



**JOHN CHIANG**  
**California State Controller**

July 11, 2007

George Spiliotis  
Executive Officer  
Wildomar/Riverside Local Agency  
Formation Commission  
3850 Vine Street, Suite 110  
Riverside, CA 92507-4277

Dear Mr. Spiliotis:

The State Controller's Office has completed a review of the questions raised by Mr. Gerard Ste. Marie regarding the Comprehensive Fiscal Analysis prepared for the Proposed Wildomar City Incorporation. A report of the review and findings is enclosed.

My audit staff is available to consult with you on the details of our review and findings, at your request.

Sincerely,

*Original signed by*

JEFFREY V. BROWNFIELD, Chief  
Division of Audits

JVB/wm

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## Review Findings

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# Executive Summary

## Background

The Wildomar Incorporation Now committee presented a proposal to the Riverside Local Agency Formation Commission (LAFCO) to incorporate the Wildomar area of Riverside County as a new city. Authority for the request comes from the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000.

The Wildomar Incorporation Now proponents employed a consultant to prepare a comprehensive fiscal analysis (CFA) for the proposed incorporation, in accordance with the requirements of Government Code section 56800. Two CFAs were prepared: one was dated July 13, 2006, and the other was dated April 30, 2007. The April 30, 2007, CFA is the subject of this report.

Government Code section 56801 allows any interested party to ask LAFCO to request that the State Controller's Office (SCO) review specified elements of the CFA with regard to the accuracy and reliability of the information, methodologies, and documentation used in the analysis. The request by an interested party must specify in writing which elements of the comprehensive fiscal analysis the SCO is requested to review and the reasons the SCO is requested to review each element. The SCO is required to issue a report to the executive officer of LAFCO within 45 days of receiving the analysis. The executive officer must include the results of the SCO's report into his or her own report and recommendation issued pursuant to Section 56665. Notwithstanding Sections 56378 and 56386, the SCO may charge the commission for the actual costs incurred pursuant to Section 56801. The commission may recover these costs by charging the party who requested the Controller's review.

On May 14, 2007, interested party Gerard Ste. Marie (Requestor) submitted a request to the Riverside LAFCO asking that the SCO review six issues. The SCO received the request on May 16, 2007. After review of associated legal questions by its legal office, the SCO accepted the request in its entirety on June 7, 2007.

## Summary of Review Findings

### Issue 1—Reserve Fund Allocation

The Requestor questioned whether the identification of the "Cumulative General Fund Operating Surplus" as operating reserve is consistent with the incorporation guidelines issued by the Governor's Office of Planning and Research (OPR). The Requestor also questioned the presentation of operating and contingency reserves in the CFA.

### SCO Conclusion

The SCO concludes that, although the Wildomar CFA may not have been prepared according to the suggested OPR approach in all instances, and the CFA does not clearly identify reserves in the manner suggested

in the OPR incorporation guidelines, the CFA does appear to provide a reasonable picture of fund reserves attributable to the proposed city area.

The SCO further concludes that the incorporation guidelines published by the OPR do not have the force of statute or regulation, even though the OPR is considered an authoritative source for the preparation of CFAs.

### **Issue 2—Road Fund Revenue Neutrality**

The Requestor, citing OPR guidelines, questioned whether the road fund revenues and expenditures are exempt from the revenue neutrality provisions of Government Code section 56815.

#### **SCO Conclusion**

The SCO concludes that, in the absence of specific statutory requirements, the LAFCO has the discretion to determine whether to include restricted funds in the determination of revenue neutrality. As noted previously, the OPR guidelines do not have the force of statute or regulation.

### **Issue 3—Structural Fire Fund Property Tax Transfer**

The Requestor asked for a determination as to whether the County Structural Fire Fund or the County Fire Department is considered the “affected agency” for the purpose of calculating the property tax transfer to the proposed new city. The Requestor also inquired about the proper methodology for the transfer of property tax revenues for fire protection services.

#### **SCO Conclusion**

The SCO concludes that the County Fire Department is the “affected agency” within the meaning of Government Code section 56810. The SCO also concludes that the Structural Fire Fund must be excluded from calculation or transfer pursuant to Government Code section 56810(c)(1). In addition, the SCO concludes that property tax revenues generated in the proposed City of Wildomar for the Structural Fire Fund are dedicated revenues for fire protection; therefore, the property tax revenues for fire protection in the proposed city will stay within the city, in accordance with Revenue and Taxation Code section 99.

