

## California: Department of Finance takes Board of Equalization to task



David M. Kall | Thursday, April 13, 2017

In a March 2017 [evaluation](#), the California Department of Finance, Office of State Audits and Evaluations revealed that the California State Board of Equalization’s (BOE) work is problematic because of its operational culture. This has “impact[ed] its ability to report accurate and reliable information to decision makers.” Moreover, “certain board member practices have intervened in administrative activities and created inconsistencies in operations, breakdowns in centralized processes, and in certain instances result in activities contrary to state law and budgetary and legislative directives.”

In support of its conclusions, the Department of Finance pointed to a number of issues, including:

- The BOE had difficulty providing complete and accurate documentation in response to evaluation inquiries.
- In some instances, various levels of BOE management were not aware of, and could not speak to, certain district activities for which they held oversight responsibilities.
- Staffing practices have negatively impacted personnel and accounting records, such that they do not accurately reflect operational activities.
- Some BOE members violate state law by utilizing revenue-generating staff to perform non-revenue generating activities, like outreach.
- Supplemental annual reports submitted to the Legislature do not comply with the requisite reporting requirements set forth in state law.

As a result, revenue and personnel costs are incorrect. Additionally, the skewed cost-benefit ratios make it difficult for lawmakers to assess the effectiveness of the BOE's existing sales and use tax audit and compliance efforts, and the appropriateness of the BOE's activities in general.

### **Background**

The evaluation provides that the BOE is the nation's only elected tax commission. Its mission is to serve the public through fair, effective, and efficient tax administration by collecting and allocating the state and local sales and use tax for cities, counties, and other districts.

With an annual operating budget of \$1.5 million and a dedicated staff, the five-member BOE administers over 30 tax and fee programs. Along with an executive management team, the BOE is responsible for establishing and implementing a fair, effective, and efficient tax administration program.

In fiscal year 2014-15, the BOE generated \$60.5 billion in revenue. Sales and use tax activities accounted for 86 percent of this amount, or \$52.1 billion. Because a majority of sales and use taxes are self-assessed, the BOE has developed an audit and compliance program to verify that businesses remit the correct amounts, and to provide related education. The other three areas of concentration are property taxes, special taxes, and the tax appellate program. Under the latter, the BOE acts in a quasi-judicial capacity, as the appellate body for appeals from business tax assessments, Franchise Tax Board actions, and public utility assessments.

The BOE's five-member governing body has the following duties:

- Establish and adopt BOE policies in monthly public meetings
- Meet to hear and decide tax appeals, approve regulator changes, annually set property tax values for state assessments, consider reports from various department managers, and receive input from the public
- Hire the Executive Director and approve the hiring of all executive leaders and Career Executive Assignments
- Ensure that the agency runs effectively and efficiently by setting policy and guiding executive leadership
- Supervise policy development

Additionally, individual members spend time facilitating and resolving constituent concerns, educating taxpayers, influencing public policy, and interacting with the media.

In 2002, by way of an Annual Report on Sales and Use Tax Audit and Collection Activities, the BOE began reporting performance data to the Legislative Analyst's Office (LAO), as required by the 2002-03 Budget Act Supplemental Report. Mandatory information includes the following:

- Revenue and cost impacts associated with any increase or decrease in resources devoted to audit and compliance activities
- Audit selection methodologies
- Cost benefit analysis
- Statewide Compliance and Outreach Program (SCOP) performance

### **Results contained in the evaluation**

At the outset of the results section, the evaluation proclaims that the BOE's operational culture and

environment precluded the Department of Finance from comprehensively evaluating the BOE's sales and use tax resource utilization, outreach activities, and sales and use tax reporting. This is a consequence of the following:

- Individuals responsible for specific functions within BOE were unable to provide complete and accurate documentation, or answer basic questions regarding operations related to the Evaluation's objective.
- Various levels of management were not aware of, and could not speak to, certain activities conducted within the districts for which they held oversight responsibilities.
- Several individuals stated that board members, acting individually, intervene in the daily operations within their respective districts.
- Several individuals also reported a fear of retaliation if staff did not respond or follow the directions of the individual board members. Examples include being informed of potential office relocations or told "one more vote and you're gone" meaning their job appointment could be dismissed by a vote of three board members.

Such intervention creates inconsistencies in operations, breakdowns in centralized processes, and in certain instances, results in activities contrary to state law and budgetary and legislative directives.

Nor do the BOE's personnel and accounting records accurately depict its operational activities. For instance, when revenue-generating staff is redirected to non-revenue generating tasks, the BOE may not be in compliance with state law, such that its accounting records and supplemental annual reports do not appropriately reflect revenue and cost impacts.

Similarly, inconsistent adherence to policy has caused the BOE's education and outreach activities to have a limited connection to its tax programs. Instead, these activities focus more on board member driven events.

Yet another area of concern is the BOE's reporting of sales and use tax information, in that it does not comply with Budget Act reporting requirements, and is prone to errors due to the manual nature of certain processes and procedures. Thus, the legislature is not able to assess the BOE's sales and use tax audit and compliance efforts, so cannot measure the appropriateness, accuracy and clarity of the BOE's current efforts.

Finally, an ongoing problem with the BOE has been multiyear reporting errors and misallocations of sales and use tax monies to various funds. These funds include the State Local Revenue Fund, 2011 Local Revenue Fund, Local Public Safety Fund, Fiscal Recovery Fund, State General Fund, and local, county, and special taxing jurisdictions.

### **The BOE's response**

On March 24, 2017, the BOE responded by letter to the Evaluation. Agreeing that it does indeed have a "fiduciary responsibility to promote an operational environment that provides fair, effective, and efficient tax administration over the billions of dollars for which it is responsible," the BOE acknowledged the concerns contained in the Evaluation, and its need to "continue to effect cultural change and improve its practices."

However, it disagreed with certain characterizations, asserting that contrary to the Evaluation's findings, the BOE "has exercised due diligence in documenting its methodologies and assumptions." Also in contrast to the report's assertion, BOE claimed that it provided the Department of Finance with "complete,

accurate, and comprehensive supporting documentation and explanation of the Sales and Use Tax allocation and proposed adjustment methodologies.” The BOE underscored its commitment to “strengthening and developing a number of policies and controls.”

### **Calls to revoke BOE authority**

The [Sacramento Bee](#) reported that the longest-serving member on the Board of Equalization, controller Betty Yee, has called on lawmakers to “strip the embattled Board of Equalization of much of its authority and create a new state department to manage dozens of tax and fee programs.” Another board member asked Gov. Brown to appoint a public trustee to manage the BOE, though the article suggests he is reluctant to do so. Various hearings and audits are scheduled to take place this spring, giving the legislature the opportunity to consider its next moves.



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[Team member bio](#)