



1400 K Street, Suite 400 • Sacramento, California 95814
Phone: 916.658.8200 Fax: 916.658.8240
www.cacities.org

DATE: April 1, 2011

TO: Members: Revenue and Taxation Policy Committee

FROM: Robert Ming, (Chair), Mayor, Laguna Niguel
Dan Carrigg, League Staff (916) 658-822

RE: **REVENUE AND TAXATION MEETING**
DATE: **Friday, April 8, 2011**
TIME: **10:00 a.m. – 3:00 p.m.**
PLACE: **Doubletree Hotel**
222 N. Vineyard Avenue
Ontario, CA 91764

Special Order
Joint Policy Committee State Budget and Redevelopment Update
10:00 a.m., Harvest Room, Doubletree Hotel

Attached are the agenda and background materials for the upcoming policy committee meeting. If you plan to attend, and have not yet returned the attendance form, please contact Meg Desmond at mdesmond@cacities.org. Registration for this meeting is not required; however, your response will help us determine the meal count.

AIR TRANSPORTATION: Low, refundable airfares are available through the Enhanced Local Government Airfare Program. The program requires that a city be pre-registered, check with your city's travel coordinator. This program is ticketless and includes Southwest, United and United Express. For city pairs, rates or if your city has not yet registered, please check the League Website at <http://www.cacities.org/travel> for details.

If you plan to drive, you may check either of the following websites for directions to the hotel: www.yahoomaps.com or www.mapquest.com.

OVERNIGHT ACCOMODATIONS: A block of rooms are available at the Doubletree Hotel, 222 N. Vineyard Avenue, Ontario. For a reservation, please phone the hotel directly: (800) 222-8733 or (909) 937-0900. Complementary shuttle service from the Ontario airport to the Doubletree Hotel is available.

PARKING: Complementary parking is available at the hotel.

We look forward to seeing you in April!

Deadline for Submitting Annual Conference Resolutions
Saturday, July 23, 2011, by email, regular mail or fax
For more information, visit: www.cacities.org/resolutions or contact: mdesmond@cacities.org

REVENUE AND TAXATION POLICY COMMITTEE

Friday, April 8, 2011

10:00 a.m. – 3:00 p.m.

Doubletree Hotel, 222 N. Vineyard Avenue, Ontario Room: Harvest

Special Order
Joint Policy Committee State Budget and Redevelopment Update
10:00 a.m., Harvest Room, Doubletree Hotel

A G E N D A

- I. **Welcome and Introductions**
- II. **Public Comment**
- III. **State Budget Discussion** *Governor's Budget — Michael Coleman, Fiscal Policy Advisor and Dan Carrigg, Legislative Director* (Attachment A)
- IV. **Perspective on State Budget Deliberations (11:30 am)**
(Invited)- Senator Bob Dutton, Senate Republican Leader (R-31, Inland Empire)
- V. **Update on Pension Issues** *Natasha Karl, League Legislative Representative (Attachment B)*
- VI. **State Legislative Action Items:**
 - a. Policy Discussion on Pending Audit Legislation (Attachment C)
 - b. Other will be brought to committee (as necessary).
- VII. **Proposition 26 Implementation Update - Dan Carrigg, Legislative Dir.** (Attachment D)
- VIII. **Federal Legislative Update** (Attachment E)
- IX. **Committee Work Program**
2011 Draft Work Program (Attachment F)
- X. **Next Meeting: FRIDAY, June 17, 2011, Sacramento Convention Center**

Brown Act Reminder: The League of California Cities' Board of Directors has a policy of complying with the spirit of open meeting laws. Generally, off-agenda items may be taken up only if:

1) Two-thirds of the policy committee members find a need for immediate action exists and the need to take action came to the attention of the policy committee after the agenda was prepared (Note: If fewer than two-thirds of policy committee members are present, taking up an off-agenda item requires a unanimous vote); or

2) A majority of the policy committee finds an emergency (for example: work stoppage or disaster) exists.

A majority of a city council may not, consistent with the Brown Act, discuss specific substantive issues among themselves at League meetings. Any such discussion is subject to the Brown Act and must occur in a meeting that complies with its requirements.

NOTE: Policy committee members should be aware that lunch is usually served at these meetings. The state's Fair Political Practices Commission takes the position that the value of the lunch should be reported on city officials' statement of economic interests form. Because of the service you provide at these meetings, the League takes the position that the value of the lunch should be reported as income (in return for your service to the committee) as opposed to a gift (note that this is not income for state or federal income tax purposes—just Political Reform Act reporting purposes). The League has been persistent, but unsuccessful, in attempting to change the FPCC's mind about this interpretation. As such, we feel we need to let you know about the issue so you can determine your course of action.

If you would prefer not to have to report the value of the lunches as income, we will let you know the amount so you may reimburse the League. The lunches tend to run in the \$30 to \$45 range. To review a copy of the FPCC's most recent letter on this issue, please go to www.cacities.org/FPPCletter on the League's Website.

ATTACHMENT A

GOVERNOR BROWN PUTS BUDGET NEGOTIATIONS WITH REPUBLICANS ON HOLD

Window for June Election on Tax Increases Now Likely Closed

Late Tuesday afternoon, Gov. Jerry Brown announced that he had called off budget negotiations citing a long list of Republican demands (<http://ow.ly/1sh90s>). The Governor was critical of the list of requested policy changes. He said he felt were not directly related to the budget and that the list undermines his attempt at a balanced approach to the budget.