### **Issue 4—Fire Protection Service Cost Sharing Arrangement**

The Requestor asked for determinations regarding a proposed cost-sharing arrangement between the new city and the county, noting that the CFA used speculative revenue projections to reduce the potential cost of providing services to the proposed city.

**SCO Conclusion**

The SCO concludes that it would be inappropriate for a CFA to base fiscal viability upon unsecured, speculative revenues, but that the CFA can note potential mitigating revenues and the county could commit general fund revenues to help a proposed city become financially viable.

**Issue 5— National Pollutant Discharge Elimination System (NPDES) Compliance Cost Estimates**

The Requestor questioned whether the CFA accurately reflected costs associated with NPDES program compliance and whether such costs should be separately analyzed in the comparable cities' analysis.

**SCO Conclusion**

The SCO concludes that the methodology used to determine NPDES costs in the CFA resulted in an inaccurate determination of those costs. The SCO also concludes that the inaccuracy did not have a material impact on the determination of viability. The SCO further concludes that the CFA does not need a separate comparable-cities analysis of NPDES costs unless the LAFCO requires such an analysis.

**Issue 6—Sales Tax Projections**

The Requestor questioned whether the presentation of sales tax revenue projections in the CFA is in compliance with LAFCO policy requiring conservative projections, and inquired as to what adjustments should be made to provide a more realistic projection.

**SCO Conclusion**

The SCO concludes that the determination of whether the sales tax projections are conservative or whether adjustments should be made is a determination rightly made by the LAFCO.

# Review Findings

## Issue 1

The Requestor raised the following issue in the request to LAFCO:

### **“Reserve Fund Allocation”**

The Requestor identified three concerns to support the position that the CFA did not adequately compute and establish the reserve fund allocations in conformance with OPR Guidelines. These concerns are:

**Requestor Concern 1:** “Is identification of the “Cumulative General Fund Operating Surplus” as an operating reserve consistent with OPR Guidelines?”

**Requestor Concern 2:** “Should the reserve fund be set aside as a separate line-item fund in the appropriate tables of the CFA in the same manner as the contingency fund?”

**Requestor Concern 3:** “Should the past experience of comparable new cities be consulted prior to default to the minimum allowable 10 % reserve fund set-aside?”

### **Analysis of Underlying Concerns Cited by the Requestor as the Basis for Issue 1**

#### **Requestor Concern 1**

The Requestor noted that the CFA has made proper appropriation for a 10% contingency fund set-aside as a line item in the tables at pages 4 and 5 of the CFA, as well as at Tables 1-A and 5-A of the Appendix and further noted that no such line item exists in those tables for any reserve fund set-aside. It was then further noted that, in response to comments, the consultant confirmed that the “Cumulative General Fund Operating Surplus” contained in the tables is considered as an operating reserve. The Requestor finally noted that identification of a cumulative surplus as an operating reserve was expressly recommended against by the LAFCO Incorporation Guidelines from the Governor’s Office of Planning and Research (2003).

The Requestor then asked if the identification of the “Cumulative General Fund Operating Surplus” as an operating reserve is consistent with OPR incorporation guidelines.

SCO’s Analysis and Response to Requestor Concern 1: The SCO concludes that the CFA has not clearly defined the operating reserve fund, but did note that the consultant has stated that the cumulative reserve was intended to meet this qualification.

Though the OPR incorporation guidelines are considered an authoritative source and discourage the use of a cumulative surplus as the operating reserve, they don’t have the authority of statute or regulation and as such are not absolutely required to be followed.

In discussion with LAFCO staff, a willingness to accept the cumulative reserve as used in the CFA was expressed with a belief that the separate line item for an operating reserve was not an absolute requirement.

### **Requestor Concern 2**

The Requestor asks whether the reserve fund should be set aside as a separate line-item fund in the CFA in the same manner as the contingency fund.

SCO's Analysis and Response to Requestor Concern 2: The SCO has determined that the CFA should have set aside the reserve fund in a separate line item. This item is strongly suggested in the OPR guidelines, as noted by the Requestor. However, as observed above, though the guidelines are strongly recommended, they may not actually be required.

