

California State Auditor

B U R E A U O F S T A T E A U D I T S

The State-County Property Tax Administration Program:

*The State and the Counties Continue to
Benefit, but the Department of Finance
Needs to Improve Its Oversight*



April 2000
99142

The first copy of each California State Auditor report is free.
Additional copies are \$3 each. You can obtain reports by contacting
the Bureau of State Audits at the following address:

**California State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, California 95814
(916) 445-0255 or TDD (916) 445-0255 x 216**

OR

**This report may also be available
on the World Wide Web
<http://www.bsa.ca.gov/bsa/>**

Permission is granted to reproduce reports.



CALIFORNIA STATE AUDITOR

MARY P. NOBLE
ACTING STATE AUDITOR

STEVEN M. HENDRICKSON
CHIEF DEPUTY STATE AUDITOR

April 27, 2000

99142

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning whether the State-County Property Tax Administration Program (program) is still needed.

This report concludes that continuing the program makes good business sense, but the Department of Finance (department) needs to improve its oversight of the program. Specifically, the program continues to generate additional tax revenues that benefit both the State and the counties. Additionally, it provides counties a much-needed infusion of funds that reduces existing work backlogs and strengthens local property tax systems. However, the department currently makes its decisions to fund county loans based on insufficient and unverified county-reported data.

Respectfully submitted,

MARY P. NOBLE
Acting State Auditor

CONTENTS

<i>Summary</i>	1
<i>Introduction</i>	5
<i>Audit Results</i>	
Continuing the Program Makes Good Business Sense	11
Because of Its Weak Oversight, the Department of Finance Does Not Have Adequate Information to Make Good Business Decisions	16
Recommendations	21
<i>Appendix A</i>	
Counties Participating in the State-County Property Tax Administration Program	25
<i>Appendix B</i>	
Suggested Methods for Calculating Revenues Generated From State-County Property Tax Administration Program Loan Funds	29
<i>Response to the Audit</i>	
Department of Finance	33
<i>California State Auditor's Comments on the Response From the Department of Finance</i>	35

SUMMARY

Audit Highlights . . .

The State-County Property Tax Administration Program (program) should be continued because:

- Loans to assessors generate a significant amount of new property tax revenues that benefit the State, the counties, and other local governments.*
- Assessors' offices continue to rely on loan funds to reduce or prevent backlogs of work.*
- The program is successful during recessions as well as during times of prosperity.*

Despite the program's success, oversight from the Department of Finance (department) has been weak. As a result:

- The department often makes loans based on insufficient and unverified information.*
 - The department loses track of unspent county loan funds.*
-

RESULTS IN BRIEF

In 1995, the Legislature created the State-County Property Tax Administration Program (program), which allows county assessors to contract with the Department of Finance (department) to receive performance-based loans. The legislation responded to the financial straits of county assessors, who were facing substantial work backlogs created by major budget reductions. County assessors use the state loans to finance various local property tax administration activities, such as processing backlogs of assessment appeals, searching for unassessed property, or enhancing computer systems. The department considers the loans repaid if the assessors complete the additional workloads their loan agreements specify. The Legislature is deliberating whether it should continue the program, which is scheduled to end in fiscal year 2000-01.

Continuing the program makes good business sense. Although department oversight has been weak, the program continues to generate a significant amount of new property tax revenues that benefit the State and the counties. For the most current completed loan year, the 47 counties participating in the program reported that \$50.9 million in state-funded loans generated more than \$590 million in new property tax revenues. Although this average rate of return of almost \$12 for every dollar loaned was overstated, the program still provides a positive return to the State, counties, cities, special districts, and redevelopment agencies. Also, the program is financially successful in times of recession as well as prosperity because counties have the discretion to use loan money for whatever property tax work produces the most revenue at a given time. In addition, assessors are still reporting backlogs, which suggests a continued reliance on loans from the State. All but 1 of the 47 participating counties reported backlogs of property tax work at the end of the most current completed loan year. Finally, the program provides a much-needed infusion of funds that strengthens the local property tax administration system.

Although we believe the program should continue, we found that the department makes loans to counties based on insufficient and unverified information and does not have enough data to evaluate the program's success. In addition, the

department has allowed counties to carry over unused funds without requiring them to explain how and when they plan to use the funds. As a result, the department could be making loans that are larger than necessary. Further, the department has less assurance that program funds ultimately will be spent on property tax administration. The information gap has resulted primarily because the department has not required adequate county reporting.

Finally, the Legislature recently required the Legislative Analyst's Office to develop alternatives for restructuring the property tax allocation system. If the Legislature makes significant changes to the property tax allocation system, the need for the program should be re-evaluated.

RECOMMENDATIONS

To ensure additional growth in property tax revenues that benefit local governments and the State, the Legislature should continue the State-County Property Tax Administration Program.

If the Legislature continues the program, the department should improve its oversight by requiring that counties do the following:

- Use a standard process for reporting additional workloads, revenues, and expenditures related to loan funds, and for showing that the county has contributed an appropriate amount of its own resources for property tax administration.
- Specify in the loan agreements how the counties will calculate additional workloads, revenues, and expenditures related to loan funds and how they will demonstrate that an appropriate level of county resources was used for property tax administration.

To ensure that the counties use loan funds only for property tax administration and that reported revenues are attributable to loan funds actually spent, the department should require counties to do the following:

- Explain how they plan to use any loan funds remaining from the previous years, along with any funds they request for the current year.

- Report the actual amount of loan funds they spent during the loan period.
- Calculate additional revenues generated by the loan funds actually used.

Finally, to ensure that the department is receiving accurate information from the counties, the department should require each county auditor to validate county reports on the following:

- Additional workloads, revenues, and expenditures resulting from loan funds, as well as the county's method of calculating the additional revenues.
- The amount of county revenue spent on property tax administration.
- The amount of unused loan funds from prior years and how the county used those funds.

AGENCY COMMENTS

The department generally concurred with our recommendations. It acknowledged that if the program is continued, it should improve its oversight of the program and require a more standardized reporting format by the counties. The department also indicated that if the program sunsets at the end of fiscal year 2000-01, as provided in current law, it will consider implementing the recommendations to the extent feasible throughout the remainder of the current program. ■

Blank page inserted for reproduction purposes only.