While the Governor has already signed \$11.2 billion in cuts (about half of the \$26.6 billion deficit), which will become effective on July 1 regardless of whether the main budget bill has been signed, the other half of the Governor's proposal contemplated a special election to extend approximately \$12 billion annually in various taxes.

The focus on recent budget agreement deadlines has been driven by the Governor's desire to have a June special election. A June special election was preferred because the tax extensions in Gov. Brown's plan would be considered new taxes on any ballot after their June 30 expiration. Also, county clerks need 88 days to comply with state law to print and mail ballots. Senate pro Tem Darrell Steinberg (D-Sacramento) said a June election is off the table in light of the breakdown in negotiations. While the Legislature can legally adopt a tax increase with a two-thirds vote of its body, Gov. Brown previously promised voters that tax increases would only be approved with their support.

Speculation continues about possible next steps for the Governor. He may pursue other options to balance the budget including gathering signatures for a November ballot initiative to extend taxes, or using an untested legal theory and attempt to place the tax extensions on the ballot with a simple majority vote of the Legislature. Both options are problematic. The Governor could also present an all-cuts budget.

A November ballot initiative would leave the budget unsettled for four months into the new fiscal year, and if the taxes failed at the ballot, the budget would be further complicated. Senate pro Tem Steinberg has said that he will not pursue the majority vote option, which would likely be tied up in legal challenges.

On March 25, in his letter to Sen. Robert Dutton (R-Inland Empire), the Governor said he was willing to resume budget negotiations with Republicans when they are prepared to narrow their focus on the three main issues: pension reform, regulatory reform and a spending cap. It is unclear given Tuesday's reports whether or not that offer remains on the table.

Redevelopment

Since early January, the League, the California Redevelopment Association (CRA) and a large coalition of stakeholders (<http://www.protectourlocaleconomy.com/sites/default/files/REDEV%20Coalition%20List%203.18.11.pdf>), have been fighting Gov. Brown's unconstitutional proposal to eliminate redevelopment agencies and take their funds for state purposes. If elimination should occur and legal action is necessary, the League board of directors has authorized the League to be a named plaintiff in any litigation challenging the constitutionality of a redevelopment elimination proposal.

CRA has developed an alternative proposal under which redevelopment agencies would be granted extensions of their project life-spans in exchange for voluntarily contributing to local schools as follows:

- An additional two-year extension in exchange for a one time contribution of 20 percent of their funds (equivalent to their annual housing set-aside) to local schools.
- Up to 10 years in project–life extensions in exchange for up to 10 percent of their tax increment funds to local schools within their redevelopment project areas. For every one percent of tax increment contributed, the agency would receive one addition project year.

Either or both of these options can be used to accomplish up to 12 years in extended project life. Because the program would be voluntary, it would not violate the State Constitution or Proposition 22.

CRA conservatively estimates that up to \$1 billion in FY 2011-2012 would be available as a one-time contribution to local schools, which the state may elect to credit against its Prop. 98 school funding obligations. The first year contribution would either be derived from, or equivalent to, approximately \$700 million in annual affordable housing set-aside funds and approximately \$250 million per year for 10 years of ongoing contributions. Thus, the total combined value of the proposal in the first year (\$1 billion) and the additional contributions over the remaining 9 years of the proposal (\$2.25 billion) could yield a total of \$3.25 billion over the 10 year life of the proposal.

CRA has also conveyed to legislators that they are committed to responding to perceived misuses of redevelopment authority by proposing reforms including:

- Tightening expenditures of housing funds;
- Improving data collection and audit procedures; and
- Broadening the use of redevelopment authority to better reflect articulated state principles and policies such as assisting with the creation of high quality jobs including manufacturing, improving brownfield remediation, promoting infill and transit-oriented development and other priorities.

Enterprise Zones

The League and other stakeholders also remain opposed to the Governor’s proposal to eliminate enterprise zones, which provide tax benefits to businesses which create jobs in economically depressed areas. There are many legal problems with this proposal. Legislative hurdles include a two-thirds vote requirement because the removal of these previously committed and accrued tax benefits is considered a tax increase for the affected businesses.

Transportation

On a more positive note, the Governor, on March 24, signed the transportation trailer bill that included the Gas Tax Swap clean-up. Without this bill, revenues from the "new" Highway Users Tax Account (HUTA) would have been in jeopardy beginning in November 2011.

The Legislature and Gov. Schwarzenegger approved a Gas Tax Swap in March 2010 that exempted gasoline from sales tax, and increased the gas excise tax, or HUTA. The Swap had no net effect on the amount of city HUTA revenues, but did allow the state some flexibility in using HUTA revenues to pay state bond debt service. However, with the passage of Prop. 26, these revenues were put in jeopardy unless re-enacted with a two-thirds vote of the legislature. Prop. 22 also limited the use of HUTA for bond debt and general fund relief and some clean-up legislation was required to allow the state to use weight fees rather than the excise tax to pay for transportation-related bond debt service.

The legislation also contains provisions clarifying that the new HUTA funds are not subject to the requirements and restrictions applicable to the former Prop. 42 funds, including maintenance of effort requirements.

