



AGENDA ITEM: 7
DATE OF MEETING: October 20, 2010
ACTION: _____
INFORMATION: X

**FISCAL YEAR-END SUMMARY
(FISCAL YEAR ENDING JUNE 30, 2009)**

SUMMARY

Staff will provide the Commission fiscal briefings in four areas: First 5 California's year-end revenue and expenditure for Fiscal Year (FY) 2009-10, revenue projections through FY 2012-13, the Fund Condition beginning FY 2010-11, and revenue trends.

BACKGROUND

Pursuant to Health and Safety Code (HSC) section 130105, the California Children and Families Trust Fund (hereinafter referred to as "the Fund"), was created in the State Treasury and consists of Proposition 10 revenues collected pursuant to the taxes imposed by Section 30131.2 of the Revenue and Taxation Code.

The Board of Equalization (BOE) administers the Fund and determines the amounts to be transferred to the following seven Proposition 10 accounts: Counties, Mass Media Communications, Education, Child Care, Research and Development, Administration, and Unallocated. HSC section 130105 establishes the percentage of funds to be disbursed to each account, which are all interest-bearing accounts.

The BOE determines the amount for adjustments to the Fund prior to the transfer of funds to the designated State Commission and county commission funds. These adjustments include the annual backfill to the Proposition 99 Fund and Breast Cancer Fund and the monthly BOE operational costs for tax collection and enforcement programs.

Attachment A, Funding Structure, provides an overview of how the funds are transferred to the individual Proposition 10 State Commission and county commission funds. Per HSC sections 130100 to 130155, First 5 California disburses 80 percent of Proposition 10 tobacco tax revenue to county commissions monthly if requirements specified in statute have been met. Each month, the BOE provides First 5 California with the amount of tobacco tax revenue that is available for disbursement to the county commissions. These funds are transferred into the county fund. County commissions receive the portion of the total moneys available to all county commissions equal to the percentage of the number of births recorded in the relevant county in proportion to the entire number of births recorded in California. Interest that accumulates in the county account is also disbursed annually to the county commissions using this same formula.

First 5 California's Administrative Services Division (ASD) disburses funds from the six state funds consistent with the directives of the State Commission and the Executive Director or Chief Deputy Director, and the Bylaws for the California Children and Families Commission. ASD also maintains financial records of disbursements.

The annual Financial Statement Audits of the Children and Families Trust Fund and Related Accounts are available on <http://www.cafc.ca.gov/commission/fiscal.asp>. The audit report for FY 2009-10 will be available in December 2010.

FY 2009-10 YEAR END SUMMARY:

Revenue Collection, Fund Administration and Adjustments

The total Proposition 10 tobacco tax revenue collected by the BOE in FY 2008-09 (prior to BOE adjustments) was \$557.4 million. The total revenue received in FY 2009-10 was \$513.4, representing a 7.89% decrease in revenue from FY 2008-09.

As represented in Agenda Item 7, Attachment B, the BOE adjustments to the tax revenue includes the following:

- The FY 2009-10 Backfill totaled \$21.8 million, an increase of 4.92% from FY 2008-09.
- Adjustments for BOE operational costs for tax collection and enforcement activities totaled \$12.7 million, an increase of 8.29% from FY 2008-09.

On August 17, 2010, the BOE hosted an informational meeting attended by First 5 California, First 5 county commissions, the State Controller's Office, and several legislative representatives to explain the BOE costs associated with tax collection operations and enforcement requirements. The BOE's presentation included an explanation of the agreement between 46 states and the four largest cigarette manufacturers called the Master Settlement Agreement (MSA). Under the MSA, state lawsuits against manufacturers seeking reimbursement for public health costs would be dismissed in exchange for on-going settlement payments. In exchange for California's \$9.3 billion in public health cost funds, states must protect the market share of manufacturers, ensure taxes are paid, and enforce all provisions of the law, among other things, or risk being sued for the return of MSA payments. States must exercise "due diligence" to protect payments. The BOE's Cigarette and Tobacco Products Tax Program Administration is a primary source of evidence to demonstrate California's diligent enforcements. The Cigarette and Tobacco Products Licensing Act (AB 71) and Senate Bill 1701 established statewide enforcement programs and required the development and use of advanced stamp technology to support enforcement and minimize evasion and violations for contraband, including counterfeit stamp cigarettes.