INTRODUCTION

BACKGROUND

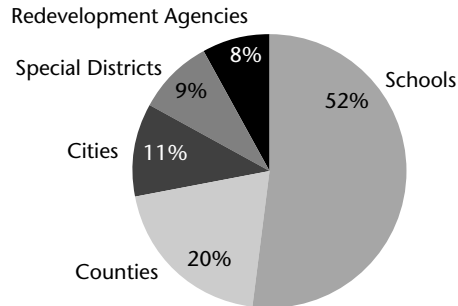
During the 1990s, California experienced a prolonged recession in which property values declined significantly, creating a dramatic increase in the number of Proposition 8 assessments. As a result of Proposition 8, a constitutional amendment passed in 1978, county assessors are allowed to reduce assessments on property that has declined in market value. Beginning in the early 1990s, assessors saw an increase in the number of downward Proposition 8 assessments as well as appeals filed by property owners who thought the market value of their property was less than the assessed value. As the number of appeals increased, the workload grew rapidly at the assessors' offices and the counties began to experience backlogs of unresolved appeals.

As the assessors' workload increased, their operating budgets suffered a steep decline. In 1992 and 1993, the Legislature shifted more than \$3 billion of property tax revenues from counties and local agencies to California's public schools through the Educational Revenue Augmentation Fund (ERAF). This shift increased the schools' share—but significantly decreased the counties' share—of property tax revenues. To compensate for the loss in revenues, local officials cut the budgets and reduced the staff of many county departments, including assessors' offices. With more work to do and less money to do it with, assessors began to have major backlogs of uncompleted assessments.

Because of ERAF, the counties receive a smaller percentage and the schools receive a larger percentage of all property taxes collected. These percentages vary from county to county. Generally, however, when schools receive more property tax money, the State's General Fund obligation to schools is reduced. Property tax revenues are split among schools, counties, cities, and other local agencies. Figure 1 displays the current statewide allocation percentages for each property tax dollar collected.

FIGURE 1

**Average Statewide Allocation of Property Taxes
(Fiscal Year 1998-99)**



Source: The Legislative Analyst's report, *The 1998-99 Budget: Perspectives and Issues*.

In 1995, to provide some financial relief to counties and to ensure the integrity of the property tax administration system, the California Legislature established the State-County Property Tax Administration Program (program) through Assembly Bill 818 (Chapter 914, Statutes of 1995). This program, administered by the Department of Finance (department), allows county assessors to receive performance-based loans from the State to help reduce their backlogs and improve their administration of the property tax system. The program allocated up to \$60 million a year to the counties for fiscal years 1995-96, 1996-97, and 1997-98, identifying specific maximum amounts for each county. In 1997, the Legislature passed Assembly Bill 719 (Chapter 420, Statutes of 1997), which extended the program through fiscal year 2000-01.

The program specifies that a county is eligible to receive funding if it can produce additional property tax revenue that will reduce the State's General Fund obligation to the schools. As listed in Appendix A, we found that 47 of the State's 58 counties participated in the program during the most current completed loan year. The current completed loan year for the participating counties began as early as January 1, 1998, and ended as late as October 31, 1999, depending on each county's specific reporting period. Each of the 47 participating counties has entered into an agreement with the department that details the program requirements. In accordance with its agreement, each county submits an annual loan request that specifies the work it expects to complete within the loan period. In addition, the county

must demonstrate that completing the additional specified work will produce enough revenue to reduce the State's General Fund school obligation by the loan amount. If the county demonstrates this, it is an "eligible" county and the department will award the loan. The State caps the amount of funds each county can request based on a specified portion of the program's overall funding as stated in Chapter 420, Statutes of 1997.

Both the agreements and the annual loan requests define repayment of the loan as completion of the specified workloads, not as production of revenue. If a county finishes the stated amount of work, it has by definition "repaid" the loan. However, if a county completes the work but has not reduced the General Fund obligation by the loan amount, the department may decide not to award a future loan.

Under the law, loan funds must be used to enhance the county's property tax administration program and must not be used to supplant the current level of funding. In other words, independent of the loan funds, the counties themselves must invest each year a sufficient amount of funds to equal or exceed the base year level, which as the program required, is either fiscal year 1993-94 or 1994-95. This investment is referred to as the county's maintenance of effort.

At the end of each loan period, each county must submit to the department an annual report detailing the number and kind of assessments completed and the resulting change in assessed property value. The county's auditor, according to the loan agreement, must verify the accuracy of the annual report.

The department reviews the annual reports to ensure that the counties have completed the work promised in their loan requests. The department then uses the county-reported change in assessed value to calculate what each county's schools get from the property tax revenue. Additionally, the department reviews the schools' share of the additional reported revenues to determine whether that amount is at least equal to that of the loan. If counties meet the performance measures laid out in the agreement, but the schools' share is not equal to or greater than the loan amount, the department will determine whether it should continue to award loans to the county.

Under current law, the State and counties do not pay for the costs of administering the property tax system to the degree that they benefit from its revenues. This differs from another tax

administration system, the sales-and-use tax system administered by the State Board of Equalization, in which the State and local governments pay a share of the system's administration costs in proportion to the revenue they receive. Under the current property tax administration system, counties pay approximately 70 percent of the costs and receive approximately 20 percent of the revenues. In contrast, schools receive approximately 52 percent of the revenues, but do not pay any administrative costs. The remaining beneficiaries, including cities, special districts, and redevelopment agencies, pay a share of the administration costs in proportion to the revenues they receive.

In 1999, the Legislature required the Legislative Analyst's Office to develop ways to restructure the property tax allocation system. As discussed in the Scope and Methodology section of this report, our review focuses specifically on whether the program should continue, not on the fairness of the allocation of property tax administration costs. If the Legislature changes the property tax allocation system, the need for the loan program should be re-evaluated.

SCOPE AND METHODOLOGY

The Joint Legislative Audit Committee (committee) requested that the Bureau of State Audits (bureau) review the program to see if it is still needed and whether the department and counties have operated the program as intended by the law.