In discussion with LAFCO staff, a willingness to accept the cumulative reserve as used in the CFA was expressed with a belief that the separate line item for an operating reserve was not an absolute requirement.

### **Requestor Concern 3**

The Requestor questions why no analysis of comparable new cities is made for determination of an adequate level of reserve.

SCO's Analysis and Response to Requestor Concern 3: The SCO has determined that though the CFA computed the minimum 10% level of reserves as required by the Guidelines, the guidelines further state that the reserve should be based on the experience of comparable new cities and that a preferred level of funding could vary.

While it may be preferable to have a study of comparable new cities, this may be somewhat subjective since actual comparable new cities may not actually exist. In addition, it would be within the purview of the LAFCO to request such an analysis and comparison. The LAFCO chose not to do so, and the SCO will not put itself in the place of the LAFCO.

### **SCO's Conclusion to Requestor Issue 1**

The SCO concludes that the OPR incorporation guidelines, while considered an authoritative source for the preparation of CFAs, do not have the force of statute or regulation. The SCO further concludes that, although the preparation of the CFA may not have taken the suggested approach in all instances and the CFA does not clearly identify reserves in the manner suggested in the OPR guidelines, the CFA does appear to provide a reasonable picture of fund reserves attributable to the proposed city area.

**Issue 2**

The Requestor raised the following issue in the request to LAFCO:

**“Road Fund Revenue Neutrality”**

The Requestor identified one concern related to the road fund and revenue neutrality. This concern is:

**Requestor Concern:** “Are road fund revenues and expenditures categorically exempt from revenue neutrality provisions of Government Code section 56815 as being revenue neutral by definition?”

**Analysis of Underlying Concerns Cited by the Requestor as the Basis for Issue 2**

The Requestor expressed his concern as follows:

Although revenue neutrality mitigation calculations were made with respect to general fund revenues and expenditures (see Exhibit 3 in the Appendix to the CFA), no such calculations were made with respect to road fund revenues and expenditures. In response to Comment E-3 on page 5 of “Response to Comments,” the consultant opined that calculations of revenue neutrality are not required because revenue/expense transfers are considered revenue neutral by definition under the statute.

The Requestor further notes:

The statute does not qualify between different types of revenue which must be considered in the neutrality documentation, but requires consideration of all revenues currently received by the county which would accrue to the new city upon incorporation of the affected territory. (Government Code § 56815(b)(1).) The OPR Guidelines do, on the other hand, qualify that services funded on a full cost recovery basis (such as building inspection) are by definition revenue neutral and should not be included in the analysis. (OPR Guidelines, p.43.) The Guidelines also suggest that restricted and unrestricted revenues should be evaluated separately. (OPR Guidelines, p.44.)

**SCO’s Analysis and Response to Requestor Concern:** The SCO concludes that although the OPR incorporation guidelines are considered an authoritative source for the preparation of CFAs, they don’t have the authority of statute or regulation and as such are not absolutely required to be followed. In addition, if the LAFCO wanted to include restricted funds in the determination of revenue neutrality, it could have made restricted funds analysis part of that determination.

The SCO further concludes that the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 does not state or provide a definition of certain revenue/expenditure combinations that are neutral by definition.

### **SCO's Conclusion to Requestor Issue 2**

The SCO concludes that the LAFCO could have included restricted funds in the determination of revenue neutrality if it had wanted to and that a definition of certain revenue/expenditure combinations that are neutral by definition is not included in statute.

### **Issue 3**

The Requestor raised the following issue in the request to LAFCO:

#### **“Structural Fire Fund Property Tax Transfer”**

The Requestor identified five concerns related to the Structural Fire Fund property tax transfer and whether the Structural Fire Fund or the County Fire Department was the “affected agency” within the meaning of Government Code section 56810. These concerns are:

**Requestor Concern 1:** “Is it the County Structural Fire Fund or the County Fire Department which is the “affected agency” pursuant to Gov. Code § 56810 with the responsibility for providing fire protection services within the community of Wildomar for purposes of calculating the property tax transfer to the proposed new city?”

