



Transmitted via e-mail

November 22, 2010

Ms. Kris Perry, Executive Director
First 5 California
2389 Gateway Oaks Drive, Room 260
Sacramento, CA 95833

Dear Ms. Perry:

Final Report—First 5 California, 2010 Financial Statement Audit of the Children and Families Trust Fund and Related Accounts

The Department of Finance, Office of State Audits and Evaluations (Finance), has completed its audit of the First 5 California's Children and Families Trust Fund and related accounts for the fiscal year ended June 30, 2010.

The enclosed report is for your information and use. The financial statements were fairly presented in accordance with generally accepted accounting principles. Because there were no audit findings or issues requiring a response, we are issuing the report as final.

In accordance with Finance's policy of increased transparency, this report will be placed on our website. Additionally, pursuant to Executive Order S-20-09, please post this report in its entirety to the Reporting Government Transparency website at <http://www.reportingtransparency.ca.gov/> within five working days of this transmittal.

We appreciate the assistance and cooperation of First 5 California, Department of General Services, and the California State Board of Equalization. If you have any questions regarding this report, please contact Kimberly Tarvin, Manager, or Alma Ramirez, Supervisor, at (916) 322-2985.

Sincerely,

David Botelho, CPA
Chief, Office of State Audits and Evaluations

Enclosure

cc: Ms. Diane Levin, Chief Deputy Director, First 5 California
Ms. Kim Gauthier, Chief Counsel, First 5 California
Ms. Terry L. Miller, Chief, Administrative Services Division, First 5 California
Ms. Sandra Beck, Fiscal Operations Manager, First 5 California
State Controller's Office, Division of Audits, First 5 Oversight Unit

A F INANCIAL S TATEMENT A UDIT

First 5 California
Children and Families Trust Fund
and Related Accounts
For the Fiscal Year Ended
June 30, 2010

Prepared By:
Office of State Audits and Evaluations
Department of Finance

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This report is also available on our website at <http://www.dof.ca.gov>

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EXECUTIVE SUMMARY

The Department of Finance, Office of State Audits and Evaluations (Finance), performed this audit in accordance with an interagency agreement with First 5 California. The objectives of our audit were to:

- Express an opinion on the *Balance Sheet and Statement of Revenue, Expenditures, and Changes in Fund Balance* of the Children and Families Trust Fund (Fund) and related accounts for the fiscal year ended June 30, 2010.
- Verify that the financial statements were prepared in conformity with generally accepted accounting principles for governmental funds.
- Report on internal control and compliance weaknesses, and provide recommendations for improving controls over operations of the Fund and related accounts.

Audit Results

- The aforementioned financial statements are fairly presented for the fiscal year ended June 30, 2010.
- The audit did not identify any reportable internal control or compliance weaknesses.

This report is intended solely for the information and use of First 5 California, those charged with governance, and the Legislature, and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.



INDEPENDENT AUDITOR'S REPORT

Ms. Kris Perry, Executive Director
First 5 California
2389 Gateway Oaks Drive, Room 260
Sacramento, CA 95833

We have audited the accompanying *Balance Sheet* as of June 30, 2010, and the related *Statement of Revenue, Expenditures, and Changes in Fund Balance* of the Children and Families Trust Fund (Fund) and related accounts, for the fiscal year then ended. These financial statements are the responsibility of First 5 California's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In connection with our audit, there are certain disclosures required by *Government Auditing Standards*. The Department of Finance (Finance) is not independent of the audited entity, as both are part of the State of California's Executive Branch. As required by various statutes within the California Government Code, Finance performs certain management and accounting functions. These activities impair independence. However, sufficient safeguards exist for readers of this report to rely on the information contained herein.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund and related accounts as of June 30, 2010, and the results of operations and changes in fund balance thereof for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States of America.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements of the Children and Families Trust Fund (Fund) and related accounts as of and for the year ended June 30, 2010, in accordance with auditing standards generally accepted in the United States of America, we considered the internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements,

but not for the purpose of expressing an opinion on the effectiveness of the internal control. Accordingly, we do not express an opinion on the effectiveness of the internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Children and Families Trust Fund (Fund) and related accounts' financial statements as of and for the year ended June 30, 2010, are free of material misstatement, we performed tests of compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of First 5 California management, those charged with governance, and the Legislature, others within the organization, and is not intended to be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.



