



AGENDA ITEM: 9

DATE OF MEETING: January 24, 2013

ACTION: X

INFORMATION: _____

FISCAL YEAR 2011-12 ANNUAL REPORT

SUMMARY OF REQUEST

This is a request for Commission approval of the First 5 California Annual Report for Fiscal Year 2011-12, which includes the State Controller's annual review of the county commissions' audits for Fiscal Year 2010-11, and the findings from the Department of Finances' audit of First 5 California for Fiscal Year 2011-12.

BACKGROUND

The California Children and Families Act of 1998 (the Act) states that First 5 California shall:

Conduct an audit and prepare a written report on the implementation and performance of the state commission functions during the preceding fiscal year, including, at a minimum, the manner in which funds were expended and the progress toward, and the achievement of, program goals and objectives. (Health & Safety Code, § 130150(b)(1).)

The Act also states that the Commission shall:

Prepare a written report that consolidates, summarizes, analyzes, and comments on the annual audits and reports submitted by all of the county commissions and the Controller for the preceding fiscal year. The written report shall include a listing, by category, of the aggregate expenditures on program areas funded by the state and county commissions pursuant to the purposes of this act, according to a format prescribed by the state commission. This report by the state commission shall be transmitted to the Governor, the Legislature, and each county commission. (Health & Safety Code, § 130150(b)(2).)

These requirements must be met on or before January 31 of each year. (Health & Safety Code, § 130150(b).)

To meet these statutory responsibilities, First 5 California prepares an annual report that includes: program descriptions and expenditure information; the State Controller's

annual review of the county commissions' independent audits; and the findings from the Department of Finances' annual audit of First 5 California.

First 5 California staff has prepared and organized the First 5 California Annual Report for Fiscal Year 2011-12 as follows:

- Brief history of First 5 California, its structure and partnerships with the county commissions, and its funding and audit findings.
- Summary of how First 5 California supports children, parents, and early learning teachers through its Signature Programs and corresponding local commission programs.
- Appendices outlining result areas and services.
- The California State Controller's Annual Report, Results of Audit Oversight of Local Commissions, for Fiscal Year 2010-11.
- Findings from the Department of Finance's annual audit of First 5 California for Fiscal Year 2011-12.¹

HIGHLIGHTS

The report documents how First 5 California's programs leverage funding, skills and systems to deliver high-quality services to improve the health and early learning of high needs children, ages 0 to 5. The 2011-12 Annual Report features the Child, Teacher and Parent Signature Programs. First 5 California's Power of Preschool (PoP) program, School Readiness program, Educare, Developmental Screenings and Services, Comprehensive Approaches to Raising Educational Standards (CARES) Plus and the Parent Signature Program all contribute significantly to the overall health and early learning of children ages 0 to 5 and their families. This year's annual report also reflects areas of state and county partnerships and coordinated investments that work to improve the overall health and school readiness for children through family functioning, professional development and support for teachers and caregivers.

Child Signature Program

Power of Preschool

First 5 California's PoP program provides disadvantaged children with free, voluntary, high-quality, part-day preschool to assist them in becoming effective learners. PoP leverages Head Start, State Preschool, General Child Care, and Title I funds and adds quality dimensions related to teacher qualifications and the classroom environment. The Fiscal Year 2011-12 data show that:

¹ For your reference, the complete annual report, the State Controller's report, and the audit and management letter transmitted by the Department of Finance on November 14, 2012 are attached to this memorandum.

- PoP preschools are high quality: Environmental assessments of classrooms rate an average 5.8 out of a 7. And 7 out of the 8 participating counties reported average scores above 5 using the Early Childhood Environment Rating Scale instrument.
- PoP preschool classrooms have highly qualified teachers, with 62 percent of master teachers having earned a bachelor's degree or higher.

PoP requires participating counties to use the Desired Results Developmental Profile (DRDP). The DRDP is designed for teachers to observe, document and reflect on learning development and progress of children. PoP counties performed DRDP assessments on 22,252 out of 26,381 children served in the program.

First 5 California's PoP program, along with its Teacher Signature Program (CARES Plus), helped demonstrate that the State is capable of implementing quality early learning programs, and thus was one of nine states awarded with a federal grant under the Race to the Top Early Learning Challenge. California's grant is \$52 million.

Developmental Screenings and Services

During Fiscal Year 2011/12, First 5 California contributed \$50 million to the California Department of Developmental Services to fund new developmental screenings and intervention services for 17,016 infants and toddlers ages 0 to 2 entering the Early Start program.

Teacher Signature Program

CARES Plus

Teacher quality is a powerful contributor to children's learning and success. First 5 California's CARES Plus program provides early educators with quality, research-based professional education and support so they can improve the level of quality they provide to the children they serve. The primary goals of CARES Plus are to:

- Improve the effectiveness of early educators
- Positively impact the learning and developmental outcomes of young children
- Reduce turnover among early educators

Two validated tools have been introduced to improve the quality of education delivered:

- The CLASS™ Observation tool, an online, interactive, multimedia, self-paced course.
- MyTeaching Partner™, an evidence-based professional development tool focused on improving classroom interactions through intensive coaching, classroom observation and analysis of teaching practice.

In Fiscal Year 2011-12, more than 4,200 teachers participated in CARES Plus across 34 counties, effectively reaching more than 80,000 children. In a survey conducted by First 5 California, more than 80 percent of the teachers who responded reported that the CARES Plus program enhanced their professional development options; would enable them to stay in the field of early education; and, had a positive impact on the children in their care.

Parent Signature Program

First 5 California recognizes parents as a child's first teacher. Through the Parent Signature Program, First 5 California provides parents with the information and tools to raise healthy children ready to grow and thrive in school.

As part of this effort, First 5 California provides information to parents through a variety of mediums in six different languages, reflecting the rich diversity of California's population.

Kit for New Parents

Our award-winning *Kit for New Parents* was redesigned in 2011 with streamlined content and environmentally friendly packaging. In Fiscal Year 2011-12, we distributed 332,000 kits to new parents. The *Kit* features a practical guide for the first 5 years, a health handbook and other information on literacy, learning, child safety, developmental milestones and finding quality childcare.

Hands-On Health Express

The Hands-On Health Express is a traveling exhibit van that seeks to educate parents and entertain children with hands-on activities about healthy eating and exercise. In Fiscal Year 2011-12, the van traveled to more than 100 events in every county, engaging with more than 62,000 families who receive a wealth of information and leave with First 5 resources.

Web and Social Media

Recognizing that parents are increasingly using the Internet to access information, First 5 California's parent website has been redesigned, and since April 2012 has generated more than 1.1 million hits, representing an 89 percent increase from the previous year. First 5 California is driving parents to its site through its traditional advertising methods, as well as through its social media efforts. First 5 California's Facebook page generates nearly 243,000 unique visitors per week. Its Twitter account has more than 7,500 followers, and both audiences received daily parenting tips on everything from healthy pregnancy to child rearing, healthy eating, and activities that engage bodies and minds.

Smoking Cessation

In Fiscal Year 2011-12, First 5 California contributed \$1 million to the California Smoker's Helpline (1-800-NO-BUTTS) to help parents and caregivers stop smoking. The Helpline provided services for 364 pregnant smokers and 6,549 tobacco-using parents and caregivers. This effort also included reaching out to doctors' offices encouraging OBGYNs to discuss smoking cessation with their clients.

Accountability and Audits

The California Department of Finance, Office of State Audits and Evaluations, conducted an audit of the First 5 California financial records for Fiscal Year 11-12. Submitted in November 2012, the report on the California Children and Families Trust Fund was free of any negative findings. The audit was accompanied by a management letter which included two observations:

The first observation was that the Board of Equalization's methodology for calculating the program and administrative costs to the Fund is not written, contrary to the Government Code and the State Administrative Manual. In a written response, BOE agreed with the observation and stated that its budget staff is preparing written documentation. (See BOE letter dated November 1, 2012, attached.) First 5 California is awaiting a response from BOE as to the timeline for this deliverable.

The second observation is that the motion approving the transfer of \$50 million to the Department of Developmental Services in FY 2011-12 failed to include a determination that the funds were not needed in First 5 California's contributing accounts before being transferred to the Unallocated Account. Since July 2012, First 5 California has established internal procedures to ensure that the Commission makes a finding that funds are not needed in the originating account before being approved for transfer for any purpose.

The State Controller's Office conducts an annual review of the 58 county commissions' independent audits. In November 2012, the Controller published its review of the counties' audits for Fiscal Year 10-11. That review summarized several findings but did not deem any of them significant enough to withhold funding.

STAFF RECOMMENDATION

Staff recommends the Commission approve the 2011-2012 First 5 California Annual Report and its submission to the Governor, the Legislature, and county commissions, as required by statute.

