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A Commitment to Service

Board of Supervisors

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Mark Luce
Chair

FILED

AUG 26 2009

Clerk of the Napa Superior Court
By: C. Brennan
Deputy

August 11, 2009

The Honorable Raymond A. Guadagni
Presiding Judge
Superior Court of California, County of Napa
825 Brown Street
Napa, CA 94559

Dear Judge Guadagni:

As required by Penal Code Section 933(c), enclosed is the response to the 2008-2009 Grand Jury Final Report on the Napa Valley Transient Occupancy Tax *How Much is Being Lost?*, Napa County Flood Control and Water Conservation District Napa County Flood Protection Sales Tax Measure A and Napa Valley Gangs.

Grand Jury activity takes place over the course of a number of months. As such, their findings and recommendations often address issues which county departments have already identified as problems and to which solutions are in the process of being developed.

The Board acknowledges the members of the 2008-2009 Grand Jury for the time they have devoted in preparing their report.

Sincerely,

Handwritten signature of Mark Luce in black ink.

Mark Luce, Chair
Napa County Board of Supervisors

Enclosure

cc: Foreman, 2008-09 Grand Jury

Received
Napa Superior Court

AUG 24 2009

Court Executive Office

Brad Wagenknecht
District 1

Mark Luce
District 2

Diane Dillon
District 3

Bill Dodd
District 4

Keith Caldwell
District 5

**Napa County
Responses to Grand Jury Report
Napa Valley Transient Occupancy Tax (TOT) “How Much is Being Lost?”
Fiscal Year 2008-2009**

2008-2009 Napa County Grand Jury Report on Napa Valley Transient Occupancy Tax “How Much is Being Lost?” was a report based on an investigation of the County of Napa, Cities of American Canyon, Napa, St. Helena and Calistoga, and the Township of Yountville Finance Departments’ process of reporting, auditing, and collecting the TOT. Request for responses were directed to each of the local agencies and did not indicate the specific position the responses should be coming from. In the case of Napa County, the County Executive Office requested responses from the Treasurer-Tax Collector, Auditor-Controller, Conservation, Development and Planning and County Counsel departments to respond to the appropriate findings and recommendations. Also, as a clarification, “Tax Administrator” referenced in the Grand Jury report in the case of Napa County is the County’s Treasurer-Tax Collector. While the County is only required to respond to the Recommendations, consistent with our past practice, the County is responding to both the findings and the recommendations.

Finding #1. The most recurring items of noncompliance were the lack of acceptable records and underreporting of gross receipts by the operators.

Response, County Auditor-Controller. The County Auditor-Controller agrees with this finding. In most cases the underreporting of gross receipts is not material and is corrected going forward.

Response, County Treasurer-Tax Collector. The County Treasurer-Tax Collector agrees with this finding based on the operator audit reports performed by the County Auditor-Controller’s Department.

Response, County Board of Supervisors. The Board of Supervisors concurs with the County Treasurer-Tax Collector’s and County Auditor-Controller’s responses.

Finding #2. Not every local governmental agency provides adequate information to a new operator.

Response, County Treasurer-Tax Collector. The County Treasurer-Tax Collector disagrees with this finding with regard to Napa County. New operators are given an Application for Certificate Registration form to be completed upon receiving a permit from the Planning Department. When the form has been completed and returned, the operator is issued a Certificate of Authority to Collect Transient Occupancy Tax, along with a copy of the complete TOT Ordinance. This registration must be renewed annually in January. Prior to each quarterly payment date, each operator is sent a Return on

Transient Room Tax which indicates the covered time period and payment due date; a self-addressed envelope is included for returning the completed return and remittance.

Napa County permits very few new developments; thus most new operators are a result of ownership changes to existing permitted establishments. Also see response to Recommendation #1.

Response, County Auditor-Controller. The County Auditor-Controller disagrees with this finding. When the County Auditor-Controller's department is notified of a change of ownership, the entity is placed in the audit plan for the current or subsequent year. Although providing information to new operators is not the department's responsibility, it has been the practice to discuss with the new owners the procedures and requirements of reporting and submitting TOT along with all the consequences of not following the procedures. Also see response to Recommendation #1.

Response, County Board of Supervisors. The Board of Supervisors concurs with the County Treasurer-Tax Collector's and County Auditor-Controller's responses.

Finding #3. There is a lack of communication between the Finance Departments and the licensing departments of the local governmental agencies.

