

August 6, 2012

Mr. Craig Watson, Director  
California Arts Council  
1300 I Street, Suite 930  
Sacramento, CA 95814

Dear Mr. Watson:

### **Review of the California Arts Council's Graphic Design License Plate Account, Fund 0078**

At the request of the Governor's Office, the Department of Finance (Finance) performed a review of the Graphic Design License Plate Account (Fund 0078) administered by the California Arts Council (Council). The purpose of the review was to determine whether fees collected from sales of the Graphic Design License Plates are being used in accordance with the authorizing statutes.

#### **Results Summary**

The Council is generally in compliance with the uses and restrictions as outlined in the California Vehicle Code. However, the Council's compliance with the 25 percent administrative cost cap could not be determined. The fund balance as of June 30, 2011, is \$3,599,000 with no outstanding fund transfers/loans.

We have reviewed the Council's response and have incorporated it into this report as Attachment A. The Council states the Department of Motor Vehicles (DMV) will issue new guidance regarding the 25 percent administrative cap. The Council also intends to seek legislation clarifying the meaning of the administrative restriction and will modify their approach accordingly.

Based on our review of the referenced statutes and the Council's response, our report remains unchanged.

#### **Scope and Methodology**

To determine if fees collected from sales of the Graphic Design License Plates are used in accordance with the authorizing statutes, we performed the following:

- Reviewed applicable laws, regulations, and criteria to identify authorized fund uses and restrictions.
  - Interviewed key personnel at the Council and DMV to gain an understanding of the fund accounting and reporting processes.
  - Reviewed accounting records to determine total revenues and expenditures for the prior three fiscal years.
  - Selected a sample of grant agreements to verify the scope of work was consistent with the authorized fund uses.
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## Results

The Polanco-Bates License Plates for the Arts Act of 1993 (California Vehicle Code section 5074) established the Graphic Design License Plate Account (Fund 0078) within the General Fund to be used by the Council for arts education and local arts programming. In 2011, the DMV reported 57,074 outstanding Graphic Design License Plates. See Exhibit 1 for the distribution of fees collected.

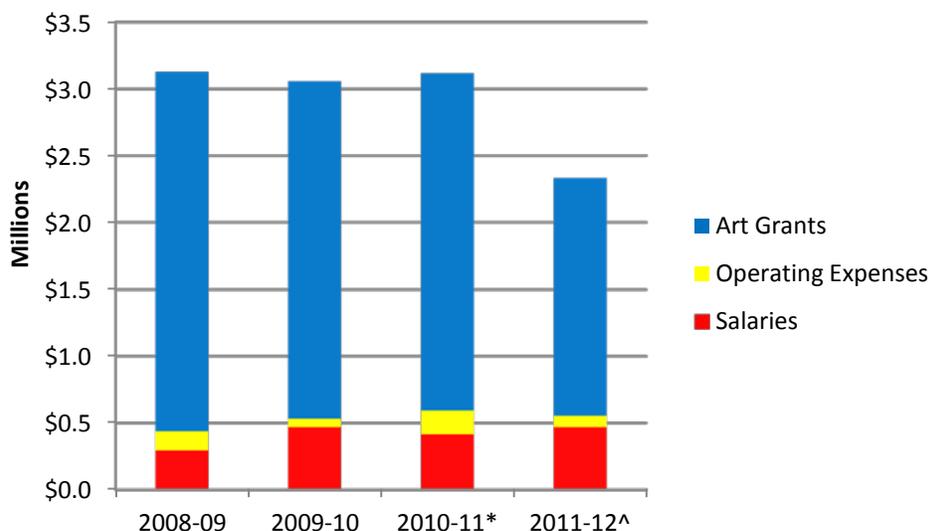
AUTHORIZED PER STATUTE	COMPLIANCE RESULTS
<p><b>AUTHORIZED USES</b>  <i>Vehicle Code section 5074(c)</i> – The funds in the account shall be used by the California Arts Council, upon appropriation by the Legislature, for <b>arts education and local arts programming</b>.</p>	Yes
<p><b>USE RESTRICTION</b>  <i>Vehicle Code section 5074(d)</i> – The California Arts Council shall use the revenue derived from the <b>fee increases</b> authorized...during the 2003-04 Regular Session <b>exclusively for arts education and local arts programming</b>. <b>The Council shall not use that revenue for its administrative costs</b>.</p>	Yes
<p><b>EXPENDITURE LIMITATION</b>  <i>Vehicle Code section 5060(g)</i> – Shall not expend annually more than <b>25 percent</b> of those funds on <b>administrative costs, marketing, or other promotional activities</b> associated with encouraging application for, or renewal of, the special license plates.</p>	Undetermined
<p><b>REQUIREMENT</b>  <i>Vehicle Code section 5060(d)(2)(A)</i> – If the number of <b>currently outstanding and valid special interest license plates</b> in any particular program...<b>is less than 7,500</b> <b>DMV will no longer issue or replace</b> those special interest license plates.</p>	Yes