Attachments:

- 2011-2012 First 5 California Annual Report
- State Controller's Annual Report, Results of Audit Oversight of Local Commissions, for Fiscal Year 2010-11
- Department of Finance's 2012 Financial Statement Audit of the Children and Families Trust Fund and Related Accounts
- Department of Finance's Management Letter dated November 13, 2012
- Board of Equalization's Letter dated November 1, 2012

ANNUAL REPORT TO THE FIRST 5 CALIFORNIA COMMISSION

RESULTS OF AUDIT OVERSIGHT OF LOCAL COMMISSIONS

For the Period of July 1, 2010, through June 30, 2011



JOHN CHIANG
California State Controller

October 2012

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JOHN CHIANG
California State Controller

October 29, 2012

Renee Webster-Hawkins, Interim Executive Director
First 5 California
2389 Gateway Oaks Drive, Suite 260
Sacramento, CA 95833

Dear Ms. Webster-Hawkins:

I am pleased to submit our annual report to the First 5 California Commission. Our report summarizes the results of our review of the independent audits of the local First 5 county commissions (local commissions) for Fiscal Year (FY) 2010-11. This report also summarizes the results of our review of the audit findings identified in the independent auditors' reports to the local commissions.

This is the fifth report submitted in accordance with Senate Bill 35 (Chapter 243, Statutes of 2005), which mandated an expanded audit of every county commission funded by the California Children and Families Program Act of 1998. Each commission was required to adopt a range of policies, including contracting and procurement, administrative expenditure limits, conflict of interest, staff compensation, and long-range financial planning. Each local commission is required to have an annual independent audit that is reviewed by the State Controller's Office.

Our review focused on the local commissions' compliance with program requirements (as reported by their independent auditors) specified in the Health and Safety Code. We also verified the independent auditors' compliance with audit standards and the expanded audit guidelines when performing the local commission audits. As required by statute, our annual report summarizes the results of our review and assesses the audit reports issued by the independent auditors. In addition, the audit findings and audit finding follow-up section of our report presents information related to the findings from each local commission's independent audit report. Lastly, our report contains comparative statistics from the results of our desk reviews of the independent audits for FY 2010-11, FY 2009-10, and FY 2008-09, where applicable.

I hope our report will be useful to you in assessing the local commissions' activities and compiling your annual report to the Legislature. Please direct any comments regarding the content of the report to Lisa Hughes, Chief, Community-Related Audits Bureau, at (916) 322-8489.

Sincerely,

Original signed by

JOHN HIBER
Chief Operating Officer

cc: Jennifer Kent, Commission Chair
 First 5 California Commission
Kathryn Icenhower, Ph.D., Commission
 First 5 California Commission
Conway Collis, Commissioner
 First 5 California Commission
Magdalena Carrasco, Commissioner
 First 5 California Commission
Patrick Duterte, Commissioner
 First 5 California Commission
Casey McKeever, Commissioner
 First 5 California Commission
Joyce Iseri, Commissioner
 First 5 California Commission
Diana Dooley, Ex Officio Member
 First 5 California Commission
Jim Suennen, Designee
 First 5 California Commission
Sandy Beck, Chief
 Administrative Services Division
 First 5 California Commission

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Executive Summary

The California Children and Families Act (Act) was created in 1998 by the passage of Proposition 10. The Act was amended in 2005, giving the State Controller's Office (SCO) oversight responsibility for audits of the local First 5 county commission (local commissions). The objective of the amendment was to provide the state commission with independently verified fiscal and state compliance information obtained from audits performed in accordance with applicable standards and requirements.

The State Controller's oversight responsibility includes providing audit guidelines, reviewing local commissions' annual audit reports for compliance with applicable audit standards and guidelines, and following up on findings contained in the audit reports to ensure compliance with policies and practices specified in the Health and Safety Code. As needed, the SCO approves and makes substantive changes to the audit guide after consultation with an audit guide committee composed of representatives from the First 5 state commission and local commissions.

This is the fifth report submitted in accordance with the expanded audit statutes chaptered into law in 2005; therefore, this report includes comparative results. In summary, our report contains the following key observations we made during our review of the local commissions' independent audit reports:

- Of the 58 independent audit reports, 37 (64%) independent audit reports complied with audit guide requirements and/or audit standards, an increase compared to prior reporting periods. In Fiscal Year (FY) 2009-10, only 40% of the independent audit reports submitted complied with all standards and/or requirements, while in FY 2008-09, 60% were in compliance.
- Of the 58 local commissions, 48 (83%) submitted the required audit reports by the November 1st deadline. In comparison, 69% of the audits in FY 2009-10 and 60% of the audits in FY 2008-09 were submitted by the deadline.

In addition to the observations we made during our review of the reports, the independent auditors identified a total of 19 audit findings at 14 local commissions; these findings were categorized as either "internal control" (14) or "state compliance" (5). In comparison, 11 of the FY 2009-10 audit reports contained 14 audit findings (13 internal control and 1 state compliance). In FY 2008-09, 16 of the audit reports contained 27 audit findings (18 internal control and 9 state compliance).

For FY 2010-11, the SCO did not recommend withholding funding allocations for any commission for failure to correct (or provide a viable plan to correct) audit findings.

Introduction

Overview

The State Controller's Office (SCO), Division of Audits, is responsible for performing the oversight activities for the independent audits of local commission administering the First 5 program authorized by the California Children and Families Act. Oversight activities consist of:

- Developing an audit guide based on the Health and Safety Code, audit standards generally accepted in the United States, and government auditing standards;
- Verifying (via desk reviews/analysis) that the independent audit reports contracted for by the local First 5 commissions (local commissions) comply with auditing standards and the audit guide; and
- Verifying local commission compliance with policies and practices (specified in Health and Safety Code) by reviewing and following up on audit findings reported in the independent audits.

Health and Safety Code section 130151 (added by Chapter 243, Statutes of 2005) requires that the SCO issue guidelines for annual expanded audits¹ that require independent auditors to review local commission compliance with policies and practices related to:

- Contracting and procurement
- Administrative costs
- Conflict of interest
- County ordinance
- Long-range financial plans
- Financial condition of commission
- Program evaluation
- Salaries and benefit policies

In addition, Health and Safety Code section 130151 also requires that the SCO:

- Determine, within six months of the state or county commission's response pursuant to subdivision 130151(d), whether the local commission has successfully implemented corrective action in response to the findings contained in its audit report;
- Recommend that the state commission withhold the funding allocation for local commissions unable to provide the SCO with a viable plan to correct identified audit findings; and
- Submit to the First 5 Commission, by November 1 of each year, a report summarizing the results of the reviews of the local commissions' audits for the preceding reporting cycle.

¹ *Standards and Procedures for Audits of Local Entities Administering the California Children and Families Act (First 5).*

Background

First 5 Program

The California Children and Families Act of 1998 (Act) authorized the First 5 program. The Act required that the First 5 program be funded by surtaxes imposed on the sale and distribution of cigarettes and tobacco products. The Act further required that the funds be deposited into the California Children and Families Trust Fund for the implementation of comprehensive early childhood and smoking-prevention programs.

SCO Oversight

The SCO's oversight and reporting requirements (Health and Safety Code section 130151) were added by Senate Bill (SB) 35 (Chapter 243, Statutes of 2005). Prior to SB 35, existing law already included a fiscal/audit reporting component; therefore, the addition of SCO oversight was considered to be an expansion of those requirements. Consequently, the local First 5 county commissions (local commissions) refer to the SCO audit guidelines as "expanded" audit guidelines.

The SCO, along with a committee—composed of representatives from the First 5 California Commission, local commissions, the Government Finance Officers Association, county auditor-controllers, and independent auditors—developed the initial audit guide based on statutory requirements enumerated in Health and Safety Code section 130151(b). The guide is updated as needed by a committee composed of representatives from the SCO, the First 5 state commission, and the local commissions. Health and Safety Code section 130151(b) states that the scope of the independent audits will address the commissions' policies and practices related to:

- Contracting and procurement
- Administrative costs
- Conflict of interest
- County ordinance
- Long-range financial plans
- Financial condition of commission
- Program evaluation
- Salaries and benefit policies

Independent Audit Report Requirements

The Health and Safety Code requires the auditors for the local commissions, or the local commissions themselves², to submit an independent audit report to both the SCO and the First 5 California Commission each year by November 1. The fiscal year ending June 30, 2011 was the fifth year that the 58 local First 5 county commissions were subject to the SCO's expanded audit guidelines; the resulting audit reports were due by November 1, 2011.

