

VENTURA COUNTY

Audit Report

PROPERTY TAX APPORTIONMENT AND ALLOCATION SYSTEM

July 1, 2003, through June 30, 2006



JOHN CHIANG
California State Controller

December 2008



JOHN CHIANG
California State Controller

December 23, 2008

Christine L. Cohen
Auditor-Controller
Ventura County
Auditor-Controller's Office, #1540
800 South Victoria Avenue
Ventura, CA 93009-1540

Dear Ms. Cohen:

The State Controller's Office audited the methods employed by Ventura County to apportion and allocate property tax revenues for the period of July 1, 2003, through June 30, 2006. 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 excluded the Educational Revenue Augmentation Fund from supplemental apportionments.

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:vb

cc: Jody Martin

Joint Legislative Budget Committee
Peter Detwiler, Consultant
Senate Local Government Committee
Elvia Dias, Assistant
Senate Local Government Committee
Dixie Martineau-Petty, Secretary
Assembly Local Government Committee
Martin Helmke, Consultant
Senate Revenue and Taxation Committee
Kimberly Bott, Chief Consultant
Assembly Revenue and Taxation Committee
David Botelho, Chief
Office of State Audits and Evaluations
Department of Finance
Catherine Smith, Executive Director
California Special Districts Association

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Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by Ventura County to apportion and allocate property tax revenues for the period of July 1, 2003, through June 30, 2006.

Our audit disclosed that the county complied with California statutes for the allocation and apportionment of property tax revenues, except that it excluded the Educational Revenue Augmentation Fund (ERAF) from supplemental apportionments. Additionally, we observed that the county includes the ERAF in the unitary apportionment process. We believe that the ERAF should not be included in the unitary apportionment process. The ERAF must be removed from the unitary apportionment process.

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 8 (AB 8), 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 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:

- Performed 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.
- Reviewed reports and computations prepared by the county to determine any increases in property tax revenues due cities having low or non-existent property tax amounts.

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, 2006. 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.

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, Ventura County complied with California statutes for the apportionment and allocation of property tax revenues for the period of July 1, 2003, through June 30, 2006. The county should correct the item discussed in the Finding and Recommendation section.

Additionally, we observed that the county includes the ERAF in the Unitary Apportionment Process. We believe that the ERAF should not be included in the Unitary Apportionment Process. The ERAF must be removed from the Unitary Apportionment Process.

Follow-up on Prior Audit Findings

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

Views of Responsible Officials

We issued a draft audit report on December 14, 2007. Christine L. Cohen, Auditor-Controller, responded by letter dated January 2, 2008 (Attachment), disagreeing with the audit results.

Subsequent Event

As of the end of audit fieldwork, no events have occurred subsequent to June 30, 2006, that would require adjustment to property tax apportionments and allocations for the audit period; however, Ventura County is the respondent in the civil case of *Community Development Commission of the City of Oxnard, etc., et al.*, which could require a future adjustment if the petitioners prevail in the lawsuit. The case concerns the Auditor-Controller's interpretation of statutes governing the computation of tax increments to be paid to a redevelopment agency. The Kern County Superior Court entered a Notice of Judgment in the county's favor on February 24, 2006. The Community Development

Commission filed an appeal on August 10, 2006. The Court of Appeal, Fifth Appellate District, reversed the Kern County Superior Court judgment. The Court of Appeal instructed the trial court to enter a new and different judgment requiring the county to include escape assessments in its calculation of the tax increment due to redevelopment agencies. The county estimated that an adjustment to property tax apportionments and allocations as of June 30, 2006, will be in the range of \$400,000 to \$1.2 million.