### Art Council Meets the Fund’s Authorized Uses and Restrictions

Pursuant to Vehicle Code changes in 2004, revenues derived from the “fee increases” cannot be used for administrative costs. Based on our review, the Council has ensured “fee increase” revenues are used exclusively for arts education and arts programming.

The Council’s expenditures for Fund 0078 include salaries and fringe benefits, operating expenses, and arts program grants. Arts grants were awarded to local governments and nonprofit organizations for various programs such as the State/Local Partnership Program, Poetry Out Loud Program, and Technical Assistance Grants. Over 80 percent of all special license plate fees received by the Council were expended on grants for arts education and local arts programs. See Chart 1 for types of expenditures by appropriation year.

**Chart 1: Types of Expenditures for All Fee Revenues**



Source: CALSTARS reports  
 \* : Amount includes expenditures and encumbrances as of June 30, 2011.  
 ^ : Amount includes expenditures and encumbrances as of May 31, 2012.

**Compliance with Administrative Expenditure Limitation Could Not Be Determined**

Fees derived from the “original fees” under Vehicle Code section 5060(g) are restricted to a 25 percent administrative cap. The Council received ambiguous guidance regarding application of this cap and as a result, considers the cap to only include administrative costs associated with *marketing and promoting* the license plates. The Council does not include staff salaries or other non-marketing costs in their “administrative” cost cap and reports administrative costs of less than 5 percent in their annual report to the Department of Motor Vehicles.

However, administrative costs typically include all non-direct costs such as salaries for administrative staff, legal, accounting, and other non-program related units. Because the Council does not separately account for direct or indirect salaries and operating expenditures, we are unable to determine compliance with the administrative cap. As noted in Table 1, total salaries and operating expenditures exceed 25 percent of original fee revenues; however, some of these salaries include direct program costs. Going forward, we recommend the Council separately identify and track all direct and indirect salaries and operating expenditures to ensure compliance with the 25 percent administrative cap.

**Table 1: Salaries and Operating Expenditures Percentages**

Fiscal Year	Estimated Original Fees <sup>1</sup>	Salaries	% of Total	Operating Expenditures	% of Total
2008-09	\$1,130,620	\$294,864	26 %	\$143,809	13 %
2009-10	\$1,080,578	\$468,250	43 %	\$ 65,087	6 %
2010-11	\$925,074	\$414,418	45 %	\$179,726	19 %
2011-12	\$868,312	\$468,549	54 %	\$ 85,436	10 %

Source: The Council’s methodology to estimate “Original Fees” and CALSTARS reports.

<sup>1</sup> Revenues collected from the fee increases are not separately accounted for by the Department of Motor Vehicles; however, the Council has implemented a reasonable methodology to estimate the revenue derived from “original fee” vs. “fee increase.”