² Submission deadline is based on two statutory codes, one requiring the submission and one specifying the deadline. Specifically:

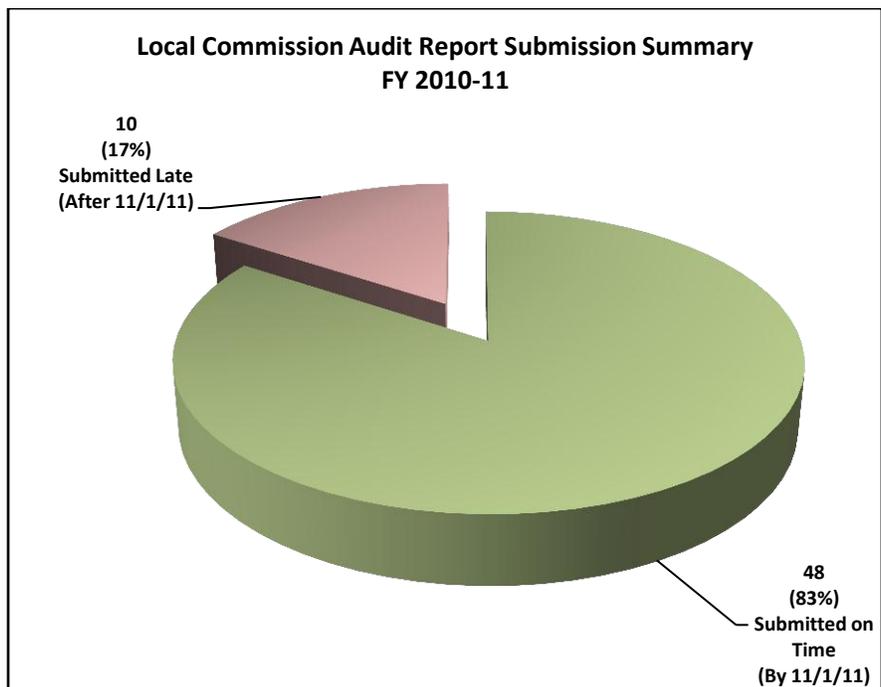
- Health and Safety Code section 130151(c) requires that "the auditor for the state commission or the county commission shall submit each audit report, upon completion, simultaneously to both the Controller and to the state commission or applicable county commission."
- Health and Safety Code section 130150(a) requires that "... on or before November 1 of each year, each county commission shall submit its audit and report to the state commission. . . ."

Results of Oversight Activities

Audit Report Submissions

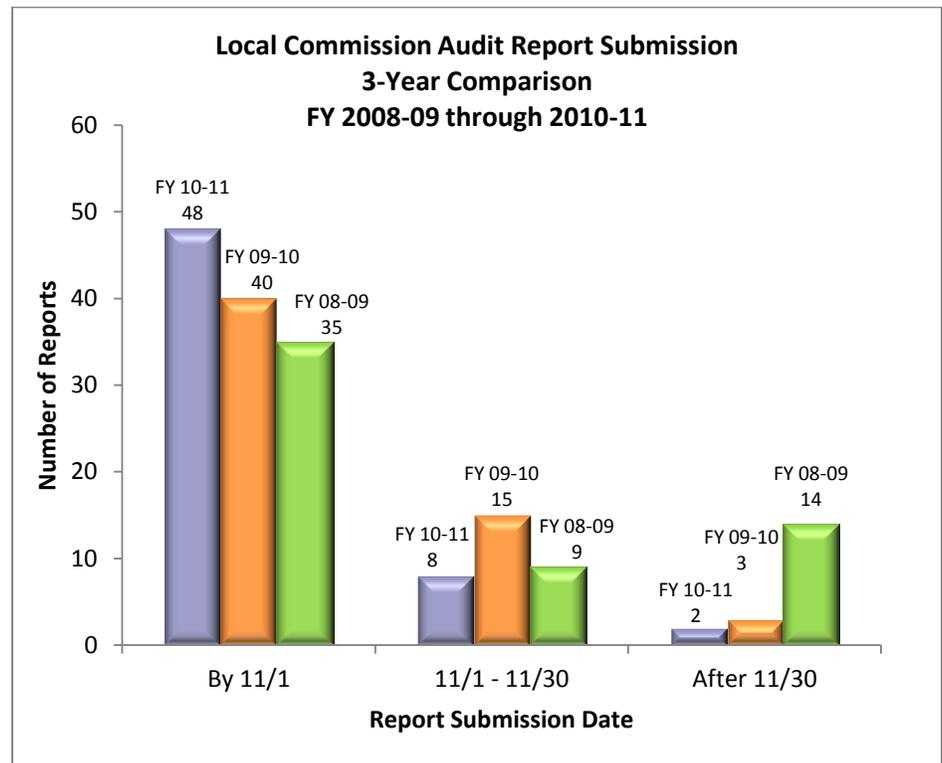
Audit reports for the preceding fiscal year must be filed with the SCO by November 1 of the current fiscal year. As noted in Figure 1, for FY 2010-11, 48 of 58 (83%) local commission audit reports were submitted by the required deadline. Another 8 audit reports (14%) were submitted within 30 days of the deadline, while the remaining 2 reports (3%) were submitted more than 30 days late. The two local commissions that submitted their reports more than 30 days late indicated that they were unable to prepare the financial statements in a timely manner.

Figure 1



Compared with the FY 2009-10 audit review cycle, in 2010-11 there was an increase in audit reports submitted on time. There was also a decrease in the number of FY 2010-11 reports submitted more than 30 days late when compared to the FY 2009-10 audit review cycle. See Figure 2 for comparative data on report submissions.

Figure 2



Audit Review and Certification Process

In accordance with Health and Safety Code section 130151, the SCO reviews and certifies (certification cycle) the annual independent audit reports issued by the auditors for each local First 5 county commission (local commission) for compliance with applicable auditing standards and audit guidelines set out in the *Standards and Procedures for Audits of Local Entities Administering the California Children and Families Act – First 5* (First 5 Audit Guide).

To facilitate the consistent review and certification of each audit, the SCO created a comprehensive desk review checklist that details and categorizes the program requirements specified in the First 5 Audit Guide. The desk review checklist also includes the required components of an audit based on both auditing standards generally accepted in the United States and government auditing standards. Any instances of non-compliance we found in the preparation of the independent auditors' reports (Audit Report Deficiencies) are summarized in this report.

At the end of the FY 2007-08 audit report certification cycle, the SCO issued an advisory (dated September 10, 2009) to all independent auditors for the local commissions. The advisory provided information to assist independent auditors in performing audits of the First 5 program in accordance with audit standards and the audit guide. The advisory, which applies to audit years beginning with FY 2008-09, provided clarification of the:

- Applicability of certain audit requirements (public disclosure wording in auditor opinions);

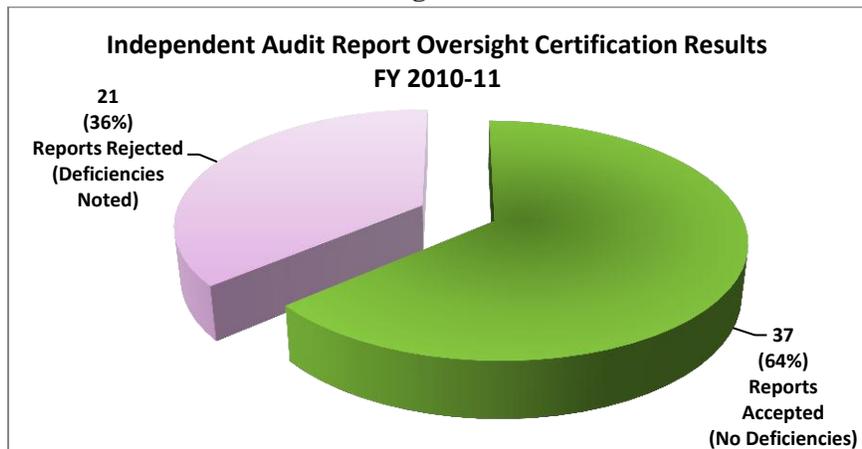
- Need for independence-related disclosures required by government audit standards when the audit is performed by the county auditor-controller;
- Need for audit reports to comply with the Governmental Accounting Standards Board (GASB) Statement 34 reporting model;
- Disclosure required when a local commission exercises the option not to provide a Management Discussion and Analysis to introduce its financial statements; and
- Request to submit commission agendas, minutes, and approved corrective action plans needed for the SCO to perform audit finding follow-up and verify public discussion of audit findings.

The advisory also made the independent auditors aware of miscellaneous quality control issues (i.e., incorrect report titles, typographical errors in opinions and financial statements, and report reproduction issues).

Audit Report Deficiencies

This section describes deficiencies found in the independent auditors' reports. A deficiency is an instance of an independent auditor's non-compliance with audit standards and/or the expanded audit guidelines (First 5 Audit Guide) issued by the SCO. Independent auditors (not local commissions) are responsible for addressing deficiencies in their reports on the local commissions. Based on our desk reviews of the FY 2010-11 independent auditors' reports on the local commissions, we found that 21 of the 58 independent audits (see Figure 3) contained a total of 39 deficiencies. The SCO notified the independent auditors and local commissions in writing that the audit report required correction(s). The written rejection letters identified the deficiency/deficiencies noted and the criteria used to determine non-compliance.