**Requestor Concern 2:** “If the County Structural Fire Fund is the “affected agency” pursuant to Gov. Code § 56810 with the responsibility for providing fire protection services within the community of Wildomar for purposes of calculating the property tax transfer to the proposed new city, would the new city be assuming all of the service responsibilities, or less than all of the service responsibilities of the affected agency?”

**Requestor Concern 3:** “If the County Structural Fire Fund is the “affected agency” pursuant to Gov. Code § 56810 with the responsibility for providing fire protection services within the community of Wildomar for purposes of calculating the property tax transfer to the proposed new city, and the new city would be assuming less than all of the service responsibilities of the affected agency, should the Structural Fire Fund be excluded from calculation or transfer as being “revenue which, by statute, is required to be used for a specific purpose” pursuant to Gov. Code § 56810(c)(1)(A)?”

**Requestor Concern 4:** “If the County Fire Department is the “affected agency” pursuant to Gov. Code § 56810 with the responsibility for providing fire protection services within the community of Wildomar for purposes of calculating the property tax transfer to the proposed new city, should the Structural Fire Fund be excluded from calculation or transfer as being “revenue which, by statute, is required to be used for a specific purpose” pursuant to Gov. Code § 56810(c)(1)(A)?”

**Requestor Concern 5:** “What would be the proper methodology for transfer of property tax revenues related to the provision of fire protection services.” [all sic]

**Analysis of Underlying Concerns Cited by the Requestor as the Basis for Requestor Issue 3**

**Requestor Concerns 1 through 5**

The Requestor provides a lengthy discourse discussing whether it is the Structural Fire Fund or the County Fire Department that is the “affected agency” within the meaning of Government Code section 56810. At the end, he concludes:

But the bottom line is that the “affected agency” with the service responsibility for fire protection in the Wildomar community is not really the Structural Fire Fund at all, but rather it is the Riverside County Fire Department, whose service responsibility is merely subsidized by proceeds from the Structural Fire Fund.

SCO’s Analysis and Response to Requestor Concern 1: The SCO concludes that the County Structural Fire Fund is a county fund. It is not a governmental subdivision or agency. It provides no fire protection services. It does not own fire fighting or protection equipment. It has no employees. Its sole purpose is to receive property tax revenues to be used in providing fire protection services in Riverside County. On the other hand, the County Fire Department is responsible for providing fire protection services within the county including the Wildomar area. Should the Wildomar area become a city, it is anticipated that it would assume the responsibility for providing fire protection services within its boundaries from the County Fire Department. Therefore, the SCO concludes that the County Fire Department is the “affected agency” within the meaning of Government Code section 56810.

SCO’s Analysis and Response to Requestor Concern 2: See the response to Concern 1.

SCO’s Analysis and Response to Requestor Concern 3: See the response to Concern 1.

SCO’s Analysis and Response to Requestor Concern 4: The SCO concludes that the Structural Fire Fund must be excluded from calculation or transfer pursuant to Government Code section 56810(c) (1) because it is “revenue which, by statute, is required to be used for a specific purpose” pursuant to Government Code section 56810(c)(1)(A).

SCO’s Analysis and Response to Requestor Concern 5: The SCO concludes that Revenue and Taxation Code section 99 applies to the property tax revenues for fire protection services in the case of city incorporation. The property tax revenues generated in the proposed City of Wildomar for the Structural Fire Fund are dedicated revenues for fire protection; therefore, the property tax revenues for fire protection in the proposed city will stay within the city.

In the event that the Structural Fire Fund does not currently fund 100% the fire protection services for the proposed city (i.e. General Fund monies supplement fire protection), the General Fund monies used for fire protection should be included in the calculation of the Auditor's Ratio.

### **SCO's Conclusion to Requestor Issue 3**

The SCO concludes that the County Fire Department is the "affected agency" within the meaning of Government Code section 56810.

The SCO concludes that the Structural Fire Fund must be excluded from calculation or transfer pursuant to Government Code section 56810(c)(1) because it is required to be used for a specific purpose.

The SCO concludes that property tax revenues generated in the proposed City of Wildomar for the Structural Fire Fund are dedicated revenues for fire protection; therefore the property tax revenues for fire protection in the proposed city will stay within the city in accordance with Revenue and Taxation Code section 99.

