

CONTRA COSTA COUNTY

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2005, through June 30, 2008



JOHN CHIANG
California State Controller

April 2009



JOHN CHIANG
California State Controller

April 17, 2009

The Honorable Stephen Ybarra
Auditor-Controller
Contra Costa County
Finance Building
625 Court Street, Room 103
Martinez, CA 94553-1282

Dear Mr. Ybarra:

The State Controller's Office audited the methods employed by Contra Costa County to apportion and allocate property tax revenues for the period of July 1, 2005, through June 30, 2008. The audit was conducted pursuant to the requirements of Government Code section 12468.

Our audit disclosed that the county complied with California statutes, except that it included the Educational Revenue Augmentation Fund in the unitary tax apportionment computation during the audit period.

In the past, SCO auditors have accepted the county's Tax Equity Allocation (TEA) formula computation. However, a legal challenge in another county has raised the possibility that the county may not be in compliance with the Revenue and Taxation Code. At this time, this finding does not warrant a reportable condition, but is only an observation until the legal issues are resolved. After all legal challenges are resolved, this process will be reviewed again to determine if any adjustments or corrections are warranted and the report will be modified accordingly.

Prior to fiscal year 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 revenues, in reimbursement for the 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 fiscal year 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 a county has used to impose the fee for the services provided under Revenue and Taxation Code sections 97.68 and 97.70. Contra Costa County has used this method to impose the fee. Therefore, at this time, 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 the report will be modified accordingly, including allowing the county to modify its method of imposing the fee.

If you have any questions, please contact Steven Mar, Chief, Local Government Audits Bureau, at (916) 324-7226.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB/sk

cc: Jody Martin
 Joint Legislative Budget Committee
 Peter Detwiler, Consultant
 Senate Local Government Committee
 Elvia Dias, Assistant
 Senate Local Government Committee
 Dixie Martineau-Petty, Secretary
 Assembly Local Government Committee
 Martin Helmke, Consultant
 Senate Revenue and Taxation Committee
 Kimberly Bott, Chief Consultant
 Assembly Revenue and Taxation Committee
 Catherine Smith, Executive Director
 California Special Districts Association

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Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by Contra Costa County to apportion and allocate property tax revenues for the period of July 1, 2005, through June 30, 2008.

Our audit disclosed that the county complied with California statutes for the allocation and apportionment of property tax revenues, except that it included the Educational Revenue Augmentation Fund (ERAF) in the unitary tax apportionment computation during this audit period.

Our audit disclosed that the county complied with California Statutes for the allocation and apportionment of property tax revenues for the period audited, except for the effects, if any, of the matter discussed below.

Prior to fiscal year 2006-07, counties could not impose a fee, charge or other levy on a city, or reduce a city's allocation of ad valorem property tax revenue in reimbursement for the services performed by the county under Revenue and Taxation Code section 97.75. Beginning with fiscal year 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 cannot exceed the actual cost of providing the services.

A legal challenge has arisen regarding the method a county has used to impose the fee for the services provided under Revenue and Taxation Code sections 97.68 and 97.70. Contra Costa County has used the same method to impose the fee. Therefore, at this time, 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 or corrections are warranted and the report will be modified accordingly, including allowing the county to modify its method of imposing the fee.

Though the county's process in computing the "no-and low-property tax cities" (also known as Tax Equity Allocations or TEA) has been accepted in the past, a legal challenge in another county has raised the possibility that it may not be in compliance with the Revenue and Taxation Code. Until the legal issues are resolved, this process is noted here, but will not be determined complete. This process will be reviewed again to determine if any adjustments or corrections are warranted.

Background

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

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

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

The AB 8 base process involved numerous steps, including the transfer of revenues from schools to local agencies (AB 8 shift) and the development of the tax rate area annual tax increment apportionment factors (ATI factors), which determine the amount of property tax revenues to be allocated to each jurisdiction.

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

Subsequent legislation removed revenues generated by unitary and operating nonunitary property from the AB 8 system. This revenue is now allocated and apportioned under a separate system.