Figure 3

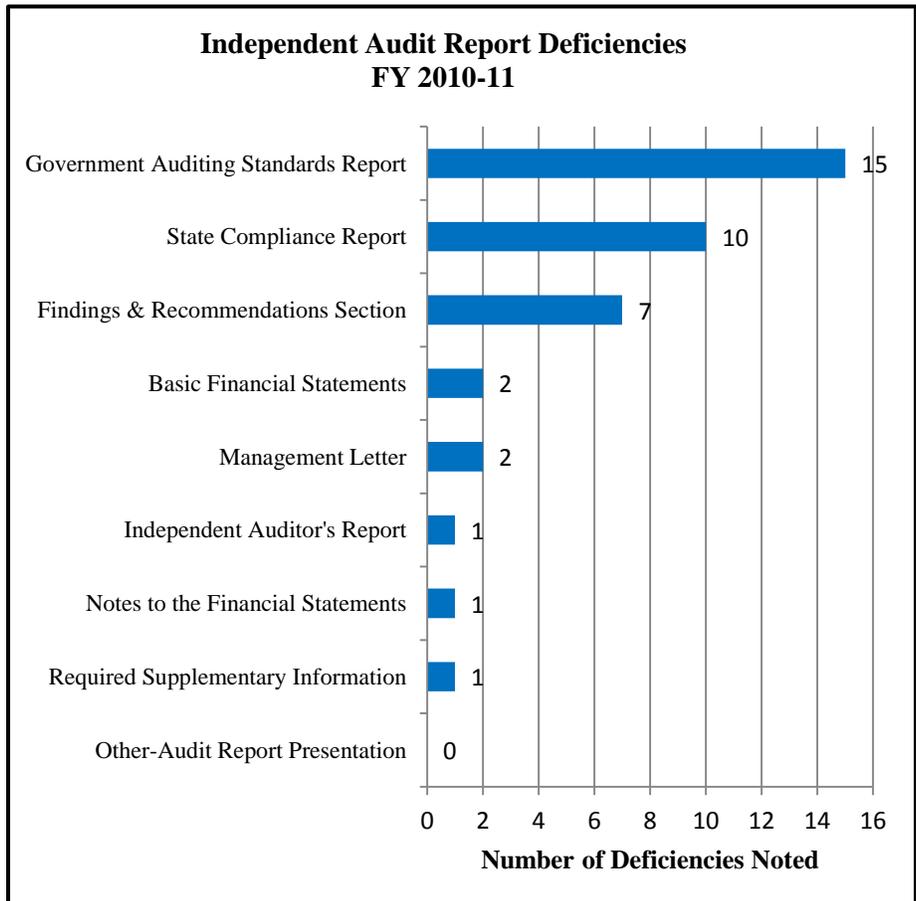


Notable Audit Report Deficiencies

As detailed in Figure 4, during this review and certification cycle the SCO identified 39 deficiencies in the 21 rejected reports. The audit report deficiencies were related to basic financial statements, state compliance reports, the findings and recommendations section of the audit, and the audit report presentation. The most notable issues were:

- State compliance reports that were not prepared in accordance with Statement on Auditing Standards (SAS) No. 117, and/or were not in the required format;
- The Government Audit Standards Report was not prepared in accordance with SAS No. 115;
- Findings and recommendations that were missing the required element(s) of an audit finding;
- Audit reports that reference management letters that were not submitted to the SCO with the annual audit report; and
- Basic Financial Statements that did not total correctly and/or the title of the financial statement did not correspond with the presentation of the financial statement.

Figure 4



See Appendix A-1 for detailed category breakdown.

Comparison of Audit Report Deficiencies by Fiscal Year

Fewer audits (39) had deficiencies in FY 2010-11 than in the prior year (FY 2009-10), when 114 deficiencies were identified. Of the 114 total audit deficiencies noted during FY 2009-10, a significant amount (76) were related to the 25 local commission independent auditor reports containing state compliance reports that were not prepared in accordance with SAS No. 117. SAS No. 117 provided new compliance reporting requirements effective for fiscal periods ending on or after June 15, 2010. For FY 2008-09, 33 deficiencies were identified.

During this review cycle, the SCO identified no recurring deficiencies. For FY 2009-10, three of the independent audit reports had one or more audit report deficiencies previously identified in FY 2008-09 that had not been corrected. For FY 2008-09, we noted two recurring deficiencies identified previously in FY 2007-08.

Figure 5 provides a breakdown by category of audit deficiencies for the current and previous reporting periods. Appendix A-2 provides additional detail for each category for the three audit years.

**Figure 5
Independent Audit Report Deficiencies - Comparison by Fiscal Year**

Category	Number of Occurrences		
	2010-11	2009-10	2008-09
Independent Auditor's Report	1	0	4
Basic Financial Statements	2	2	6
Notes to the Financial Statements	1	2	0
Required Supplementary Information	1	0	3
Government Audit Standards Report	15	19	5
Management Letter	2	2	4
State Compliance Report	10	76	6
Findings and Recommendations Section	7	9	3
Other--Audit Report Presentation	<u>0</u>	<u>4</u>	<u>2</u>
Total	<u>39</u>	<u>114</u>	<u>33</u>

Findings Reported by the Independent Auditors

This section describes the audit findings reported by the local commission’s independent auditors. The independent auditors for 14 of the 58 local commissions (see Figure 6A) reported a total of 19 audit findings (see Figure 6B) categorized as either “internal control” or “state compliance.”

Figure 6A

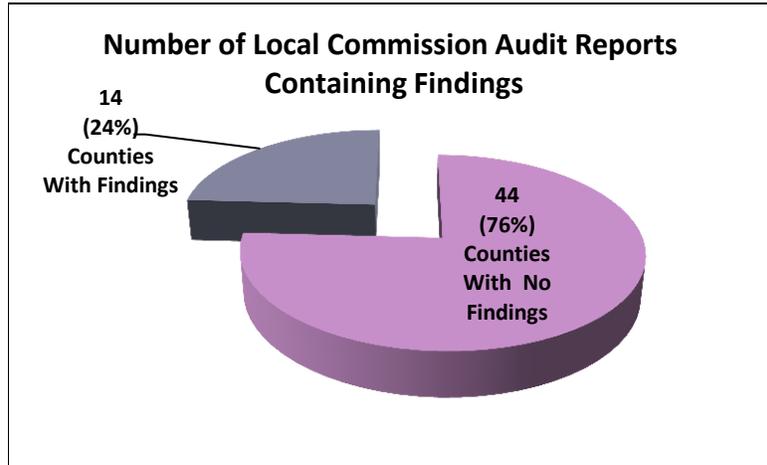
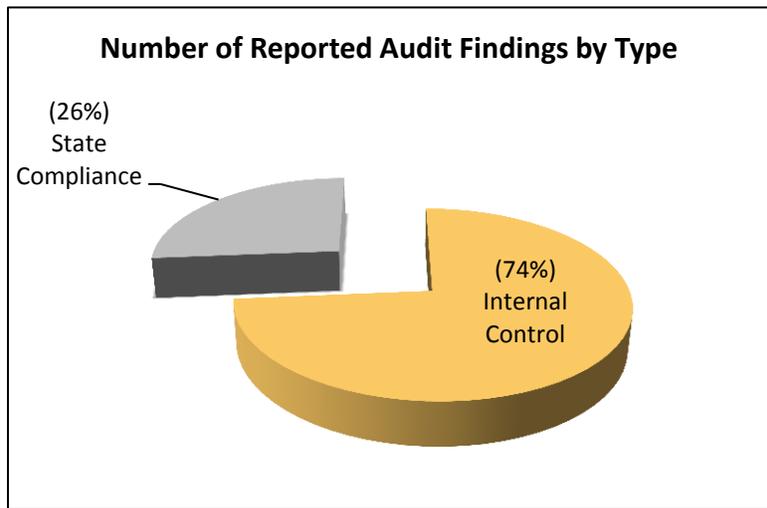


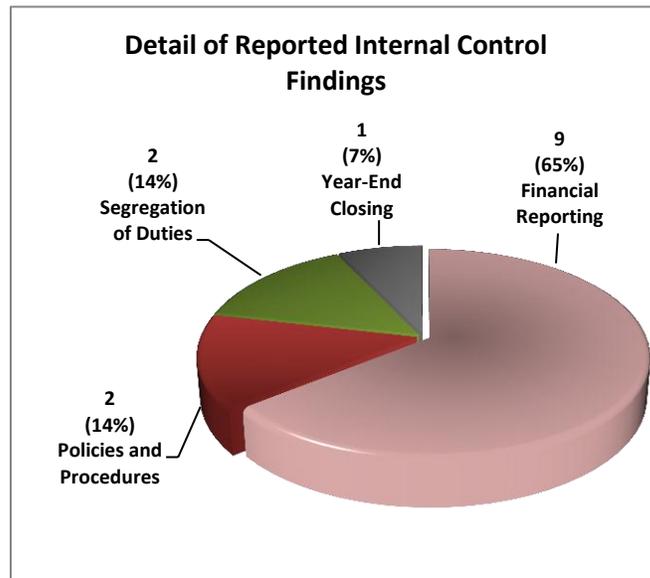
Figure 6B



**Breakdown of
Reported Internal
Control Findings**

Four functional areas are represented in the 14 internal control findings reported for FY 2010-11, as summarized in Figure 7.

Figure 7



The majority of the internal control findings (9 of the 14) are in the financial reporting category. Eight of the 9 financial reporting findings included in the audit reports relate to a recurring situation that is not readily corrected in one reporting cycle. Specifically, these findings address the local commissions' reliance on their independent auditors to draft financial statements and/or the accompanying notes to the financial statements.