David Botelho, CPA
Chief, Office of State Audits and Evaluations
(916) 322-2985

November 15, 2010

BALANCE SHEET

First 5 California Children and Families Trust Fund and Related Accounts For the Fiscal Year Ended June 30, 2010

	Children and Families Trust Fund (0623)	Counties Account (0585)	Mass Media Communications Account (0631)	Education Account (0634)	Child Care Account (0636)	Research and Development Account (0637)	Administration Account (0638)	Unallocated Account (0639)
Assets								
Cash	\$37,350,908	\$ 435	\$ 470	\$ 592	\$ 775	\$ 57,979	\$ 47,491	\$ 884
Deposits in SMIF	5,335,000	213,000	74,317,000	94,781,000	37,678,000	54,607,000	23,770,000	26,261,000
Receivables	40,300,387						3,467	
Due from Other Funds ¹	2,270,459	68,221,311	5,223,579	4,856,595	2,614,554	2,639,753	885,858	13,218,159
Due from Other Governments								2,428,345
Prepaid Expenses							96,663	
Total Assets	\$85,256,754	\$68,434,746	\$79,541,049	\$99,638,187	\$40,293,329	\$57,304,732	\$24,803,479	\$41,908,388
Liabilities								
Accounts Payable			\$ 1,112,120	\$ 126,853	\$ 291,350	\$ 622,274	\$ 112,863	
Due to Other Funds ¹	\$85,252,482		42,070,819	14,967,159	2,054,641	2,975,030	153,168	
Due to Other Governments		\$68,434,746		13,822,829	311,648	49,282	1,230	\$12,692,127
Total Liabilities	85,252,482	68,434,746	43,182,939	28,916,841	2,657,639	3,646,586	267,261	12,692,127
Fund Balance								
Reserved for Encumbrances								
Reserved for Unencumbered Balances of Continuing Appropriations	4,272		36,358,110	70,721,346	37,635,690	53,658,146	24,536,218	29,216,261
Total Fund Balance	4,272	0	36,358,110	70,721,346	37,635,690	53,658,146	24,536,218	29,216,261
Total Liabilities and Fund Balance	\$85,256,754	\$68,434,746	\$79,541,049	\$99,638,187	\$40,293,329	\$57,304,732	\$24,803,479	\$41,908,388

¹ - See Note 2

The accompanying notes are an integral part of the financial statements.

STATEMENT OF REVENUE, EXPENDITURES AND CHANGES IN FUND BALANCE

First 5 California Children and Families Trust Fund and Related Accounts For the Fiscal Year Ended June 30, 2010

	Children and Families Trust Fund (0623)	Counties Account (0585)	Mass Media Communications Account (0631)	Education Account (0634)	Child Care Account (0636)	Research and Development Account (0637)	Administration Account (0638)	Unallocated Account (0639)
Revenue								
Cigarette Tax Revenue	\$512,492,223							
SMIF Interest Revenue	200,435	\$ 102,809	\$ 592,458	\$ 653,916	\$ 343,215	\$ 455,932	\$ 157,822	\$ 176,966
Other Revenue			5,598	4,511,072			(1,004)	
Total Revenue	512,692,658	102,809	598,056	5,164,988	343,215	455,932	156,818	176,966
Expenditures								
Appropriation Expenditures	11,739,040	383,426,390	89,811,530	64,254,767	33,234,367	36,790,958	5,477,022	3,520,960
Excess (Deficiency) of Revenues Over(Under) Expenditures	500,953,618	(383,323,581)	(89,213,474)	(59,089,779)	(32,891,152)	(36,335,026)	(5,320,204)	(3,343,994) ²
Other Financing Sources & Uses								
Operating Transfers In ³		383,323,581	28,749,269	23,957,724	14,374,634	14,374,634	4,791,545	9,583,090
Operating Transfers Out ³	500,954,477							
Net Change in Fund Balance	(859)		(60,464,205)	(35,132,055)	(18,516,518)	(21,960,392)	(528,659)	6,239,096
Fund Balance July 1, 2009	5,131		96,822,315	105,853,401	56,152,208	75,618,538	25,064,877	22,977,165
Fund Balance June 30, 2010	\$ 4,272	\$ 0	\$ 36,358,110	\$70,721,346	\$37,635,690	\$53,658,146	\$24,536,218	\$29,216,261

²- See Note 4

³- See Note 5

The accompanying notes are an integral part of the financial statements.

