

NAPA COUNTY

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2003, through June 30, 2009



JOHN CHIANG
California State Controller

December 2010



JOHN CHIANG
California State Controller

December 10, 2010

The Honorable Tracy A. Schulze
Auditor-Controller
Napa County
1195 3rd Street, Room B-10
Napa, CA 94539-3097

Dear Ms. Schulze:

The State Controller's Office audited the methods employed by Napa County to apportion and allocate property tax revenues for the period of July 1, 2003, through June 30, 2009. The audit was conducted pursuant to the requirements of Government Code section 12468.

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

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

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB/sk

cc: The Honorable Diane Dillon, Chairperson
Board of Supervisors, Napa County
Jody Martin, Principal Consultant
Joint Legislative Budget Committee
Peter Detwiler, Staff Director
Senate Local Government Committee
Elvia Dias, Committee Assistant
Senate Local Government Committee
Dixie Martineau-Petty, Secretary
Assembly Local Government Committee
Gayle Miller, Staff Director
Senate Revenue and Taxation Committee
Oksana Jaffe, Chief Consultant
Assembly Revenue and Taxation Committee
Neil McCormick, Executive Director
California Special Districts Association

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Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by Napa County to apportion and allocate property tax revenues for the period of July 1, 2003, through June 30, 2009.

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

Additionally, we made the following observation.

Prior to fiscal year (FY) 2006-07, counties could not impose a fee, charge or other levy on a city, nor reduce a city's allocation of ad valorem property tax revenue, in reimbursement for the services performed by the county under Revenue and Taxation Code sections 97.68 and 97.70. Pursuant to Revenue and Taxation Code section 97.75, for FY 2006-07 and thereafter, a county may impose a fee, charge, or other levy on a city for these services, but the fee, charge, or other levy shall not exceed the actual cost of providing the services.

A dispute has arisen between the counties and the cities regarding the application of Revenue and Taxation Code section 95.3 relating to the computation of Property Tax Administration Fees (PTAF). The counties generally contend that distribution factors for purposes of distributing PTAF to taxing agencies should be computed including amounts received by cities under Revenue and Taxation Code section 97.68, commonly known as the "Triple Flip," and section 97.70, commonly known as the "VLF Swap." The cities generally believe that the Triple Flip and the VLF Swap should be excluded from the computation.

We are aware of two legal actions that have been filed on this issue.

- In the first action, 47 cities in Los Angeles County filed suit against the county. On June 2, 2009, the court referee determined that the method used by Los Angeles County was correct.
- In the second action, filed in Fresno County, seven cities filed suit against the county. In this action, the court ruled that the method used by Fresno County was not in accordance with statute. This is the same method approved by the referee in Los Angeles County.

The SCO will make a determination on the computation of the PTAF at such time as appeals (if any) are resolved.

Background

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

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

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

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

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

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

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

Revenues generated by the different types of property tax are apportioned and allocated to local agencies and schools using prescribed formulas and methods, as defined in the Revenue and Taxation Code. Taxable property includes land, improvements, and other properties that are accounted for on the property tax rolls maintained primarily by the

county assessor. Tax rolls contain an entry for each parcel of land, including the parcel number, the owner's name, and the value. Following are the types of property tax rolls:

- *Secured Roll*—This roll contains property that, in the opinion of the assessor, has sufficient value to guarantee payment of the tax levies and that, if necessary, can be sold by the tax collector to satisfy unpaid tax levies.
- *Unsecured Roll*—This roll contains property that, in the opinion of the assessor, does not have sufficient “permanence” or have other intrinsic qualities to guarantee payment of taxes levied against it.
- *State-Assessed Roll*—This roll contains public utility and railroad properties, assessed as either unitary or nonunitary property by the State Board of Equalization.
- *Supplemental Roll*—This roll contains property that has been reassessed due to a change in ownership or the completion of new construction, where the resulting change in assessed value is not reflected in other tax rolls.

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

Objective, Scope, and Methodology

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

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

We performed the following procedures:

- Conducted tests to determine whether the county correctly apportioned and allocated property tax revenue.
- Interviewed key personnel and reviewed supporting documentation to gain an understanding of the county's property tax apportionment and allocation processes.
- Reviewed apportionment and allocation reports prepared by the county showing the computations used to develop the property tax distribution factors.
- Reviewed tax rate area (TRA) reports to verify that the annual tax increment was computed properly.

- Reviewed county unitary and operating nonunitary reports and Board of Equalization reports and verified the computations used by the county to develop the unitary and operating nonunitary property tax distribution factors.
- Reviewed redevelopment agency (RDA) reports prepared by the county and verified the computations used to develop the project base amount and the tax increment distributed to the RDA.
- Reviewed property tax administration cost reports prepared by the county and verified administrative costs associated with procedures used for apportioning and allocating property tax to local government agencies and school districts.
- Reviewed ERAF reports prepared by the county and verified the computations used to determine the shift of property taxes from local agencies to the ERAF and, subsequently, to public schools.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The audit covered the period of July 1, 2003, through June 30, 2009. However, we did not audit the county's financial statements. Our audit scope was limited to:

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

A property tax bill contains the property tax levied at 1% tax rate pursuant to the requirement of Proposition 13. A bill may also contain special taxes, debt service levies on voter-approved debts, fees, and assessments levied by the county or a city. The scope of our audit is concerned with the distribution of the 1% tax levy. Special taxes, debt service levies on voter-approved debts, fees, and assessments levied by the county or a city are beyond the scope of our audit and were not reviewed or audited.