Statement on Auditing Standards 1, Section AU 110.03, states that the financial statements and the accompanying notes are the responsibility of management. Therefore, when the independent auditor must prepare (or significantly assist in preparing) these documents, it must be reported as an internal control finding under auditing standards applicable to FY 2010-11. However, all eight local commissions indicated that they do not have the resources and/or do not find it feasible to hire staff to prepare the financial statements and/or accompanying notes. Based on our audit finding follow-up, our review of corrective action plans included in Commission meeting minutes, and the local commissions' responses to audit findings, we noted that:

- Five of the eight local commissions indicated that it is cost-prohibitive to hire staff or retain a public accountant to prepare the financial statements but are working with their county's auditor-controller to assist in preparing the financial statements and/or accompanying notes; and

- Three of the eight local commissions have determined that it is not cost-effective to engage someone to prepare the financial statements and accompanying notes, and they plan to continue relying on their independent auditor to prepare the annual financial statements.

Our review of local commissions’ board minutes indicated that all eight local commissions kept their governing commissions apprised of their attempts to find corrective action or implement mitigating procedures. This issue is not easily remedied due to a number of factors including the limited resources/options of smaller or remotely located local commissions. As a result, seven of the eight findings determined to have carried forward from FY 2009-10 (repeat findings) were related to local commissions relying on their auditors to prepare the financial statements and accompanying notes.

In comparison, 13 internal control findings reported for FY 2009-10 were in two functional areas. The FY 2008-09 audits contained a total of 18 internal control findings (in three functional areas). Taking into account the issue previously discussed, the local commissions appear to be correcting audit findings within a reasonable timeframe.

For FY 2010-11, there were five state compliance findings (in four functional areas). In comparison, one state compliance finding was reported in 2009-10. In FY 2008-09, three functional areas were represented in nine of the state compliance findings. Fiscal-year comparison by year is summarized in Figure 8.

***Breakdown of
Reported State
Compliance Findings***

Figure 8

Comparative Detail of Audit Findings–State Compliance			
	<u>2010-11</u>	<u>2009-10</u>	<u>2008-09</u>
Report Submission	1	0	0
Program Evaluation	1	0	0
Procurement and Contracting	0	0	3
Policies and Procedures	2	0	0
Conflict of Interest	0	1	4
County Ordinance	0	0	2
Administrative Costs	<u>1</u>	<u>0</u>	<u>0</u>
	<u>5</u>	<u>1</u>	<u>2</u>

**SCO Follow-up on
Reported Audit
Findings**

In addition to performing our desk review of the local commission audits, we are required to follow up on findings reported in the local commission audits. Specifically, Health and Safety Code section 130151(e) requires:

Within six months of the state or county commission's response pursuant to subdivision (d), the Controller shall determine whether a county commission has successfully corrected its practices in response

to the findings contained in the audit report. The Controller may, after that determination, recommend to the state commission to withhold the allocation of money that the county commission would otherwise receive from the California Children and Families Trust Fund until the Controller determines that the county commission has a viable plan and the ability to correct the practices identified in the audit.

The commissions, in accordance with Health and Safety Code section 130151(d) and *Government Auditing Standards* paragraph 5.32, are required to submit a response to findings in their audit reports. Audit finding follow-up is accomplished in three ways.

1. Review of evidence that the local commission has adopted a corrective action plan and/or resolved any findings. Evidence reviewed includes commission minutes, signed commission meeting agenda item documentation, and commission-approved audit finding responses.
2. Review of the subsequent fiscal year financial and compliance audit. Audit standards require that the independent auditor or auditor-controller determine the status of previously reported audit findings.
3. On-site visits by SCO staff to local commissions with audit findings.

For the FY 2010-11 audit review cycle, the SCO followed up on 11 findings via telephone conference for 7 of the 14 local commissions whose independent audits contained findings. Our follow-up resulted in a review of a total of 19 of the FY 2010-11 findings, representing 58% of the total reported findings for all 14 local commissions. All 7 local commissions provided corrective action plans and other documentation to substantiate resolution of their FY 2010-11 audit findings. In addition, we followed up on one FY 2009-10 finding during FY 2010-11. The FY 2009-10 finding was previously reported in FY 2008-09, at which time the SCO conducted an on-site visit to follow up on the finding. Based on our follow-up, the FY 2009-10 finding was corrected.

Based on our desk reviews of commission meeting minutes and telephone conference follow-up of audit findings, the SCO did not recommend withholding funding allocations for any commission for failure to correct (or provide a viable plan to correct) audit findings.

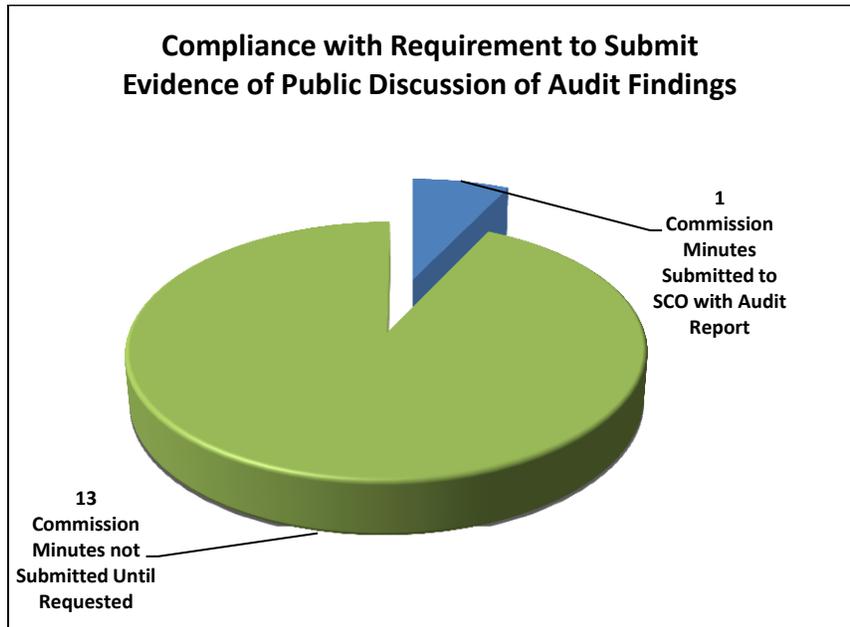
Compliance with Requirement for Public Discussion of Reported Audit Findings

The local commissions are required to discuss their audit findings in a public hearing. Specifically, Health and Safety Code section 130151(d) states, in part, that:

. . . each respective county commission shall schedule a public hearing within two months of receipt of the audit to discuss findings within the report and any response to the findings. Within two weeks of the public hearing, the state or county commission shall submit to the Controller a response to the audit findings.

In September 2009, the SCO issued an advisory requesting that the local commissions submit evidence (commission minutes and/or signed commission meeting agenda item documentation) of public discussion of audit findings and any related corrective action plans with their independent audit reports. However, for the last four review cycles, a significant number of local commissions have not submitted the required documentation until requested to do so by the SCO. For FY 2010-11, only one (7%) of the 14 local commissions whose independent audits contained findings submitted public discussion-related documentation to the SCO with its audit report (see Figure 9). Upon request, the remaining 13 local commissions submitted similar documentation; however, one local commission did not submit the requested documentation until after the third request.

Figure 9



Our review of the public discussion-related documentation submitted by the local commissions indicated that nine local commissions with audit findings held public hearings discussing the findings and related corrective action plans. The documentation initially submitted by the five remaining local commissions with audit findings did not contain detail sufficient to determine compliance with the public hearing requirement. At the request of the SCO, all five local commissions presented their findings at a subsequent public hearing and submitted the required documentation. We conclude that all 14 local commissions with audit findings complied with the requirement to discuss their audit findings and related corrective action plans in a public hearing.

Appendix A-1 Summary of Independent Audit Report Deficiencies Fiscal Year 2010-11

Description of Audit Report Deficiency	Number of Occurrences
<u>Independent Auditor's Report</u>	
The Independent Auditor's Report did not contain a statement that the purpose of the separately issued Government Auditing Standards report is to describe the scope of the testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance.	1
	<u>1</u>
<u>Basic Financial Statements</u>	
The <i>Balance Sheet-Governmental Funds</i> in the basic financial statements did not total correctly and/or the title of the financial statement did not correspond with the presentation of the financial statement.	1
The <i>Balance Sheet-Governmental Funds</i> title did not correspond with the presentation of the financial statement.	1
	<u>2</u>
<u>Notes to the Financial Statements</u>	
The notes to the financial statements did not include adequate disclosure of long-term debt; it did not include a schedule of changes or a statement of debt service requirements to maturity.	1
	<u>1</u>
<u>Required Supplementary Information (RSI)</u>	
The RSI of the budgetary comparison data for the general fund and any major special revenue funds did not total correctly.	1
	<u>1</u>
<u>The Report on Internal Control Over Financial Reporting and Compliance and Other Matters (GAS Report)</u>	
The GAS Report was not prepared in accordance American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards (SAS) No.115.	1
The GAS Report did not include the correct or complete definition of a deficiency in internal control or a material weakness.	1
The GAS Report did not include the required SAS No. 115 language for the auditor's consideration of internal control over financial reporting.	1
The GAS Report included contradicting statements that result in ambiguity in the independent auditor's opinion.	1
The GAS Report did not include the correct statement of the auditor's consideration of internal control over financial reporting when material weaknesses were noted.	5
The GAS Report did not include the required statement related to compliance with provisions of laws, regulations, contracts, and grant agreements.	6
	<u>15</u>

