

NAPA COUNTY

Audit Report

APPORTIONMENT AND ALLOCATION OF PROPERTY TAX REVENUES

July 1, 2015, through June 30, 2022



MALIA M. COHEN
California State Controller

October 2023



MALIA M. COHEN
CALIFORNIA STATE CONTROLLER

October 9, 2023

The Honorable Tracy A. Schulze, Auditor-Controller
Napa County
1195 3rd Street, B10
Napa, CA 94559

Dear Ms. Schulze:

The State Controller's Office audited Napa County's process for apportioning and allocating property tax revenues for the period of July 1, 2015, through June 30, 2022. We conducted the audit pursuant to the requirements of Government Code section 12468.

Our audit found that the county incorrectly calculated the excess Educational Revenue Augmentation Fund amount.

The county has disputed certain facts related to the conclusions and recommendations contained in this audit report. The State Controller's Office has an informal audit review process by which to resolve a dispute of facts. To request a review, the county should submit, in writing, a request for a review and all information pertinent to the disputed issues within 60 days of receiving this audit report.

The request and supporting documents should be submitted to Harpreet Nakhwal, Acting Chief Counsel, State Controller's Office, Post Office Box 942850, Sacramento, California 94250. In addition, please provide a copy of the request letter to Lisa Kurokawa, Chief, Compliance Audits Bureau, Division of Audits, State Controller's Office, Post Office Box 942850, Sacramento, California 94250.

If you have any questions, please contact Lisa Kurokawa, Chief, Compliance Audits Bureau, by telephone at (916) 327-3138.

Sincerely,

Original signed by

KIMBERLY TARVIN, CPA
Chief, Division of Audits

KT/ac

Ms. Tracy A. Schulze

October 9, 2023

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cc: Paul Phangureh, Auditor-Accountant Manager
Napa County Auditor-Controller's Office
The Honorable Ryan Gregory, Chairperson
Napa County Board of Supervisors
Chris Hill, Principal Program Budget Analyst
Local Government Unit
California Department of Finance
Harpreet Nakhwal, Acting Chief Counsel
State Controller's Office

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Audit Report

Summary

The State Controller's Office (SCO) audited Napa County's process for apportioning and allocating property tax revenues to determine whether the county complied with California statutes for the period of July 1, 2015, through June 30, 2022.

Our audit found that the county incorrectly calculated the excess Educational Revenue Augmentation Fund (ERAF) amount.

Background

After the passage of Proposition 13 in 1978, the California State Legislature (Legislature) enacted new methods for apportioning and allocating property tax revenues to local government agencies, school districts, and community college districts. The main objective was to provide these agencies and districts with a property tax base that would grow as assessed property values increased. The method has been further refined in subsequent laws passed by the Legislature.

One key law was Assembly Bill 8, Chapter 282, Statutes of 1979, which established the method of allocating property taxes for fiscal year (FY) 1979-80 and subsequent fiscal years. The methodology is commonly referred to as the "AB 8 process."

Property tax revenues are apportioned and allocated to local government agencies, school districts, and community college districts using prescribed formulas and methods defined in the Revenue and Taxation Code. In general, the amount that an agency or district receives is based on the amount received in the prior year plus a share of the property tax growth within its boundaries.

The AB 8 process involves several steps, including the transfer of revenues from school and community college districts to local government agencies and the development of the tax rate area (TRA) annual tax increment (ATI) apportionment factors, which determine the amount of property tax revenues to be allocated to each jurisdiction.

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

Subsequent legislation removed from the AB 8 process revenues generated by unitary and operating nonunitary properties, pipelines, regulated railway companies, and qualified electric properties. These revenues are now apportioned and allocated under separate processes.

Other legislation established an ERAF in each county. Most local government agencies are required to transfer a portion of their property tax revenues to the fund. The fund is subsequently apportioned and allocated to school and community college districts by the county auditor according

to instructions received from the county superintendent of schools or the chancellor of the California community colleges.