To understand the program, including how the department determines county eligibility and awards loans, we interviewed department and county staff. We also reviewed the department's agreements with each participating county to gain an understanding of the requirements on counties' use and repayment of loan funds. We analyzed the revenue and property tax workload data reported on each of the counties' most current annual reports to determine if the State was benefiting from the loan program.

To determine if the department and the participating counties were complying with the requirements of the statutes, we reviewed the county agreements, loan requests, and final reports on file with the department. We found signed loan agreements on file with the department for all 47 counties participating in the program. Each county's agreement provided compliance, performance, and reporting requirements. In addition, each county had submitted annual reports as required by its loan agreements.

To determine if the program information the counties submit to the department is reliable and accurate, we visited five counties: Los Angeles, Madera, Placer, Sacramento, and Santa Clara. They represented a cross-section of counties participating in the program, including both large and small counties as well as counties with high and low rates of return reported from their use of the loan funds. We interviewed each county auditor to gain an understanding of the extent of their efforts to ensure the accuracy of the assessors' reports. We also reviewed auditor-developed audit programs and working papers, if available, to determine what specific assessor reported data their review validated. When the county auditor's review process appeared to be inadequate, we verified whether the raw data on the county's most current annual report was accurate by tracing amounts to supporting county records.

To determine if counties were using loan funds to supplant their county budgets, at each of the five counties we visited, we analyzed whether the funding level for the assessor's office exceeded the amount established in the base year for each year the county participated in the program. To determine if the counties were using loan funds on appropriate activities, we reviewed expenditure reports at the five counties. ■

Blank page inserted for reproduction purposes only.

AUDIT RESULTS

CONTINUING THE PROGRAM MAKES GOOD BUSINESS SENSE

The State-County Property Tax Administration Program (program) generates significant new property tax revenue that benefits the State, the counties, and other local governments. In addition to increasing revenues, the program enables counties to reduce or eliminate their assessment backlogs and to make improvements that strengthen the local property tax system. Furthermore, the program's flexibility enables assessors to achieve tax revenue increases during times of recession and economic growth. For these reasons, continuing this successful loan program is a good business decision.

Despite Overstated County Returns, the Program Still Benefits the State and the Counties

By generating additional property tax revenues, the program reduces the State's obligation for funding schools and increases the amount of revenue available to counties. Although some current county reports overstate revenues that result from the loans, the program still appears to give the State a substantial return on its investment. Further, counties are using some of the state loan money to update old technology and procedures, thereby increasing the overall value of the property tax system.

In evaluating the program's success for the most current completed loan year, we found that county auditors at all 47 participating counties certified that the counties "repaid" their loans by completing the workloads specified in their loan agreements with the Department of Finance (department). Also, 45 of these counties reported that they generated sufficient new revenues to offset the State's cost of their loans. The department dropped only one county from the program because that county submitted a loan request for the following year with workloads that the department believed would not generate enough revenues to offset the State's cost of a new loan.

In our efforts to assess the program's financial benefits to the State and counties, we found that certain counties have overstated the amount of revenues in their reports to the department. Nine of the 47 counties incorrectly reported total revenues from

Forty-five of the 47 participating county assessors reported that they generated sufficient new property tax revenues to offset the State's cost of their loans.

Certain counties have overstated the benefits of the program in their reports to the department.

completed assessor workloads rather than just the additional (incremental) revenues generated from activities financed with loan funds. To accurately reflect the amount of incremental property tax revenues resulting from the counties' use of loan funds, we separated the 9 counties that incorrectly reported total revenues from the 38 that appropriately reported incremental revenues, as shown in Appendix A. The figures reported by the 38 counties show a total of \$461 million in new property tax revenues generated from the \$42 million in state-funded loans to these counties. This represents an average rate of return of almost \$11 in new property tax revenues for every dollar of loan funds. These new property tax revenues reduced the State's obligation to fund schools by more than \$237 million, a 5-to-1 return. Additionally, the loan funds generated an estimated \$224 million in new property tax revenues for counties and other local governments.

At the five counties, we took a closer look at the program information the counties submit to the department. As discussed later, we noted flaws in the incremental revenue calculations of 2 of the 38 counties. To determine the extent of the potential overstatement in revenues reported by the 2 counties, we compared the amount of county-reported revenue with the amount of revenue we calculated using an alternate method that we believe to be more accurate in certain circumstances. This method is detailed in Appendix B. Under our method of revenue calculation, the 2 counties appear to have overstated their reported revenues by about 186 percent. Despite this overstatement, the 2 counties still generated \$9.7 million in new property tax revenues from \$2.2 million in state-funded loans. These new property tax revenues reduced the State's obligation to fund schools by more than \$5.3 million and generated an estimated \$4.4 million in new property tax revenues for the counties and other local governments. So the State not only recouped its \$2.2 million, it benefited by an additional \$3.1 million, a 150 percent return for the State in reduced school funding obligation for every dollar the State loaned to the 2 counties.

Our calculated rate of return for these 2 counties is considerably less than the overall reported rate of the 38 counties. But even at our reduced calculated rate, the program still provides the State a 150 percent return on its money. If participating counties enhance

their reporting and improve their methods of calculating revenues, as we recommend, the department can assess the program's financial benefits more accurately. Under the program's eligibility requirements, the department is able to protect the State's financial interests and drop from the program any county that is not able to generate sufficient new property tax revenues to offset the State's cost of the loan. In the future, counties may elect to go in and out of the program depending on the level of their backlogs and their ability to generate new property tax revenues from completing these backlogs. However, the department will still be able to protect the State's financial interests by enforcing the program's eligibility requirements.

The loan program also strengthens local property tax administration systems, allowing the county assessors to update technology, improve procedures, and make their operations more fair and efficient.

In addition to increasing revenues for the State and the counties, the loan program strengthens the local property tax administration systems. In particular, state loans provide counties a much-needed infusion of funds to update their technology, improve their procedures, and make their operations more fair and efficient. For example, some counties we visited used a portion of their loan funds to replace computer systems and to complete legally required audits and downward assessments of properties. They also used the money to hire staff to work on the more traditional revenue-producing activities, such as upward and new construction assessments resulting from appreciation in property values. These types of activities add long-term value to, and increase the integrity of, the counties' property tax systems.