Appendix A-1 (continued)

Description of Audit Report Deficiency	Number of Occurrences
<u>Management Letter</u>	
Audit report refers to a separate management letter that was not submitted to the SCO.	2
	<u>2</u>
<u>Auditor's Report State Compliance (State Compliance Report)</u>	
The state compliance report did not identify applicable compliance requirements or a reference to where they can be found.	4
The state compliance report did not include the statement that the auditor's responsibility is to express an opinion on the local commission's compliance with the applicable compliance requirements based on the compliance audit.	1
The state compliance report was not in the format required by the SCO First 5 Audit Guide.	1
The state compliance report incorrectly referenced the title of the SCO First 5 Audit Guide.	4
	<u>10</u>
<u>Findings and Recommendations</u>	
The reported audit findings did not include all elements required by GAS (criteria, condition, and finding reference number).	6
The audit report did not include a Schedule of Prior Audit Findings.	1
	<u>7</u>
Total	<u>39</u>

Appendix A-2

Summary of Independent Audit Report Deficiencies Three-Year Comparison

Description of Audit Report Deficiency	Number of Occurrences		
	2008-09	2009-10	2010-11
<u>Independent Auditor's Report</u>			
The introductory paragraph of the Independent Auditor's Report did not indicate which financial statements were covered by the independent auditor's opinion as required.	1	0	0
The Independent Auditor's Report did not include the independence-related disclosure statement required by government auditing standards when the audit is prepared by the county auditor-controller.	1	0	0
The Independent Auditor's Report did not contain a statement that the purpose of the separately issued GAS Report is to describe the scope of the testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance.	2	0	1
<u>Basic Financial Statements</u>			
The <i>Statement of Activities</i> in the basic financial statements did not total correctly.	6	1	1
<i>Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets</i> amounts shown did not match amounts referenced in the notes to the financial statements.	0	1	0
The <i>Balance Sheet-Governmental Funds</i> title did not correspond with the presentation of the financial statement.	0	0	1
<u>Notes to the Financial Statements</u>			
The notes to the financial statements did not include adequate disclosure of long-term debt; it did not include a schedule of changes or a statement of debt service requirements to maturity.	0	1	1
The notes to the financial statements did not include adequate disclosure of all material items necessary for a fair presentation of the financial statements.	0	1	0
<u>Required Supplementary Information (RSI)</u>			
The Schedule of Budgetary Comparison is missing a required element (final version of legally adopted budget), had improperly labeled amounts, did not total correctly (contained mathematical error/errors), and/or was not in a presentation consistent governmental accounting principles.	3	0	0
The RSI of the budgetary comparison data for the general fund and any major special revenue funds did not total correctly.	0	0	1

Appendix A-2 (continued)

Description of Audit Report Deficiency	Number of Occurrences		
	2008-09	2009-10	2010-11
<u>Government Auditing Standards (GAS) Report</u>			
Report on Internal Control over Financial Reporting and Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards (GAS Report) included in the audit report was not properly titled and/or is not in the correct format.	1	0	1
The GAS Report was not prepared in accordance with the American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards (SAS) No. 112/115.	2	3	0
The GAS Report did not include the correct and/or complete definition of a deficiency in internal control or a material weakness.	0	7	1
The GAS Report did not include the correct statement for the auditor's consideration of internal control over financial reporting when material weaknesses were noted.	0	1	5
The GAS Report included contradicting statements that resulted in ambiguity in the independent auditor's opinion.	0	1	1
The GAS Report did not include a statement that deficiencies identified are considered significant deficiencies, and/or the description of the significant deficiencies (including management views/response and corrective action).	0	2	0
The GAS Report did not include the definition of a significant deficiency when significant deficiencies were identified and/or included the definition when no significant deficiencies were identified in the audit report.	0	3	0
The GAS Report did not include the statement that no material weaknesses were identified when no significant deficiencies were noted in the audit report.	0	1	0
The GAS Report did not include the statement that no material weaknesses were identified when significant deficiencies were noted in the audit report.	0	1	0
The GAS Report did not include the required statement related to compliance with provisions of laws, regulations, contracts, and grant agreements.	0	0	6
The GAS Report included an incomplete and/or incorrect statement that the auditor's consideration of the internal control over financial reporting was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weakness.	0	0	1
The closing paragraph of the GAS Report did not properly identify recipients of the report, including the SCO.	2	0	0
<u>Management Letter</u>			
The audit report refers to a separate management letter that was not submitted to the SCO.	4	2	2
<u>Auditor's Report State Compliance (State Compliance Report)</u>			
The state compliance report did not include the word <i>independent</i> in the title of the report.	0	1	0
The state compliance report did not identify applicable compliance requirements or a reference to where they can be found.	0	21	4
The state compliance report did not include the statement that compliance with the requirements of laws, regulations, contracts, and grants applicable to the California Children and Families Act (Act) is responsibility of local commission's management.	0	3	0

Appendix A-2 (continued)

Description of Audit Report Deficiency	Number of Occurrences		
	2008-09	2009-10	2010-11
The state compliance report did not include the statement that the auditor's responsibility is to express an opinion on the local commission's compliance with the applicable compliance requirements based on the compliance audit.	0	15	1
The state compliance report did not include the statement that the compliance audit includes examining, on a test basis, evidence about the local commission's compliance with those requirements and performing such other procedures as the auditor considered necessary in the circumstances.	0	14	0
The state compliance report was not in the format required by the SCO First 5 Audit Guide.	6	4	1
The state compliance report did not include the statement that the compliance audit does not provide a legal determination of the local commission's compliance with compliance audit requirements.	0	7	0
The state compliance report did not include an opinion on whether the local commission complied, in all material respects, with the applicable compliance requirements.	0	11	0
The state compliance report incorrectly referenced the title of the SCO First 5 Audit Guide.	0	0	4
<u>Findings and Recommendations Section</u>			
Audit Findings did not include all elements required by government auditing standards.	3	5	6
Auditee's corrective action plan to correct non-compliance was not included.	0	1	0
Schedule of Prior Audit Findings was not included in the audit report.	0	2	1
Audit report did not indicate that the current-year finding was also an audit finding in a prior year.	0	1	0
<u>Other Audit Report Presentation Issues</u>			
The auditor's opinions within the audit report were not signed and/or dated as required by auditing standards.	1	3	0
Audit report presentation was not consistent with government accounting standards (GASB 34) or audit standards.	1	1	0
Total	<u>33</u>	<u>114^a</u>	<u>39</u>

^a The number of report deficiencies is primarily due to the 25 independent auditors' state compliance reports that did not comply with SAS No. 117. Specifically, the 25 reports contained a total of 72 instances of non-compliance with SAS. No 117.

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

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



Transmitted via e-mail

November 13, 2012

Ms. Jennifer Kent, Chair
First 5 California Commission
2389 Gateway Oaks Drive, Room 260
Sacramento, CA 95833

Dear Ms. Kent:

Final Report—First 5 California, 2012 Financial Statement Audit of the Children and Families Trust Fund and Related Accounts

The Department of Finance, Office of State Audits and Evaluations, 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, 2012.

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 requiring a response, we are issuing the report as final. This report will be placed on our website.

We appreciate the assistance and cooperation of First 5 California, Department of General Services, and 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. Renee Webster-Hawkins, Interim Executive Director, First 5 California
Ms. Sandra Beck, Chief, Administrative Services Division, First 5 California
Ms. Cynthia Bridges, Executive Director, State Board of Equalization
Ms. Lynn Bartolo, Chief, Special Taxes and Fees Division, State Board of Equalization
Ms. Liz Peralta, Chief Accounting Officer, Accounting Section, State Board of Equalization
Mr. Brock Wimberley, Acting Chief, Internal Audit Division, State Board of Equalization
Ms. Jaana Brown, Manager, Contracted Fiscal Services, Department of General Services
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, 2012

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

MEMBERS OF THE TEAM

Kimberly Tarvin, CPA
Manager

Alma Ramirez, CPA
Supervisor

Staff
Bryan Nguyen
Jeremy Jackson
Matt Fong

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

You can contact our office at:

Department of Finance
Office of State Audits and Evaluations
915 L Street, 6th Floor
Sacramento, CA 95814
(916) 322-2985

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EXECUTIVE SUMMARY

The Department of Finance, Office of State Audits and Evaluations, 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, 2012.
- 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, 2012.
- We noted matters involving the internal control over financial reporting and its operation, and compliance with laws and regulations, that we have reported to First 5 California and Board of Equalization in a separate letter dated November 13, 2012.

This report is intended solely for the information and use of the Fund's management, 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. Jennifer Kent, Chair
First 5 California Commission
2389 Gateway Oaks Drive, Room 260
Sacramento, CA 95833

We have audited the accompanying *Balance Sheet* as of June 30, 2012, 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, 2012, and the results of its 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 Fund and related accounts as of and for the year ended June 30, 2012, 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.