Taxable property includes land, improvements, and other properties that are accounted for on the property tax rolls, which are primarily maintained by the county assessor. Tax rolls contain an entry for each parcel of land, including parcel number, owner's name, and value. The types of property tax rolls are:

- *Secured Roll*—Property that, in the opinion of the assessor, has sufficient value to guarantee payment of the tax levies and that, if the taxes are unpaid, the obligation can be satisfied by the sale of the property by the tax collector.
- *Unsecured Roll*—Property that, in the opinion of the assessor, does not have sufficient permanence or other intrinsic qualities to guarantee payment of taxes levied against it.
- *State-Assessed Roll*—Utility properties composed of unitary and operating nonunitary value assessed by the California State Board of Equalization.
- *Supplemental Roll*—Property that has been reassessed due to a change in ownership or the completion of new construction, where the resulting change in assessed value is not reflected in other tax rolls.

To mitigate problems associated with the apportionment and allocation of property tax revenues, Senate Bill 418, which requires the SCO to audit the counties' apportionment and allocation methods and report the results to the Legislature, was enacted in 1985.

Apportionment and allocation of property tax revenues can result in revenues to an agency or agencies being overstated, understated, or misstated. Misstated revenues occur when at least one taxing agency receives more revenue than it was entitled to, while at least one taxing agency receives less revenue than it was entitled to.

The agency that received less tax revenue than its statutory entitlement would have standing to require that adjustments be made by the county, either on a retroactive or prospective basis. The SCO does not have enforcement authority or standing to require the county to take corrective action with respect to misallocation of tax revenues, unless the misallocation resulted in overpaid state funds (funds intended for the ERAF, school districts, or community college districts). The SCO has authority to recover misallocations resulting in overpaid state funds pursuant to Government Code (GC) sections 12410, 12418, and 12419.5.

GC section 12410 provides the SCO with broad authority to "superintend the fiscal concerns of the state." GC section 12418 provides the SCO with the authority to "direct and superintend the collection of all money due the State, and institute suits in its name" against all debtors of the State. GC section 12419.5 provides the SCO with the authority to offset any amounts due the State against any amounts owed to the debtor by the State.

Revenue and Taxation Code (RTC) section 96.1(b) allows a reallocation of current audit findings and unresolved prior audit findings.

RTC section 96.1(c)(3) limits a cumulative reallocation or adjustment to one percent of the total amount levied at a one-percent rate of the current year's original secured tax roll. For reallocation to the ERAF, school districts, or community college districts, a reallocation must be completed in equal increments within the following three fiscal years, or as negotiated with the SCO.

Audit Authority

We conducted this audit under the authority of GC section 12468, which requires the SCO to audit the apportionment and allocation of property tax revenues on a one-, three-, or five-year cycle, depending on the county's population. The audit results are reported annually to the Legislature along with any recommendations for corrective action.

Objective, Scope, and Methodology

Our audit objective was to determine whether Napa County complied with Revenue and Taxation Code, Health and Safety Code, and Government Code requirements pertaining to the apportionment and allocation of property tax revenues.

A property tax bill contains the property tax levied at a one percent tax rate pursuant to the requirement of Proposition 13. A tax bill may also contain special taxes, debt service levies on voter-approved debt, fees, and assessments levied by the county or a city. The scope of our audit is concerned with the distribution of the one percent tax levy. Special taxes, debt service levies on voter-approved debt, fees, and assessments levied by the county or a city are beyond the scope of our audit and were not reviewed or audited.

The audit period was July 1, 2015, through June 30, 2022.

To achieve our objective, we performed the following procedures:

- We gained an understanding of the county's process for apportioning and allocating property tax revenues by interviewing key personnel.
- We reviewed the county's written procedures for apportioning and allocating property tax revenues.
- We reviewed documents supporting the transaction flow for apportioning and allocating property tax revenues.
- We assessed the reliability of data from the property tax system by interviewing county staff members knowledgeable about the system, tracing transactions through the system, and recalculating data produced by the system. We determined that the data was sufficiently reliable for purposes of this report.
- We judgmentally selected a non-statistical sample of five from approximately 30 taxing jurisdictions within the county for all fiscal years in the audit period.