Response, County Treasurer-Tax Collector. The County Treasurer-Tax Collector disagrees with this finding with regard to Napa County. The County does not issue business licenses, however the tax administrator does not issue a new Certificate of Authority to collect TOT until verification is received from the Planning Department that a use permit exists or has been issued. In addition, the tax administrator requests that Planning Department staff review the list of Transient Operators on a regular basis. Also see response to Recommendation #2.

Response, County Auditor-Controller. The County Auditor-Controller disagrees with this finding. Communication is mainly between the Treasurer-Tax Collector and Planning Departments. For auditing purposes, the County Auditor-Controller requests an updated list of the Transient Operators in the County unincorporated area from the tax administrator. To enhance the process for all future audits, the department will be verifying the number of permitted rooms per establishment with the Planning Department prior to conducting an audit. Also see response to Recommendation #2.

Response, County Board of Supervisors. The Board of Supervisors concurs with the County Treasurer-Tax Collector's and County Auditor-Controller's responses.

Finding #4. Provisions in the municipal codes/ordinances for interest and penalties are not being executed.

Response, County Treasurer – Tax Collector. The County Treasurer-Tax Collector disagrees with this finding. The tax administrator's current procedure is to invoice any and all penalties and interest on any delinquent or understated quarterly remittance, in

accordance with Section 3.32.090(A) of the TOT Ordinance. Further, if any additional amounts are found to be due, as the result of an audit performed by the County Auditor-Controller's Department, an invoice is sent to the operator including penalty and interest through the date of the audit.

Section 3.32.090(B) of the TOT Ordinance gives the tax administrator discretion to review the original amounts determined to be due and to change any tax, interest or penalties based on further evidence provided by the operator. This has in the past, on occasion, resulted in the reduction of amounts due on a case by case basis, including some items identified by audit. Also see response to Recommendation #3.

Response, County Auditor-Controller. The County Auditor-Controller disagrees with this finding. The County Auditor-Controller applies all interest and penalties due per the County's ordinance. Interest is applied at 1.5% per month as of the day the taxes become delinquent (30 days after the quarter). Penalties are applied at 10% of tax, when tax becomes delinquent and then an additional 10% penalty is applied when the delinquency exceeds 30 days. Also see response to Recommendation #3.

Response, County Board of Supervisors. The Board of Supervisors concurs with the County Treasurer-Tax Collector's and County Auditor-Controller's responses.

Finding #5. The tax administrator has sole discretion to waive TOT and/or interest and penalties due local governments.

Response, County Treasurer-Tax Collector. The County Treasurer-Tax Collector disagrees with this finding with regard to the County. The tax administrator does not have sole discretion to waive TOT, interest and/or penalties. If an operator does not agree with the assessed tax, penalties or interest, Section 3.32.090 of the County TOT Ordinance allows for a review hearing with the tax administrator to offer evidence that the amounts assessed were incorrectly computed. After this hearing, the tax administrator shall determine the proper tax to be remitted, considering any evidence presented by the operator. If the operator does not agree with the final determination of the tax administrator, Section 3.32.100 of the County TOT Ordinance provides for an appeal procedure allowing the operator to request a hearing by the Board of Supervisors. If such a hearing is held, the findings of the Board of Supervisors are final and conclusive.

Response, County Counsel. County Counsel disagrees with this finding. The tax administrator does not have sole discretion to waive Transient Occupancy Tax, interest or penalties. The tax administrator can review Transient Occupancy Tax, interest and penalties and if the operator can demonstrate that they were incorrectly computed, the Tax Administrator can waive them to the extent permitted by law. After a hearing before the tax administrator, any operator aggrieved by the tax administrator's decision has the opportunity to appeal the decision to the Board of Supervisors. The Board of Supervisor's findings are final and conclusive.

Response, County Board of Supervisors. The Board of Supervisors concurs with County Counsel's response.

Finding #6. Audits provided by the Cities and the County of Napa show past due TOT has not been collected from 2005 to the present.

Response, County Treasurer-Tax Collector. The County Treasurer-Tax Collector disagrees with this finding with regard to the County. All shortages identified by the County Auditor-Controller's Department in the audits performed during this period have been collected or dismissed, and are not overdue. At the time of the Grand Jury review, there were three items which have been subsequently invoiced and collected by the time of this response. Following are the total findings based on the audits performed and resulting collections were as follows:

	<u>Total of Findings</u>	<u>Total Collected</u>	<u>Total Outstanding</u>
FY05/06	\$ 5,214.64	\$5,214.64	\$ 0.00
FY06/07*	\$12,449.75	\$7,241.41	\$ 0.00

* In FY06-07 \$5,208.34 was dismissed by the Treasurer-Tax Collector after operator provided additional supporting evidence, in accordance with the TOT ordinance. It should also be noted that the audit resulted in a finding of an overpayment in the amount of \$5,095, for which the operator is unable to identify transients to be refunded, therefore the funds remain with the County.