Counties Continue to Rely on the Program to Address Work Backlogs

Most counties still have backlogs of property tax workloads, suggesting a continued need for the program. As shown in Table 1, all but 1 of the 47 participating counties reported work backlogs at the close of their most recently completed loan years. These backlogs consist of various property tax administration activities, such as reassessments of individual and business properties, additions to the property tax rolls from new construction or changes in ownership, and audits and appeals of property assessments.

TABLE 1

Counties Participating in the Program Report Continuing Backlogs of Property Tax Administration Work

Number of Participating Counties	Range of County-Reported Work Backlogs*
1	0
17	1-500
4	501-1,000
7	1,001-5,000
9	5,001-10,000
9	more than 10,000
47 In Total	

* The figures represent county-reported work backlogs at the end of the county's most current completed loan year, which began as early as January 1, 1998, and ended as late as October 31, 1999, depending on the county. These backlogs represent various activities, including reassessments of individual and business properties, property tax roll updates from new construction or changes in ownership, and audits and appeals of property assessments. The reported backlogs may take varying amounts of time and resources to complete, depending on the nature of the specific activity.

Moreover, the only county reporting no backlogs submitted a loan request for the following period, confirming that it still needed a state loan to complete its local property tax activities and that it expects the loan to generate sufficient new property tax revenue to offset the State's cost. Finally, the five county assessors we interviewed indicated that eliminating the program would result in growing backlogs of work that could jeopardize the integrity of county property tax administration.

Although the backlogs of uncompleted work suggest the assessors need more money than the loans provide, the State caps each county's loan amount based on its specified portion of the program's total funding as stated in Chapter 420, Statutes of 1997.

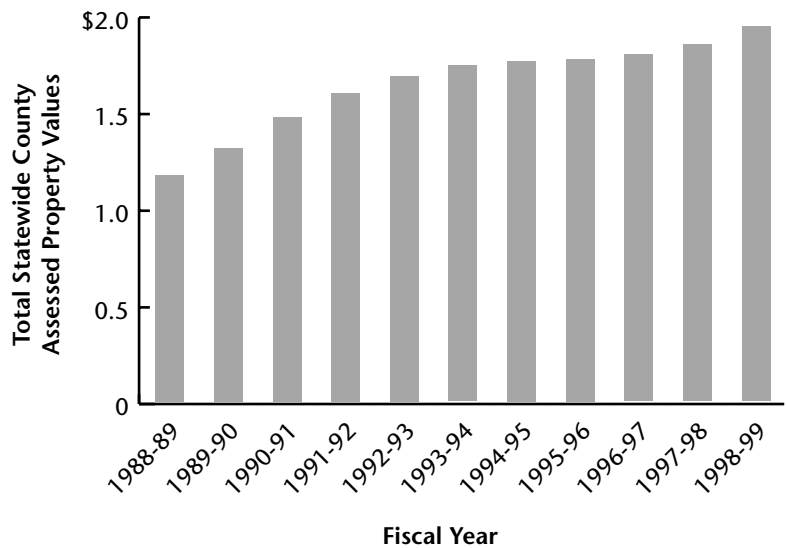
The Program Works in All Economic Markets

Counties have some discretion about how they use the loans, so the program can increase property tax revenues during economic recessions and during prosperous times. As shown in Figure 2, the aggregate value of county property tax rolls has

continued to increase over the past 10 years, even though the State's economy was in a recession during some of those years. Although we believe the state of the economy is a main factor, we acknowledge that there are other factors that affect the growth of the county property tax rolls.

FIGURE 2

**Statewide County Assessed Property Values Have Steadily Increased Over the Last 10 Years
(In Trillions)**



Source: State Board of Equalization 1997-98 Annual Report.

Under the program's current requirements, counties can choose the property tax activities they will fund with the loan proceeds as long as they meet the workload goals stipulated in their agreements with the department and generate sufficient new property tax revenues to offset the State's loan. Within these requirements, counties are free to select the most appropriate property tax activities to fund based on the type of market they are experiencing and their own particular needs.

For example, in a declining market, counties may have a large increase in downward reassessments and assessment appeals as individuals and businesses strive to have their property tax bills reflect the drop in values. Under these circumstances, counties

The counties may opt to use state loans to fund the property tax activities they feel are most appropriate.

can use loan funds to protect property tax rolls from unjustified reductions resulting from assessment appeals. During such appeals, taxpayers often request a greater reduction in the assessed value of their property than what actually has occurred. Unless the county addresses the appeal and establishes the property's correct value, the taxpayer's requested lower value becomes the property's new assessed value after two years, reducing property tax revenues. Further, as counties shift resources to catch up on the increasing number of reassessments and appeals experienced in a declining market, they may neglect traditional revenue-producing activities, such as updating tax rolls for property transfers and new construction. Loan funds offer counties the additional means to keep up with these activities. On the other hand, in recovering markets counties can use loan funds to restore values that were reassessed at lower amounts in declining markets. The loans also allow counties to update their property tax rolls promptly as new construction and building permits increase during periods of strong economic growth.

BECAUSE OF ITS WEAK OVERSIGHT, THE DEPARTMENT OF FINANCE DOES NOT HAVE ADEQUATE INFORMATION TO MAKE GOOD BUSINESS DECISIONS

The department lacks sufficient, independently verified information to assess which counties are eligible for state loans and for what amount. In addition, the department has allowed counties to carry over unused loan funds without requiring them to explain how and when they plan to use the funds. Furthermore, the limited scope of county auditors' reviews of county reports does not provide adequate assurance about the accuracy of assessor workloads, revenues, and expenditures. As a result, the department cannot be sure it knows whether (1) each participating county actually produced incremental revenue greater than the loan funds it received, (2) counties used the loan funds for appropriate property tax administration purposes, (3) counties used loan funds to replace baseline county funding for property tax administration, and (4) counties ultimately use carry-over funds for property tax administration.

The department does not have this information because it has not required counties to report sufficient data regarding program revenues and expenditures and the methods used to calculate them. It also has not provided sufficient guidance to county auditors regarding the scope of their reviews.