The actual number of taxing jurisdictions can vary from year to year based on jurisdictional changes. For testing purposes, we included the ERAF in our sample of taxing jurisdictions. We also tested a special district, a school district, a city, and the county. We selected only one of each type of local agency because when the apportionment and allocation for one jurisdiction is incorrect, the error affects every other taxing jurisdiction.

We tested the sampled jurisdictions as follows:

- We tested apportionment and allocation reports to verify computations used to develop property tax apportionment factors.
- We tested TRA reports to verify that the correct TRA factors were used in the computation of the ATI.
- We reviewed supplemental property tax administrative costs and fees to determine whether recovery costs associated with administering supplemental taxes were based on actual costs and did not exceed five percent of revenues collected, as prescribed in statute.
- We verified computations used to develop supplemental property tax apportionment factors.
- We verified unitary and operating nonunitary, unitary regulated railway, and qualified electric property computations used to develop apportionment factors.
- We reviewed redevelopment agency (RDA) reports and verified computations used to develop the project base amount and the tax increment distributed to the RDA.
- We reviewed Redevelopment Property Tax Trust Fund (RPTTF) deposits.
- We reviewed property tax administrative cost reports and recomputed administrative costs associated with work performed for apportioning and allocating property tax revenues to local government agencies, school districts, and community college districts.
- We reviewed ERAF reports and verified computations used to determine the shift of property taxes from local government agencies to the ERAF and, subsequently, to school and community college districts (see the Finding).
- We reviewed the Sales and Use Tax letter, and verified the Vehicle License Fee computations used to determine the amount transferred from the ERAF to counties and cities to compensate for the diversion of these revenues.
- We reviewed tax equity allocation reports to determine any increases in property tax revenues due cities having low or nonexistent property tax amounts.
- We reviewed California State Board of Equalization jurisdictional change filing logs and their impact on the tax apportionment and allocation system.

Errors found were not projected to the intended (total) population.

We did not audit the county's financial statements.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Conclusion

Our audit found that Napa County did not comply with California statutes for the apportionment and allocation of property tax revenues for the audit period because it incorrectly calculated the excess ERAF amount.

This instance of noncompliance is described in the Finding and Recommendation section.

Follow-up on Prior Audit Findings

Our prior audit report on Napa County, for the period of July 1, 2009, through June 30, 2015, issued on September 7, 2016, disclosed no findings.

Views of Responsible Officials

We issued a draft report on July 13, 2023. Napa County's representative responded by letter dated July 24, 2023, disagreeing with the audit results. The county's response is included as an attachment to this audit report.

Restricted Use

This audit report is solely for the information and use of Napa County, the Legislature, the California Department of Finance, and the SCO; it is not intended to be, and should not be, used by anyone other than these specified parties. This restriction is not intended to limit distribution of this audit report, which is a matter of public record and is available on the SCO website at www.sco.ca.gov.

Original signed by

KIMBERLY TARVIN, CPA
Chief, Division of Audits

October 9, 2023

Finding and Recommendation

FINDING— Excess Educational Revenue Augmentation Fund amount

After dissolution of Napa County’s RDAs, the county created a reserve account for the former RDAs RPTTF residual revenues. During our testing of the ERAF shift, we found that the county had incorrectly included the residual amounts in its excess ERAF calculations for FY 2019-20 through FY 2021-22. The residual revenues should have been excluded from the excess ERAF calculations beginning in FY 2019-20 (Schedule). The error resulted in an \$8,167,780 misallocation from the ERAF.

Health and Safety Code (HSC) section 34188(d) and RTC sections 97.2(d)(4)(B) and 97.3(d)(4)(B) provide the legal requirements for calculating excess ERAF.

RTC sections 96.1 through 96.5 and 97 through 97.3 provide the legal requirements for calculating the ERAF shift.

In FY 1992-93 and FY 1993-94, some local government agencies and special districts were required to shift an amount of property tax revenues to the ERAF using formulas detailed in the Revenue and Taxation Code. Since FY 1993-94, the amount has been annually adjusted for growth.