FY07/08	\$ 40,122.00	\$6,637.26	\$ 0.00
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In accordance with the County TOT Ordinance, an operator may challenge the amount of TOT assessed and have a hearing with the Treasurer-Tax Collector to present additional information to demonstrate that the amount assessed is incorrect. This occurred in this instance which addressed energy surcharges that were added to the room charges. TOT was not collected on the energy surcharge amounts, and due to the ambiguity of the County TOT ordinance, the tax administrator dismissed the tax, penalty, and interest in the amount of \$33,484.74 until clarification notices were sent to all operators, who now include this type of charge in TOT calculations.

FY08/09	\$ 17,964.80	\$ 17,964.80	\$ 0.00
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At the time of the Grand Jury review there were outstanding items which have since been collected in full. It should also be noted that the audit resulted in a finding of an overpayment of \$136.00, for which the operator has not yet filed a refund request.

Response, County Auditor-Controller. The County Auditor-Controller disagrees with this finding. Department's records show that establishments have paid the delinquent TOT. Uncollected funds are due to the Treasurer-Tax Collector dismissing the penalties and/or interest and are not overdue.

Response, County Board of Supervisors. The Board of Supervisors concurs with the County Treasurer-Tax Collector's and County Auditor-Controller's responses.

Finding #7. The City of Napa does not have an adequate method of tracking its TOT revenue, relying in part on an out-of-date manual accounting system

Response, Not applicable for the County of Napa.

Finding #8. Most local governmental agencies do not have an accurate record of how many rooms are available for transient occupancy.

Response, County Treasurer-Tax Collector. The County Treasurer-Tax Collector disagrees with this finding with regard to legally established transient occupancies in the unincorporated areas of the county. The tax administrator maintains a listing of all legally permitted entities which includes the number of rooms for which each operator has been approved to collect TOT. This listing is provided to the Planning Department for review on a regular basis, and the information is shared with the County Auditor-Controller's Department for their use in preparing their audit plans.

The Planning Department's code enforcement unit identifies violations of County Code, including illegally established vacation rentals, and seeks to abate those violations with assistance from County Counsel and the District Attorney. We do not know the number of illegally established vacation rentals, and do not collect TOT on occupancies which have not been properly permitted.

Response, County Auditor-Controller. The County Auditor-Controller disagrees with this finding and is in concurrence with the Treasurer-Tax Collector's response. The department relies on data provided by the tax administrator. Our audit process includes determining if the revenues collected are reasonable for the number of rooms provided by the tax administrator. If there is evidence or appearance of additional rooms, this would be communicated to the Planning Department's code enforcement unit for abatement of the associated code violation (s).

Response, County Board of Supervisors. The Board of Supervisors concurs with the County Treasurer-Tax Collector's response.

Finding #9. The Cities and County do not conduct audits with any degree of frequency or regularity.

Response, County Auditor-Controller. The County Auditor-Controller partially agrees with this finding. The number of audits and frequency of audits performed is related to available staff resources to conduct the audits. In earlier years, staff vacancies slowed the auditing efforts. The goal of the department is to perform audits on the larger agencies with the most revenue potential every three years. Smaller entities are randomly chosen each year and the goal is to visit each upon change of ownership and then at least once

every seven years. This goal depends on staffing resources available to complete the amount of work involved. Also see response to Recommendation #7.

Response, County Board of Supervisors. The Board of Supervisors concurs with the County Auditor-Controller's response.

Finding #10. Potential revenue from uncollected TOT, interest, and penalties in the millions of dollars is being lost throughout the County.

Response, County Auditor-Controller. The County Auditor-Controller disagrees with this finding with regard to the County. Although audits are not conducted on every agency every year, because of our current process in place, each entity is aware that they could be audited at any time. As reported in the performance measures in the County's budget book for the Auditor-Controller, the findings of these audits are mostly due to non-monetary issues. For the most part, very minimal taxes are found to be due. If large dollars are found, this is usually due to a specific misunderstanding of what TOT should be charged for. Additionally, we receive annually a report from the tax administrator that records revenues by entities on a quarterly basis, which allows the tax administrator to monitor revenues. The County Auditor-Controller uses this data in developing our audit plan and determining the reasonableness of the revenues reported for the operators selected within the plan.