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

Revenues generated by the different types of property tax are apportioned and allocated to local agencies and schools using prescribed formulas and methods, as defined in the Revenue and Taxation Code. Taxable property includes land, improvements, and other properties that are accounted for on the property tax rolls maintained primarily by the county assessor. Tax rolls contain an entry for each parcel of land, including the parcel number, the owner's name, and the value. Following are the types of property tax rolls:

- *Secured Roll*—This roll contains property that, in the opinion of the assessor, has sufficient value to guarantee payment of the tax levies and that, if necessary, can be sold by the tax collector to satisfy unpaid tax levies.
- *Unsecured Roll*—This roll contains property that, in the opinion of the assessor, does not have sufficient “permanence” or have other intrinsic qualities to guarantee payment of taxes levied against it.

- *State-Assessed Roll*—This roll contains public utility and railroad properties, assessed as either unitary or nonunitary property by the State Board of Equalization.
- *Supplemental Roll*—This roll contains property that has been reassessed due to a change in ownership or the completion of new construction, where the resulting change in assessed value is not reflected in other tax rolls.

To mitigate problems associated with the apportionment and allocation of property taxes, legislation (SB 418) was enacted in 1985 that requires the State Controller to audit the counties' apportionment and allocation methods and report the results to the California State Legislature.

Objective, Scope, and Methodology

Our audit objective was to review the county's apportionment and allocation of property tax revenues to local government agencies and public schools within its jurisdiction to determine whether the county complied with Revenue and Taxation Code requirements.

To meet the objective, we reviewed the systems for apportioning and allocating property tax revenues used by the county auditor and the subsystems used by the tax collector and the assessor.

We performed the following procedures:

- Performed tests to determine whether the county correctly apportioned and allocated property tax revenue.
- Interviewed key personnel and reviewed supporting documentation to gain an understanding of the county's property tax apportionment and allocation processes.
- Reviewed apportionment and allocation reports prepared by the county showing the computations used to develop the property tax distribution factors.
- Reviewed tax rate area (TRA) reports to verify that the annual tax increment was computed properly.
- Reviewed county unitary and operating nonunitary reports and Board of Equalization reports and verified the computations used by the county to develop the unitary and operating nonunitary property tax distribution factors.
- Reviewed redevelopment agency (RDA) reports prepared by the county and verified the computations used to develop the project base amount and the tax increment distributed to the RDA.
- Reviewed property tax administration cost reports prepared by the county and verified administrative costs associated with procedures used for apportioning and allocating property tax to local government agencies and school districts.

- Reviewed ERAF reports prepared by the county and verified the computations used to determine the shift of property taxes from local agencies to the ERAF and, subsequently, to public schools.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The audit covered the period of July 1, 2005, through June 30, 2008. We did not audit the county's financial statements. Our audit scope was limited to:

- Reviewing operational procedures and significant applicable controls over the apportionment and allocation process;
- Examining selected property tax apportionment and allocation records; and
- Reviewing related property tax revenue data used to determine the apportionment and allocation computation process.

We limited our review of the county's internal controls to gaining an understanding of the transaction flow in order to develop appropriate auditing procedures. We did not evaluate the effectiveness of all internal controls.

In addition, we tested transactions used to apportion and allocate property taxes and performed other procedures deemed necessary. This report relates solely to the method used by the county to apportion and allocate property taxes.

Conclusion

Our audit disclosed that, except for the items discussed in the Finding and Recommendation section of this report, Contra Costa County complied with California statutes for the apportionment and allocation of property tax revenues for the period of July 1, 2005, through June 30, 2008. The county should correct the item discussed in the Finding and Recommendation section.

Our audit disclosed that the county complied with California Statutes for the allocation and apportionment of property tax revenues for the period audited, except for the effects, if any, of the matter discussed below.

Prior to fiscal year 2006-07, counties could not impose a fee, charge or other levy on a city, or reduce a city's allocation of ad valorem property tax revenue in reimbursement for the services performed by the county under Revenue and Taxation Code section 97.75. Beginning with fiscal year 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 cannot exceed the actual cost of providing the services.