The BOE also discussed increases in BOE Operations Costs, funding sources for the Licensing Act, cigarette tax share of costs, the statutory authority for BOE's reimbursement for expenses incurred in the administration and collection of taxes imposed by Proposition 10, and the BOE's annual Governor's Budget development process that reviews and approves costs for BOE's operations and enforcement activities. The BOE responded to questions by First 5 California and county commissions and estimated that the annual BOE adjustment amounts will likely level out over the next six years because it has executed a new cigarette stamp multiple-year agreement. During this meeting the BOE provided extensive and detailed print information that responded to First 5 California's concerns. First 5 California's expressed appreciation for the extensive commitment of time and resources by the BOE to respond to the State Commission's inquiry on BOE cost adjustments. Upon request, First 5 California staff will provide commissioners a copy of the meeting materials.

The amount of monthly revenue received varies each month, each year. During the first and fourth quarters of each year, revenues received are consistently higher than during the second and third quarters. The BOE calculated backfill typically occurs during the second quarter. Agenda Item 7, Attachment C, First 5 California Trust Fund History, displays the variance in monthly Proposition 10 tax revenues collected each year.

In FY 2009-10, the BOE transferred a total of \$479,154,476 to the seven state and county funds. The State Commission's share of the FY 2009-10 tobacco tax revenue available to transfer (after backfill and BOE adjustments occur) totaled \$95.8 million, representing an 8.76% decrease from FY 2008-09 revenue. Eighty percent of the total amount available for transfer was directed to the county fund totaling \$383.3 million.

Surplus Money Investment Fund Earnings

First 5 California investments consist of cash in excess of current needs on deposit in the State 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 is transferred to the SMIF for investment purposes. All earnings derived from investment of the SMIF are apportioned to the contributing fund as provided in the Government Code.

The rate of interest earned on investment changes regularly and is posted to First 5 California's accounts quarterly. Currently, the interest rate is .0559, as reflected in the Yield Rate Charts developed by the State Controllers' Office.

In FY 2009-10 First 5 California received a total of \$2,380,308 in interest earnings for all state accounts, representing a decrease of 72% from FY 2008-09 interest earnings. With an approximate 33% decrease in the prior year end fund balance and the significant reduction in the interest yield rates, the interest earning on First 5 California accounts are minimal.

FY 2009-10 Fund Condition

The fund and related accounts are classified as “Other Government 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. Agenda Item 7, Attachment D, provides a summary of First 5 California’s Fund Condition for as of June 30, 2010.

Table 1 shows First 5 California’s FY 2009-10 year end revenue and expenditure results and the FY 2009-10 year end balances by fund. Each of the following First 5 California funds ended FY 2009-10 in a positive position.

Table 1

Fund	FY 09-10 Revenue	FY 09-10 Expenditure	FY 09-10 End Balance
Mass Media Communications	\$29,347,324.52	\$89,575,551.15	\$36,358,109.61
Education	\$29,122,711.70	\$63,871,065.95	\$70,721,345.50
Child Care	\$14,717,849.42	\$33,042,112.49	\$37,635,689.79
Research and Development	\$14,830,565.58	\$36,533,522.83	\$53,658,146.04
Administration	\$4,948,363.04	\$5,477,022.61	\$24,536,217.53
Unallocated ¹	\$9,760,055.52	\$3,520,959.55	\$29,216,261.38
Totals	\$102,726,869.78	\$232,020,234.58	\$252,125,769.85

While four of the five local assistance funds show expenditures in FY 2009-10 that exceeded revenue received in those funds, the State Commission approved these expenditures through the assignment of funds from prior year fund balances (also referred to as carryover).

The FY 2009-10 year-end fund balance totals \$252.1 million, representing a 33.9% decrease from FY 2008-09 year-end fund balance.