The purpose of our audits is to not only ensure operators are remitting the right amount of TOT, but also to assist them in their understanding of TOT rules and regulations in order to increase the likelihood that correct taxes are collected and paid. Furthermore, if any agency is found to be greatly underreporting revenues, a follow up audit is conducted within 2 years. Therefore, overall it is the opinion of the County Auditor-Controller that our audits are sufficient to ensure that minimal dollars are lost in actual TOT collections. Of course, with additional staffing for this purpose, more agencies could be audited more frequently to make these dollars even less.

Response, County Treasurer-Tax Collector. The County Treasurer-Tax Collector disagrees with this finding in regards to the County, due to the degree of potential revenue cited. Over the last four fiscal years, a total net of \$70,500.19 was found to have been under-collected. Of this, \$38,693.08 was dismissed and \$37,058.11 collected; \$5,251 has been over-collected pending identification of transients to be refunded.

The County Treasurer-Tax Collector cannot speak to potential lost revenue on non-permitted rooms, as this type of activity is considered illegal and as such is beyond the scope of the tax administrator's authority to collect.

Response, County Board of Supervisors. The Board of Supervisors concurs with the County Treasurer-Tax Collector's and County Auditor-Controller's responses.

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Recommendation #1. Local governmental agencies provide an operator with a copy of the local ordinance/municipal code and all forms needed to file and remit TOT.

Response, County Treasurer-Tax Collector. The recommendation has already been implemented; County's Treasurer-Tax Collector already had procedure in place prior to the Grand Jury review. Also see response to Finding #2. A copy of the ordinance is sent to the operator with their initial Certificate of Authority and each Return on Transient Room Tax is mailed to the operators at the end of each quarter. Any other form is sent to the operators upon request.

Response, County Auditor-Controller. The recommendation is for the tax administrator, which in the case of Napa County is the Treasurer-Tax Collector. However, during our audits, we provide copies upon request. Also see response to Finding #2.

Response, County Board of Supervisors. The Board of Supervisors concurs with the County Treasurer-Tax Collector's response.

Recommendation #2. Licensing departments alert local Finance Departments when issuing new licenses to TOT applicants indicating number of rooms for transient occupancy.

Response, County Conservation, Development and Planning Director. The recommendation will be implemented. The County does not issue business licenses, and approves very few development projects, but in the event that a new Transient Occupancy is approved, the department will notify the tax administrator and the County Auditor-Controller.

Response, County Treasurer-Tax Collector. This recommendation is for the Licensing department, which in case of Napa County is the Conservation, Development and Planning Department. However, the Treasurer-Tax Collector as stated in the response to Finding #3, will continue with the process already in place verifying the number of rooms between the tax administrator and Planning Department. At this time, the County permits very few new developments. The Planning Department will notify the tax administrator should any change in room numbers be permitted.

Response, County Auditor-Controller. This recommendation is for the Licensing department, which in the case of Napa County is the Conservation, Development and Planning Department. However, the Auditor-Controller's office will implement a new process to verify the number of rooms for transient occupancy. At this time, our office is not alerted of new licenses, however we receive a listing of TOT operators and the corresponding revenue generated from their operations from the tax administrator. For all future audits, the County Auditor-Controller will also verify the number of permitted rooms prior to an audit.

Response, County Board of Supervisors. The Board of Supervisors concurs with the County's Conservation, Development and Planning Director's response.

Recommendation #3. Local governmental agencies follow the municipal code/local ordinance in assessing penalties and interest.

Response, County Treasurer-Tax Collector. This recommendation has already been implemented; the tax administrator's current procedure already is to invoice any and all penalties and interest on any delinquent or understated quarterly remittance, in accordance with Section 3.32.090(A) of the TOT Ordinance. Further, if any additional amounts are found to be due, as the result of an audit performed by the County Auditor-Controller's Department, an invoice is sent to the operator including penalty and interest through the date of the audit.

Section 3.32.090(B) of the TOT Ordinance gives the tax administrator discretion to review the original amounts determined to be due and to change any tax, interest or penalties based on further evidence provided by the operator. This has in the past, on occasion, resulted in the reduction of amounts due on a case by case basis, including some items identified by audit.

In the past, there was one instance where the tax administrator dismissed tax, penalties and interest based on review by the operator of their draft audit and prior to issuance of an invoice. In this instance an invoice was not issued for the dismissed amount, as the review was allowed to occur out of order. In the future, we will not allow operator challenges and review to occur until after their audit is finalized, accepted by the Board of Supervisors, and all taxes due are invoiced, as required by the County TOT Ordinance.

Response, County Auditor-Controller. This recommendation has already been implemented; The County Auditor-Controller already applies all interest and penalties due, based on the audit, per the County's ordinance. Interest is applied at 1.5% per month as of the day the taxes become delinquent (30 days after the quarter). Penalties are applied at 10% of tax, when tax becomes delinquent and then an additional 10% penalty is applied when the delinquency exceeds 30 days.

