

California State Auditor

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

Vehicle License Fee Adjustment:

*Calculations by the State Controller's
Office Complied With State Law*



October 2005
2005-125.2

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CALIFORNIA STATE AUDITOR

ELAINE M. HOWLE
STATE AUDITOR

STEVEN M. HENDRICKSON
CHIEF DEPUTY STATE AUDITOR

October 27, 2005

2005-125.2

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

Dear Governor and Legislative Leaders:

RESULTS IN BRIEF

State law requires the State Controller's Office (controller's office) to calculate and report by October 15, 2005, the vehicle license fee adjustment for fiscal year 2005–06. The term *vehicle license fee adjustment* is used in state law when referring to the compensation local cities and counties receive from property taxes to make up for the reduced revenues from vehicle license fees. Our audit report 2005-125.1, issued on September 30, 2005, describes more fully the statutory changes that altered the funding source for compensating local governments. The funding source changed from the General Fund to local property taxes.

We found that the controller's office complied with state laws when it calculated the vehicle license fee adjustment for fiscal year 2005–06 and notified county auditors of the adjustment effective October 14, 2005. Specifically, the controller's office calculated the three statutorily required components of the vehicle license fee adjustment. For the first component, the controller's office correctly calculated a \$4.4 billion vehicle license fee adjustment. To make this calculation, the controller's office started with the amount of vehicle license fees that would have been deposited in the Transportation Tax Fund—Motor Vehicle License Fee Account (Transportation Tax Fund) in fiscal year 2004–05 and allocated to local governments if the vehicle license fee rate remained at 2 percent after deducting the State's costs to administer and enforce the vehicle license fee program. Then the

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controller's office computed the difference between that amount and the actual vehicle license fees paid from the Transportation Tax Fund to local governments during the same period.

For the second statutorily required component, the controller's office took into account the growth factor for assessed property values in cities and counties, as required by state law, and calculated a \$0.5 billion increase in property values between fiscal years 2004–05 and 2005–06. By adding the \$0.5 billion growth factor to the \$4.4 billion difference computed in the first component, the controller's office calculated that the vehicle license fee adjustment with growth factor totaled \$4.9 billion for fiscal year 2005–06.

Finally, for the third component of the vehicle license fee adjustment, the controller's office determined that its calculation of the vehicle license fee adjustment for fiscal year 2005–06 was \$0.3 billion greater than the fiscal year 2004–05 estimated adjustment. The controller's office increased the fiscal year 2005–06 vehicle license fee adjustment to incorporate that difference. As a result, the controller's office calculated that the countywide vehicle license fee adjustment—the amount allocated to cities and counties throughout the State—totaled \$5.2 billion for fiscal year 2005–06.

AGENCY COMMENTS

The controller's office concurred with the results of our review and acknowledged the cooperative effort between the Bureau of State Audits (bureau) and the controller's office in determining the vehicle license fee adjustment.

BACKGROUND

The annual vehicle license fees that vehicle owners in California pay are an important source of revenue for cities and counties. The Department of Motor Vehicles (DMV) collects the fees, and the controller's office allocates the fees to local governments based on their populations. The rate for vehicle license fees that owners paid remained stable for many years at 2 percent of the market value of their vehicles, but recently the Legislature amended state law to reduce that rate. To fully compensate cities and counties for the resulting reduction in revenues, the law originally required the State to transfer amounts from the General Fund. However, in 2004 the Legislature enacted other

changes to state law that repealed the requirement that General Fund transfers be used to make up for the lost revenues. Instead, according to the amended state law, each county must make up for the lost revenue by reducing the amount of local property tax revenue it otherwise would be required to allocate to the county Educational Revenue Augmentation Fund (ERAF).