Recommendation

We recommend that the county:

- Review HSC section 34188(d), RTC section 97.2(d)(4)(B), and RTC section 97.3(d)(4)(B);
- Exclude residual revenue from former RDAs from its excess ERAF calculations;
- Dissolve the reserve account that was established for the RPTTF residual revenues;
- Recalculate its excess ERAF for FY 2019-20 through FY 2021-22; and
- Make monetary adjustments to the ERAF.

County’s Response

I respectfully disagree with the results of the audit report. The calculation of the [excess ERAF] amount was not calculated incorrectly. The question at hand is the inclusion, or not, of RDA RPTTF being part of the schools ERAF entitlement. Currently, there is a pending argument throughout the state of which way is correct. Due to the uncertainty of the legal interpretations, Napa County worked with [its] Cities/Town[s] and Schools to impound the amount in question until a definitive decision was made so as to not harm any of the parties entitled to this revenue. The funds are held in an interest-bearing account awaiting this decision.

Napa County’s single RDA dissolved in fiscal year ended June 30, 2021. Therefore, this issue does not carry forward. We impounded all years

required based on the State Controller's Guidelines. We fully disclosed our approach with the State Controller's staff throughout the development of the Guidelines and provided all the information to the auditors during their field review.

Based on the conclusion presented in the audit, in advance of any final resolution to this issue, we will release the funds from the impound account and include them in the FY 2023-24 ERAF fund for distribution.

SCO Comment

Our finding and recommendation remain unchanged.

Napa County incorrectly calculated the excess ERAF amounts by including the former RDA RPTTF residual revenues in the excess ERAF calculation. We issued excess ERAF guidelines on February 16, 2021, requiring counties to exclude the RPTTF residual revenues from the excess ERAF calculation, pursuant to HSC section 34188(d).

We are aware that a few counties disagree with the exclusion of the RPTTF residual revenues from the excess ERAF calculation. However, the California School Board Association's litigation regarding the SCO excess ERAF guidelines resulted in affirming the legality of the SCO ERAF guidelines.

Based on our understanding of Napa County's response, the county intends to distribute the impounded funds to the ERAF. We will follow up on the impounded funds in the next audit.

**Schedule—
Summary of Misallocations to the
Educational Revenue Augmentation Fund**

Fiscal Years Affected	Amount owed to the ERAF
2019-20 and 2021-22	\$ 8,167,780
Total	\$ 8,167,780

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



A Tradition of Stewardship
A Commitment to Service

Auditor-Controller

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Tracy A. Schulze
Auditor-Controller

July 24, 2023

Lisa Kurokawa
Chief, Compliance Audits Bureau
Division of Audits
State Controller's Office
P.O. Box 942850
Sacramento, CA 94250
Via email: lkurokawa@sco.ca.gov

Dear Ms. Kurokawa.

I respectfully disagree with the results of the audit report. The calculation of the Excess Educational Augmentation Fund (ERAF) amount was not calculated incorrectly. The question at hand is the inclusion, or not, of RDA RPTTF being part of the schools ERAF entitlement. Currently, there is a pending argument throughout the state of which way is correct. Due to the uncertainty of the legal interpretation, Napa County worked with its Cities/Town and Schools to impound the amount in question until a definitive decision was made so as not to harm any of the parties entitled to this revenue. The funds are held in an interest-bearing account awaiting this decision.

Napa County's single RDA dissolved in fiscal year ended June 30, 2021. Therefore, this issue does not carry forward. We impounded all years required based on the State Controller's Guidelines. We fully disclosed our approach with the State Controller's Staff throughout the development of the guidelines and provided all the information to the auditors during their field review.

Based on the conclusion presented in the audit, in advance of any final resolution to this issue, we will release the funds from the impound accounts and include them in the 2023-24 ERAF fund for distribution.

Respectfully,

A handwritten signature in blue ink that reads "Tracy A. Schulze".

Tracy A. Schulze
Napa County Auditor-Controller

**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250**

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