among all taxing jurisdictions that contributed to the ERAF.

Contra Costa County (July 1, 2005, through June 30, 2008)

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— 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 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 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. The ERAF’s share should be distributed proportionately among all taxing jurisdictions that contributed to the fund.

County’s Response

The Office of the State Controller listed one finding in the audit for Contra Costa County for its inclusion of the Educational Revenue Augmentation Fund (ERAF) in the unitary tax allocation. The State Controller bases this audit finding in a State Controller internal memorandum from Gary D. Hori. The memo is unclear, noting that Revenue and Taxation code section 95 does not spell out a definition of a “taxing jurisdiction”. The internal memorandum uses the phrase “*we believe that the commonly understood term of ‘taxing jurisdiction’ as used in section 100 of the Revenue and Taxation Code, means a local jurisdiction capable of levying a tax*”. Section 100 of the Revenue and Tax Code is referring to agencies that receive property tax revenues and not just those agencies that can “levy a tax”. Specifically, Revenue and Taxation Code section 100(e)(3) includes redevelopment agencies as a taxing jurisdiction and Revenue and Taxation Code section 100.95(a)(3)(A)(i) states:

“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”

Revenue and Taxation Code section 95(f) includes ERAF as a school entity. Statute provides support that a taxing jurisdiction need not be “*capable of levying a tax*” to be a tax jurisdiction. Contra Costa County requests that you remove this audit finding.

In Summary, ERAF is a school entity and receives property tax revenues as established by various statutes. “Taxing jurisdiction” is not defined by statute and the code section referenced in the legal opinion supports a definition contrary to the State Controller’s position. The State Controller’s legal opinion uses non-definitive terms to justify their positions such as “*commonly understood*” and “*we believe*”. The

methodology used by Contra Costa County is consistent with Property Tax Manager's Reference Manual and has been deemed correct in previous audits by the State Controller.

SCO's Comments

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

The county points out that Revenue and Taxation Code section 100(e)(3) includes redevelopment agencies as a taxing jurisdiction. The county is apparently trying to demonstrate that the Legislature, in enacting the section, is including a non-taxing entity in the definition of a taxing jurisdiction. We concur. This demonstrates that the Legislature can include non-taxing entities in the definition of taxing jurisdiction. In this case, it omitted the ERAF from the definition of taxing jurisdiction.

The county states that Revenue and Taxation Code section 100 is referring to “agencies that receive property tax revenue and not just those agencies that can ‘levy a tax.’” The SCO disagrees. Revenue and Taxation Code section 100(c)(1) states, in part:

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

Taxing jurisdictions would be a subset of entities that receive property tax revenue.

It should also be noted that Revenue and Taxation Code section 95(b) defines a jurisdiction as a “local agency, school district, community college district, or county superintendent of schools. . . .” In addition, Revenue and Taxation Code section 95(f) includes the ERAF in the definition of school entities.

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

From the above it can be seen that the definition of jurisdiction does not include the ERAF but does include all defined school entities except the ERAF. Defining the ERAF as a school entity does not make it a jurisdiction.

The county quotes from Revenue and Taxation Code section 100.95(a)(3)(A)(i) to support its position that the ERAF should receive a portion of unitary and operating nonunitary taxes. Specifically, the county points out that the section refers to Revenue and Taxation Code section 95(f) which includes the ERAF as a school entity. This demonstrates that the Legislature can include the ERAF as an entity to receive specified property tax revenues.

What is not stated or discussed is that Revenue and Taxation Code section 100.95(a)(3)(A)(i) refers to certain specified “qualified property” as defined in Revenue and Taxation Code section 100.95(c)(1)(A) through (c)(1)(C):

- (c) For purposes of this section, all of the following apply:
 - (1) “Qualified property” means all plant and associated equipment, including substation facilities and fee-owned land and easements, placed in service by the public utility on or after January 1, 2007, and related to the following:
 - (A) Electrical substation facilities that meet either of the following conditions:
 - (i) The high-side voltage of the facility's transformer is 50,000 volts or more.
 - (ii) The substation facilities are operated at 50,000 volts or more.
 - (B) Electric generation facilities that have a nameplate generating capacity of 50 megawatts or more.
 - (C) Electrical transmission line facilities of 200,000 volts or more.

We concur that for the defined qualified property, the ERAF should receive a portion of the taxes. However for purposes of unitary and operating nonunitary taxes pursuant to Revenue and Taxation Code section 100, the ERAF does not receive a share.