The Department's Oversight of the Program Has Been Inadequate

The department is not managing the program well enough to ensure that loan decisions are based on sufficient information because it does not require the counties to submit the necessary data. None of the 47 counties' loan agreements requires the counties to report workloads accomplished and revenues produced on an incremental basis. The department believed that all counties were reporting incremental workloads and revenues, but not all were. In addition, none of the contracts requires the counties to report the actual uses of loan funds or their compliance with maintenance of effort requirements. Furthermore, none of the loan agreements requires the county auditors to verify a county's use of loan funds or its compliance with maintenance of effort requirements. Finally, the department does not require counties to specify how and when they plan to use carry-over funds and places no limits on the length of time that funds may be carried over. We believe the department's oversight has been deficient because there has been so little clear guidance to the counties about reporting information critical to making good loan decisions. When we discussed these issues with department officials, they stated that detailed and restrictive guidelines were not developed because the program was intended to be temporary. The department agreed that oversight could be improved and that a more standardized reporting format would be desirable from an administrative standpoint, but noted that there was also a concern of placing additional reporting burdens on the counties.

Loan decisions are based on insufficient information because the department does not require the counties to submit needed data.

The Department Cannot Be Sure It Is Making Good Business Decisions

Because county-reported data on the loan program is insufficient and unverified, the department cannot be sure it is making prudent decisions in awarding the loans. If counties do not report the increment of workloads and added tax revenues achieved because of the loan funds, the department cannot ensure that all counties produced incremental revenue greater than their loan funds. In addition, if counties overstate the benefits achieved through use of the loan funds, the department bases its loan decisions on misleading information.

Further, if counties do not report sufficient data to show how they used loan funds and how they met maintenance of effort requirements, the department cannot be assured that counties are using the loan funds for property tax administration and that they invest the appropriate share of county resources in

these efforts. Moreover, to the extent that the county auditors are not reviewing assessor-reported data, the department lacks independent verification regarding the accuracy of the data.

The Department Cannot Effectively Evaluate the Program Because County Reports Do Not Provide Sufficient, Verified Information on Actual Program Results

The department does not receive sufficient information from the counties to effectively evaluate the program or the counties' use of loan funds. Further, the department loses track of unspent county loan funds carried over from one loan period to another. Finally, the county auditors verify little of the key information related to the program. As a result, the department cannot be sure it is making good business decisions.

County Reported Data Is Insufficient

Information counties report is not always sufficient to determine workloads completed and revenues generated with the loan money. In some cases, the counties report total workloads and revenues financed with both county and state funds, so the portion only relating to the loan funds is obscured. In particular, we found that 9 of the 47 counties participating in the program reported total rather than incremental workload and revenue data. The assistant assessor at one county we visited that reported total workloads indicated that she believed the county was reporting appropriately, as agreed upon in the county's original loan agreement with the department.

In addition, we found that the methodologies used to calculate incremental workload and revenues at two of the five counties we visited overstate the amounts attributable to loan funds. Sacramento and Placer counties subtract base year workloads from the totals completed in the current reporting period and attribute the difference to the loan funds. However, using base year amounts that are several years old does not consider and adjust for workload and revenue growth that has occurred independently of the use of loan proceeds. For example, this calculation fails to consider any county-funded growth in an assessor's office or efficiencies derived from improvements to computer systems and other processes. Instead, this method attributes all increases in workloads and revenues over the base year figures to the loan, which overstates revenues generated from the loan funds. We developed an alternative approach that better matches the actual use of loan funds to the additional

Some counties report total rather than incremental workloads and revenue, thus obscuring the accomplishments funded via state loans.

revenue generated. In Appendix B, we compare our method to the two counties' current methods and provide a detailed description of the calculation process.

Moreover, Los Angeles and Madera used most of their loan funds to pay for additional assessor's office staff. These counties reported to the department the amount of revenues attributable to the work the staff completed during the loan period. For the purposes of this report, we are calling this the direct method of computing new tax revenue because this method directly links revenues to the efforts of staff funded by loan funds. This method is valid, but we believe the department's ability to judge the reasonableness of the counties' reported data would be enhanced by using the proration method described in Appendix B. This method allows the department to better isolate the amount of added revenues generated by using loan funds from the amount of added revenues generated from the county's own funds. Use of this alternate method would allow the department to do a reasonableness check on county reported data and could highlight situations that may warrant further scrutiny, such as when a county's reported amount of revenues generated from loan funds greatly exceeds the ratio of revenues generated from county funds. The fifth county we visited, Santa Clara, reported total rather than incremental figures, therefore there was no method for us to assess.

Counties do not report sufficient data on how they spent their loans, although at five counties we verified that funds were used appropriately.

Further, counties do not report sufficient data on actual expenditures to show how they used loan funds or to demonstrate that they met their agreements' maintenance of effort requirements. The counties report proposed loan expenditures at the beginning of each year and specify their required maintenance of effort in their original loan agreements, but the department does not require the counties to report how loans were spent. We reviewed expenditure reports during our visits at the five counties and verified that loan funds were used for appropriate purposes. In addition, we determined from the county accounting records that all five had met their maintenance of effort requirements. Unfortunately, the counties do not submit these records and reports, so the department remains uninformed about these basic indicators of the program's success.

The Department Loses Track of Unspent Loan Funds

Some counties carry over loan funds unspent in one loan period to succeeding loan periods. When counties do this without explaining how and when they plan to spend the excess, the

department jeopardizes its ability to determine that loan funds ultimately are spent on property tax administration. In addition, carrying over funds suggests that the department's awards are larger than necessary.

We found that two of the five counties we visited were carrying over unspent funds from past loan periods to the current loan period. For example, in its 1999-2000 loan request, Los Angeles County reported a total of \$6.4 million carried over from its 1998-99 loan period. Upon further review, we found that this amount actually was an accumulation of unspent loan funds: \$3.4 million from its 1995-96 loan, \$1.1 million from each of the 1996-97 and 1997-98 loans, and \$805,000 from its 1998-99 loan. Although Los Angeles County reported the total amount carried over each year when it applied for its new loan—and suggested through its expenditure proposals that it would spend all carry-over amounts and the new loan funds in the next year—it has not done so and the carry-over amount has grown each year. In addition to 2 of the 5 counties we visited, we noted that 7 out of 13 other counties, whose most recent loans exceeded \$1 million, reported funds carried over from the prior loan period. Like Los Angeles, 3 of the 7 indicated how they planned to use the carry-over funds and suggested that this would occur in the next year. However, 2 other counties provided no indication of how and when they planned to use the funds. The remaining 2 counties provided partial information about their planned use of carry-over funds.