Realignment

The Governor's realignment plan depends on voter approval for a State Constitutional Amendment (SCA) 1 x 1, titled "The Schools and Local Public Safety Protection Act of 2011."

SCA1 x 1 does three things:

- It would create a \$12 billion annual funding source if voters approve extending for five years the temporary increases in income, sales tax and vehicle license fees that were adopted in 2009.
- It allocates the proceeds of the extended income tax to support state funding for schools, and dedicates the proceeds of the extended sales tax and vehicle license fees to funding the realignment of various state responsibilities to local agencies.
- It contemplates undefined yet-to-come "2011 Realignment Legislation" that will determine the details of how tax monies reallocated to local agencies will be implemented as "public safety services." "Public safety services" is awkwardly defined to include various health and human services in addition to law enforcement and fire protection, and creates confusion as to its eventual scope.

Public Safety and Corrections Realignment

The Senate and Assembly both approved the main corrections realignment bills, AB 109 and AB 111, with a simple majority vote. Like many of the other budget trailer bills, it previously required a two-thirds vote. This was changed after preliminary votes failed to earn support from any Republican member. Unlike most of the other budget trailer bills, AB 109 and AB 111 have yet to be signed by Gov. Brown. Both bills were sent to the Governor's desk on March 22.

AB 109 makes the statutory changes needed to shift low-level offenders (non-serious, non-violent, non-sex offenses, along with a specific list as requested by statewide law enforcement associations, including the California Police Chiefs Association) from state to county jail facilities, including post-release probation and parole duties.

AB 111 allows local jail construction to proceed with fewer restrictions and award preferences on county agencies for contracting purposes. It also opens up uncommitted state funding provided through the AB 900 (Solario; 2007) reentry facility monies.

The intended funding source for these bills is the tax extension provided SCA1 x 1 that would have been placed before voters in a June special election. However, because negotiations between the Governor and Republicans have stalled, it is unclear what will happen with this legislation.

The Governor could proactively sign AB 109 and AB 111 or wait until April 4 (twelve days after receipt) and they will become law automatically. However, even if signed, these corrections realignment bills would still not go into effect because they include language that requires a dedicated funding source. It has been rumored that if he does sign these bills, the Governor's signing message will reiterate the importance of providing adequate funding and that the realignment program cannot go into effect until such a source is secured.

Alternatively, Gov. Brown could veto AB 109 and AB 111 to avoid them passing into law without a funding source. New trailer bill language could then be introduced that mirrors the realignment agreement but provides a funding source other than tax extensions and requires a simple majority vote. However, a more likely action would be that the legislative leadership pulls the bills off the Governor's desk and amendments are introduced to avoid a veto on public safety realignment, which could be interpreted as a strong symbolic message of the Governor's opposition to the plan.

SCA1 x 1 has been supported by several local government and law enforcement associations. The California State Association of Counties' board of directors formally adopted a support position on the legislation. The California Police Chiefs Association, California State Sheriffs'

Association, and regional law enforcement groups also issued letters of support namely to provide funding for COPS program and county law enforcement programs, which are set to expire on June 30.

The COPS funding component of the realignment package is of critical importance to local governments. Since the current funding source will expire June 30, and there will likely not be a June election to continue funding, cities and counties will have to wait for SCA1 x 1 or any of the other three legislative proposals to be approved. Like SCA1 x1, AB 66 (Chesbro), AB 168 (Gorell), and AB 192 (Logue), continue appropriating funds for COPS and county law enforcement programs and also face a two-thirds legislative approval challenge.

Fire Service Realignment Kept to Minimum, For Now

A whittled down shift for California Department of Fire and Forestry Protection services is authorized in SCA1 x 1, but is also destined for definition to be set forth by the "2011 Realignment Legislation" trailer bill. It is anticipated that the realignment will closely follow the Governor's revised fire service proposal from early March that changes appropriations for existing contracts from the state general fund dollars to realignment monies. Those contracts are with six local agencies or Joint Powers Authorities representing the counties of Kern, Los Angeles, Marin, Orange, Santa Barbara, and Ventura.

Details on Senate Republicans Budget Demands

On March 30, Senate Republicans released a seven-page list of policy changes they would like to see in before approving the Governor's budget.

The list of Republican demands includes:

- Pension reforms such as 401(k)-style plans, anti-spiking and cost control measures for current and future employees and other reforms as recommended in the Little Hoover Commission Report.
- A hard permanent spending cap to lock spending at a rate no greater than inflation and population growth and use any extra money for debt repayment and building a budget reserve was rejected by Gov. Brown. In response, Republicans have requested a temporary cap that would expire once the State pays various debts and builds a 10 percent reserve, with an exemption for K-12 and community college spending growth.
- Implementing CRA's alternative redevelopment proposal and maintaining enterprise zones.

Other requested reform issues include:

- Regulatory reform;
- CEQA reform;
- Education reform;
- Single Sales Factor;
- Realignment issues; and
- Taxes.

The budget demands and the Governor's responses have been published in the *Los Angeles Times* at <http://documents.latimes.com/calif-gop-budget-demands>.