The finding remains as written.

Glenn County (July 1, 2002, through June 30, 2007)

Follow-up on Prior Audit Findings

Our prior audit report, issued June 20, 2003, included no findings related to the apportionment and allocation of property tax revenues by the county.

FINDING— Unitary and operating nonunitary apportionment

The county included the Educational Revenue Augmentation Fund (ERAF) in the unitary tax apportionment computations for all years 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

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 in the unitary computation and its amount should be distributed proportionately among 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. If this issue is resolved by the State Legislature and there are clear, consistent guidelines available, then the County Auditor will follow the code.

SCO’s Comment

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

The finding and recommendation remain as written.

Imperial County (July 1, 2002, through June 30, 2007)**Follow-up on Prior Audit Findings**

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

**FINDING—
Educational Revenue Augmentation Fund (ERAF) underfunded**

The ERAF was underfunded by the County Library’s share of the ERAF shift (Schedule 1).

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 deposit \$959,203 in the county ERAF.

County's Response

I agree with the explanations within the report and with the Finding and Recommendation. The County has initiated and is pursuing passage of legislation which will deem the allocations made for 2001-02 thru 2006-07 to be correct with the proviso that all calculations after that period be made according to the Revenue and Taxation Code. Beginning in 2007-08, we corrected our calculations and are allocating ERAF from the County Library fund per the Revenue and Taxation Code. Attached to this letter is a history of A.B. 1339, the aforementioned legislation. A.B. 1339 has passed the assembly unanimously and is currently in the Senate awaiting review. It appears that the Senate will probably not address the bill until September 2009 or later. We are going to wait until the bill is either passed or denied before determining any repayment plan for the funds due.

SCO's Comments

The SCO will follow up on this finding with the county upon the final disposition of AB 1339.

Kings County (July 1, 2002, through June 30, 2008)**Follow-up on Prior Audit Findings**

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

**FINDING—
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 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 tax apportionment computations, the county should not include the ERAF as it does not qualify as a “taxing jurisdiction under the Revenue and Taxation Code section 100.” The county should distribute the ERAF’s share proportionately among all taxing jurisdictions that contributed to the fund.

County’s Response

On June 18, 2009, Harold Nikoghosian, Acting Finance Director, responded by e-mail stating, “Per our telephone conversation of this afternoon regarding the Property Tax Audit Report dated March 20, 2009, please be advised that we agree with your findings and recommendation and you may proceed with finalizing that report. Thank you.”

Los Angeles County (July 1, 2006, through June 30, 2007)**Follow-up on Prior
Audit Findings**

Our prior audit report, issued March 21, 2007, included no findings related to the apportionment and allocation of property tax revenues by the county.

**FINDING—
Unitary and operating
nonunitary
apportionment**

The county included the Educational Revenue Augmentation Fund (ERAF) in the unitary tax apportionment computation during this audit period. The ERAF should not be included because it is a fund and not a taxing agency.

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

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.

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

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.

An unpublished SCO legal opinion supports our position that the ERAF is not a taxing jurisdiction.

We are not aware of a State Attorney General Opinion on this subject.

The finding remains as written.

Mendocino County (July 1, 2001, through June 30, 2008)

Follow-up on Prior Audit Findings

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

FINDING 1— Calculation and distribution of ATI

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

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

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

Recommendation

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

County's Response

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

SCO's Comment

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

The finding remains as written.

FINDING 2— Jurisdictional changes

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

The legal requirements for jurisdictional changes are found in Revenue and Taxation Code section 99. A jurisdictional change involves a change in the organization or boundaries of a local government agency or school district. Normally, these are service area or responsibility changes between the local jurisdictions. As part of the jurisdictional change, the local government agencies are required to negotiate any exchange of base year property tax revenue and annual tax increment. After the

jurisdictional change, the local agency whose responsibility increased, receives additional annual tax increment, and the base property tax revenues are adjusted according to the negotiated agreements.

Recommendation

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

County's Response

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

SCO's Comment

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

The finding remains as written.

FINDING 3— Supplemental property tax- administrative costs

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

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

Recommendation

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

County's Response

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

**FINDING 4—
Redevelopment
agencies**

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

Requirements for the apportionment and allocation of property tax to RDAs are found in Revenue and Taxation Code sections 96.4 and 96.5. California community redevelopment law generally entitles a community redevelopment agency to all of the property tax revenues that are realized from growth in values since the redevelopment project's inception.