## Revenues and Fund Balance

In addition to Fund 0078, the Council also receives funding from the General Fund (Fund 0001), Federal Trust Fund (Fund 0890), and Reimbursements (Fund 0995). For 2010-11, Fund 0078 represented over 50 percent of the Council's funding sources as shown in Table 2 below.

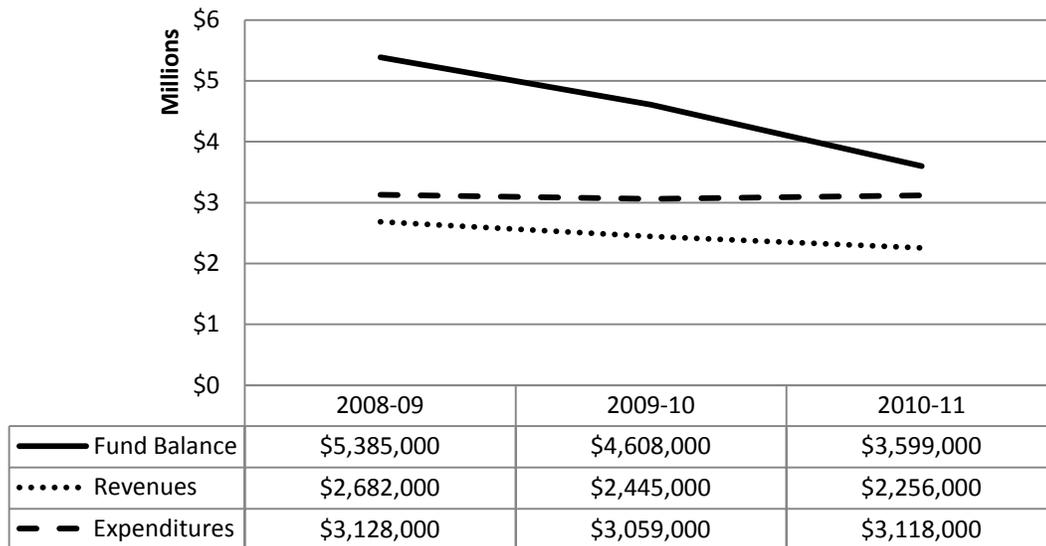
**Table 2: Funding Sources Appropriated in 2010-11**

Fund	Amount	Percent of Total
0001	\$1,011,000	18 %
0078	\$3,118,000	57 %
0890	\$1,322,000	24 %
0995	\$ 27,000	1 %
Total	\$5,478,000	100 %

Source: Governor's Budget 2012-13

As noted in Chart 2, the fund balance for Fund 0078 has been decreasing over the prior three years due to expenditures exceeding revenues, which have also decreased over the same three-year period.

**Chart 2: Fund Balance, Revenues, and Expenditures by Appropriation Year**



Source: Budgetary/Legal Basis Annual Reports prepared by the State Controller's Office and CALSTARS reports.

The results in this report are based on our review performed from June 2012 through July 2012. We provided the results to the Council's management on July 18, 2012, and as necessary, updated the report to incorporate their responses.

We appreciate the assistance and cooperation of the Council. If you have any questions regarding this report, please contact Diana Antony, Manager, or Lisa Negri, Supervisor, at (916) 322-2985.

