



Transmitted via e-mail

November 8, 2011

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

Dear Ms. Perry:

**Final Report—First 5 California, 2011 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, 2011.

The enclosed report is for your information and use. Because there were no audit observations or issues 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 the First 5 California, Department of General Services, and the 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,

Original signed by:

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

Enclosure

cc: Ms. Marsha Jones, Chief Deputy Director, First 5 California  
Ms. Kim Gauthier, Chief Counsel, First 5 California  
Ms. Terry L. Miller, Chief, Administrative Services Division, First 5 California  
Ms. Sandra Beck, Fiscal Operations Manager, First 5 California  
Ms. Kristine Cazadd, Executive Director, State Board of Equalization  
Ms. Liz Peralta, Chief Accounting Officer, Accounting Section, State Board of Equalization  
Mr. Mike Skikos, Acting Chief, Internal Audit Division, State Board of Equalization  
Mr. Jim Martone, Acting Chief, Contracted Fiscal Services, Department of General Services  
State Controller's Office, Division of Audits, First 5 Oversight Unit

A FINANCIAL STATEMENT AUDIT

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First 5 California  
Children and Families Trust Fund  
and Related Accounts  
For the Fiscal Year Ended  
June 30, 2011

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  
David Munoz, CPA  
Wrenna Finche

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

You can contact our office at:

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# EXECUTIVE SUMMARY

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

- Express an opinion on the *Balance Sheet and Statement of Revenue, Expenditures, and Changes in Fund Balance* of the Children and Families Trust Fund (Fund) and related accounts for the fiscal year ended June 30, 2011.
- 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, 2011.
- The audit did not identify any reportable internal control or compliance weaknesses. However, we noted other matters involving the internal control over financial reporting and its operation that we have reported to First 5 California management in a separate letter dated November 8, 2011.

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.



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## INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying *Balance Sheet* as of June 30, 2011, 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 paragraphs, 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, 2011, and the results of operations and changes in fund balance thereof for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States of America.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements of the Fund and related accounts as of and for the year ended June 30, 2011, 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 noted matters involving the internal control over financial reporting and its operation that we have reported to First 5 California management in a separate letter dated November 8, 2011.

### **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, 2011, are free of material misstatement, we performed tests of compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of 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.

Original signed by:

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

October 28, 2011

# BALANCE SHEET

## First 5 California Children and Families Trust Fund and Related Accounts For the Fiscal Year Ended June 30, 2011

	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)
<b>Assets</b>								
Cash	\$34,489,936	\$ 406	\$ 100	\$ 926	\$ 785	\$ 676	\$ 46,665	\$ 152,686
Deposits in SMIF	8,429,000	33,184,000	29,428,000	39,859,000	24,289,000	17,149,000	23,526,000	3,776,000
Receivables	42,581,440						5,440	
Due from Other Funds <sup>1</sup>	2,162,720	70,147,315	5,522,249	4,434,083	2,658,285	2,652,895	904,817	4,787,641
Due from Other Governments								857,132
Prepaid Expenses							71,331	
<b>Total Assets</b>	<b>\$87,663,096</b>	<b>\$103,331,721</b>	<b>\$34,950,349</b>	<b>\$44,294,009</b>	<b>\$26,948,070</b>	<b>\$19,802,571</b>	<b>\$ 24,554,253</b>	<b>\$9,573,459</b>
<b>Liabilities</b>								
Accounts Payable			\$ 3,007,450	\$ 569,867	\$ 1,748,742	\$ 744,932	\$ 47,404	
Due to Other Funds <sup>1</sup>	\$87,658,824		535,704	1,206,454	747,339	759,251	146,042	
Due to Other Governments		\$103,331,721		17,465,641	1,321,244	465,643		\$4,147,005
<b>Total Liabilities</b>	<b>87,658,824</b>	<b>103,331,721</b>	<b>3,543,154</b>	<b>19,241,962</b>	<b>3,817,325</b>	<b>1,969,826</b>	<b>193,446</b>	<b>4,147,005</b>
<b>Fund Balance</b>								
Restricted for purposes specified in the <i>California Children and Families Act of 1998</i> <sup>2</sup>	4,272	0	31,407,195	25,052,047	23,130,745	17,832,745	24,360,807	5,426,454
<b>Total Fund Balance</b>	<b>4,272</b>	<b>0</b>	<b>31,407,195</b>	<b>25,052,047</b>	<b>23,130,745</b>	<b>17,832,745</b>	<b>24,360,807</b>	<b>5,426,454</b>
<b>Total Liabilities and Fund Balance</b>	<b>\$87,663,096</b>	<b>\$103,331,721</b>	<b>\$34,950,349</b>	<b>\$44,294,009</b>	<b>\$26,948,070</b>	<b>\$19,802,571</b>	<b>\$24,554,253</b>	<b>\$9,573,459</b>