Recommendation

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

County's Response

We concur with your finding and have corrected the allocations.

**FINDING 5—
Unitary and operating
nonunitary
apportionment**

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

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

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

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

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

Recommendation

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

County's Response

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

Unitary – Failure to include RDA

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

Unitary – Railroad revenues

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

Unitary – Debt Service allocations

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

SCO's Comment

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

**FINDING 6—
Educational Revenue
Augmentation Fund
(ERAF)**

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

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

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

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

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

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

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

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

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

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

- Deducting the FY 1992-93 ERAF shift for the district from the FY 1992-93 property tax allocation;
- Multiplying the result by the SDAF factor for the district effective on June 13, 1993 (net current-year bailout equivalent);
- For a district governed by a board of supervisors, deducting the amount received from the SDAF in FY 1992-93 from the net current-year bailout equivalent; or, for an independent district, deducting the amount received from the SDAF and the difference between the net current-year bailout equivalent and the amount contributed to the SDAF from the net current-year bailout equivalent;
- Adjusting this amount for growth; and
- Adding this amount to the FY 1992-93 ERAF shift, adjusted for growth.

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

Recommendation

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

County's Response

We reiterate our position from the prior audit report comments that the county did not err in re-computing the appropriate ERAF amount. Our approach was based upon your approved 1987 audit findings and

recommendations. We further believe that the County of Mendocino is in compliance with state statute on a prospective basis commencing in fiscal year 1997-98.

SCO's Comment

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

The finding remains as written.

Mono County (July 1, 2002, through June 30, 2008)

Follow-up on Prior Audit Findings

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

FINDING— Unitary and operating nonunitary apportionment

The county included the Educational Revenue Augmentation Fund (ERAF) in the unitary tax apportionment computation during this audit period. The ERAF is not a taxing jurisdiction and should not be included in the 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

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.

County's Response

Mono County adjusted their Unitary Apportionment worksheet to eliminate ERAF from unitary apportionments beginning in the current fiscal year 2008-09 and this change will be reflected in future years.

Orange County (July 1, 2005, through June 30, 2008)**Follow-up on Prior Audit Findings**

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

**FINDING—
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 FY 1988-89, the Legislature established a separate system for apportioning and allocating 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 county should not include the ERAF. The ERAF does not qualify as a “taxing jurisdiction” under Revenue and Taxation Code section 100. Thus, the ERAF is not eligible to share in the unitary apportionment and the ERAF amount should be distributed proportionately among all taxing jurisdictions that contributed to the fund.

County Auditor-Controller's Response

We disagree with this recommendation. The methodology utilized by Orange County to include ERAF in the unitary apportionment computation has passed review in previous audits and is consistent with our interpretation of the applicable statutes. This methodology is also consistent with that which is outlined in the Property Tax Manual utilized by county property tax managers throughout the state, and which is approved by the County Auditor's Association of California. We will continue with this methodology until this issue is resolved either through legislation or through litigation.

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.

Placer County (July 1, 2004, through June 30, 2008)**Follow-up on Prior Audit Findings**

Our prior audit report, issued March 4, 2005, included no findings related to the apportionment and allocation of property tax revenues by the county.

**FINDING—
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 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 tax apportionment computations, the ERAF should not be included in the calculation because the ERAF does not qualify as an affected taxing agency under the Revenue and Taxation Code. Thus, the ERAF is not eligible to share in the unitary apportionment. Any amount calculated for the ERAF should be proportionately shared among all taxing jurisdictions that contributed to the ERAF.

Auditor-Controller's Response

We disagree with this finding and will continue to follow the County Auditor's Association of California's approved methodology for the apportionment of Unitary and Operating Nonunitary property taxes by including ERAF in our computations.

SCO's Comment

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. The finding remains as written.

San Benito County (July 1, 2002, through June 30, 2008)**Follow-up on Prior Audit Findings**

Findings noted in our prior audit, issued July 28, 2005, have been satisfactorily resolved by the county, with the exception of the ERAF being underfunded as described in the Finding and Recommendation section of this report.

**FINDING—
Underallocation to Educational Revenue Augmentation Fund**

In a previous SCO audit, issued December 11, 1998, we determined that the Educational Revenue Augmentation Fund (ERAF) was underfunded by \$514,016. The county did not reimburse the ERAF for this amount. In our subsequent audit issued on July 28, 2005, the same amount had grown to \$3,929,689. Per Revenue and Taxation Code section 96.81, the \$514,016 is forgiven but the difference of \$3,415,673 must be returned to the ERAF. Also, in the subsequent audit (July 28, 2005), new audit findings were discovered but are subject to a limit imposed by the Revenue and Taxation Code. The limit imposed by the Revenue and Taxation Code reduced this additional finding to \$439,284.