Sincerely,

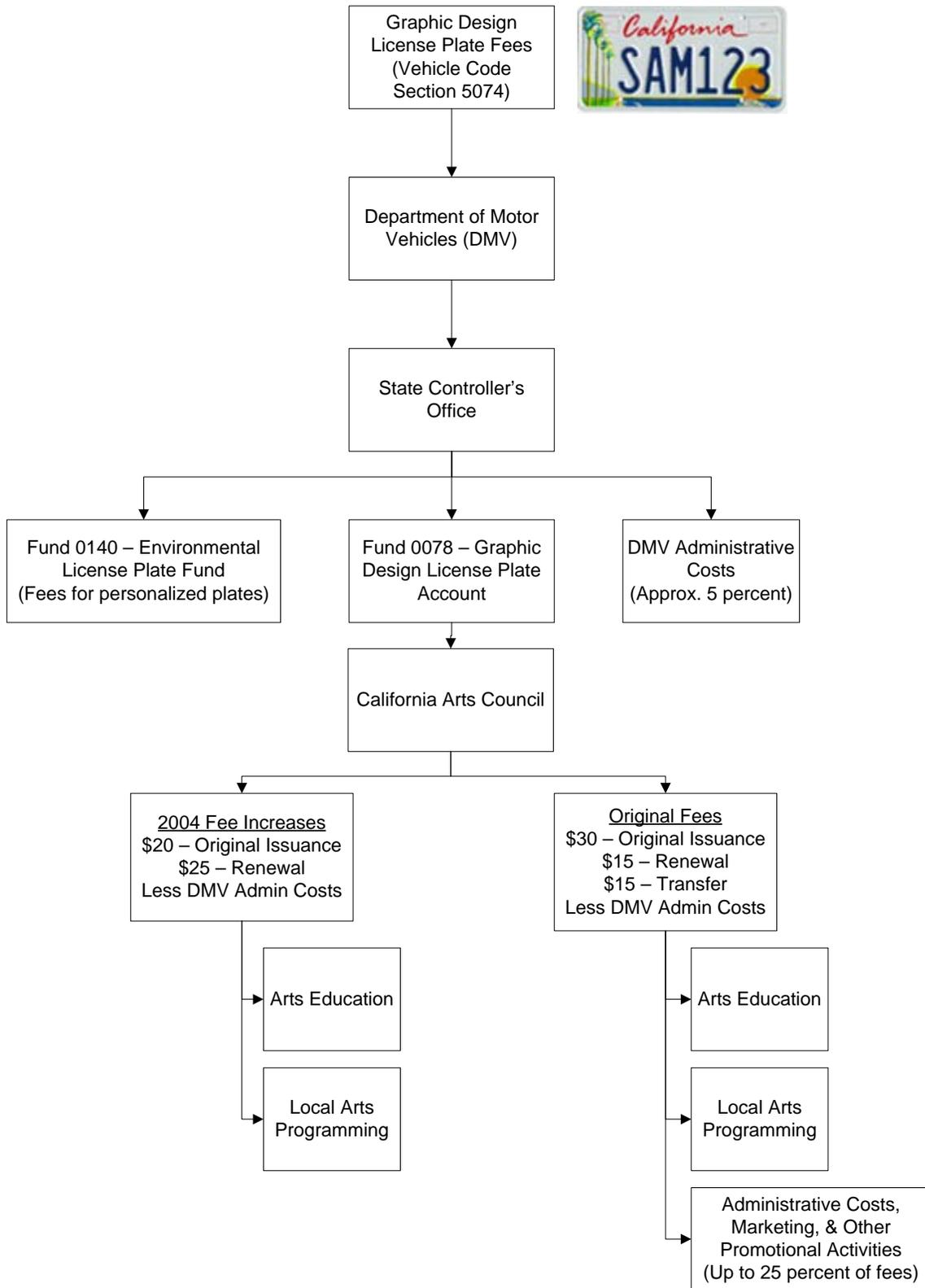
Original signed by:

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

Attachment

cc: Ms. Marilyn Nielsen, Chief Deputy Director, California Arts Council  
Mr. Scott Heckes, Deputy Director, California Arts Council  
Mr. Andrew Conway, Chief, Registration Operations Division, Department of Motor Vehicles  
Ms. Kitty Kramer, Program Manager, Department of Motor Vehicles  
Mr. Jeff Mansur, Chief, Financial Services Branch, Department of Motor Vehicles  
Mr. Jim Humes, Executive Secretary for Administration, Legal Affairs and Policy, Office of the Governor  
Ms. Sue Johnsrud, Director of Operations, Office of the Governor

**Exhibit 1 – Distribution of Fees Collected**



**Attachment A – California Arts Council Response**



# Memorandum

California Arts Council  
1300 I. Street, Suite 930  
Sacramento, CA 95814  
916.322.6555