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

<sup>1</sup> See Note 2

<sup>2</sup> 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, 2011

	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)
<b>Revenue</b>								
Cigarette Tax Revenue	\$504,520,899							
SMIF Interest Revenue	163,290	\$ 68,543	\$ 184,025	\$ 353,841	\$ 173,764	\$ 227,359	\$ 115,722	\$ 149,310
Other Revenue			635,635	843,523			521	
<b>Total Revenue</b>	<b>504,684,189</b>	<b>68,543</b>	<b>819,660</b>	<b>1,197,364</b>	<b>173,764</b>	<b>227,359</b>	<b>116,243</b>	<b>149,310</b>
<b>Expenditures</b>								
Appropriation Expenditures	14,229,862	376,272,005	27,985,835	35,379,379	11,886,339	13,160,390	4,994,197	128,244,205 <sup>3</sup>
<b>Excess (Deficiency) of Revenues Over(Under) Expenditures</b>	<b>490,454,327</b>	<b>(376,203,462)</b>	<b>(27,166,175)</b>	<b>(34,182,015)</b>	<b>(11,712,575)</b>	<b>(12,933,031)</b>	<b>(4,877,954)</b>	<b>(128,094,895)</b>
<b>Other Financing Sources &amp; Uses</b>								
Operating Transfers In <sup>4</sup>		376,203,462	28,215,260	23,512,716	14,107,630	14,107,630	4,702,543	104,305,087
Operating Transfers Out	490,454,327 <sup>4</sup>		6,000,000	35,000,000 <sup>3</sup>	16,900,000 <sup>3</sup>	37,000,000 <sup>3</sup>		
<b>Net Change in Fund Balance</b>	<b>0</b>	<b>0</b>	<b>(4,950,915)</b>	<b>(45,669,299)</b>	<b>(14,504,945)</b>	<b>(35,825,401)</b>	<b>(175,411)</b>	<b>(23,789,808)</b>
<b>Fund Balance July 1, 2010</b>	4,272		36,358,110	70,721,346	37,635,690	53,658,146	24,536,218	29,216,262
<b>Fund Balance June 30, 2011</b>	<b>\$ 4,272</b>	<b>\$ 0</b>	<b>\$ 31,407,195</b>	<b>\$25,052,047</b>	<b>\$23,130,745</b>	<b>\$17,832,745</b>	<b>\$24,360,807</b>	<b>\$5,426,454</b>

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

<sup>3</sup> See Note 4

<sup>4</sup> See Note 5

# NOTES TO FINANCIAL STATEMENTS

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## First 5 California Children and Families Trust Fund and Related Accounts For the Fiscal Year Ended June 30, 2011

### NOTE 1 Summary of Significant Accounting Policies

#### A. Definition of Reporting Entity

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

The programs authorized by this Act are administered by First 5 California and by county children and families commissions. The First 5 California Commission is made up of seven members. During fiscal year 2010-11 one seat was vacated and filled by a new commissioner.

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. Furthermore, the Department of General Services performs accounting services for First 5 California.

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

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

<b>Account</b>	<b>Account Title</b>	<b>Percent Allocation</b>	<b>Account Purpose</b>
0585	Counties Children and Families Account	80%	For allocation to county commissions <sup>1</sup> for the purposes authorized 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. <sup>2</sup>
0634	Education Account	5%	For funding of education goals and purposes as specified in the Act <sup>2</sup> .
0636	Child Care Account	3%	For funding for child care goals and purposes as specified in the Act <sup>2</sup> .
0637	Research and Development Account	3%	For funding research and development goals and purposes as specified in the Act <sup>2</sup> .
0638	Administration Account	1%	For funding of administrative costs and other purposes as specified in the Act <sup>2</sup> .
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.

<sup>1</sup> Each First 5 county commission is allocated funds from Account 0585 based on the number of live births recorded in each county in proportion to the entire number of live births recorded statewide. For the fiscal year 2009-10 allocations, the 2008 birth vital statistics compiled by the California Department of Public Health were used as this was the most recent reporting period available.