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

Although the property tax system has been fully corrected, the county must still reimburse the ERAF in the amount of \$3,854,957.

County's Response

We continue to be in disagreement with the interpretation by the State Controller's Office of Revenue and Taxation Code 96.1(b) and 96.1(c)(3) for the findings of the under-allocations of the Educational Revenue Augmentation Fund (ERAF) occurring in the prior periods of July 1, 1993 through June 30, 2001 and July 1, 2001 through June 30 2002.

SCO's Comment

As noted in the above finding, the county has not complied with Revenue and Taxation Code section 96.1 as referenced, and has not made the necessary adjustment. Therefore, the finding remains as stated.

**OTHER ISSUE—
Exclusion of the ERAF
from the unitary and
operating nonunitary
apportionment process**

In its response letter, the county raised an additional issue regarding the exclusion of the ERAF from the unitary and operating nonunitary apportionment process. The county's comment and the SCO's response are as follows.

County's Comment

During the course of this audit we were informed by your audit staff, that the State Controller's Office legal counsel had opined ERAF should not be used as part of the unitary tax formula. We disagree with that interpretation. The State Association of County Auditors (SACA) Property Tax Guidelines specifically includes ERAF in the Unitary Tax formula. Under protest and threat of listing this issue as an official audit finding we reluctantly recalculated and redistributed the amount from the ERAF shift back to the contributing agencies. Since the State Association of County Auditor's Property Tax Guidelines were approved by the State Controller's Office, the California State Association of Counties, the League of California Cities and the California Department of Finance, we believe that for consistent and equitable unitary tax revenue treatment that the SACA Property Tax Guidelines should be followed by the current State Controller's Administration.

SCO's Response

Revenue and Taxation Code section 100(c)(1) requires the allocation of unitary and operating nonunitary taxes to taxing jurisdictions. The ERAF is a fund—an accounting entity—not a taxing jurisdiction, and with respect to the allocation and apportionment of unitary and operating nonunitary taxes the California State Legislature has not defined it as a taxing jurisdiction.

Revenue and Taxation Code section 100(e)(3) includes a redevelopment agency as a taxing jurisdiction. This demonstrates that the Legislature can include non-taxing entities in the definition of a tax jurisdiction if it so chooses. In this case, the Legislature omitted the ERAF from the definition of taxing jurisdiction.

It is also important to point out that the State Controller's Office has never approved the Property Tax Guidelines.

San Mateo County (July 1, 2003, through June 30, 2006)

**Follow-up on Prior
Audit Findings**

The county has satisfactorily resolved the findings noted in our prior audit report, issued August 13, 2004.

**FINDING 1—
Calculation and
distribution of the
annual tax increment**

The county's tax rate area (TRA) #078-016 included two hospital districts: Sequoia Hospital District and Peninsula Hospital District. Sequoia Hospital District incorrectly received the property tax revenues. According to State Board of Equalization documents, the only hospital district designated in this TRA is Peninsula Hospital District.

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 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 must remove Sequoia Hospital District from the TRA and allocate the revenues to the Peninsula Hospital District.

**FINDING 2—
Unitary and operating
nonunitary
apportionment**

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

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

Since the ERAF is not considered a taxing entity, the county must exclude the ERAF from the unitary and operating nonunitary apportionment system.

Santa Clara County (July 1, 2004, through June 30, 2007)

**Follow-up on Prior
Audit Findings**

The county has satisfactorily resolved the findings noted in our prior audit report, issued January 13, 2005.

**FINDING—
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 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 tax apportionment computations, the ERAF should not be included in the calculation because the ERAF does not qualify as an affected taxing agency under the Revenue and Taxation Code. Thus, the ERAF is not eligible to share in the unitary apportionment. Any amount calculated for the ERAF should be proportionately shared among all taxing jurisdictions that contributed to the ERAF.

Auditee’s Response

Your draft audit report has one finding pertaining to the inclusion of Educational Revenue Augmentation Fund (“ERAF”) in unitary tax apportionment. We disagree with the audit finding for the following reasons.