## **Issue 4**

The Requestor raised the following issue in the request to LAFCO:

### **"Fire Protection Service Cost Sharing Arrangement"**

The Requestor identified two concerns to support the position that the CFA used inappropriate revenue offsets to reduce the cost to the proposed city of providing required services. These concerns are:

**Requestor Concern 1:** "When determining costs to be incurred by a new city relative to an incorporation proposal, is it a proper methodology to allow offsets to cost estimates for the provision of required services based on a yet to be negotiated cost sharing agreement and an unsecured funding allocation?"

**Requestor Concern 2:** "Is it acceptable as a matter of public policy, as embodied in the Cortese-Knox-Herzberg Local Government Reorganization Act of 2000, for a county to offset municipal service costs to a proposed new city by interjecting public finances in order to salvage an otherwise infeasible incorporation proposal?"

### **Analysis of Underlying Concerns Cited by the Requestor as the Basis for Issue 4**

#### **Requestor Concern 1**

The Requestor noted that the CFA concludes that the City of Wildomar, as proposed, is not financially viable without revenue or cost sharing enhancements. (CFA, p.3.) In order to get around this obstacle, the Riverside County Board of Supervisors passed a resolution authorizing a prospective cost sharing agreement between the County and the future city in the event incorporation should occur.

The Requestor noted the following:

No firm funding was secured from the County as a result of the resolution, and no formal cost sharing agreement has yet been negotiated. The CFA was adjusted to accommodate for a one possible cost sharing scenario which would solve the budgetary shortfall. (CFA, p.5.) Based on revenue assumptions contrived under this cost sharing scenario, incorporation for Wildomar was pronounced feasible. (CFA, p.3.)

SCO's Analysis and Response to Requestor Concern 1: The SCO concludes that it would not be appropriate for the CFA to include unsecured, speculative revenue sources as justification for fiscal viability. However, it is appropriate to note possible mitigating revenues that could change the fiscal viability of a proposal.

#### **Requestor Concern 2**

The Requestor asks whether it is acceptable as a matter of public policy, under the Cortese-Knox-Herzberg Act of 2000, for a county to offset municipal service costs to a proposed new city by interjecting public finances in order to salvage an otherwise infeasible incorporation proposal.

SCO's Analysis and Response to Requestor Concern 2: The SCO has reviewed the Cortese-Knox-Herzberg Act and found no specific reference that would preclude the county from assisting a city. It is therefore determined that, though no specific commitment has been made by the county, it is within the authority of a county board of supervisors to provide financial assistance to any governmental entity within their sphere of influence.

#### **SCO's Conclusion to Requestor Issue 4**

The SCO concludes that it would be inappropriate for a CFA to base fiscal viability upon unsecured, speculative revenues, but that the CFA can note potential mitigating revenues and the county could commit general fund revenues to help a proposed city become financially viable.

### **Issue 5**

The Requestor raised the following issue in the request to LAFCO:

#### **“NPDES Compliance Cost Estimates”**

The Requestor noted two concerns related to NPDES compliance cost estimates. These concerns are:

**Requestor Concern 1:** “Does the CFA accurately reflect costs associated with NPDES program compliance?”

**Requestor Concern 2:** “Should NPDES compliance costs be separately analyzed in a comparable cities analysis?”

### **Analysis of Underlying Concerns Cited by the Requestor as the Basis for Issue 5**

#### **Requestor Concern 1**

The Requestor notes that the proposed city will be “required to adopt programs to maintain compliance with the National Pollution Discharge Elimination System (NPDES). (CFA, p.34.) He further notes the “large disparity between cost estimates made in the CFA compared to those made in the RSG Draft CFA completed just a few months earlier (see RSG Draft CFA, p.25-26).”

SCO’s Analysis and Response to Requestor Concern 1: The Riverside County Flood Control and Water Conservation District provided the information used to determine NPDES costs in the CFA. NPDES costs for fiscal year 2004-05 for four cities in Riverside County (Murrieta, Norco, Perris, and San Jacinto) was used to determine a per-capita cost of approximately \$5.99. This amount was multiplied by an assumed population of approximately 30,000 to arrive at an NPDES cost of \$180,000 for fiscal year 2009-10. To this amount, \$30,000 for AB 939 administration was added to arrive at a per-capita amount of \$6.60 for fiscal year 2009-10. In subsequent years, an inflation factor of approximately 3% was used to increase costs.