NOTES TO FINANCIAL STATEMENTS

First 5 California Children and Families Trust Fund and Related Accounts For the Fiscal Year Ended June 30, 2010

NOTE 1 Summary of Significant Accounting Policies

A. Definition of Reporting Entity

The Children and Families Trust Fund (Fund) and its related accounts were created by the California Children and Families Act of 1998 (Act). Programmatic and fiscal oversight for the Act was placed with the California Children and Families Commission (State Commission). Subsequent to the Act, legislation was passed that provided for the State Commission to also be known as First 5 California. The Act is intended to promote, support, and improve the early development of children from the prenatal stage to five years of age. The programs authorized by this Act are administered by First 5 California and by county children and families commissions.

The First 5 California Commission is made up of seven members. During fiscal year 2009-10 six Commissioners' seats were vacated and filled by new commissioners.

Prior to January 1, 1999, the California State Board of Equalization (BOE) was authorized to collect 37 cents for each cigarette pack distributed. On January 1, 1999, section 30131.2 of the Revenue and Taxation Code authorized the BOE to collect an additional 50 cents for each cigarette pack distributed and a surtax on other tobacco products for a total of 87 cents for each cigarette pack. Of the 87 cents collected, 50 cents is allocated and deposited into the Fund. The remainder funds the Proposition 99 and Breast Cancer programs.

While First 5 California has the full responsibility for the program and financial statements, the BOE receives, accounts for, and deposits the Cigarette Tax revenue into the Fund. Furthermore, the Department of General Services performs accounting services for First 5 California.

The Fund was established to provide funding for promoting, supporting, and improving the early development of children from the prenatal stage to five years of age with emphasis on community awareness, education, nurturing, child care, social services, health care, and research. It primarily functions as a pass-through account which transfers funds to the seven related accounts according to allocation percentages established by the Act. The county commissions receive 80 percent of the funding and First 5 California receives 20 percent, which is allocated to six separate accounts that implement specific functions of the Act, as illustrated in Table 1.

**Table 1. California Children and Families Trust Fund (0623)
Cigarette Tax Revenue Allocation**

Account	Account Title	Percent Allocation	Account Purpose
0585	Counties Children and Families Account	80%	For allocation to county commissions ¹ for the purposes authorized in the <i>California Children and Families Act of 1998 (Act)</i> and in accordance with each county's strategic plan. All county commission expenditures must be incurred in accordance with the provisions of the Health and Safety Code section 130105 (d)(2).
0631	Mass Media Communications Account	6%	For funding of communications to the general public utilizing television, radio, newspapers, and other mass media furthering the goals and purposes specified in the Act ² .
0634	Education Account	5%	For funding of education goals and purposes as specified in the Act ² .
0636	Child Care Account	3%	For funding for child care goals and purposes as specified in the Act ² .
0637	Research and Development Account	3%	For funding research and development goals and purposes as specified in the Act ² .
0638	Administration Account	1%	For funding of administrative costs and other purposes as specified in the Act ² .
0639	Unallocated Account	2%	For funding any other purposes of the Act except for administrative costs.

B. Basis of Presentation—Fund Accounting

The Fund and related accounts are classified as *Other Governmental Cost Funds* for State of California financial reporting purposes. *Other Governmental Cost Funds* are special revenue funds used to account for revenues restricted by law for specified purposes. The financial statements are presented in accordance with generally accepted accounting principles.

C. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared using a current financial resources measurement focus and the modified accrual basis of accounting. This measurement focus concentrates on transactions that increase or decrease resources available for spending in the near future. Under the modified accrual basis of accounting, revenues are recorded when they become measurable and available to finance expenditures of the current period. Expenditures are recorded when the related liability is incurred.

¹ Each First 5 county commission is allocated funds from Account 0585 based on the number of live births recorded in each county in proportion to the entire number of live births recorded statewide. For the fiscal year 2009-10 allocations the 2007 birth vital statistics compiled by the California Department of Public Health were used as this was the most recent reporting period available.

² Effective September 22, 2009, AB1422 amends the Act to allow any funds not needed in these five accounts to be transferred to the *Unallocated Account (0639)* upon approval by First 5 California.

D. Budget and Budgetary Control

The accounting policies of First 5 California conform to the State Administrative Manual (SAM) based on the state's budgetary provisions. Program funds are continuously appropriated without regard to fiscal year. First 5 California management is responsible for exercising budgetary control to ensure appropriations are not overspent at the Fund and related accounts level. The State Controller's Office is responsible for statewide appropriation control and does not allow expenditures in excess of authorized appropriations.