<sup>2</sup> Effective September 22, 2009, AB1422 amends the Act to allow any funds not needed in these five accounts to be transferred to the *Unallocated Account (0639)* upon approval by 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 School Readiness Program expenditures incurred on behalf of the other accounts.

**Table 2: Due From Other Funds**

<b>Fund/Account</b>	<b>Fund/Account Due From</b>	<b>Amount</b>
Fund 0623: Trust Fund		
	BOE General Fund (0001)	\$2,126,138
	Surplus Money Investment Fund (0681)	<u>36,582</u>
	Total Due From Other Funds	\$2,162,720
Account 0585: Counties		
	Children and Families Trust Fund (0623)	\$70,127,060
	Surplus Money Investment Fund (0681)	<u>20,255</u>
	Total Due From Other Funds	\$70,147,315
Account 0631: Mass Media		
	Children and Families Trust Fund (0623)	\$5,259,529
	Health Care Deposit Fund (0912)	230,297
	Surplus Money Investment Fund (0681)	<u>32,423</u>
	Total Due From Other Funds	\$5,522,249
Account 0634: Education		
	Children and Families Trust Fund (0623)	\$4,382,941
	Surplus Money Investment Fund (0681)	<u>51,142</u>
	Total Due From Other Funds	\$4,434,083
Account 0636: Child Care		
	Children and Families Trust Fund (0623)	\$2,629,765
	Surplus Money Investment Fund (0681)	<u>28,520</u>
	Total Due From Other Funds	\$2,658,285
Account 0637: Research and Development		
	Children and Families Trust Fund (0623)	\$2,629,765
	Surplus Money Investment Fund (0681)	<u>23,130</u>
	Total Due From Other Funds	\$2,652,895
Account 0638: Administration		
	Children and Families Trust Fund (0623)	\$876,588
	Surplus Money Investment Fund (0681)	<u>28,229</u>
	Total Due From Other Funds	\$904,817
Account 0639: Unallocated		
	Children and Families Trust Fund (0623)	\$1,753,176
	Mass Media Communications Account (0631)	535,704
	Education Account (0634)	1,190,454
	Child Care Account (0636)	505,943
	Research and Development Account (0637)	744,032
	Surplus Money Investment Fund (0681)	<u>58,330</u>
	Total Due From Other Funds	\$4,787,639

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

**Table 3: Due To Other Funds**

<b>Fund/Account</b>	<b>Due From Fund/Account</b>	<b>Amount</b>
Fund 0623: Trust Fund		
	Counties' Account (0585)	\$70,127,059
	Mass Media Communications Account (0631)	5,259,529
	Education Account (0634)	4,382,941
	Child Care Account (0636)	2,629,765
	Research and Development Account (0637)	2,629,765
	Administration Account (0638)	876,588
	Unallocated Account (0639)	<u>1,753,176</u>
	Total Due To Other Funds	\$87,658,824
Account 0631: Mass Media		
	Unallocated Account (0639)	<u>\$535,704</u>
	Total Due To Other Funds	\$535,704
Account 0634: Education		
	General Fund	\$ 16,000
	Unallocated Account (0639)	<u>1,190,454</u>
	Total Due To Other Funds	\$1,206,454
Account 0636: Child Care		
	General Fund	\$241,396
	Unallocated Account (0639)	<u>505,943</u>
	Total Due To Other Funds	\$747,339
Account 0637: Research and Development		
	General Fund	\$ 15,217
	Unallocated Account (0639)	<u>744,034</u>
	Total Due To Other Funds	\$759,251
Account 0638: Administration		
	General Fund	\$ 91,023
	Various other funds	<u>55,019</u>
	Total Due To Other Funds	\$146,042

**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) as required for financial statements issued after June 15, 2010. 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 Unallocated Account (0639) Expenditures**

On January 26, 2011, the State Commission authorized 2010-11 funding for the following two programs: (1) \$81.4 million for the Healthy Families Program administered by the Managed Risk Medical Insurance Board (MRMIB); and (2) \$50 million for the Early Start Program administered by the Department of Developmental Services (DDS). Payments totaling \$131.4 million were made from the Unallocated Fund's Clearing Account.

The reported expenditure amount for Account 0639 includes abatements of \$8.87 million for the return of funds from MRMIB for the Healthy Families Program previously transferred to MRMIB in 2008-09 and 2009-10.