The definition of a school entity per R&T Code Section 95(f) includes ERAF. The R&T Code Sections §100.95(a)(3)(A)(i) which deal with Unitary, refer to this Code Section for definition of school entity. Therefore, ERAF should get a share in unitary apportionment.

The second reason for our disagreement is that the methodology used by the County of Santa Clara was previously accepted by the State Controller’s Office. Please note that the State Controller in the audit of Marin and Tehama counties cited them for not including ERAF in unitary apportionment. The current audit finding of the State Controller’s Office is contradicting to the previous position [*sic*].

The third reason for the disagreement with the audit finding is our current practice is to follow the guideline methodology set in Property Tax Manager’s Reference Manual. The State Association of County Auditors has also recommended that counties should continue to follow the Tax Manager’s Reference manual until this issue is resolved by the State legislature in clear and unambiguous terms. Our statewide survey on this topic revealed majority of counties consistently include ERAF in unitary apportionment [*sic*].

SCO’s Comment

The county is correct. Revenue and Taxation Code section 95(f) does include the ERAF in the definition of school entities. However, in defining jurisdictions, in Revenue and Taxation Code section 95(b), the ERAF is not included, although school districts and community college districts are included. The ERAF, as its name implies, is a fund, an accounting entity, and not a jurisdiction.

The county's reference to Revenue and Taxation Code section 100(a)(C)(i) does not exist, the correct Revenue and Taxation Code citation should be section 100.11(a)(2)(C)(i). Revenue and Taxation Code section 100.11(a)(2)(C)(i) reads in part:

(C) The revenues derived from the application of these rates to this value shall be allocated in the manner described in subdivisions (c) and (d) of Section 100, which manner shall be modified as follows:

(i) School entities, as defined in subdivision (f) of Section 95, in a county 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 regulated railway company in the county.

Revenue and Taxation Code section 100.11 pertains to the allocation of property tax revenues paid by regulated railway companies and not the unitary and operating nonunitary revenues allocated pursuant to Revenue and Taxation Code section 100.

Similarly, Revenue and Taxation Code section 100.95(a)(3)(A)(i) pertains to the allocation of property tax revenue from certain qualified property which is defined in section (c)(1) as:

(c) For purposes of this section, all of the following apply:

(1) "Qualified property" means all plant and associated equipment, including substation facilities and fee-owned land and easements, placed in service by the public utility on or after January 1, 2007, and related to the following:

(A) Electrical substation facilities that meet either of the following conditions:

(i) The high-side voltage of the facility's transformer is 50,000 volts or more.

(ii) The substation facilities are operated at 50,000 volts or more.

(B) Electric generation facilities that have a nameplate generating capacity of 50 megawatts or more.

(C) Electrical transmission line facilities of 200,000 volts or more.

It should be noted that these are not the unitary and operating nonunitary revenues allocated pursuant to Revenue and Taxation Code section 100. In addition, when performing certain computations under Revenue and Taxation Code section 100, Revenue and Taxation Code section 100(c)(3) specifically excludes revenues under Revenue and Taxation Code section 100.95.

The SCO acknowledges that its past position allowed the ERAF to receive unitary and operating nonunitary revenues. However, at the request of another county, the SCO revisited the issue and determined that the ERAF was not a taxing jurisdiction and therefore was not eligible to receive unitary and operating nonunitary revenues.

Finally, regardless of the methodology described in the Property Tax Manager's Reference Manual, 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. The finding remains as written.

Sutter County (July 1, 2002, through June 30, 2008)

Follow-up on Prior Audit Findings

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

The county had no reportable findings.

Yolo County (July 1, 2001, through June 30, 2007)

Follow-up on Prior Audit Findings

The county has satisfactorily resolved the findings noted in our prior audit report, issued December 17, 2002.

FINDING— 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 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 tax apportionment computations, the ERAF should not be included in the calculation because the ERAF does not qualify as an affected taxing agency under the Revenue and Taxation Code. Thus, the ERAF is not eligible to share in the unitary apportionment. Any amount calculated for the ERAF should be proportionately shared among all taxing jurisdictions that contributed to the ERAF.

County Auditor-Controller’s Response

This is a continuing issue that has caused significant debate, but has yet to yield any substantive resolution. To be consistent with the recommendation of the County Auditor’s Association of California (CAAC), we intend to follow the guidelines established in the Property

Tax Manager's Reference Manual, as they currently exist. Until such time as the issue is resolved by the California Legislature or an opinion of counsel or a revision of code is accepted and recommended by CAAC, we will maintain compliance with established guidelines.

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, because 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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