However, we identified a deficiency in internal control that we consider to be a significant deficiency. We communicated the significant deficiency to First 5 California and Board of Equalization in a separate letter dated November 13, 2012. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund and related accounts' financial statements as of and for the year ended June 30, 2012, 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*. However, we noted a matter involving compliance that we have reported to First 5 California in a separate letter dated November 13, 2012.

This report is intended solely for the information and use of Fund management, those charged with governance, and the Legislature, 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

October 26, 2012

BALANCE SHEET

First 5 California Children and Families Trust Fund and Related Accounts As of June 30, 2012

	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	\$ 2,303,834	\$ 65	\$ 833	\$ 636	\$ 508	\$ 805	\$ 49,726	\$ 659
Deposits in SMIF	42,768,000	29,818,000	18,401,000	35,862,000	26,419,000	11,072,000	22,578,000	9,121,000
Receivables	39,169,231						7,641	
Due from Other Funds ¹	1,089,272	68,274,466	5,332,066	4,299,252	2,584,627	2,576,065	874,225	4,492,519
Prepaid Expenses							55,382	
Total Assets	\$85,330,337	\$98,092,531	\$23,733,899	\$40,161,888	\$29,004,135	\$13,648,870	\$23,564,974	\$13,614,178
Liabilities								
Accounts Payable			\$ 3,502,621		\$ 86,680	\$ 115,234	\$ 319,740	
Due to Other Funds ¹	\$85,326,065		500,223	\$ 1,111,608	472,433	694,755	155,812	
Due to Other Governments		\$98,092,531		17,813,305	3,945,594	454,554		\$ 2,972,528
Total Liabilities	85,326,065	98,092,531	4,002,844	18,924,913	4,504,707	1,264,543	475,552	2,972,528
Fund Balance								
Restricted for purposes specified in the California Children and Families Act of 1998 ²	4,272	0	19,731,055	21,236,975	24,499,428	12,384,327	23,089,422	10,641,650
Total Fund Balance	4,272	0	19,731,055	21,236,975	24,499,428	12,384,327	23,089,422	10,641,650
Total Liabilities and Fund Balance	\$85,330,337	\$98,092,531	\$23,733,899	\$40,161,888	\$29,004,135	\$13,648,870	\$23,564,974	\$13,614,178

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

¹ See Note 2

² See Note 3

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, 2012**

	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	\$ 499,012,028							
SMIF Interest Revenue	107,951	\$ 64,929	\$ 121,192	\$ 138,253	\$ 100,460	\$ 73,942	\$ 87,788	\$ 23,001
Other Revenue			720,266					
Total Revenue	499,119,979	64,929	841,458	138,253	100,460	73,942	87,788	23,001
Expenditures								
Appropriation Expenditures	15,711,540	373,591,680	40,532,104	27,298,747	12,739,030	19,529,613	6,028,256	4,145,974
Excess (Deficiency) of Revenues Over(Under) Expenditures	483,408,439	(373,526,751)	(39,690,646)	(27,160,494)	(12,638,570)	(19,455,671)	(5,940,468)	(4,122,973)
Other Financing Sources & Uses								
Operating Transfers In ³		373,526,751	28,014,506	23,345,422	14,007,253	14,007,253	4,669,084	9,338,169
Operating Transfers Out ³	483,408,439							
Net Change in Fund Balance	0	0	(11,676,140)	(3,815,072)	1,368,683	(5,448,418)	(1,271,384)	5,215,196
Fund Balance July 1, 2011	4,272	0	31,407,195	25,052,047	23,130,745	17,832,745	24,360,806	5,426,454
Fund Balance June 30, 2012	\$ 4,272	\$ 0	\$ 19,731,055	\$21,236,975	\$24,499,428	\$12,384,327	\$23,089,422	\$10,641,650

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

³ See Note 5

NOTES TO FINANCIAL STATEMENTS

First 5 California Children and Families Trust Fund and Related Accounts For the Fiscal Year Ended June 30, 2012

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 comprised of seven members. During fiscal year 2011-12 two seats were vacated and filled by new commissioners.

Prior to January 1, 1999, the 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 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, BOE receives, accounts for, and deposits the cigarette tax revenue into the Fund. Further, 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</i> (Act) 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 of 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 2011-12 allocations, the 2009 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, Assembly Bill 1422, Chapter 157, statutes of 2009, amends the Act to allow any funds not needed in these five accounts to be transferred to the *Unallocated Account (0639)* upon approval by the First 5 California Commission.

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's management is responsible for exercising budgetary control to ensure that 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 adjustment for estimated versus actual BOE expenditures. Additionally, the Unallocated Account (0639) includes reimbursement accruals for expenditures incurred on behalf of the other accounts.

Table 2: Due From Other Funds

Fund/Account	Fund/Account Due From	Amount
Fund 0623: Trust Fund		
	BOE General Fund (0001)	\$1,065,460
	Surplus Money Investment Fund (0681)	<u>23,812</u>
	Total Due From Other Funds	\$1,089,272
Account 0585: Counties		
	Children and Families Trust Fund (0623)	\$68,260,852
	Surplus Money Investment Fund (0681)	<u>13,614</u>
	Total Due From Other Funds	\$68,274,466
Account 0631: Mass Media		
	Children and Families Trust Fund (0623)	\$5,119,564
	Health Care Deposit Fund (0912)	186,121
	Surplus Money Investment Fund (0681)	<u>26,381</u>
	Total Due From Other Funds	\$5,332,066
Account 0634: Education		
	Children and Families Trust Fund (0623)	\$4,266,303
	Surplus Money Investment Fund (0681)	<u>32,949</u>
	Total Due From Other Funds	\$4,299,252
Account 0636: Child Care		
	Children and Families Trust Fund (0623)	\$2,559,782
	Surplus Money Investment Fund (0681)	<u>24,845</u>
	Total Due From Other Funds	\$2,584,627
Account 0637: Research and Development		
	Children and Families Trust Fund (0623)	\$2,559,782
	Surplus Money Investment Fund (0681)	<u>16,283</u>
	Total Due From Other Funds	\$2,576,065
Account 0638: Administration		
	Children and Families Trust Fund (0623)	\$853,261
	Surplus Money Investment Fund (0681)	<u>20,964</u>
	Total Due From Other Funds	\$874,225
Account 0639: Unallocated		
	Children and Families Trust Fund (0623)	\$1,706,521
	Mass Media Communications Account (0631)	500,223
	Education Account (0634)	1,111,608
	Child Care Account (0636)	472,433
	Research and Development Account (0637)	694,755
	Surplus Money Investment Fund (0681)	<u>6,979</u>
	Total Due From Other Funds	\$4,492,519

The Due To Other Funds represents the cigarette tax revenue accrued for transfer to the related accounts as of year-end, and reimbursements to the Unallocated Account (0639) at year-end.

Table 3: Due To Other Funds

Fund/Account	Due From Fund/Account	Amount
Fund 0623: Trust Fund		
	Counties' Account (0585)	\$68,260,852
	Mass Media Communications Account (0631)	5,119,564
	Education Account (0634)	4,266,303
	Child Care Account (0636)	2,559,782
	Research and Development Account (0637)	2,559,782
	Administration Account (0638)	853,261
	Unallocated Account (0639)	<u>1,706,521</u>
	Total Due To Other Funds	\$85,326,065
Account 0631: Mass Media		
	Due To Unallocated Account (0639)	\$500,223
Account 0634: Education		
	Due To Unallocated Account (0639)	\$1,111,608
Account 0636: Child Care		
	Due To Unallocated Account (0639)	\$472,433
Account 0637: Research and Development		
	Due To Unallocated Account (0639)	\$694,755
Account 0638: Administration		
	General Fund	\$100,263
	Various other funds	<u>55,549</u>
	Total Due To Other Funds	\$155,812

NOTE 3 Fund Balance

First 5 California financial statements comply with the fund balance reporting requirement detailed in Statement Number 54 issued by the Governmental Accounting Standards Board (GASB 54). GASB 54 provides the following classifications of the fund balance.

- A. *Nonspendable Fund Balance*: Amounts that cannot be spent because they are either not in a spendable form or are legally or contractually required to be maintained intact.
- B. *Restricted Fund Balance*: Amounts that are restricted to specific purposes because of constraints placed on the use are either externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or are imposed by law through constitutional provisions or enabling legislation. Enabling legislation authorizes the government to assess, levy, charge, or otherwise mandate payment of resources (from external resource providers) and includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

- C. *Committed Fund Balance*: Amounts that can only be used for specific purposes pursuant to constraints imposed by formal action of the government's highest level of decision-making authority. The highest level of decision-making authority for the Fund and related accounts is the State Commission and the formal action required to establish a fund balance commitment is a majority vote.
- D. *Assigned Fund Balance*: Amounts that are constrained by the government's intent to be used for specific purposes, but are neither restricted nor committed. The Executive Director or designee per the State Commission Bylaws, pursuant to Health and Safety Code section 13030, can assign funds to contracts of up to \$150,000 for purposes authorized in the Act.
- E. *Unassigned Fund Balance*: The unassigned fund balance classification is the residual classification for the General Fund. This classification represents fund balance that has not been assigned to other funds and that has not been restricted, committed, or assigned to specific purposes within the General Fund.