The department does not require counties to report unspent loan funds carried over to subsequent loan periods.

These carry overs are reason for concern because the department does not require counties to detail how they expect to use carried over funds and places no limits on the amount of carry-over funds or the length of time that funds can be carried over. The department indicated that its intent in allowing counties to carry over unspent funds was to provide counties greater flexibility in implementing systems or processes that may take more than a year to complete. For example, a county may wish to use the loan funds to acquire a computer system. Between purchasing and installing the system and developing and testing the software, the project could take several years to complete. It is reasonable to expect counties to enter into contracts that may take more than one loan period to complete. However, the department must keep better track of the planned and actual use of carry-over funds. Otherwise, it cannot be sure that loan funds are used for property tax administration and may award unnecessarily large loans.

Information reported by the counties is not always adequately verified by the county auditor.

County Reported Data Is Unverified

The department awards loans to counties based on unverified information. The department believed that all county auditors verify incremental workloads completed, additional revenues generated, actual use of loan funds, and compliance with maintenance of effort requirements. However, the agreements with the counties do not require auditors to verify a county's use of loan funds or its compliance with maintenance of effort requirements. In addition, the agreements do not explicitly require the auditors to verify incremental workloads accomplished and additional revenues generated. In fact, although all five county auditors we visited verify workload figures submitted in the annual report, only two verify the additional tax revenues generated. In addition, none of the auditors we visited verifies the county's actual use of loan funds or its compliance with maintenance of effort requirements. The auditors told us that county agreements with the department do not require such reviews.

RECOMMENDATIONS

To ensure additional growth in property tax revenues that benefit the State and local governments, the Legislature should continue the State-County Property Tax Administration Program.

If the Legislature continues the program, the department should improve its oversight by requiring that counties do the following:

- Use a standard process for reporting incremental workloads, revenues, and expenditures related to loan funds, including evidence to demonstrate an appropriate county investment of resources in property tax administration.
- Specify in the loan agreements how they will calculate incremental workloads, revenues, and expenditures related to loan funds and how they will demonstrate that an appropriate level of county resources was used for property tax administration.

To ensure that the counties use loan funds only for property tax administration and that reported revenues are attributable to loan funds actually spent, the department should require counties to do the following:

- Explain how they plan to use any loan funds remaining from the previous years, along with any new loan funds requested for the current year.
- Report the actual amount of loan funds they spent during the loan period.
- Calculate additional revenues generated from their actual use of loan funds using either the direct or proration methods.

Finally, to ensure that the department is receiving accurate and reliable information from the counties, it should require each county auditor to validate, according to the agreement language, its county's reports on the following:

- Incremental workloads, revenues, and expenditures resulting from loan funds, including the county's chosen method for calculating additional revenues generated from the use of loan funds.
- The amount of county revenue spent on property tax administration.
- The amount of unused loan funds from prior years and how the county used those funds.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

A handwritten signature in black ink that reads "Mary P Noble". The signature is written in a cursive style with a large, stylized "M" and "P".

MARY P. NOBLE
Acting State Auditor

Date: April 27, 2000

Staff: John F. Collins II, CPA
Reed M. McDermott, CPA
Kenneth Cools
Jennifer Rarick
Vince J. Blackburn, Esq.
Nuno P. Da Luz
Fernando Valenzuela

Blank page inserted for reproduction purposes only.

APPENDIX A

Counties Participating in the State-County Property Tax Administration Program

For the most current completed loan year, we determined from our review of the Department of Finance’s (department) files of county-submitted reports that 47 counties participated in the State-County Property Tax Administration Program (program) and 11 counties did not.

Counties Currently Not Participating in the Program

- | | |
|-------------|--------------|
| 1. Alpine | 7. Modoc |
| 2. Imperial | 8. Monterey |
| 3. Inyo | 9. Orange |
| 4. Lake | 10. Siskiyou |
| 5. Marin | 11. Trinity |
| 6. Mariposa | |

For each of the 47 counties participating in the program, we calculated the State’s return on loan investment based on the counties’ reported information to the department. To accurately reflect the amount of incremental revenues generated

from the loan funds, we separated the 9 counties that incorrectly reported total revenues from the 38 counties that appropriately reported incremental revenues as shown in Table 2 on the following pages.

TABLE 2

State's Return on Loan Investment*

County	Loan Amount [†]	Schools' Share Percentage	Revenues Generated From Property Tax Administration Activities						State's Reduction in School Funding Obligation	Net Return on Loan Investment [▲] (percent)
			Audits	New Construction	Assessment Appeals	Prop. 8	Property Transfers	Other [‡]		
Counties Reporting Incremental Property Tax Revenues:										
Merced	\$ 298,004	62.0%			\$ 5,188,584	\$ 415,359	\$ 204,275	\$1,000,947	\$ 6,809,165	2,185%
Placer [§]	628,047	61.5			275,430	565,430		5,639,399	6,480,259	932
Sonoma	1,035,049	63.0		\$ 3,453,492		827,184	6,148,864		10,429,540	908
Riverside	2,358,068	55.0	\$ 815,000		18,964,088	676,632		1,712,602	22,168,322	840
San Diego	5,413,943	63.3		27,013,275			13,774,662	1,093,016	41,880,953	674
Shasta	342,399	68.0	3,411	4,467		1,972,747		484,529	2,465,154	620
Contra Costa	2,022,000	50.0	66,510	30,650	7,050,597	5,130,454			12,278,211	507
San Benito	90,408	75.0	7,301		178,349	311,944		39,508	537,102	494
Santa Cruz	565,000	59.0	109,297			3,208,106			3,317,403	487
San Bernardino	2,139,938	47.5	1,020,300	8,918,208	1,589,328	271,968	633,784		12,433,588	481
Napa	366,020	65.0	3,317	4,348	1,656,959	442,573		6,928	2,114,125	478
Sacramento [§]	1,554,245	51.0		605,013	5,809,910	640,134	1,734,516		8,789,573	466
Ventura	1,477,789	55.2	95,796		6,930,497	1,226,544			8,252,837	458
Los Angeles [§]	13,451,670	42.0		4,376,877	27,557,712	17,246,880	17,902,773	2,592,198	69,676,440	418
Yolo	278,309	58.2	99,773		974,369	76,170		174,107	1,324,419	376
Del Norte	36,203	68.8				158,698		9,341	168,039	364
San Mateo	2,220,001	65.0	18,255	4,190,699		1,857,380	3,078,935		9,145,269	312
Alameda	2,152,429	44.0		1,495,036	238,209		5,645,610		7,378,855	243
San Joaquin	818,686	57.0	504,230		1,549,247	746,700		1,622	2,801,799	242
Glenn	59,197	68.0	5,275	50,797		14,057	57,502	74,913	202,544	242
Nevada	234,292	59.8		302,750	217,329	100,835		154,309	775,223	231
El Dorado	302,795	48.6	(19,370)	693,349	635,570	(335,897)			973,652	222
Colusa	53,957	57.5	39,008		55,047	23,690		25,668	143,413	166
Kings	138,653	57.0	4,469	6,698	135,010	87,259	106,982	4,113	344,531	148