Since the early 1990s every county must allocate a specific amount of its local property tax revenue to the county ERAF for local educational agencies to augment state funding for public education. The 2004 changes to state law require counties to reduce their ERAF allocations, except in fiscal years 2004–05 and 2005–06, by essentially the same amounts they would have received if the State were still providing money from the General Fund. Each county must allocate the amount of the ERAF allocation reduction—known as the *countywide vehicle license fee adjustment*—to local governments to compensate for the revenues they lost as a result of the lower vehicle license fees that vehicle owners paid. In addition, to make up for the reduced amount of money available in county ERAFs, state law requires adjustments be made to the percentage of General Fund money the State appropriates for funding public education so local educational agencies experience no net fiscal effect.

The DMV's vehicle license fee collections and offset information serves as the primary source for the controller's office to use in calculating the vehicle license fee adjustment for fiscal year 2005–06. In the audit report 2005–125.1 we issued on September 30, 2005, we concluded that the DMV effectively captured the information needed to calculate the adjustment.

Because it will play an important role in the calculation of adjustments in subsequent years, an accurate calculation of the vehicle license fee adjustment for fiscal year 2005–06 is particularly crucial. Revenue and Taxation Code (code), Section 97.76(b), requires the controller's office to determine by October 15, 2005, the vehicle license fee adjustment for each city, county, and combined city and county for fiscal year 2005–06 and notify each county auditor of these amounts. Section 97.70(c) of the code requires the calculation of the vehicle license fee adjustment by the controller's office to contain three components:

- The difference between the vehicle license fees that would have been deposited in the Transportation Tax Fund in fiscal year 2004–05 and allocated to each local government

if the vehicle license fee rate remained at 2 percent, and the actual vehicle license fees allocated in the same period from the fund to each local government.¹

- The difference calculated for each local government (as described in the previous bullet point) multiplied by that local government's percentage change in assessed property values (growth factor) between fiscal years 2004–05 and 2005–06.
- Increases or decreases for the difference between the fiscal year 2004–05 vehicle license fee adjustment and the fiscal year 2005–06 vehicle license fee adjustment, as the difference is applied to each local government.

County auditors will use the vehicle license fee adjustments to transfer sufficient property tax revenues to the local governments in their counties to maintain vehicle license fee revenues as if the collections and allocations had continued at the historical 2 percent rate. Moreover, in each subsequent year county auditors will calculate the current year's transfers from county ERAFs by using the prior year's vehicle license fee adjustments, modified by the percentage change in property values.

SCOPE AND METHODOLOGY

The Joint Legislative Audit Committee requested the bureau to verify that the calculation of the vehicle license fee adjustment for fiscal year 2005–06 is accurate and fully complies with state law. To obtain an understanding of the vehicle license fee adjustment, we reviewed current and prior state laws relevant to the calculation of the adjustment. In addition, we reviewed statutes related to the assessment, collection, and reporting of vehicle license fees by the DMV. Further, we reviewed the data included in the DMV's accounting records and its information systems to support the vehicle license fees collected and the related offsets. We reported the results of our review of the DMV's capture of the information needed to calculate the adjustment in our audit report 2005-125.1, issued on September 30, 2005.

¹ The DMV deposits the vehicle license fees it collects into two accounts, in statutorily required percentages: the Transportation Tax Fund—Motor Vehicle License Fee Account and the Local Revenue Fund—Vehicle License Fee Account. The required percentages for each fund have varied in recent years.

To determine whether the methods the controller's office used to calculate the vehicle license fee adjustment resulted in a sound amount, we validated the calculation the controller's office made to determine that it complied with the relevant state laws.

To evaluate the accuracy of the adjustment the controller's office calculated for cities and counties and determine whether it was made in accordance with the code, we analyzed the mathematical accuracy and completeness of the calculations the controller's office made. We also conducted tests of the calculations the controller's office made to distribute the vehicle license fee adjustment to local governments. Although we did not test the accuracy of the city and county population figures, we ensured that the controller's office used in its calculations the population figures the Department of Finance certified for fiscal year 2004–05.