E. Deposits in Surplus Money Investment Fund

Investments consist of cash in excess of current needs on deposit in the Surplus Money Investment Fund (SMIF). The Fund and related accounts participate in the State of California's Pooled Money Investment Program, whereby cash on deposit in the State Treasury determined to be in excess of immediate needs are transferred to the SMIF for investment purposes. All earnings derived from investments of the SMIF are apportioned to the contributing fund as provided in the Government Code.

F. Revenue

Revenue consists of the cigarette taxes collected on sales of cigarette packs and other tobacco products, interest income earned on funds deposited in the SMIF, refunds from reverted appropriations, and unclaimed checks escheated to the issuing fund.

G. Compensated Absences

Liability for vested and unpaid vacation and annual leave is reported as a long-term liability on the government-wide financial statements. It is anticipated that compensated absences will generally not be used in excess of a normal year's accumulation. Unused sick leave balances are not included in compensated absences because they do not vest to employees. For further information, refer to the *State of California Comprehensive Annual Financial Report*.

H. Retirement Plan

Employees of First 5 California are members of the California Public Employees' Retirement System (CalPERS), which is a defined benefit contributory retirement plan. Retirement contributions by employees are set by statute as a percentage of payroll (Tier I employees), or are zero (Tier II employees). Retirement contributions are actuarially determined under a program where total contributions plus CalPERS' investment earnings will provide the necessary funds to pay retirement benefits when incurred. The employer contributions are included in the cost of personal services. For further information, refer to the *State of California Comprehensive Annual Financial Report*, and to the *CalPERS Comprehensive Annual Financial Report*.

NOTE 2 Due From Other Funds and Due To Other Funds

The Due From Other Funds includes cigarette tax and SMIF interest revenue accruals, and an abatement from the BOE General Fund for unused administration funds. Additionally, the Unallocated Account (0639) includes reimbursement accruals for School Readiness Program expenditures incurred on behalf of the other accounts.

Table 2: Due From Other Funds

Fund/Account	Fund/Account Due From	Amount
Fund 0623:	BOE General Fund (0001)	\$2,232,519
	Surplus Money Investment Fund (0681)	<u>37,940</u>
	Total Due From Other Funds	\$ 2,270,459
Account 0585: Counties		
	Children and Families Trust Fund (0623)	\$68,201,986
	Surplus Money Investment Fund (0681)	<u>19,325</u>
	Total Due From Other Funds	\$68,221,311
Account 0631: Mass Media		
	Children and Families Trust Fund (0623)	\$5,115,149
	Surplus Money Investment Fund (0681)	<u>108,430</u>
	Total Due From Other Funds	\$5,223,579
Account 0634: Education		
	Children and Families Trust Fund (0623)	\$4,262,624
	Health Care Deposit Fund (0912)	459,369
	Surplus Money Investment Fund (0681)	<u>134,602</u>
	Total Due From Other Funds	\$4,856,595
Account 0636: Child Care		
	Children and Families Trust Fund (0623)	\$2,557,575
	Surplus Money Investment Fund (0681)	<u>56,979</u>
	Total Due From Other Funds	\$2,614,554
Account 0637: Research and Development		
	Children and Families Trust Fund (0623)	\$2,557,575
	Surplus Money Investment Fund (0681)	<u>82,178</u>
	Total Due From Other Funds	\$2,639,753
Account 0638: Administration		
	Children and Families Trust Fund (0623)	\$852,525
	Surplus Money Investment Fund (0681)	<u>33,333</u>
	Total Due From Other Funds	\$885,858
Account 0639: Unallocated		
	Children and Families Trust Fund (0623)	\$1,705,050
	Mass Media Communications Account (0631)	2,070,818
	Education Account (0634)	4,617,159
	Child Care Account (0636)	1,924,326
	Research and Development Account (0637)	2,870,768
	Surplus Money Investment Fund (0681)	<u>30,038</u>
	Total Due From Other Funds	\$13,218,159

The Due To Other Funds represents the cigarette tax revenue accrued for transfer to the related accounts as of year-end, and School Readiness Program reimbursements to the Unallocated Account (0639), as well as funds disbursed to the Department of Developmental Services (DDS) General Fund (0001) at year-end for the Early Start Program.

