

COLUSA COUNTY

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2003, through June 30, 2009



JOHN CHIANG
California State Controller

May 2011



JOHN CHIANG
California State Controller

May 18, 2011

The Honorable Peggy Scroggins
Auditor-Controller
Colusa County
546 Jay Street, Suite 202
Colusa, CA 95932

Dear Ms. Scroggins:

The State Controller's Office (SCO) audited the methods employed by Colusa 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 the county:

- Miscalculated the annual tax increment amounts, and did not carry forward some of the base revenues from the prior year, thereby causing errors in the current year's revenues, growth percentages, and AB 8 apportionment factors;
- Incorrectly computed the supplemental property tax apportionment factors;
- Incorrectly computed the unitary and operating non-unitary property tax apportionment factors and allocations. In addition, it included the Educational Revenue Augmentation Fund (ERAF) in the tax apportionment process;
- Incorrectly computed the unitary railroad base revenues and tax apportionment factors and allocations, and also excluded the ERAF from the tax apportionment process;
- Incorrectly computed the pro rata share of administrative costs attributable to all local agencies, resulting in errors in the charges;
- Miscalculated the annual tax increment amounts, thereby causing errors in the ERAF shift amounts, which in turn, resulted in errors in the growth percentages.

During the audit fieldwork, and with assistance from the SCO, the county re-computed the AB 8 system and made the proper adjustments to all but one of the affected areas. The county included the ERAF in the unitary and operating non-unitary tax apportionment process.

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/vb

cc: Honorable Mark D. Marshall, Chairman
Board of Supervisors, Colusa 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 Colusa 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 the county:

- Miscalculated the annual tax increment amounts, and did not carry forward some of the base revenues from the prior year, thereby causing errors in the current year's revenues, growth percentages, and AB 8 apportionment factors;
- Incorrectly computed the supplemental property tax apportionment factors;
- Incorrectly computed the unitary and operating non-unitary property tax apportionment factors and allocations. In addition, it included the Educational Revenue Augmentation Fund (ERAF) in the tax apportionment process;
- Incorrectly computed the unitary railroad base revenues and tax apportionment factors and allocations, and also excluded the ERAF from the tax apportionment process;
- Incorrectly computed the pro rata share of administrative costs attributable to all local agencies, resulting in errors in the charges;
- Miscalculated the annual tax increment amounts, thereby causing errors in the ERAF shift amounts, which in turn, resulted in errors in the growth percentages.

During the audit fieldwork, and with assistance from the SCO, the county re-computed the AB 8 system and made the proper adjustments to all but one of the affected areas. The county included the ERAF in the unitary and operating non-unitary tax apportionment process.

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 292, Statutes of 1979, which established the method of allocating property taxes for fiscal year (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 nonunitary properties, regulated railway companies, and qualified electric properties from the AB 8 system. These revenues are now allocated and apportioned under separate systems.

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 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 a 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 items discussed in the Findings and Recommendations section of this report, Colusa 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 items discussed in the Findings and Recommendations section.

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.

**Follow-up on Prior
Audit Findings**

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

**Views of
Responsible
Official**

We issued a draft audit report on December 10, 2010. Peggy Scroggins, Auditor-Controller, responded by letter dated April 1, 2011 (Attachment). She agreed with the audit results with the exception of Finding 3.

Restricted Use

This report is solely for the information and use of Colusa 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

May 18, 2011

Findings and Recommendations

FINDING 1— Calculation and distribution of ATI

The county miscalculated the annual tax increment amounts, and did not carry forward some of the base revenues from the prior year, causing the current year's revenues, growth percentages, and AB 8 apportionment factors computations to be incorrect. As a result, all agencies received incorrect tax allocations.

Requirements for the apportionment and allocation of the annual tax increment (ATI) are found in Revenue and Taxation Code sections 96 through 96.5. The annual increment of property tax, which is the change in assessed value from one year to the next, is allocated to Tax Rate Areas (TRAs) on the basis of each TRA's share of the incremental growth in assessed valuations. The tax increment is then multiplied by the jurisdiction's annual tax increment apportionment factors for each TRA. These factors were developed in the 1979-80 base year and are adjusted for jurisdictional changes. The tax increment is then added to the tax computed for the prior fiscal year to develop the apportionment for the current fiscal year.

Recommendation

During the audit fieldwork, the county re-computed the AB 8 system and made the proper adjustments to the tax allocations. The county then provided copies of the corrected AB 8 documents to the SCO auditors. We will review the tax allocations again during the next audit to ensure that the county implemented the correction for FY 2009-10 and each fiscal year thereafter.

County's Response

I accept the findings with the knowledge that all necessary revisions have been accomplished and audited by your staff.