Governor Releases His Pension Proposals

On Thursday afternoon, Gov. Brown released bill language for his Twelve-Point Pension Reform Plan.

http://dl5.activatdirect.com/fs/distribution:w/ze7pzanwmhlzgt/zlm41vxfe553hp/daid/zlm5zks23x4kfq?_c=d%7Cze7pzanwmhlzgt%7Czlm5zks23x4kfq&_ce=1301608582.b15295e81080818802f3

[1a0f0ffbd9b7](#)). It is unclear whether this proposal impacts the current budget negotiations. However, all 12 of the Governor's proposed reforms were part of the negotiations with Republicans. The Governor has indicated he plans to move forward with these reforms "with or without" Republicans.

Next Steps

The next steps are somewhat unclear. Negotiations with Republicans could resume in some form and result in a budget agreement covering any number of the items previously discussed. Absent a larger agreement, the next typical step in the annual budget process would be for the Governor to issue his May Revise which contains updates to state revenue and cost projections and often contains altered or new policy proposals from his initial budget. The Constitution requires the Legislature to send a budget to the Governor by June 15 and subsequently requires the Governor to sign the budget by July 1.

Following the May Revise but before the Legislature's June 15 deadline, the League will host its annual Legislative Action Days and Advanced Leadership Workshop on May 18 – 20. Attendees will be briefed on the most current budget information and have the opportunity to meet with Legislators. To register for the League's Legislative Actions Days and Advanced Leadership Workshop please go to www.cacities.org/events.

ATTACHMENT B

2011 City Manager Pension Survey

The League of California Cities (League) City Managers Department in January 2011 sent a survey to the 481 cities in California and asked that they respond to questions that would help in determining the latest trends in pension changes across the state. This is the first in what will be an annual survey conducted by the League. For other pension resources and information please visit the League's Pension Information Center at www.cacities.org/pensions.

DEMOGRAPHIC INFORMATION

Survey Respondents: 296 out of 449 cities that contract with CalPERS

Regional Division Representation:

Every regional division in the League was represented

Divisions with more than 20 cities responding include:

Central Valley (23)
East Bay (26)
Los Angeles County (49)
North Bay (26)
Orange County (22)
Peninsula (23)
Sacramento Valley (33)

Divisions with fewer than 10 cities responding include:

Imperial County (1)
Redwood Empire (5)
Riverside County (9)

TIERING

Cities were asked to indicate whether they adopted a new tier of benefits and when the new tier was adopted. They were also asked to indicate both the previously offered benefit level as well as the new level of benefits.

- 22% of cities responding have adopted a new pension tier and it appears that most of the new tiers were adopted in the last two years.
- 73% of the new tiers adopted are for miscellaneous employees.

Trends in Fire Plans

Most cities that negotiated changes to their fire plans reduced benefit levels. Most cities that provided the 3% at 50 plan adopted a lower benefit of 3% at 55 plan. The 2% at 50 plan is the second most commonly adopted new formula.

Trends in Police Plans

Most cities that negotiated changes to their police plans reduced benefit levels. Most cities that provided the 3% at 50 plan adopted a lower benefit of 3% at 55 plan. The 2% at 50 plan is the second most commonly adopted new formula.

Trends in Miscellaneous Plans

The survey indicates that there is no commonly offered benefit level to miscellaneous employees. The 2% at 55, 2.5% at 55, and the 2.7% at 55 plans were equally provided by cities that responded. However, what is common among miscellaneous employees is that they are being offered a lower benefit level of 2% at 60.

COST SHARING

Cities were asked to provide information on whether they had negotiated an increase in employee cost sharing of pension costs.

- 38% of cities responding have adopted some form of cost sharing with many of those changes occurring over the last two years.

Trends in Fire Plans

57% of cities that said they negotiated an increase in employee cost sharing indicated that their fire units will be picking up more of the pension costs. Formerly the common trend among these employees was to contribute 0% toward pension costs and now they are contributing 9%.

It also appears that 10% of these agencies have asked their fire units to pick up a portion of the employer contribution rate. Agencies have negotiated a 2—4% pick up of the employer contribution.

Trends in Police Plans

73% of cities that said they negotiated an increase in employee cost sharing indicated that their police units will be picking up more of the pension costs. Formerly the common trend among these employees was to contribute 0% toward pension costs and now they are contributing 9%.

It also appears that less than one-percent of these agencies have asked their police units to pick up a portion of the employer contribution rate. Agencies have negotiated a 1—4% pick up of the employer contribution.

Trends in Miscellaneous Plans

89% of cities that said they negotiated an increase in employee cost sharing indicated that their miscellaneous employees will be picking up more of the pension costs. Formerly the common trend among these employees was to contribute 0% toward pension costs and now they are contributing 8%.

It also appears that just about one-percent of these agencies have asked their miscellaneous employees to pick up a portion of the employer contribution rate. Agencies have negotiated a 2—6% pick up of the employer contribution.

FINAL AVERAGE EARNINGS (FAE)

Cities were asked to provide information on changes they negotiated to the FAE formula (also referred to as the final compensation calculation).

- 12% of cities responding have negotiated changes to their final compensation calculations. It appears that an overwhelming majority of these cities negotiated a change in formula from the highest one-year to an average of the highest three years for future fire, police, and miscellaneous employees.

CONCLUSION

There is strong indication that we will continue to see changes adopted at the local collective bargaining table. The survey results show that 62% of responding cities are currently considering negotiating changes to their pension offerings.

CONTACT

For questions regarding this survey please contact Natasha Karl, legislative representative, at nkarl@cacities.org.