Table 3: Due To Other Funds

Fund/Account	Due From Fund/Account	Amount
Fund 0623: Trust Fund		
	Counties' Account (0585)	\$68,201,986
	Mass Media Communications Account (0631)	5,115,149
	Education Account (0634)	4,262,624
	Child Care Account (0636)	2,557,574
	Research and Development Account (0637)	2,557,574
	Administration Account (0638)	852,525
	Unallocated Account (0639)	<u>1,705,050</u>
	Total Due to Other Funds	\$85,252,482
Account 0631: Mass Media		
	General Fund (0001)	\$40,000,000
	Unallocated Account (0639)	<u>2,070,819</u>
	Total Due to Other Funds	\$42,070,819
Account 0634: Education		
	General Fund (0001)	\$10,350,000
	Unallocated Account (0639)	<u>4,617,159</u>
	Total Due to Other Funds	\$14,967,159
Account 0636: Child Care		
	General Fund (0001)	130,315
	Unallocated Account (0639)	<u>\$ 1,924,326</u>
	Total Due to Other Funds	\$ 2,054,641
Account 0637: Research and Development		
	General Fund (0001)	104,262
	Unallocated Account (0639)	<u>\$ 2,870,768</u>
	Total Due to Other Funds	\$ 2,975,030
Account 0638: Administration		
	General Fund (0001)	98,918
	Various other funds	<u>54,250</u>
	Total Due to Other Funds	\$ 153,168

NOTE 3 Fund Balance

The term *fund balance* is defined as the excess of the fund's assets over its liabilities. Part or all of the total fund balance may be reserved as a result of law or generally accepted accounting principles. Reserves represent those portions of the fund balance that are legally segregated for specific uses.

Reserved for Encumbrances

First 5 California utilizes encumbrance accounting to reserve funds for current year commitments. Although an expenditure or liability has not been incurred, the reservation recognizes that funds have been committed for a specified purpose that will be liquidated in the following fiscal year. Encumbrances include interagency agreements, program agreements, and other commitments. Encumbrances are reported as the *Reserved for Encumbrances* portion of the statutorily established accounts' fund balance.

First 5 California enters into multi-year agreements with vendors and county commissions, typically in periods of three-to-five years. However, encumbrances for agreements only include the unpaid and remaining commitment for the current fiscal year (not the entire agreement), based on available estimates of expenditures for goods and services provided.

Reserved for Unencumbered Balances of Continuing Appropriations

The reserve represents the unencumbered balances of all appropriations for which the period of availability extends beyond the period covered by this report. These appropriations are legally segregated for a specific future use, including state commission approved statewide programs and direct service initiatives such as School Readiness, Power of Preschool Bridge, Comprehensive Approaches to Raising Educational Standards (CARE) Plus, Kit for New Parents, smoking cessation, and research and evaluation efforts.

NOTE 4 Unallocated Account (0639) Expenditures

The reported expenditure amount for Account 0639 includes abatements from county commission contributions for the Healthy Families Program funds transferred to the Managed Risk Medical Insurance Board (MRMIB) in the prior year. The breakdown of this account balance for fiscal year 2009-10 is as follows:

Unallocated Account (0639) Expenditure Analysis	
Expenditures Balance Reported	\$ 3,520,960
Less: County Contributions	<u>(7,588,624)</u>
Total Expenditures	\$11,109,584

NOTE 5 Operating Transfers

Legally authorized transfers between state funds are reported on the *Statement of Revenue, Expenditures, and Changes in Fund Balance* as Operating Transfers In or Operating Transfers Out, and are accounted for as increases or decreases in residual equity.

The Fund's Operating Transfers Out represents the sum of the Operating Transfers In to the seven related accounts and the statutorily required backfill of \$21,800,000 for the Proposition 99 and Breast Cancer programs. The Transfers In for the seven related accounts are calculated based on the applicable allocation percentages specified in Note 1. Balances are derived as follows:

Operating Transfers	
Cigarette Tax Revenue (Fund 0623):	
Current Year	\$ 512,492,223
SMIF Interest Revenue	200,435
Board - State Operations	<u>(11,738,181)</u>
Total Operating Transfers Out	500,954,477
Backfill	<u>(21,800,000)</u>
Total Operating Transfers In- Related Accounts	\$ 479,154,477

Section 130105 of the Health and Safety Code requires the Fund on an annual basis to backfill the loss of funding for certain Proposition 99 (the Tobacco Tax and Health Protection Act of 1988) and Breast Cancer Fund programs to offset the revenue loss from declining cigarettes and tobacco product consumption resulting from the imposition of additional taxes on cigarettes and tobacco products by the Act. The Board makes the fiscal determination and transfers the appropriate funds.