The SCO concludes that this methodology did not result in an accurate determination of NPDES costs in the CFA for the following reasons:

- The budgeted increase in NPDES costs for the four cities was from approximately 9% to 157%.
- An inconsistent approach was employed because an inflation factor was not applied to the fiscal year 2004-05 per-capita amount when computing fiscal year 2009-10 costs, but then an inflation factor of 3% was applied in subsequent years.
- A justification was not available, other than consultant experience, for the assumed \$30,000 AB 939 administration costs.

In addition, the consultant stated the costs identified as NPDES costs were for administration. Other NPDES costs the city would incur were included in the Road Fund but not separately identified.

The SCO further concludes that while the methodology did not produce an accurate determination of costs, the impact on the determination of viability in the CFA was not material. The RSB Draft CFA is not relevant to this determination.

**Requestor Concern 2**

The Requestor expressed his concern as follows:

. . . although it is stated in the CFA that ongoing costs were projected based on similar costs to other Riverside County cities that are in the program (p.34), no cost figures were discussed and no comparative cities analysis was done to substantiate those cost projections, which are depicted on Table 2-B of the Appendix.

SCO's Analysis and Response to Requestor Concern 2: The SCO concludes that, unless the LAFCO requires a separate comparable-cities analysis of NPDES costs, one is not required under the provisions of the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000. The SCO further concludes that such an analysis may be of little benefit if it includes comparable cities outside of Riverside County because of differing geographical situations and ecological concerns (coastal area vs. inland area or nearby rivers, streams, lakes, marshes, etc.). However, a determination of NPDES costs of similarly situated or sized cities within Riverside County may prove beneficial in validating the projected costs.

**SCO's Conclusion to Requestor Issue 5**

The SCO concludes that the methodology to determine NPDES costs in the CFA did not result in an accurate determination of those costs but did not have a material impact on the determination of viability. The SCO further concludes that the CFA did not need a separate comparable-cities analysis of NPDES costs unless the LAFCO requires one.

**Issue 6**

The Requestor raised the following issue in the request to LAFCO:

**“Sales Tax Projections”**

The Requestor noted two concerns related to sales tax projections. These concerns are:

**Requestor Concern 1:** “Does the methodology employed for projection of sales tax revenues comply with Riverside LAFCO policy and procedure requiring conservative revenue projections?”

**Requestor Concern 2:** “What adjustments should be made to the forecast model in order to provide a more realistic projection of sales tax revenues?”

## **Analysis of Underlying Concerns Cited by the Requestor as the Basis for Issue 6**

### **Requestor Concern 1**

The Requestor states his concern as follows:

Riverside LAFCO Policies and Procedures mandate that all revenue estimates/projections shall be conservative. . . . It is interesting to note that while the RSG Draft CFA claims to present a conservative forecast of development (p.6), the CFA under review makes no such proclamation.

SCO's Analysis and Response to Requestor Concern 1: The SCO concludes that there were two main sources of data used in the projection of sales tax revenues in the CFA. The first is sales tax revenues data provided by the State Board of Equalization. The SCO deems this data highly reliable. The second is sales tax revenue data based on projections from actual retail construction projects in the "pipeline" at the county. The SCO deems that the projections based on construction projects already started are more reliable and that projections for projects that are still in the initial planning stages are less reliable. The preparation of the CFA used a 25% deflator for sales tax revenue projections based upon sales per square foot. In the absence of a clear definition of "conservative" in the LAFCO Policies and Procedures or the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000, whether or not the sales tax projections are conservative is a matter for the Riverside LAFCO to decide. The conclusions, statements and methodologies in the RSG Draft CFA are not relevant.

### **Requestor Concern 2**

The Requestor did not provide a reason or reasoning for Concern 2.

SCO's Analysis and Response to Requestor Concern 2: In the context of Government Code section 56801, this is not a concern that we can answer.

### **SCO's Conclusion to Requestor Issue 6**

The SCO concludes that the determination of whether the sales tax projections are conservative is a determination rightly made by the LAFCO. The SCO further concludes that the second concern is not one we can answer within the context of Government Code section 56801.

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

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