COMMITTEE ON REVENUE AND TAXATION
Legislative Agenda
April 2011
Combined Staff Report: Audit Bills

Staff: Lobbyist: Dan Carrigg (916) 658-8222

Background: State's existing audit authority

Two State entities have the authority to audit State and local governments—the State Controller and the State Auditor.

The **State Controller** oversees the fiscal concerns of the State and may audit:

- the disbursement of any State money for correctness, legality, and for sufficient provisions of law for payment;
- State expenditures made to local governments; and
- federal funds allocated to local governments by the State.

The State Controller must compile and publish reports of the financial transactions of local governments. If the reports are not made in the time, form, and manner required, or if there is reason to believe that a report is false, incomplete, or incorrect, the Controller must appoint a qualified accountant to obtain the information. The accountant must report his/her findings to the Controller and the local government, which must pay for the Controller's costs.

State law empowers the Bureau of State Audits (BSA), under the direction of the **State Auditor**, to perform financial, compliance, performance and contract audits of State and local entities. The Joint Legislative Audit Committee (JLAC), composed of seven Assembly Members and seven Senators, discuss and vote on proposed audit requests in public hearings and approve them with the votes of four members from each house.

At JLACs' request, BSA has conducted a number of local government audits in recent years, including audits of:

- Local government grants from the Indian Gaming Special Distribution Fund.
- A community facilities district created by the San Dieguito Union High School District.
- Local governments' use of temporary workers.
- The Santa Clara Valley Transportation Authority.

The State Auditor's high risk government agency audit program was created to identify, audit and issue reports on any agency of the State that s/he identifies as being at high risk for the potential of waste, fraud, abuse and mismanagement or that has major challenges associated with its economy, efficiency, or effectiveness. Agencies may be identified as being at high risk based on weaknesses identified in BSA audits or investigations, or by consulting with the Legislative Analyst, Little Hoover Commission,

Department of Finance or other state oversight agencies. The State Auditor is required to notify the JLAC when it identifies a state agency as at high risk.

Issues identified as “high risk” in 2009 include the State’s ongoing deficits, administration of ARRA funds; and production and delivery of electricity. Previous issues remaining on 2009 list from prior years include: infrastructure, succession planning, postemployment State health and dental benefits, emergency preparedness and information technology governance. (For a summary of the 2009 high risk report, see <http://www.bsa.ca.gov/pdfs/factsheets/2008-601.pdf>)

Context: The Legislature reacts to misconduct in the City of Bell

In the wake of last year's news about misconduct by public officials in the City of Bell, the State Controller's Office reports that it received numerous complaints of fiscal mismanagement and financial distress in other local governments. However, the Controller's statutory authority to audit local governments extends only to State expenditures or to information from local governments' financial transactions reports. In conducting audits that identified millions of dollars in abusive expenditures of taxpayer dollars in the City of Bell, the Controller relied on the cooperation of city officials and staff. Without that cooperation, current law would have limited the Controller's ability to produce comprehensive and detailed audit findings.

The Controller's office is sponsoring 5 bills designed to expand its authority to audit local agencies: Senate Bills 186 and 449, and Assembly Bills 229, 253 and 276. In addition, Assembly Members have introduced two additional audit-related bills—AB 162 and 187. These bills are described at the end of this report.

Background: The League creates a Technical Review process

In order to quickly evaluate the 30+ bills introduced in response to the City of Bell situation, the League convened several technical review groups to screen the Bell bills: Audits, Compensation/Retirement and Governance/Transparency. Members reviewed bills in their areas and met by conference call 2-3 times in March to provide initial feedback. This input was designed to help staff set priorities for, and intervene early in, bills that could have a significant impact on cities.

Audit Task Force Members include:

- Michael Coleman, League Fiscal Advisor
- Robert Clark Leland, Director of Finance (Retired), City of Fairfield
- Leyne Milstein, Director of Finance, City of Sacramento
- Steve Strong, Director of Finance, City of Redding

During these discussions, feedback was consistent around several concerns. These have been developed into a proposed statement of League Audit Principles; adoption of these principles will guide future League policy on audit-related legislation.

Proposed League Audit Principles

Overarching Principles:

- Governmental financial audits and performance audits ensure financial integrity and promote efficient, effective and accountable local government.
- Transparent, accurate financial and performance information is necessary for citizens to have confidence that their interests are being served, and for decision makers to be accountable for ensuring that public funds are spent appropriately and effectively.
- Public trust is inspired when auditors perform their work with independence, objectivity and integrity, remaining free from personal, external and organizational impairments to that independence, both in fact and in appearance.
- Public confidence in government is maintained and strengthened when financial and performance information is collected, managed and reported in accordance with nationally recognized professional accounting and auditing standards.

Specific Criteria:

- Local governments should follow Generally Accepted Accounting Principles (GAAP) for state and local governments established by the Governmental Accounting Standards Board (GASB). Financial audits should be conducted in accordance with Generally Accepted Auditing Standards (GAAS), issued by the American Institute of CPAs (AICPA); financial and performance audits should be conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS) (“the Yellow Book”), issued by the Comptroller General of the United States.
- The need for additional State oversight is minimized when local government financial accounting and auditing are consistent with these standards. Within these standards, local governments may design financial management and reporting systems that are flexible enough to meet unique local needs and requirements.
- State investigation, review, or audit of local agencies should be undertaken only after the State meets clear and convincing criteria, such as documented evidence of material weaknesses in financial controls. Any oversight conducted should not duplicate reviews already required or completed, such as the federal Single Audit, which was instituted to avoid duplicative audit work by federal and State agencies.
- When State oversight is warranted, it should be coordinated by one State agency to be efficient and minimize disruption. That agency should conduct all audits in full compliance with Government Audit Standards and should consult with appropriate stakeholders and local government audit organizations.