**FINDING 2—
Supplemental
property tax**

The errors in the AB 8 system caused the factors and allocations in the supplemental property tax system to be incorrect beginning with FY 2003-04.

The legal requirements for supplemental roll property tax apportionment and allocation are found in Revenue and Taxation Code sections 75.60 through 75.71, and 100.2. When there is a change in assessed property value due to changes in ownership or completion of new construction, the property owner is charged a supplemental property tax. This process enables the counties to retroactively tax property for the period when changes in ownership or completion of new construction occurred, rather than at the time the secured roll is developed.

Recommendation

During the audit fieldwork, the county corrected the supplemental property tax apportionment factors and allocation of revenues. The county then provided copies of the corrected supplemental property tax documents to the SCO auditors. We will review the supplemental property tax apportionment factors again during the next audit to ensure that the county implemented the correction for FY 2009-10 and each fiscal year thereafter.

County's Response

I accept the findings with the knowledge that all necessary revisions have been accomplished and audited by your staff.

**FINDING 3—
Unitary and operating
nonunitary
apportionment**

The county did not properly compute the unitary and operating nonunitary property taxes, including the regulated railway revenues.

1. The unitary and operating non-unitary property tax apportionment factors and allocations were not computed correctly. In addition, the ERAF was included in the unitary and operating non-unitary tax apportionment process;
2. The unitary railroad base revenues, and tax apportionment factors and allocations were not computed correctly. In addition, the ERAF was excluded in the tax apportionment process.

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 FY 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

During the audit fieldwork, the county corrected all noted errors in the system and made the appropriate adjustments to the affected agencies. The county provided copies of the corrected unitary and regulated railway property tax documents to the SCO auditors. We will review the unitary and operating nonunitary allocations and the regulated railway allocations again during the next audit to ensure that the county implemented the correction for FY 2009-10 and each fiscal year thereafter.

The county should not include the ERAF in future unitary and operating non-unitary 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

Regarding the inclusion of the ERAF in the unitary and operating non-unitary tax apportionment process, I understand there is a legal opinion issued by the State Controller's Office to support the exclusion of ERAF in unitary and operating non-unity tax apportionment process. I am happy to make that correction, upon receipt of the State Controller's legal opinion. In the meantime, I am inclined to follow the Property Tax Guidelines for the ERAF calculations. The guidelines were developed by State Controller's staff and County Auditor-Controller's representatives, based on legislation, to ensure all counties consistently follow the same property tax allocation methods throughout the State.

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.

The county states that it is inclined to follow the Property Tax Guidelines for the ERAF calculations as outlined in the California Property Tax Managers' Reference Manual. While we recognize the guidelines prepared by the County Property Tax Managers' Association as a guide, it is important to note that we audit to applicable statutes. Furthermore, it must be noted that the SCO did not participate in the development of the Reference Manual and has also not approved it.

**FINDING 4—
Property tax
administrative costs**

The errors in the AB 8 system, identified in Finding 1, caused the factors and allocations in the property tax administrative costs system to be incorrect.

Requirements for the reimbursement of county property tax administrative costs are found in Revenue and Taxation Code section 95.3. County property tax administrative costs are incurred by the assessor, the tax collector, the assessment appeals board, and the auditor. The county is allowed, depending on the fiscal year and any corresponding exclusions, to be reimbursed by local agencies and public schools for these administrative costs.

Recommendation

During the audit field work, the county corrected the property tax administrative cost factors and allocations. The county then provided copies of the corrected property tax administrative cost documents to the SCO auditors. We will review the property tax administrative cost factors again during the next audit to ensure that the county implements the correction for FY 2009-10 and each fiscal year thereafter.

County's Response

I accept the findings with the knowledge that all necessary revisions have been accomplished and audited by your staff.

**FINDING 5—
Educational Revenue
Augmentation Fund
(ERAF)**

The errors in the AB 8 system, identified in Finding 1, and the failure to carry forward some of the agencies' ERAF shift amounts from the prior year caused the ERAF shift amounts for all fiscal years to be incorrect.

Requirements for the local agency shift of property tax revenues to the ERAF are primarily found in Revenue and Taxation Code sections 97.1 through 97.3. Beginning in FY 1992-93, most local agencies were required to shift an amount of property tax revenues to the ERAF using formulas detailed in the code. The property tax revenues in the ERAF are subsequently allocated to the public schools using factors supplied by the county superintendent of schools.