**Table 4: Unallocated Account (0639) Expenditures**

<b>Transferring Account</b>	<b>MRMIB</b>	<b>DDS</b>	<b>Total</b>
Mass Media Communications Account (0631)	\$ 6,000,000	\$ 0	\$6,000,000
Education Account (0634)	15,000,000	20,000,000	35,000,000
Child Care Account (0636)	13,400,000	3,500,000	16,900,000
Research and Development Account (0637)	26,500,000	10,500,000	37,000,000
<b>Transfer in subtotal</b>	<b>60,900,000</b>	<b>34,000,000</b>	<b>94,900,000</b>
From Fund 0639	20,500,000	16,000,000	<u>36,500,000</u>
Total expenditures for MRMIB and DDS			\$131,400,000
Other expenditures			5,714,849
Less: Abatements from MRMIB			<u>(8,870,644)</u>
<b>Expenditures from Unallocated Fund 0639</b>			<b>128,244,205</b>

**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 \$20.2 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:

**Table 5: Operating Transfers**

Cigarette Tax Revenue (Fund 0623):	
Current Year	\$504,520,899
SMIF Interest Revenue	163,290
Board - State Operations	<u>(14,229,862)</u>
Total Operating Transfers Out	490,454,327
Backfill	<u>(20,200,000)</u>
Total Operating Transfers In Related Accounts	\$470,254,327



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**

### **A. First 5 California Legal Proceedings**

1. SEIU v. Schwarzenegger, et al. Case Numbers RG09456750 and RG010516259. Each of these cases relate to petitioners challenging the validity of the Governor's Executive Orders furloughing state employees in special fund departments for various days per month. These cases are filed in various courts and in various different counties. First 5 California is a respondent in two of the three cases filed and is represented by the Department of Personnel Administration (DPA) in this litigation. These cases are still in active litigation and pending judicial decisions. First 5 California's total furlough liability for all three years of the furlough program (2008-09 through 2010-11) is approximately \$735,000.
2. Assembly Bill Number 99, Chapter 4, 2011, authorizes \$50 million dollars from the First 5 California accounts, including reserve funds, upon approval of the state commission, be transferred to and deposited in the Children and Families Health and Human Services Fund (CFHHS Fund) to support state health and human services programs for children from birth through five years of age. The bill also authorizes \$950 million from the combined balances of all the county Children and Families Trust Funds be transferred to the CFHHS Fund. To date, eight counties have filed actions challenging the legality of AB 99 and three counties have intervened in existing litigation or expressed in court filings their intent to intervene. The named respondents include Governor Brown, State Controller Chiang, and the Director of the Department of Finance. In summary, all the Petitions for Writ of Mandate contend that AB 99 unlawfully amended the California Children and Families Act and illegally expropriate \$1,000,000,000 in trust funds contrary to the language, purpose and intent of Proposition 10. As all of the actions are challenging AB 99 on the same or similar grounds, all six matters have been transferred, coordinated, and consolidated in the Superior Court for the County of Fresno, Court Case Number 11CECG01077. It is anticipated that the Court's ruling should be issued on or before November 28, 2011. The parties will have 60 days from the date of the ruling to file an appeal.

### **B. BOE Legal Proceedings**

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. Taxpayers filed a refund lawsuit on December 5, 2007, for tobacco taxes paid. These taxpayers are the shareholders and officers of a corporation, who had continued distributing cigarettes and tobacco products after the corporation was suspended for failure to pay franchise taxes. BOE asserted controlling person liability against taxpayers under the Cigarette and Tobacco Products Tax Law. On February 23, 2009, the trial court entered judgment in favor of taxpayers in the amount of \$69,763 plus interest. Subsequently, the trial court awarded attorneys' fees to taxpayers under Code of Civil Procedure section 1021.5 in the amount of \$627,797. BOE appealed both the judgment and the attorneys' fee award. The appellate court reduced the tax refund awarded to the plaintiffs, limiting it to the \$1,500 actually paid in taxes plus interest, and remanded the matter of attorney's fees back to the trial court to clarify its finding and recalculate the attorney's fees award if appropriate. The impact to the Fund is estimated at 36.5 percent of the total award.
2. Various tobacco retailers have filed claims for refunds for the tax year 2008-2009, 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.
3. 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. On October 19, 2011, the State Commission approved funding up to \$135 million over three years, beginning in 2012-13, (\$45 million annually) for the Child Signature Program—Power of Preschool.
- B. On October 19, 2011, the State Commission authorized First 5 California to extend and fund \$31.4 million for the Parent Signature Program—Education and Outreach project beginning in 2012-13.