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

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

Conclusion

Our audit disclosed that, except for the item discussed in the Finding and Recommendation section of this report, Napa County complied with California statutes for the apportionment and allocation of property tax revenues for the period of July 1, 2003, through June 30, 2009. The county should correct the item discussed in the Finding and Recommendation section.

Additionally, we made the following observation.

Prior to FY 2006-07, counties could not impose a fee, charge or other levy on a city, nor reduce a city's allocation of ad valorem property tax revenue, in reimbursement for the services performed by the county under Revenue and Taxation Code sections 97.68 and 97.70. Pursuant to Revenue and Taxation Code section 97.75, for FY 2006-07 and thereafter, a county may impose a fee, charge, or other levy on a city for these services, but the fee, charge, or other levy shall not exceed the actual cost of providing the services.

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The SCO will make a determination on the computation of the PTAF at such time as appeals (if any) are resolved.

**Follow-up on Prior
Audit Findings**

The county has satisfactorily resolved the findings noted in our prior audit report, issued October 24, 2005.

**Views of
Responsible
Official**

We issued a draft audit report on June 23, 2010. Tracy Schulze, Auditor-Controller, responded by letter dated October 26, 2010 (Attachment). She disagreed with our audit finding.

Restricted Use

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

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

December 10, 2010

Finding and Recommendation

**FINDING—
ERAF included in
unitary and
operating nonunitary
apportionment**

The county included the Educational Revenue Augmentation Fund (ERAF) in the unitary and operating nonunitary tax apportionment computation during this audit period.

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in Revenue and Taxation Code section 100.

Unitary properties are those properties on which the Board of Equalization “may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee” (i.e., public utilities and railroads). The Revenue and Taxation Code further states, “Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee.”

In fiscal year 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The Legislature established the unitary and operating nonunitary base year and developed formulas to compute the distribution factors for the fiscal years that followed.

Recommendation

The county should not include the ERAF in future unitary and operating nonunitary tax apportionment computations, as the ERAF does not qualify as a “taxing jurisdiction” under Revenue and Taxation Code section 100. Thus, the ERAF is not eligible to share and its amount should be distributed proportionately among all taxing jurisdictions that contributed to the fund.

County’s Response

We respectfully disagree with the finding stating that Napa County has incorrectly included the Educational Revenue Augmentation Fund (ERAF) in the unitary and operating nonunitary tax apportionment.

Pursuant to the California Property Tax Managers’ Reference Manual, the County of Napa is in full compliance with the methodology regarding including the ERAF in our unitary calculations. We fully understand the State Controller’s Office has treated the inclusion of ERAF in the unitary apportionment inconsistently throughout the years with findings written for not including ERAF in the unitary apportionment calculations noted in the State Controller’s Office report to the Legislature for calendar year 2003. However, until the issue is addressed by the California State Legislature, Napa County will continue to follow the California Property Tax Managers’ Reference Manual and include the ERAF in our unitary calculations.

SCO's Comment

Our finding and recommendation remain unchanged.

The ERAF is a fund—an accounting entity, not a taxing jurisdiction. Revenue and Taxation Code section 100 requires that taxes from unitary and operating nonunitary property be allocated to taxing jurisdictions. As the ERAF is not a taxing jurisdiction, it is not eligible to receive unitary and operating nonunitary taxes.

The county's statement that "Napa County will continue to follow the California Property Tax Managers' Reference Manual" is not relevant. The SCO is not bound by the Property Tax Managers' Reference Manual. We audit to applicable statutes.

Revenue and Taxation Code section 100(d)(1) states, "... an amount shall be computed for each taxing jurisdiction" while section 100(e)(3) states, "'Taxing jurisdiction' includes a redevelopment agency." The statute does not include the ERAF as a taxing jurisdiction.

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



A Tradition of Stewardship
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Auditor-Controller

1195 Third Street · Room B10
Napa, CA 94559
www.countyofnapa.org

Main: (707) 253-4551
Fax: (707) 226-9065

Tracy A. Schulze
Auditor-Controller

October 26, 2010

Mr. Steven Mar
Chief, Local Government Audits Bureau
State Controller's Office
Division of Audits
P.O. Box 942850
Sacramento, CA 94250-5874

Dear Mr. Mar,

Please accept this response to the June 23, 2010 letter we received from the State Controller's Office regarding the results of your audit of the apportionment and allocation of property tax revenues for the period of July 1, 2003, through June 30, 2009. We respectfully disagree with the finding stating that Napa County has incorrectly included the Educational Revenue Augmentation Fund (ERAF) in the unitary and operating nonunitary tax apportionment.

Pursuant to the California Property Tax Managers' Reference Manual, the County of Napa is in full compliance with the methodology regarding including the ERAF in our unitary calculations. We fully understand the State Controller's Office has treated the inclusion of ERAF in the unitary apportionment inconsistently throughout the years with findings written for not including ERAF in the unitary apportionment calculations noted in the State Controller's Office report to the Legislature for calendar year 2003. However, until the issue is addressed by the California State Legislature, Napa County will continue to follow the California Property Tax Managers' Reference Manual and include ERAF in our unitary calculations.

Sincerely,

A handwritten signature in black ink, appearing to read "Tracy A. Schulze", with a long horizontal flourish extending to the right.

Tracy A. Schulze
Auditor-Controller

**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874**

<http://www.sco.ca.gov>