NOTE 6 Contingent Liabilities

The First 5 California and BOE are involved in separate legal proceedings. Unfavorable outcomes to these lawsuits may result in the loss of funds available to the various First 5 California programs. No provision for the potential liability has been made in the financial statements.

Following are two significant pending lawsuits:

1. Taxpayers filed a refund lawsuit on December 5, 2007 for tobacco taxes paid. These taxpayers are the shareholders and officers of a corporation, who had continued distributing cigarettes and tobacco products after the corporation was suspended for failure to pay franchise taxes. The BOE asserted controlling person liability against taxpayers under the Cigarette and Tobacco Products Tax Law. On February 23, 2009, the trial court entered judgment in favor of taxpayers in the amount of \$69,763 plus interest. Subsequently, the trial court awarded attorneys' fees to taxpayers under Code of Civil Procedure section 1021.5 in the amount of \$627,797. The BOE has appealed both the

judgment and the attorneys' fees award. The matter is being briefed in the appellate court at this time. Risk of loss is determined to be probable and the attorney's fees award could increase to \$1.3 million. The impact to the Fund is estimated at 36 percent of the total award, or \$493,115 (based on \$69,763 taxpayer judgment plus \$1.3 million attorney's fees award).

2. On July 24, 2009, Service Employees International Union, Local 1000 (SEIU), filed suit in the Alameda County Superior Court against Governor Schwarzenegger and 67 other Respondents challenging the validity of the Governor's Executive Orders furloughing state employees three days per month. The Petition sought a declaration that the furloughs are unlawful, a prohibition on any further salary reductions, an injunction prohibiting the Governor from continuing to furlough SEIU employees whose salaries were paid by sources other than the General Fund, back pay and attorneys fees and costs. On December 31, 2009, the trial court issued its Order Granting SEIU's Petition for Writ of Mandate. This matter is now on appeal in the First Appellate District Court of Appeal, Case No. 127776.

On October 4, 2010, the Supreme Court of California issued its ruling in the related matter of *Professional Engineers in California Government, et al. v. Schwarzenegger*, Supreme Court Case No. S183411. The Supreme Court concluded that the Governor's statutory and constitutional authority to furlough state employees is limited to situations in which such unilateral authority is set forth in a memorandum of understanding entered into between the state and employee organizations representing the affected employees. However, the Supreme Court went on to find that in the case before it (which involved only the Governor's December 2008 furlough order) the Legislature, in enacting the 2009 revisions to the 2008 Budget Act, ratified the use of the two-day-a-month furlough program.

At this time, the SEIU matter to which First 5 California is a party remains on appeal. However, given the recent Supreme Court ruling, future years' losses or gains, as a result of the decision, cannot be estimated at this time.

NOTE 7 Related Party Transactions

The First 5 California Chair has a dual role as the Commission Chair and the Undersecretary for the Health and Human Services Agency (HHSA). The Chair participated in the Commission's vote approving interagency agreements that provided funding of \$81.4 million to MRMIB and \$50 million to DDS. These departments either report to or have an affiliation with the HHSA. The contract with MRMIB funds new enrollment and/or enrollment of otherwise wait-listed children ages of 0 to 5 in the Healthy Families Program. The DDS contract funds Regional Center services for new enrollment and/or enrollment of otherwise wait-listed children under the Early Start program. The First 5 California Commission made these contributions after determining that they were consistent with and furthered the purposes of the Act and First 5 California's Strategic Plan. The Chair consulted with legal counsel who advised him that these dual roles do not constitute a conflict of interest under applicable statutes and regulations. Both contracts include audit

requirements to ensure the funds are expended in accordance with the purpose of the Act.

NOTE 8 Subsequent Events

Senate Bill 870 (SB 870), Chapter 712, Statutes of 2010 (2010-11 Budget) makes appropriations, enacts statutory changes for support of state government, and reflects the final decisions of the Legislative Leadership relative to the 2010-11 Budget. The budget language includes requests of First 5 funds similar to those in prior years including:

- \$82,752,000 for the MRMIB for the Healthy Families Program.
- \$50,000,000 for the DDS Regional Centers.

As written, SB 870 states the amount payable for the proposed MRMIB and DDS fund requests is from the Counties Children and Families Account (0585).

In addition, SB 870 also includes language that directs agencies to seek funding from First 5 California to support projects related to poison control and immunization.

The authorization of the transfer of money from First 5 funds in response to the budget bill would require State Commission and/or county commission approval. As of the date of this report the State Commission had not taken action on the SB 870 funding requests. Therefore the amount of funding for these commitments cannot be estimated at this time.