THE CALCULATION OF THE FISCAL YEAR 2005–06 VEHICLE LICENSE FEE ADJUSTMENT BY THE CONTROLLER'S OFFICE COMPLIED WITH STATE LAW

The controller's office complied with state law when it calculated the fiscal year 2005–06 vehicle license fee adjustment and notified county auditors of the adjustment effective October 14, 2005. In particular, our review revealed that the controller's office included in its calculation the three statutorily required components of the vehicle license fee adjustment. As a result, the controller's office correctly calculated the vehicle license fee adjustment for cities and counties, which state law defines as the countywide vehicle license fee adjustment.

In October 2005 the DMV reported to the controller's office that it would have collected \$6.5 billion in vehicle license fees during fiscal year 2004–05 if the 2 percent rate had remained in effect. State law requires the controller's office to base the first component of its calculation of the vehicle license fee adjustment on the percentage of vehicle license fees that were statutorily required to be deposited in the Transportation Tax Fund, as the statute read on January 1, 2004. The percentage of vehicle license fees the statute required the State to distribute to the Transportation Tax Fund during fiscal year 2004–05 was 75.67 percent. The controller's office appropriately used this percentage to determine the amount the State would have deposited in the Transportation Tax Fund during fiscal year 2004–05 had the 2 percent rate remained in effect for vehicle

license fees.² As the table shows, the controller’s office correctly calculated that the State would have deposited more than \$4.9 billion in the fund during fiscal year 2004–05.

The controller’s office also took into account all the requirements specified by state law in its calculation of the vehicle license fee adjustment for fiscal year 2005–06. The table shows the components of the calculation made by the controller’s office.

TABLE

The State Controller’s Office Correctly Calculated the Components of the Fiscal Year 2005–06 Vehicle License Fee Adjustment

Components of Vehicle License Fee Adjustment Calculation	Amount
Vehicle license fees reported by the Department of Motor Vehicles that would have been collected if the 2 percent vehicle license fee rate had remained in effect.	\$6,518,465,966
Multiplying factor for vehicle license fees statutorily required to be deposited in the Transportation Tax Fund—Motor Vehicle License Fee Account during fiscal year 2004–05.	0.7567
Vehicle license fees that would have been deposited in the Transportation Tax Fund—Motor Vehicle License Fee Account during fiscal year 2004–05 if the 2 percent vehicle license fee rate had remained in effect.	4,932,523,196
Fiscal year 2004–05 costs for the State to administer and enforce the vehicle license fee program.	(288,909,152)
Vehicle license fees distributed from the Transportation Tax Fund—Motor Vehicle License Fee Account during fiscal year 2004–05.	(250,675,848)
Fiscal year 2005–06 vehicle license fee adjustment (A).	4,392,938,196
Change in assessed property values in cities and counties from the prior fiscal year to the current fiscal year (growth factor).	497,730,013
Fiscal year 2005–06 vehicle license fee adjustment, with growth factor (B).	4,890,668,209
Fiscal year 2004–05 estimated vehicle license fee adjustment as reported on September 16, 2004 (C).	(4,075,316,000)
Difference between the fiscal year 2005–06 vehicle license fee adjustment and the fiscal year 2004–05 estimated vehicle license fee adjustment (D) = (A) – (C).	317,622,196
Fiscal year 2005–06 countywide vehicle license fee adjustment (B) + (D).	\$5,208,290,405

Source: State Controller’s Office.

The controller’s office correctly calculated how the \$4.9 billion would have been distributed to each of the 535 cities and counties using the statutory requirements in effect as of January 1, 2004. These requirements included deducting nearly \$0.3 billion for the State to administer and enforce the vehicle license fee program and allocating the remaining \$4.6 billion

² The State would have deposited in the Local Revenue Fund the remaining 24.33 percent of the vehicle license fees that would have been collected if the 2 percent rate had remained in effect.

to local governments in specified percentages and basing the allocations in part on the populations of the local governments. Using its calculation of how the \$4.6 billion would have been distributed and its actual disbursements in fiscal year 2004–05, the controller’s office then determined—in total and for each local government—the difference between the vehicle license fees that would have been deposited in the Transportation Tax Fund in fiscal year 2004–05 if the 2 percent vehicle fee rate had been in effect and the vehicle license fees the controller’s office actually distributed in fiscal year 2004–05. The difference totaled \$4.4 billion.