Restricted Use

This report is solely for the information and use of Ventura 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 23, 2008

**Schedule 1—
Summary of Underallocation to the
Educational Revenue Augmentation Fund
July 1, 2003, through June 30, 2006**

| <u>Fiscal Year</u> | <u>Allocation by County</u> | <u>State Amount per Audit</u> | <u>Audit Adjustment ¹</u> |
|--------------------|---------------------------------|-----------------------------------|--|
| 2003-04 | \$ — | \$ 4,354,370 | \$ 4,354,370 |
| 2004-05 | — | 6,798,508 | 6,798,508 |
| 2005-06 | — | 6,293,558 | 6,293,558 |
| Totals | <u>\$ —</u> | <u>\$ 17,446,436</u> | <u>\$ 17,446,436</u> |

NOTE: The Revenue and Taxation Code limits the maximum amount due to ERAF to 1% of the FY 2006-07 secured levy or \$9,203,208.

¹ See the Finding and Recommendation section.

Finding and Recommendation

FINDING— Supplemental property tax

Ventura County excluded the Educational Revenue Augmentation Fund (ERAF) from Supplemental Apportionments.

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

The county must include the ERAF in future supplemental apportionments. Additionally, the county must pay \$9,203,208 into the ERAF for FY 2003-04 through FY 2005-06.

County's Response

As directed by your letter, which we received December 20, 2007, we are responding to the audit finding that asserts our County is improperly excluding the Educational Revenue Augmentation Fund (ERAF) from Supplemental Roll apportionments. In addition, although it is not included as an audit finding, we are addressing the audit's assertion that ERAF should be excluded from the Unitary Roll apportionment process.

We disagree with the finding that the County is improperly excluding ERAF from the Supplemental Roll apportionments because the finding is not supported by law or any authoritative pronouncement. During the exit conference, the auditor made it clear that this position was not based on Revenue and Taxation (R&T) code or any other applicable law, but that he was basing his finding solely upon an unpublished State Attorney General's opinion letter, a copy of which was not provided to use for our review.

We further disagree with the finding because the audit report is attempting to apply the principles for apportioning the Equalized Roll (Secured, Unsecured and State Utility Rolls), which is governed by R&T code 95, et seq., to the apportionment of the Supplemental Roll, which is governed by R&T code 75, et seq. R&T codes 75 through 75.80, as updated by R&T code 100.2 to include tax years after 1985-86, clearly identify the Supplemental Roll as a roll that is separate from the Equalized Roll. In R&T code 75.70, ERAF is not referenced as a "school entity" that is to receive Supplemental Roll apportionments. According to the code, "all elementary, high school, and unified school districts within the county," are to participate in the Supplemental Roll apportionments. R&T code 75.70 further specified that the allocation of property tax revenues to these entities is to occur "without respect to the allocation of property tax revenues pursuant to Chapter 6 (commencing with Section 95)," which governs the apportionment of the Equalized Roll and does include ERAF as a "school entity," as defined by R&T code 95(f) [school districts,

community college districts, the Educational Revenue Augmentation Fund, and county superintendents of schools].

Given R&T code 75.80 identified the specific entities that participate in the Supplemental Roll apportionments, and the code does not reference school entities as defined under R&T code 95(f), which does include ERAF as a participating school entity, the County of Ventura is correct in its exclusion of ERAF from Supplemental Roll apportionments.

Two additional items should be noted regarding the Supplemental ERAF apportionment finding: 1) In previous audits, two other State Controller auditors agreed that we are in compliance with applicable law by excluding ERAF from Supplemental Roll apportionments. 2) Other than to reference R&T code 96(c)(3), which limits the cumulative amount of the proposed adjustment, the audit report does not provide specifics on how the auditor developed the amounts of the desired ERAF adjustment for the three years under review. Since we are not able to verify the calculations, we cannot comment on their validity.

During the same exit conference where the Supplemental ERAF finding was discussed, the auditor raised the issue of excluding ERAF from the Unitary Roll apportionment process. He referenced the same, unpublished State Attorney's General's opinion letter as the basis for his opinion that ERAF should be excluded from the Unitary Roll. Our application of law to include all taxing jurisdictions, including ERAF, in the Unitary Roll apportionment for the three years under review is correct and is fully support by clarification to R&T code 100.95(a)(3)(A)(i) for the 2007-08 fiscal year. R&T code 100.95(a)(3)(A)(i) states:

"School entities, as defined in subdivision (f) of section 95 [school districts, community college districts, the Educational Revenue Augmentation Fund, and county superintendents of schools], shall be allocated an amount equivalent to the same percentage the school entities received in the prior fiscal year from the property tax revenues paid by the utility in the county in which the qualified property is located."