Lassen	54,699	71.0					107,717	107,717	97	
Amador	80,865	61.8			94,505	44,688	5,282	144,475	79	
San Luis Obispo	736,288	63.0	86,285	155,721	939,384		95,710	30,385	1,307,485	78
Butte	381,956	65.0	97,708		403,248	24,968		139,524	665,448	74
Stanislaus	866,155	76.0	85,801		1,280,275	(75,942)		186,285	1,476,419	70
Tehama	74,000	67.0	18,143			39,195		60,475	117,813	59
Mono	47,778	41.0	27,423	30,985	10,144	(2,674)		3,655	69,533	46
Sierra	7,383	35.0						10,678	10,678	45
Sutter	147,436	64.0	27,475			113,952	55,550	13,743	210,720	43
San Francisco	1,013,332	32.0	12,981	1,409,334					1,422,315	40
Madera [§]	212,991	72.0	23,493		194,121			78,947	296,561	39
Plumas	80,600	65.0						88,491	88,491	10
Tuolumne	126,067	62.3	4,471			70,303		36,749	111,523	-12
Mendocino	160,435	62.6	6,332			11,726		103,124	121,182	-24
Total	\$42,027,087		\$ 3,162,684	\$52,741,699	\$ 81,927,912	\$35,891,063	\$49,439,163	\$13,878,255	\$237,040,776	464%
Counties Reporting Total Property Tax Revenues:										
Santa Clara [§]	4,213,639	69.4	5,725,004		53,341,012	7,033,536			66,099,552	1,469
Solano	469,207	65.0		4,325,858	1,108,253	327,991			5,762,102	1,128
Santa Barbara	926,817	61.7	597,276	33,699	4,043,509	3,380	65,366		4,743,230	412
Yuba	88,968	65.0	24,563	4,487	87,157	140,985		105,052	362,244	307
Fresno	1,165,249	63.6			2,852,098	1,388,206	224,421		4,464,725	283
Tulare	501,907	61.9	6,025		1,131,610			1,145	1,138,780	127
Humboldt	210,806	63.7	13,719		118,587			99,981	232,287	10
Kern	1,211,318	61.0	1,201,090		2,196,000	142,130		710,040	4,249,260	251
Calaveras	109,897	66.6	3,732	570,319	25,986	66,863	79,956	26,652	773,508	604
Total	\$ 8,897,808		\$ 7,571,409	\$ 4,934,363	\$ 64,904,212	\$ 9,103,091	\$ 369,743	\$ 942,870	\$ 87,825,688	887%
Grand Total	\$50,924,895		\$10,734,093	\$57,676,062	\$146,832,124	\$44,994,154	\$49,808,906	\$14,821,125	\$324,866,464	538%

* The data was compiled from each county's most current annual report. These annual reports cover the counties most current completed 12-month reporting period, which began as early as January 1, 1998, and ended as late as October 31, 1999.

† The loan amounts were taken from loan requests for the most current completed loan period.

‡ Examples of "Other" include: searching for unassessed property and new oil, low-value, and Williamson Act assessments.

§ Site visited.

|| Placer County uses a single workload category to track various assessment activities, including new construction and changes in ownership.

▲ The calculation of "Net Return on Loan Investment" equals: (State's reduction in school funding obligation - loan amount) / loan amount.

Blank page inserted for reproduction purposes only.

APPENDIX B

Suggested Methods for Calculating Revenues Generated From State-County Property Tax Administration Program Loan Funds

As discussed in the body of our report, we found that two of the five counties we reviewed overstated the revenues produced from the loan funds because their calculation methods attributed more revenue to the loan program than is reasonable. In Table 3, we compare the incremental revenues the two counties reported in their annual reports to the revenues we calculated using a proration method, which we describe later in this appendix.

TABLE 3

Revenues in County Reports Are Overstated

County	Loan Amount	County Reported Revenue	BSA* Prorated Revenue	Amount Difference County/BSA*	Percent Difference County/BSA*
Placer	\$ 628,047	\$6,498,708	\$2,232,233	\$4,266,475	191%
Sacramento	1,554,245	8,789,573	3,118,005	5,671,568	182

*Bureau of State Audits

As the table shows, even though our prorated revenue amounts are lower than those originally reported by the counties, each county generated revenues that exceeded their respective loan amounts.

In our view, there are essentially two credible ways to calculate revenues attributable to the use of loan funds: a direct method and a proration method. Either of these methods, or a combination of both, would serve the Department of Finance (department) by ensuring it has the relevant data to make a well-informed loan decision. If counties use program funds for very specific activities, whose benefits can be easily tracked, they could use the direct method. Under this method, which two of the five counties we reviewed used, a county is able to link the program fund uses directly to the program benefits. For example, a county might decide to hire an individual to perform the assessor's mandatory

audits and absorb his/her costs using the program funds. In this case, an increased roll value related to mandatory audits results directly from the costs incurred by the program in hiring the individual performing this task. The direct method is the most accurate one; however, it is also very difficult to perform if a county uses a portion of the program funds to update their technology that would extend program benefits over several activities.