**To:** Diana Antony, Manager  
Department of Finance, Office of State Audits and Evaluations

**From:** Craig Watson, Director

**CC:** Marilyn Nielsen, Chief Deputy Director; Scott Heckes, Deputy Director

**Date:** July 30, 2012

**Re:** Response to DOF Review of Graphic Design License Plate Account

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The following was prepared in response to the Department of Finance's review of the Graphic Design License Plate Account, and is submitted per the instructions received by Rick Sierra, CPA, Assistant Chief, Office of State Audits and Evaluations (OSAE).

## **Compliance with Administrative Expenditure Limitation**

### Administrative Expenses

The Arts Council implemented the current reporting methodology for determining compliance with California Vehicle Code (CVC) Section 5060(g) at the direction of the Department of Motor Vehicles (DMV) in 2000. It is intended to insure that no more than 25 percent of revenues collected from the sale of special license plates are used to support the administrative costs, marketing, or other promotional costs *associated with* encouraging application for, or renewal of, the special license plates is appropriate.

We consulted DMV on this issue after receiving the OSAE Draft Report; they have now determined it would be appropriate to issue new guidance to all plate programs for future reports. The Arts Council will modify its approach accordingly.

While we accept the OSAE conclusion on the matter, we note that it represents a change in state policy. We do not believe the intent of the section is entirely clear and we will seek legislation clarifying the meaning of the restriction. License plate programs are increasingly seen as funding sources for a number of state interests, including operations traditionally served by the General Fund.

### Original Fees and Increases

As noted in the OSAE Draft Report, the Legislature adopted a fee increase for Arts Plates in 2004 (SB 1213, 2004). CVC 5074(d) restricts the use of this new revenue, "exclusively for arts education and local arts programming. The council shall not use that revenue for its administrative costs."

The report states that the cap established in CVC 5074 is 25 percent of the "original" fee revenue only and none of the increase can be used in calculating the maximum allowable spending. This is concerning, because the OSAE Draft Report states that as a result, "total salaries and operating expenditures exceed 25 percent of original fee revenues."

CVC 5060(g) states that when an agency, "receives funds from the additional fees collected from the sale of special license plates," it may not, "expend annually more than 25 percent of *those* funds on administrative costs, marketing, or other promotional activities associated with encouraging application for, or renewal of, the special license plates." The allowance speaks to all plate programs; the Arts Council is one of several entities subject to the requirement.

We believe that the OSAE Draft Report should base the percentage of administrative expenditures on total annual revenues, the plain meaning of the statute. The following table illustrates the issue using Fiscal Year 10/11 figures:

	<b>Fund Amount</b>	<b>Allowable at 25 percent</b>	<b>Arts Council Charged</b>	<b>Percent</b>	<b>Difference</b>
Total Revenue	\$3,118,057	\$779,500	\$594,144	19.05%	+ \$185,356
Estimated Original Fee Revenue	\$925,074	\$231,268	\$594,144	64.22%	- \$362,876

Because federal money in the Arts Council budget has restrictions prohibiting its use for certain activities, many programs supported by license plate revenue could only be shifted to the General Fund, the only other significant source of Arts Council funding other than license plate revenue. (However, the agency's General Fund support is sufficient to cover only 66% of personnel costs, nothing else. The remaining portion of personnel costs are supported by License Plate funds.) For example, while there is a 25 percent cap on expenses for license plate revenue, federal dollars cannot be spent on marketing or promotional activities or staff salaries supporting such activities as these are seen as fundraising expenditures and as such are prohibited federal expenditures.

Arts Council budgets have been crafted for a number of years with all parties relying on a more literal and reasonable interpretation of the language in CVC 5060(g). This position is also consistent with the rule as it is applied at other agencies receiving special license plate revenue.

We appreciate the opportunity to respond to the draft management letter and are available for further discussion or clarification.