Since the statement in the audit report related to ERAF in the Unitary Roll is not a finding, and specific Revenue and Taxation code supports our current methodology for apportioning the Unitary Roll, we will not make any modifications to our processes at this time.

SCO's Comment

Revenue and Taxation (R&T) Code section 75.70(c) provides that supplemental property tax allocations to counties, cities, and special districts are to be calculated on the basis of each entity's property tax apportionment factor determined "pursuant to section 97.5" (now section 96.2) (i.e., in accordance with section 96.2).

Supplemental property tax revenues are not included in the computation of property tax apportionment factors. However, the applicable law makes it clear that the allocation of such revenues is to be made on the basis of, and in accordance with, the apportionment factors.

After the supplemental property tax laws were enacted, section 97.5 (now section 96.2) was amended by Chapter 448, Statutes of 1984, adding as subdivision (f) the identical provision that is now in

subdivision (c) of section 96.1 (i.e., supplemental tax revenues are not to be included for purposes of the section). But subdivision (f) was in effect for less than two months (July 16 to September 10, 1984). It was deleted from section 97.5 by Chapter 946, Statutes of 1984, which substituted the following as subdivision (h) of section 97.5:

(h) Supplemental property tax revenues for 1985-86 and each year thereafter, generated by Sections 75 to 75.80, inclusive, shall be apportioned using the property tax apportionment factors for the current year.

Subdivision (h) remained in section 97.5 until reorganization of the property tax allocation statutes (Chapter 1167, Statutes of 1994). Former section 97.5 became section 96.2, and the above quoted subdivision (h) became section 100.2. The primary purpose of Chapter 1167 was to “clarify and reorganize” the property tax allocation code provisions. The Legislature did not intend any substantive change in transferring subdivision (h) to section 100.2. This provision was intended to have the same application it had over the previous ten years. The supplemental tax revenues are to be allocated by application of the current year’s apportionment factor.

However, the pertinent ERAF sections (section 97, et seq.) specifically provide that “Notwithstanding any other provision of this chapter, the computations and allocations made by each county pursuant to section 96.1 or its predecessor section . . . shall be modified. . . .” This supersedes the pre-ERAF apportionment factor formula.

Section 96.1 is modified by law. There is no unmodified section 96.1, nor any statute that provides for allocation of property tax revenues based on a pre-modified section 96.1 apportionment factor. Section 75.70(c) specifies that supplemental revenues are to be distributed using apportionment factors “pursuant” to section 96.2—that is, factors developed on the basis of a modified section 96.1.

In this regard, sections 97.2(d)(5), 98.2(e)(3), and 97.3(d)(5) specify that amounts allocated from the ERAF “shall be deemed property tax revenue allocated to the Educational Revenue Augmentation Fund in the prior fiscal year.” Additionally, section 95(f) defines “school entities” as including the ERAF. As a result of these sections, the ERAF is, in effect, treated the same as a school district with its own property tax apportionment factor. This is consistent with and supports the above interpretation that apportionment factors must be determined for all entities on the basis of a modified section 96.1—that is, after deduction of the ERAF shifts moneys.

It should also be noted that Chapter D-6 of the *California Property Tax Managers’ Reference Manual* includes the ERAF as an entity to receive supplemental property taxes.

The county has also addressed the exclusion of the ERAF from the unitary and operating nonunitary apportionment process.

The ERAF is a fund—an accounting entity, not a taxing jurisdiction—and with respect to the allocation and apportionment of unitary and operating nonunitary taxes, the Legislature has not defined it as a taxing jurisdiction.