Our review also found that the controller’s office took into account the growth factor for assessed property values in cities and counties, as required by state law. Using information provided to it by county auditors, the controller’s office calculated that property values increased by nearly \$0.5 billion between fiscal years 2004–05 and 2005–06. By adding the \$0.5 billion growth factor to the \$4.4 billion difference it computed as just described, the controller’s office calculated that the vehicle license fee adjustment totaled \$4.9 billion for fiscal year 2005–06.

Within its calculation the controller’s office determined the vehicle license fee adjustment for each city and county in the State. Moreover, the controller’s office determined that its calculation of the vehicle license fee adjustment for fiscal year 2005–06 was \$0.3 billion greater than its fiscal year 2004–05 calculation. Finally, the controller’s office complied with state law when it incorporated that difference into the fiscal year 2005–06 vehicle license fee adjustment. The controller’s office calculated the difference for each local government throughout the State. By doing so, the controller’s office ensured that the vehicle license fee adjustment for each local government appropriately took into account the statutory requirements.

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 "Elaine M. Howle". The signature is written in a cursive, flowing style.

ELAINE M. HOWLE
State Auditor

Date: October 27, 2005

Staff: Nancy C. Woodward, CPA, Audit Principal
Russ Hayden, CGFM
Alicia Jenkins
Toufic Tabshouri

Agency's comments provided as text only.

California State Controller
Division of Accounting and Reporting
P.O. Box 942850
Sacramento, CA 94250

October 19, 2005

Elaine M. Howle*
California State Auditor
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle:

This is in response to your letter and report dated October 17, 2005, regarding the State Controller's Office (SCO) calculations of the Vehicle License Fee Adjustment Amounts (VLFAA) for counties and cities.

The SCO is in concurrence with the results of the report and after reviewing the report have three minor recommendations to report to your office. All three recommendations occur in the *Component of Vehicle License Fee Adjustment Calculation* table on page 9 of the report.

- The line titled: "Fiscal year 2005-06 vehicle license adjustment (A)" should correctly read: "Fiscal year 2004-05 vehicle license adjustment (A)".
- The line titled: "Fiscal year 2004-05 vehicle license fee adjustment (C) should correctly read: "Fiscal year 2004-05 vehicle license fee adjustment estimate as reported on September 16, 2004."
- The line titled: "Difference between the fiscal year 2004-05 vehicle license fee adjustment and the fiscal year 2005-06 vehicle license fee adjustment (D) = (A) – (C)" should correctly read: "Difference between the fiscal year 2004-05 vehicle license fee adjustment estimate as reported on September 16, 2004, and the vehicle license fee adjustment amount as determined above".

The SCO would like to acknowledge the cooperative effort we have received from the Bureau of State Audits in determining the VLFAA. If you have any questions or need additional information, please contact Kelly Martell, Manager, County Cost Plans and Local Apportionments Section at (916) 327-1714.

Sincerely,

(Signed by: John A. Korach)

JOHN A. KORACH, Chief
Division of Accounting and Reporting

* California State Auditor's comments appear on page 11.

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COMMENTS

California State Auditor's Comments on the Response From the State Controller's Office

To provide clarity and perspective, we are commenting on the response to our audit report from the State Controller's Office (controller's office). The numbers below correspond to the numbers we have placed in the margin of its response.

- Revenue and Taxation Code, Section 97.70(c)(1)(B)(i), specifies that this calculation of the vehicle license fee adjustment is for fiscal year 2005–06. Accordingly, we have not changed the term in the table.
- We have changed (C) and (D) of the table to reflect that the fiscal year 2004–05 vehicle license fee adjustment was an estimate. In addition, we included in (C) that the controller's office notified county auditors of the fiscal year 2004–05 estimated vehicle license fee adjustment on September 16, 2004.

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
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