Since all five counties we visited have either used or plan to use loan funds to enhance their computer systems, we developed a second calculation, which we refer to as the proration method. Under this method, the counties would calculate an expenditure ratio comparing the program funds actually spent to the total expenditures required to support the assessor's office during the loan period. For the same period, counties would track all value added to the roll and value preserved on the roll through assessment activities. The counties would then apply this expenditure ratio to the total value added to or preserved on the roll during the loan period to determine how much of this value is attributable to the use of program funds. Finally, the counties would determine how much revenue was generated for schools from program funds by applying the 1 percent tax rate and the applicable rate for the schools' share to the value added to or preserved on the roll. The result would equitably allocate the revenue achieved through assessment activities to the two sources of spending: the loan funds and the counties' other funding sources. Below, we provide a step-by-step approach to perform this proration.

Step 1: Calculate expenditure ratio by determining the expenditures related directly to the program funds and then gather the total assessor's office expenditures for the corresponding time period.

$$\frac{\text{Program Funded Expenditures}}{\text{Total Assessor's Office Expenditures}} = \text{Ratio}$$

Step 2: Determine the value added to the assessment roll in comparison to the prior year. Also, determine the value preserved on the roll by defense of assessment appeals during the reporting period.

$$(\text{1999 Roll Value} - \text{1998 Roll Value}) + \text{Value Preserved By Defense of Assessment Appeals} = \text{Value Added/Preserved}$$

Step 3: Determine the total value added/preserved related to the use of the program funds.

Ratio (step 1) x Value Added/Preserved (step 2) = Program-Related Value Added/Preserved

Step 4: Determine total property tax revenue related to the use of program funds.

Program-Related Value Added/Preserved (step 3) x 1% = Total Program-Related Revenue

Step 5: Determine the schools' share of revenue related to the use of program funds.

Program-Related Revenue (step 4) x 51% [this rate will vary by county] = Schools' Share of Revenue

In addition to providing counties with a credible way to calculate revenues, using the proration method would provide the department a good overview of a county's property tax administration system and a clear linkage between the actual use of loan funds and the resulting incremental revenues generated.

Finally, a county might combine the proration and direct methods if it uses a portion of the program funding to upgrade information systems in addition to hiring staff to perform specific functions. In this case, the county would use the direct method to track the costs and related revenues from hiring additional staff. Then, after deducting the amounts related to the work of new staff, it could use the proration method to measure the benefits achieved from upgrading its computer systems.

Blank page inserted for reproduction purposes only.

Agency's comments provided as text only.

April 17, 2000

Department of Finance
Office of the Director
State Capitol, Room 1145
Sacramento, CA 95814-4998

Ms. Mary P. Noble
Acting State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Noble:

Thank you for the opportunity to respond to the draft report, "The State-County Property Tax Administration Program: The State and the Counties Continue to Benefit, But the Department of Finance Needs to Improve Its Oversight," received April 10, 2000.

I am pleased that you found the program has benefited the State and local governments by strengthening the local property tax administration system and generating property tax revenues. I am also pleased to note that you found the loans provided through the program were properly repaid.

I agree with the general findings of the report that recommend improved oversight of the program and a more standardized reporting format by counties, if the program is to continue. A standardized reporting format is desirable from an administrative viewpoint.

I would also like to make several comments on the findings of the report. While increasing reporting and verification requirements is beneficial if the program is to continue, the original program was intended to be temporary. As a temporary program, detailed and restrictive guidelines were not included in the statute that enacted the program in 1995. In implementing this broad statute, there was a concern with placing a substantial reporting burden on local entities. We recognized that each county is unique and so a flexible approach was taken in determining what additional information would be required to ensure that each loan would be repaid. Specifically, each loan agreement identifies the activities to be accomplished by the county assessor's office and each loan agreement is reviewed to ensure compliance with the law.

My staff rely on the fact that the county auditor-controller is required to verify that the activities in the loan agreements have been completed. Given this, we were concerned that the audit discovered that in some cases, the activities reported were not incremental workloads, but total workloads. However, my staff also require county assessors to provide additional information to demonstrate that loans will be repaid. As the report indicates, loans scrutinized by your audit team were deemed properly repaid.

①*

You recommend including additional information, including revenue information, in the loan agreements. I would like to note the concern that the overall purpose of the program, which is to assist counties in maintaining a fully functioning property tax administration program, could be obscured by focusing on revenue generation in the loan agreements.

Regarding use of the loan funds, current law requires the loan agreement to include a listing of the proposed use of the loan funds. Every agreement to date includes this information. Every agreement also includes the county's maintenance of effort level. These agreements are legally binding and we have received no information to suggest that counties have not complied with the maintenance of effort requirements or have improperly expended loan funds. However, requiring verification of the use of loan funds and the maintenance of effort amount, as you recommend, will provide additional useful information in determining the success of the program.

With regard to carryover funds, I acknowledge that some counties do have carryover funds, but note that current law does not specify how and when counties must use these funds. I agree with your recommendation that if the program is continued, counties should report the actual amount of loan funds expended during the loan period and explain how they plan to use any carryover funds.

Finally, I agree that if the program is to be continued, the other recommendations specified in your report should be implemented. If the program sunsets as provided in current law, we will consider implementing the recommendations to the extent feasible throughout the remainder of the current program. Of course, we will continue to review each loan to ensure compliance with the law and to make certain that State and local governments benefit from the program.

Sincerely,

(Signed by: B. Timothy Gage)

B. TIMOTHY GAGE
Director

*California State Auditor's comments appear on page 35.

COMMENTS

California State Auditor's Comments on the Response From the Department of Finance

To provide clarity and perspective, we are commenting on the response to our audit report from the Department of Finance (department). The number below corresponds to the number we placed in the department's response.

- ① While we agree that the overall purpose of the State-County Property Tax Administration Program (program) is to help counties enhance their property tax administration systems, the law requires counties to generate additional revenues in order to maintain their eligibility for the program. Therefore, the department needs to focus on revenue generation in the loan agreements to ensure that counties participating in the program are, in fact, eligible to receive loans.

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State
Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press