R&T Code section 95(b) defines a jurisdiction as a “local agency, school district, community college district, or county superintendent of schools. . . .” R&T Code section 95(f) includes the ERAF in the definition of school entities. It states “‘School entities’ means school districts, community college districts, the Educational Revenue Augmentation Fund, and county superintendent of schools.” It is clear that the definition of jurisdiction does not include the ERAF but does include all defined school entities except the ERAF. Defining the ERAF as a school entity does not make it a jurisdiction.

R&T Code section 100(e)(3) includes a redevelopment agency as a taxing jurisdiction, demonstrating that the Legislature knows how to include non-taxing entities in the definition of taxing jurisdiction if it so desires. In this case, it omitted the ERAF from the definition of taxing jurisdiction.

The county has stated that its application of law “to include all taxing jurisdictions, including ERAF, in the Unitary Roll apportionment . . . is correct and is fully supported [sic] by clarification to R&T code 100.95(a)(3)(A)(i) for the 2007-08 fiscal year.” The county then quotes the section as included in its response above.

However, the county did not note that R&T Code section 100.95 is concerned with certain “qualified property” and not the unitary and operating nonunitary property of R&T Code section 100. R&T Code section 100.95(c)(1) states:

“Qualified property” means all plant and associated equipment, including substation facilities and fee-owned land and easements, placed in service by the public utility on or after January 1, 2007, and related to the following:

- (A) Electrical substation facilities that meet either of the following conditions:
 - (i) The high-side voltage of the facility’s transformer is 50,000 volts or more.
 - (ii) The substation facilities are operated at 50,000 volts or more.
- (B) Electric generation facilities that have a nameplate generating capacity of 50 megawatts or more.
- (C) Electrical transmission line facilities of 200,000 volts or more.

The finding remains as written. In addition, the county should exclude the ERAF from the unitary and operating nonunitary apportionment process.

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

CHRISTINE L. COHEN
AUDITOR-CONTROLLER
County of Ventura
800 South Victoria Avenue
Ventura, CA 93009-1540



CHIEF DEPUTIES
LOUISE WEBSTER
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January 2, 2008

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

**RE: AUDIT OF VENTURA COUNTY'S METHODS FOR APPORTIONING AND ALLOCATING
PROPERTY TAX REVENUES FOR THE PERIOD OF JULY 1, 2003, THROUGH JUNE 30, 2006**

Dear Mr. Mar:

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We further disagree with the finding because the audit report is attempting to apply the principles for apportioning the Equalized Roll (Secured, Unsecured and State Utility Rolls), which is governed by R&T code 95, et seq., to the apportionment of the Supplemental Roll, which is governed by R&T code 75, et seq. R&T codes 75 through 75.80, as updated by R&T code 100.2 to include tax years after 1985-86, clearly identify the Supplemental Roll as a roll that is separate from the Equalized Roll. In R&T code 75.70, ERAF is not referenced as a "school entity" that is to receive Supplemental Roll apportionments. According to the code, "all elementary, high school, and unified school districts within the county," are to participate in the Supplemental Roll apportionments. R&T code 75.70 further specifies that the allocation of property tax revenues to these entities is to occur "without respect to the allocation of property tax revenues pursuant to Chapter 6 (commencing with Section 95)," which governs the apportionment of the Equalized Roll and does include ERAF as a "school entity," as defined by R&T code 95(f) [school districts, community college districts, the Educational Revenue Augmentation Fund, and county superintendents of schools].

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Mr. Steven Mar, Chief, Local Government Audits Bureau

January 2, 2008

Page 2

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Since the statement in the audit report related to ERAF in the Unitary Roll is not a finding, and specific Revenue and Taxation code supports our current methodology for apportioning the Unitary Roll, we will not make any modifications to our processes at this time.

I would be happy to discuss the audit and our response to the finding with you or your staff in more detail, if you wish. If you would like to speak with me, or if we can provide additional information in support of our position, please call me at (805) 654-3151. If you prefer, please do not hesitate to email me at christine.cohen@ventura.org.

Sincerely,



Christine L. Cohen
Auditor-Controller

c: Noel Klebaum, County Counsel
John F. Johnston, County Executive Officer

**State Controller's Office
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