Staff Recommendation: Adopt Audit Principles to guide policy decisions

Staff recommends that the Policy Committee discuss, revise if necessary, and adopt the Proposed Audit Principles to determine positions on all audit-related bills. By focusing on

high level policy rather than ever-changing details of individual bills, Policy Committee Members make efficient use of their time and ensure that staff has a guide for the many negotiations inherent in the legislative process.

Should significant policy issues emerge which are not covered by these Principles, staff will bring them to the Policy Committee for discussion. As technical issues arise, staff will work with technical staff to resolve them; Committee members who would like to participate in these technical discussions are welcome. Staff will provide a status report on all pending audit legislation at the June meeting.

Summary of audit-related legislation

SB 186 (Kehoe) (version: as amended March 22)

Expands the State Controller's authority to perform audits or investigations of counties, cities, special districts, joint powers agencies, and redevelopment agencies.

Consistent with the proposed Principles, staff is working with author to address these policy concerns and some technical issues:

- Add criteria to clearly state under what circumstances State Controller can audit local agencies.
- Resolve duplication with State Controller and State Auditor.

SB 449 (Pavley) (Version: As amended March 30)

Authorizes the State Controller to conduct preliminary financial reviews and audits of local governments that may have serious financial problems under specified criteria.

Consistent with the proposed Principles, staff is working with author to address these policy concerns:

- Ensure there are clear, objective criteria for auditing a local agency
- Ensure city participation in local agency financial review committee

Staff is also working to resolve technical issues.

AB 162 (Smyth) (Version: As Introduced)

Would require that if a local agency audit reveals financial irregularities, the finding be sent to the Controller immediately after the audit is completed.

Staff is working with the author to address technical concerns. No policy issues identified.

AB 187 (Lara) (Version: As Introduced)

Would authorize the State Auditor to establish a high-risk local government agency audit program to identify, audit and issue reports on any local agency that s/he identifies as being at high risk for the potential of waste, fraud, abuse or mismanagement or that has major challenges associated with its economy, efficiency or effectiveness.

Policy issues to resolve to be consistent with Principles include:

- Develop clear and consistent objective criteria governing when the State may audit a local agency.
- Address cost issues
- Resolve conflict between authority of Auditor and Controller

AB 229 (Lara) (Version: As amended March 30)

Would require federal Single Audits to be submitted to the Controller within 9 months of the audited period. If not submitted timely, Controller may appoint a CPA to complete it, with costs borne by the local agency. Would require local agencies to select a CPA from a Controller-approved directory and for audit to comply with Government Auditing Standards. Would require the Controller to propose and adopt an audit guide and to monitor the audit reports performed by independent auditors.

In addition to technical issues, policy issues to resolve to be consistent with Principles include:

- Within the context of national standards, local government financial management must reflect local needs.
- To what extent is additional State oversight and proscription of details necessary to ensure a State interest?.

Staff will be meeting with Controller's Office staff to discuss policy and technical issues next week.

AB 253 (Smyth) (Version: As amended March 15)

Would require Controller, in collaboration with a new Committee on City Accounting Procedures (with city representatives) to create and prescribe uniform accounting and reporting procedures applicable to all local agencies.

Policy issues to resolve to be consistent with Principles include:

- Unclear what is expected after State "prescribes" procedures? Local government financial accounting systems are already consistent with recognized standards; local governments need the flexibility to design financial management and reporting systems that can meet unique local needs.

AB 276 (Alejo) (Version: As introduced)

Would increase fines for local agencies who fail to submit a financial transaction report to the State Controller within the required time period. (For cities with revenues less than \$100,000, fines increase from \$1,000 to \$2,500; revenues of \$100,000 to \$250,000 from \$2,500 to \$5,000; and revenues of at least \$250,000 from \$5,000 to \$10,000.)

At this time staff does not see any policy issues. Staff will continue to monitor the bill.

AB 1350 (Lara) (Version: As introduced)

Requires that if a local jurisdiction imposes, increases, or extends a property tax rate above the 1-percent limit, prior to collection of the ad valorem property tax, the county auditor must verify that the rate imposed by the jurisdiction does not exceed the maximum rate allowable by law. The local jurisdiction is required to provide the county auditor with any documentation necessary to assist in making the verification and reimburse the county auditor for costs incurred.

Consistent with proposed principles. At this time staff will continue to work with the author's staff and address questions raised including whether it's necessary for the local jurisdiction to reimburse the county for work that may already be under its purview when collecting taxes.



1400 K Street, Suite 400 • Sacramento, California 95814
Phone: 916.658.8200 Fax: 916.658.8240
www.cacities.org

MEMORANDUM

To: Policy Committees
From: Patrick Whitnell, General Counsel
Date: April 1, 2011
Re: Update on Proposition 26

On Wednesday, April 6th, the League's City Attorney's Department will be sponsoring a webinar discussion of Proposition 26. The speakers will be Betsy Strauss, special counsel to the League, and Mark Mandell, Esq., with Mandell Municipal Consulting. The webinar will last 1 ½ hours, and both speakers will be able to take questions. We will also be recording the webinar for those who could not attend.