The Commission currently employs 47 permanent staff. In FY 2009-10, all personnel and administrative overhead costs totaled \$4 million. General operating expenses and equipment for FY 2009-10 totaled \$1.4 million.

Revenue Trends

Attached to Agenda Item 7 are several updated fiscal tracking charts and tables that provide a multi-year picture of revenue projections, actual revenue received, and FY 2010-11 projected revenue by accounts. A description of each attachment follows:

- Attachment E provides an overview of actual and projected revenue by fiscal year for both county commissions and First 5 California.
- Attachment F provides a comparison of Proposition 10 revenue projections with actual revenue received for eight prior fiscal years.
- Attachment G provides a two-year-revenue comparison by month for FY 2008-09 and FY 2009-10 actual revenue received, for state and county combined, July through June. This chart demonstrates the variance in monthly revenue received from year to year.
- Attachment H provides actual interest amounts earned by fund for the last four fiscal years.
- Attachment I shows the distribution of projected revenue for FY 2010-11 by account.

The Department of Finance (DOF) provides and releases tobacco tax revenue projections in January, after the release of the Governor’s budget, and in May, following the release of the May Revise. The table below represents the DOF Proposition 10 tax revenue projections for FY 2009-10.

Source	FY 2009-10 Revenue Projection Amount
January 2009, Governor’s Proposed Budget	\$570 million
May 2009, May Revise	\$528 million
January 2010, Governor’s Proposed Budget	\$528 million
May 2010, May Revise	\$508 million

FY 2009-10 Proposition 10 actual tax revenue receipts totaled \$513 million. The above table demonstrates the significant changes in tax revenue projections in any fiscal year, which contributes to ongoing adjustments to First 5 California staff reports on revenue and commitments and demonstrates the need for an adequate reserve of funds in First 5 California’s revenue and commitment plan to accommodate revenue fluctuations in any given fiscal year.

Federal Legislation

Signed into law by President Obama on March 31, 2010, the Prevent All Cigarette Trafficking (PACT) Act of 2009 (S. 1147) amends the Jenkins Act to revise provisions governing the collection of taxes on, and trafficking in, cigarettes and smokeless tobacco. The PACT Act:

1. requires Internet and other remote sellers of cigarettes and smokeless tobacco to comply with the same laws that apply to law-abiding tobacco retailers;
2. creates strong disincentives to illegal smuggling of tobacco products;
3. provides government enforcement officials with more effective enforcement tools to combat tobacco smuggling;
4. makes it more difficult for cigarette and smokeless tobacco traffickers to engage in and profit from their illegal activities;
5. increases collections of federal, state, and local excise taxes on cigarettes and smokeless tobacco; and
6. prevents and reduces youth access to inexpensive cigarettes and smokeless tobacco through illegal Internet or contraband sales.

According to the Congressional Budget Office (CBO) implementing S. 1147 would cost approximately \$120 million over the 2011-2015 period, assuming appropriation of the necessary amounts. Enacting the bill could affect direct spending and receipts, but the CBO estimates that any such effects would not be significant.

FY 2009-10 Financial Audit

First 5 California's audit opinion for the fiscal year, that ended June 30, 2010, will be available in December 2010 and will be presented to the State Commission at its January 2011 commission meeting.

Terry Miller, Chief of the Administrative Services Division, will present additional detail related to Fiscal Year End figures and funding changes, and highlight spending commitments for FY 2010-11 through FY 2012-13.

- Attachments:
- A. Funding Structure Diagram
 - B. BOE Adjustments (Enforcement, Administration, and Backfill)
 - C. BOE Historical Trust Fund History for First 5 California
 - D. Fund Condition Summary
 - E. Graphical Display of Six-Year Actual and Projected Revenue
 - F. Comparison of Prop. 10 Revenue Projections and Actuals
 - G. Two-Year Revenue Comparison by Month
 - H. SMIF Revenue by Account
 - I. Fiscal Year 2009-10 Projected Revenue by Account