For FY 1992-93, the ERAF shift amount for cities was determined by adding a per capita amount to a percentage of property tax revenues received by each city. The amount for counties was determined by adding a flat amount, adjusted for growth, to a per capita amount. The amount for special districts was generally determined by shifting the lesser of 10% of that district's total annual revenues as shown in the FY 1989-90 edition of the State Controller's Report on Financial Transactions Concerning Special Districts, or 40% of the FY 1991-92 property tax revenues received, adjusted for growth. Specified special districts were exempted from the shift.

For FY 1993-94, the ERAF shift for cities and counties was generally determined by:

- Reducing the FY 1992-93 ERAF shift by the FY 1992-93 per capita shift;
- Adjusting the result for growth; and
- Adding the result to a flat amount and a per capita amount determined by the Department of Finance, adjusted for growth.

The FY 1993-94 ERAF shift for special districts, other than fire districts, was generally determined by:

- Multiplying the property tax allocation for FY 1992-93, pre-ERAF, by the Special District Augmentation Fund (SDAF) factor for the district effective on June 15, 1993;
- Adjusting this amount by subtracting the FY 1992-93 shift to the ERAF;
- If the above amount is greater than zero, adjusting this amount for FY 1993-94 growth (zero is used for negative amounts); and
- Adding this amount to the FY 1992-93 ERAF shift, adjusting for growth.

For fire districts, the FY 1993-94 ERAF shift was generally determined by:

- Deducting the FY 1992-93 ERAF shift for the district from the FY 1992-93 property tax allocation;
- Multiplying the result by the SDAF factor for the district effective on June 13, 1993 (net current-year bailout equivalent);
- For a district governed by a board of supervisors, deducting the amount received from the SDAF in FY 1992-93 from the net current-year bailout equivalent; or, for an independent district, deducting the amount received from the SDAF and the difference between the net current-year bailout equivalent and the amount contributed to the SDAF from the net current-year bailout equivalent;
- Adjusting this amount for growth; and
- Adding this amount to the FY 1992-93 ERAF shift, adjusted for growth.

For fiscal years subsequent to FY 1993-94, the amounts determined are adjusted for growth annually to determine the ERAF shift amounts for that year.

Recommendation

During the audit fieldwork, the county corrected the ERAF factors and allocations. The county then provided copies of the corrected ERAF shift documents to the SCO auditors. We will review the ERAF shift amounts again during the next audit to ensure that the county implements the correction for FY 2009-10 and each fiscal year thereafter.

County's Response

I accept the findings with the knowledge that all necessary revisions have been accomplished and audited by your staff.

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

COLUSA

COUNTY

Office of
Peggy Scroggins
County Auditor-Controller
Risk Manager
Data Processing Manager



AUDITOR - CONTROLLER

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Robert Zunino
Asst. Auditor - Controller
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April 1, 2011

Mr. Steven Mar, Chief
Local Government Audits Bureau
California State Controller, Division of Audits
P. O. Box 942850
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Delivered Via Email: [jacobbinach@sco.ca.gov](mailto:jcobbinach@sco.ca.gov)

Subject: Colusa County Property Tax Audit for the Period July 1, 2003 – June 30, 2009

Dear Mr. Mar:

We have reviewed Jeffrey Brownfield's December 10, 2011, letter and the draft audit report for the Property Tax Apportionment and Allocation System for the period July 1, 2003, through June 30, 2009. The initial miscalculation of the annual tax increment amounts compounded annually and created the other findings. I accept the findings with the knowledge that all necessary revisions have been accomplished and audited by your staff. Mr. John Hill Cobbinah and I have been in contact discussing one particular finding... specifically the unitary and operating non-unitary in relation to Educational Revenue Augmentation Fund (ERAF).

Regarding the inclusion of the ERAF in the unitary and operating non-unitary tax apportionment process, I understand there is a legal opinion issued by the State Controller's Office to support the exclusion of ERAF in unitary and operating non-unity tax apportionment process. I am happy to make that correction, upon receipt of the State Controller's legal opinion. In the meantime, I am inclined to follow the Property Tax Guidelines for the ERAF calculations. The guidelines were developed by State Controller's staff and County Auditor-Controller's representatives, based on legislation, to ensure all counties consistently follow the same property tax allocation methods throughout the State.

Thomas Parker, Colusa County Counsel, has contacted Richard Chivaro, Chief Counsel to the State Controller's Office for a copy of the legal opinion which I have been informed will be provided to Colusa County next week. I will fully respond to the draft property audit once County Counsel receives and reviews that information. Assuming County Counsel fully supports Mr. Chivaro's legal opinion, I will take this information to the California State Association of County Auditors and push for a change in the Property Tax Guidelines to ensure all counties still continue to allocate property taxes consistently.

Sincerely,

COUNTY OF COLUSA

Peggy Scroggins
PEGGY SCROGGINS,
Auditor-Controller

cc: Thomas Parker, County Counsel

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