The City Attorneys' Ad Hoc Proposition 26 committee is still in the process of drafting the Proposition 26 Implementation Guide, and we hope to have it available in final form by the end of April.

The first Proposition 26 lawsuit has been filed. The lawsuit challenges the city of Redding's payment-in-lieu-of-taxes (PILOT). This is a payment that is made from the city's electric utility enterprise fund to the city's general fund. The PILOT has been in place for many years, and is a substantial portion of the city's general fund. The litigation is at an early stage in the Superior Court. The city is being represented by the Michael Colantuono of Colantuono and Levin. If you are interested in more details on this case, I suggest you have your city attorney contact Michael directly.



April 2011 Policy Committees Federal Update

I. League Officers Advocate for California City Priorities in Washington, D.C.

The League's officers and over a hundred other California city officials traveled to Washington, D.C. March 12-16 for the National League of Cities (NLC) Congressional City Conference. Focusing on NLC's priorities, California city officials advocated for the passage of a comprehensive transportation reauthorization, sustained funding for critical grant programs, and protection of existing local revenues.

The conference, held March 12-16, covered a range of topics including lobbying strategies, public safety, transportation reauthorization, and disaster response. On Thursday, March 17, attendees heard from First Lady Michelle Obama on her *Let's Move!* nationwide initiative and the link between obesity issues and economic issues.

The League's officers, President Jim Ridenour, First Vice President Mike Kasperzak, Second Vice President Bill Bogaard and Immediate Past President Judy Mitchell, lobbied heavily for California's cities' federal priorities. Meetings included:

- Sen. Barbara Boxer (D-Calif.) chair, Senate Environment and Public Works Committee;
- Congressman David Dreier (R-Calif.) ranking member, House Rules Committee;
- Chris Thompson, chief of staff to Sen. Dianne Feinstein (D-Calif.);
- Katie Wheeler Mathews and Brian Turner, deputy directors, Gov. Jerry Brown's Washington office; and
- Meetings with the U.S. Department of Housing and Urban Development, U.S. Department of Transportation officials and others.

In preparation for the NLC Conference, League staff prepared the following issue papers:

1. Protect Local Revenues
2. Priorities for Transportation Reauthorization (SAFETEA-LU)
3. Full Funding for Critical Federal Programs
4. Creating Sustainable Communities

These issue papers, along with the League's federal priorities are posted on the website at www.cacities.org/federalpriorities.

II. California Cities Encouraged to Lobby in Support of Community Development Block Grants

Congress is currently considering proposed funding cuts for FY 2011 and the President's FY 2012 Budget proposal, including cuts to the Community Development Block Grants (CDBG) program. The League sent a letter to the California Delegation stressing the importance of this program to California cities. The League encourages cities to contact their federal

representative directly via phone call and letter to ask that the program be fully funded. A sample letter can be found on the League's website at www.cacities.org/federal.

Established in 1974, CDBG is one of the longest continuously run programs offered by the Department of Housing and Urban Development. These flexible annual grants provide communities needed funding to develop and fund priorities that provide housing, better communities, and economic growth opportunities for low- and moderate- income residents. With the state considering a proposal that would eliminate redevelopment, these federal funds are more important than ever to California cities.

III. California Cities Encouraged to Lobby in Opposition to the Wireless Tax Fairness Act of 2011

The U.S. House of Representatives is moving HR 1002, a reintroduction of last year's HR 1521. The legislation imposes a five-year moratorium on state and local taxes on mobile services providers and thus limits local government taxing authority over mobile phones. The same bill has been introduced in the Senate (S. 543), but has yet to gain any momentum.

HR 1002 removes a much needed local government revenue source solely to benefit an industry whose subscribership has grown by 158 percent and whose revenues have increased by 124 percent since 2000. In addition to imposing a financial burden on local governments, HR 1002 undermines the efforts of a number of cities in California that are working directly with voters to update and simplify their tax ordinances to assure technology-neutrality.

It is important for all cities who have a utility users tax (or may want one in the future) to send their letters of opposition, especially if they have a representative on the House Judiciary Committee. The Committee membership includes: Rep. Darrell Issa (CA-49), Rep. Elton Gallegly (CA-24), Rep. Dan Lungren (CA-3), Rep. Howard Berman (CA-28), Rep. Zoe Lofgren (CA-16), Rep. Maxine Waters (CA-35), Rep. Judy Chu (CA-32) and Rep. Linda Sanchez (CA-39).

The League's opposition letter and sample opposition letter have been posted on the League's website (www.cacities.org/federal).



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February 9, 2011

The Honorable Kevin McCarthy
Majority Whip
U.S. House of Representatives
326 Cannon House Office Building
Washington, DC 20515

Dear Representative McCarthy:

As Congress works to finalize legislation extending funding for programs under the Transportation-Housing and Urban Development Appropriations bill for the remainder of FY 2011, I am writing on behalf of the League of California Cities to urge you to support the full funding at \$3.99 billion for the Community Development Block Grant, and oppose efforts to reduce funding for the program to FY 2008 levels.