Response, County Board of Supervisors. The Board of Supervisors concurs with the County Treasurer-Tax Collector's and County Auditor-Controller's responses.

Recommendation #4. Tax administrator to notify City Counsel or BOS of all past TOT, interest and penalties considered for waiver.

Response, County Treasurer -Tax Collector. The recommendation has not been implemented, but will be implemented in the future. By September 30, 2009, we will prepare an agenda item for presentation to the County Board of Supervisors which will encompass those items for which tax, penalties or interest was dismissed during the time period covered by the Grand Jury Report.

Response, County Auditor-Controller. The recommendation is for the tax administrator, which in the case of Napa County is the Treasurer-Tax Collector. However, when an audit is completed and the operator has had ample chance to respond to the findings, the County Auditor-Controller presents the audit along with all calculations of TOT due including interest and penalties for acceptance by the Board of Supervisors.

Response, County Board of Supervisors. The Board of Supervisors concurs with the County Treasurer-Tax Collector's response.

Recommendation #5. City of Napa establish adequate methods for tracking TOT, including past due amounts and consider purchase of software specifically designed to facilitate accounting for this tax.

Response, This recommendation is not applicable for the County of Napa.

Recommendation #6. Local governmental agencies expand the municipal code to include the cost of auditing if the operator does not have adequate records.

Response, County Auditor-Controller. This recommendation requires further analysis. Penalties and interest charged to establishments with monetary findings are designed to offset costs of the audit. However, how much of the actual cost is being collected requires further analysis. County Auditor-Controller with the County Executive Office will review this issue in next six months.

Response, County Board of Supervisors. The Board of Supervisors concurs with the County Auditor-Controller's response.

Recommendation #7. Internal audits or contingency audits should be conducted with regularity.

Response, County Auditor-Controller. This recommendation has already been implemented; The County's Auditor-Controller department is already conducting audits regularly. However, it should be noted that audits take staff resources and during these difficult times, additional staff resources are not an option. Therefore the number of audits is limited to what can be physically done at this time. It is the opinion of the County Auditor-Controller that the current number of audits is sufficient to ensure that minimal dollars are being lost in actual TOT collections. We need to be mindful of the cost of spending tax payer dollars for conducting audits compared to the benefit of receiving slightly higher tax revenues. Also see response to Finding #9.

Response, County Board of Supervisors. The Board of Supervisors concurs with the County Auditor-Controller's response.

Recommendation #8. Enforce the provision in the municipal code assessing the cost of auditing to an operator who does not have adequate records.

Response, County Auditor-Controller. This recommendation will not be implemented because it is not warranted. The County's current TOT ordinance does not include this provision.

Response, County Board of Supervisors. The Board of Supervisors concurs with the County Auditor-Controller's response.

Recommendation #9. Each local government agency improve its oversight and enforcement of the TOT.

Response, County Auditor-Controller. This recommendation will be implemented in the future. While the County's Auditor-Controller department already has sufficient oversight and enforcement of the TOT in place, there are some additional steps that could be taken such as verifying the number of rooms for transient prior to conducting an audit, put in place to further improve the process. The County's Auditor-Controller department is already conducting audits regularly. However, it should be noted that audits take staff resources and during these difficult times, additional staff resources are not an option. Therefore the number of audits is limited to what can be physically done at this time. It is the opinion of the County Auditor-Controller that the current number of audits is sufficient to ensure that minimal dollars are being lost in actual TOT collections. We need to be mindful of the cost of spending tax payer dollars for conducting audits compared to the benefit of receiving slightly higher tax revenues.

It is also in the opinion of the County Auditor-Controller that our presence in the unincorporated area is known and that agencies are following TOT regulations to the best of their abilities without malicious intent to under-collect or under-submit.

Response, County Treasurer-Tax Collector. This recommendation will be implemented in the future. By September 30, 2009, the tax administrator will add the following items to its oversight and enforcement procedures:

- Verify that amount of tax received is reasonable based on number of rooms and percentage of occupancy in addition to verification of 12% of rents which is already verified upon receipt of payment.
- Create a formal check-list for use with each finalized audit to insure any and all taxes, penalties and interest are invoiced and collected.

Response, County Board of Supervisors. The Board of Supervisors concurs with the County Treasurer-Tax Collector's and County Auditor-Controller's responses. Implementation of Grand Jury's Recommendation #4 will make the process more transparent and allow the Board of Supervisors to view the decisions made by the tax administrator to dismiss any TOT, interest or penalties.