A legal challenge has arisen regarding the method a county has used to impose the fee for the services provided under Revenue and Taxation Code sections 97.68 and 97.70. Contra Costa County has used the same method to impose the fee. Therefore, at this time, 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 or corrections are warranted and the report will be modified accordingly, including allowing the county to modify its method of imposing the fee.

Though the county's process in computing the "no- and low-property tax cities" (also known as Tax Equity Allocations or TEA) has been accepted in the past, a legal challenge in another county has raised the possibility that it may not be in compliance with the Revenue and Taxation Code. Until the legal issues are resolved, this process is noted here, but will not be determined complete. This process will be reviewed again to determine if any adjustments or corrections are warranted.

County's Response to Observation

The Office of the State Controller listed two observations in the audit for Contra Costa County citing a "*legal challenge*" as a basis for the observations. A legal challenge in a different county should not be a determining factor in Contra Costa County's audit report. As noted in prior audit reports Contra Costa County is complying with current procedures. The methodology used by Contra Costa County follows the established uniform guidelines set forth in the Property Tax Manager's Reference Manual. The State Controller has previously audited these items and did not note an observation. In the case of the property tax administration fee, the State Controller's Office had representatives participate in the establishment of these guidelines and Contra Costa County also received a letter from the Office of the State Controller dated July 21, 2006 indicating that Contra Costa County "*complied with the setup and implementation requirements of SB 1096 and AB 2115*". This letter specifically listed the adjustments to the property tax administrative cost apportionment factors as an item being in compliance. Contra Costa County has been consistent in the methodology used to calculate these two items; therefore, I request the State Controller remove the observations from the audit.

SCO's Comments

As noted above, the SCO has not taken issue with these items in past audits and reviews. However, due to the potential statewide impact of the legal challenges to these processes, it is appropriate to keep them open now. When the legal challenges are resolved, the items will be reviewed and the audit report modified accordingly.

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.

**Views of
Responsible
Official**

We issued a draft audit report on February 6, 2009. Stephen J. Ybarra, Auditor-Controller, responded by letter dated March 5, 2009 (Attachment). He disagreed with the audit results.

Restricted Use

This report is solely for the information and use of Contra Costa County, the California Legislature, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

April 17, 2009

Finding and Recommendation

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.

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

Contra Costa County

Office of
COUNTY AUDITOR-CONTROLLER

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Fax (925) 646-2649



Stephen J. Ybarra
Auditor-Controller
Elizabeth A. Verigin
Assistant Auditor-Controller

Thursday, March 5, 2009

Mr. Steven Mar, Chief
Local Government Audits Bureau
Division of Audits
State Controller's Office
P. O. Box 942850
Sacramento, Ca. 94258-5874

Dear Mr. Mar:

This letter is in response to the draft audit report and cover letter issued by the Office of the State Controller dated February 6, 2009 to the Office of the Auditor-Controller, Contra Costa County.

The Office of the State Controller listed two observations in the audit for Contra Costa County citing a "*legal challenge*" as the basis for the observations. A legal challenge in a different county should not be a determining factor in Contra Costa County's audit report. As noted in prior audit reports Contra Costa County is complying with current procedures. The methodology used by Contra Costa County follows the established uniform guidelines set forth in the Property Tax Manager's Reference Manual. The State Controller has previously audited these items and did not note an observation. In the case of the property tax administration fee, the State Controller's Office had representatives participate in the establishment of these guidelines and Contra Costa County also received a letter from the Office of the State Controller dated July 21, 2006 indicating that Contra Costa County "*complied with the setup and implementation requirements of SB 1096 and AB 2115*". This letter specifically listed the adjustments to the property tax administrative cost apportionment factors as an item being in compliance. Contra Costa County has been consistent in the methodology used to calculate these two items; therefore, I request the State Controller remove the observations from the audit.

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

Mr. Steven Mar, Chief
Audit Response Letter
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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 Tax 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 revenue 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:

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I ask that you take the above listed information into consideration and remove the observations and finding from the audit report for Contra Costa County.

Sincerely,



Stephen J. Ybarra
Auditor-Controller, Contra Costa County

**State Controller's Office
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