The need for CDBG funding in the state has never been greater. CDBG grants provide critical funding for community development projects in California cities, which have been severely impacted by the national economic downturn and state budget raids of California city redevelopment agencies. As a result many California cities do not have the resources necessary to advance important community improvement projects which CDBG funding supports.

Over the past 30 years, cities throughout California—both urban and rural—have relied upon CDBG funding to support affordable housing and economic revitalization activities to improve neighborhoods. These funds allow cities to undertake innovative approaches to community development that include job creation, homeownership promotion, youth employment opportunities, after-school programs and gang intervention activities. These vital services ensure that our cities and communities are safe, active and healthy.

Thank you for your consideration of this urgent matter to California's cities. We look forward to working closely with you to achieve the maximum level of funding possible for this vital program for the remainder of FY 2011.

Sincerely,

A handwritten signature in black ink that reads "Chris McKenzie". The signature is written in a cursive, flowing style.

Christopher McKenzie
Executive Director



1400 K Street, Suite 400 • Sacramento, California 95814
Phone: 916.658.8200 Fax: 916.658.8240
www.cacities.org

March 23, 2011

The Honorable Kevin McCarthy
U.S. House of Representatives
326 Cannon House Office Building
Washington, DC 20515

RE: Oppose Legislation That Would Reduce Critical Local Government Revenue

Dear Congressman McCarthy:

On behalf of the League of California Cities (League), which represents California's 481 cities, I am writing to urge you to oppose recently introduced HR 1002 – the Wireless Tax Fairness Act of 2011 – which would impose a five-year moratorium on “new” state and local taxes on mobile services and the providers of mobile services.

Prior to the economic downturn California cities already faced limited options to generate revenue to provide city services. An increasing portion of the property taxes collected at the local level have been transferred to balance the state's budget in recent years, despite the fact that California cities are experiencing the same recessionary effects as the state. As the current national economic crisis expands a number of local governments are being forced to impose severe cuts on critical services, such as police, fire, parks and libraries as well as defer important local public infrastructure maintenance and upgrade projects. This situation is being exacerbated by the turmoil in the national financial markets, which has constrained debt financing as an alternative mechanism for local governments to utilize to maintain these important services, further limiting resources available to local governments.

In response to threats to their existing tax revenues, over one-half of the one hundred-fifty (150) California cities with local taxes on all telecommunications have successfully obtained voter approval, during the past five years, of the level and scope of their local telecommunication taxes. The local voters in California overwhelmingly voted to preserve their existing tax revenues for vital government services, and impose their local tax in a non-discriminatory, technology-neutral manner. Unless this bill is amended to specifically exclude “voter approved local taxes pursuant to state law”, this federal bill could deprive local voters of self-determining their local taxes to provide local services (especially public safety), and possibly jeopardize the existing

tax revenues of many California cities that may need to seek voter approval to protect their existing local tax revenues from the effect of adverse court rulings.

For these reasons we urge you to oppose this legislation. Please let me know if you have any questions or need any additional information, or contact the League's Washington advocates, Eve O'Toole and Dustin McDonald, at (202) 419-2505 and (202) 419-2511 respectively. We look forward to continuing to work with you on California's important local priority issues.

Sincerely,

A handwritten signature in cursive script that reads "Chris McKenzie".

Christopher McKenzie
Executive Director



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COMMITTEE ON REVENUE AND TAXATION
2011 Work Program – DRAFT PROPOSAL

1. LEAGUE 2011 STRATEGIC GOALS

The committee will focus on supporting the 2011 goals adopted by the League Board of Directors. The 2011 strategic goals include:

- **Strong Partnerships for a Stronger Golden State.** Collaborate and partner with other public and private groups and leaders to reform and revitalize the structure, governance, fiscal integrity and responsiveness of our state government and intergovernmental system.
- **Sustainable and Secure Public Pension Systems.** Work in partnership with other groups and stakeholders to promote sustainable and secure public pension systems to help ensure responsive and affordable public services for the people of our state and cities.
- **Responsive and Accessible League Services.** Implement distance learning, meeting and other cost-effective strategies to deliver even more responsive and accessible League educational, information and advocacy services to the city officials of California.

While being guided by the strategic goals above, the Revenue and Taxation Policy Committee will focus on and monitor the issues below, which may or may not directly relate to the 2011 Goals:

- The 2011 Session will be a pivotal year for both the state budget and efforts to redefine the state-local relationship. Thus, the Committee will likely devote the majority of its time to state budgetary and the state-local reform issues. The committee agreed to form a subcommittee with Rev and Tax Committee members and Fiscal Officers Department members to present recommendations to the committee and League Board. It was agreed that there were two different timelines: immediate budget solution and overall fiscal reform and that both discussions need to move forward in some manner
- Actively engage in the effort to protect vital local revenues including the transient occupancy tax, and utility user's tax.
- Monitor developments on pension reform and retiree health benefit discussions.
- Monitor the implementation and effects of Proposition 26.
- Remain informed and take action, where necessary, to prohibit additional state mandates funded or unfunded.
- Monitor the progress of pending redevelopment litigation related to state diversions.
- Review, when necessary, proposed changes in Board of Equalization regulations that may affect local revenues.

** Due to heavy workload surrounding budget proposals at its January meeting, the committee did not have an opportunity to fully discuss this draft committee work plan.*