In accordance with GASB 54 the entire fund balance is classified as Restricted because the Act comprises enabling legislation for the Fund and related accounts as outlined in Note 1.

NOTE 4 Department of Development Services (DDS) Early Start Program Expenditures

On April 18, 2012, the State Commission authorized \$50 million in 2011-12 funding for the DDS Early Start Program, administered by DDS to fund Regional Centers providing services to children through age 2. The table below reflects the expenditures by fund.

Table 4: Early Start Program Expenditures

Account	Amount
Account 0631: Mass Media	\$25,000,000
Account 0634: Education	7,000,000
Account 0636: Child Care	4,000,000
Account 0637: Research and Development	<u>14,000,000</u>
Total	\$50,000,000

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 into the seven related accounts and the statutorily required backfill of \$16.5 million 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 in Table 5.

Table 5: Operating Transfers

Cigarette Tax Revenue (Fund 0623):	
Current Year	\$499,012,028
SMIF Interest Revenue	107,951
Board - State Operations	<u>(15,711,540)</u>
Total Operating Transfers Out	483,408,439
Backfill	<u>(16,500,000)</u>
Total Operating Transfers In Related Accounts	\$466,908,439

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. BOE makes the fiscal determination and transfers the appropriate funds.

NOTE 6 Contingent Liabilities

BOE is involved in legal proceedings that, if decided against BOE, may result in a loss of funds available for transfer to the various programs supported by tobacco taxes. No provision for the potential liability has been made in the financial statements.

1. Various tobacco retailers have filed claims for refunds for the tax year 2008-09, claiming that the methodology used in setting the tax rate for the fiscal year was improper. These refund claims are currently in the administrative appeals process and total \$465,920. The impact to the Fund is estimated at 36.5 percent of the total refunds.
2. A tobacco products distributor has been audited and a liability totaling \$5,557,468, including penalties and interest, has been assessed for the audit periods February 2006 through December 2008. The assessment was appealed, and the case is in the administrative appeals process. The impact to the Fund is estimated at 36.5 percent.

NOTE 7 Subsequent Events

A. *Assembly Bill 1464 (AB 1464), Chapter 21, Statutes of 2012 (2012-13 Budget)*, makes appropriations, enacts statutory changes for support of state government, and reflects the final decisions of the Legislature relative to the 2012-13 Budget. The budget language includes the following:

- \$40 million for the Department of Health Care Services for the Medi-Cal Program.
- \$40 million for the Department of Developmental Services for the Early Start Program.
- Directs agencies to seek funding from First 5 California to support projects related to poison control.

The authorization of the transfer of money from First 5 California funds in response to the budget bill would require State Commission approval. As of the date of this report, the State Commission had not taken action on the AB 1464 funding requests. Therefore, the amount of funding for these commitments cannot be estimated at this time.

- B. On October 17, 2012, the State Commission authorized First 5 California to extend funding of \$42 million over three years for the CARES Plus program beginning in 2013-14.



November 13, 2012

Ms. Jennifer Kent, Chair
First 5 California Commission
2389 Gateway Oaks Drive, Room 260
Sacramento, CA 95833

Dear Ms. Kent:

Management Letter—First 5 California, 2012 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 financial audit of the First 5 California's Children and Families Trust Fund (Fund) and related accounts for the fiscal year ended June 30, 2012. In planning and performing our audit of the financial statements of the Fund and related accounts for the fiscal year then ended, we considered the internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on internal control. Additionally, 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. During our audit we became aware of an opportunity for strengthening internal control over the Fund and an instance where the First 5 Commission did not fully comply with a legislative requirement.

Observation 1: Undocumented Cost Allocation Plan Procedures

The Board of Equalization (BOE) does not have written cost allocation plan (CAP) procedures for program and administrative costs allocated to the various funds it administers. During fiscal year 2011-12, BOE allocated \$15.7 million of program and administrative costs to the Fund. BOE relies on the knowledge of a limited number of key staff in the Budget Operations Unit to perform the calculations and allocate the costs. However, the cost allocation calculation is a complex, manual process which consists of a series of multi-layered allocations employing various methodologies (i.e. allocation bases, and cost pools). Reliance on only the knowledge of key staff without documented CAP procedures creates a risk that costs may not be allocated consistently, appropriately, and in accordance with the benefits received by the Fund.

The Financial Integrity and State Manager's Accountability Act, Government Code section 13400, et. seq., requires state agencies to maintain effective systems of internal control as an integral part of its management practices to ensure the reliability of financial information. This responsibility includes documenting the system through flowcharts, narratives, and desk procedures as specified in the State Administrative Manual (SAM) section 20050. In addition, SAM section 9203 requires documentation of cost allocation procedures in the form of a CAP, with detailed information regarding the costs being allocated, allocation methodology, frequency of the allocation, and rationale for the allocation base. It further states that CAPs should be supported by appropriately cross-referenced working papers or system documentation, updated periodically, and retained for reference and audit purposes.

Recommendation: BOE should develop a CAP to document its cost allocation methodology. This will ensure the program and administrative costs are allocated consistently, appropriately, and in accordance with the benefits received by the Fund.

Response: BOE concurred with the observation and indicated the budget staff is in the process of developing comprehensive internal documentation of the cost allocation procedures and methodology, and is making adjustments to conform to statewide requirements.

Observation 2: Commission Transfer of Funds Authorization Requirements

The First 5 Children and Families Commission (Commission) did not fully comply with the technical requirements of Assembly Bill 1422, Chapter 157, statutes of 2009 (AB 1422), to authorize funding of \$50 million for the Department of Developmental Services' (DDS) Early Start Program. AB 1422 requires Commission approval to transfer funds not needed in various accounts to the Unallocated Account for any of the purposes of the California Children and Families Act of 1998 (Proposition 10).

On April 18, 2012, the Commission approved a motion authorizing \$50 million for DDS' Early Start Program. Although the Commission authorized the \$50 million funding for DDS, the motion did not specify the composition of the funding by the various contributing accounts, a determination that these funds were not needed in those accounts, nor authorize the specific transfer of the funds to the Unallocated account for subsequent disbursement to DDS. This impacts the presentation of the financial statements as the \$50 million is only authorized to be expended directly from the various accounts and not from the Unallocated account as required.

Recommendation: The Commission should ensure motions to transfer funds conform with all requirements of AB 1422. This will appropriately authorize the transfer of any funds and ensure the consistent presentation of these expenditures in the financial statements.

Response: The Commission indicated it has put in place stronger procedures to ensure all future motions will include, if appropriate, the authorization to transfer funds from specified accounts to the Unallocated account together with any required findings that the funds are not needed in the original account. Additionally, the Commission stated that for the above motion the Commissioners were presented with a financial plan, including proposed funding by account, and the subsequent transfer of funds adhered to the funding as presented during the meeting.

This letter is intended as an internal management tool to assist the Fund's management in improving internal control and compliance. We appreciate the assistance and cooperation of BOE and First 5 California's management and staff. If you have any questions regarding this letter, please contact Kimberly Tarvin, Manager, or Alma Ramirez, Supervisor, at (916) 322-2985.

Sincerely,



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

cc: On following page

cc: Ms. Renee Webster-Hawkins, Interim Executive Director, First 5 California
Ms. Sandra Beck, Chief, Administrative Services Division, First 5 California
Ms. Cynthia Bridges, Executive Director, State Board of Equalization
Mr. Larry Norris, Budget Officer, State Board of Equalization
Mr. Brock Wimberley, Acting Chief, Internal Audit Division, State Board of Equalization
State Controller's Office, Division of Audits, First 5 Oversight Unit



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0025
1-916-445-3811 • FAX 1-916-323-9634
www.boe.ca.gov

BETTY T. YEE
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JOHN CHIANG
State Controller

CYNTHIA BRIDGES
Executive Director

November 1, 2012

Mr. David Botelho, Chief
Office of State Audits and Evaluations
Department of Finance
915 L Street, 6th Floor
Sacramento, CA 95814

Dear Mr. Botelho:

As requested, the following is our response to the observation included in the draft Management Letter you provided to us via e-mail on October 26, 2012, for the financial audit of the First 5 California's Children and Families Trust Fund and related accounts for the fiscal year ended June 30, 2012.

Observation 1: Undocumented Cost Allocation Plan Procedures

The State Board of Equalization (BOE) agrees with the audit observation regarding undocumented cost allocation plan procedures. The BOE budget staff is currently working to develop comprehensive internal documentation of the cost allocation procedures and methodology and is making adjustments to conform to statewide requirements.

If you have any questions, or would like to discuss the response further, you may contact Cecilia Watkins at (916) 324-5832.

Sincerely,

Ms. Edna Murphy
Chief, Financial Management Division

EM:ct

cc: Ms. Cynthia Bridges
Ms. Liz Houser
Mr. Larry Norris
Ms. Rosa Hernandez
Mr. Steven Mercer
Mr. Randy Silva
Mr. Brock Wimberley
Ms. Cecilia Watkins