



Transmitted via e-mail

November 14, 2013

Mr. George C. Halvorson, Chair
First 5 California Children and Families Commission
2389 Gateway Oaks Drive, Room 260
Sacramento, CA 95833

Dear Mr. Halvorson:

Final Report—First 5 California Children and Families Commission, 2013 Financial 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, 2013.

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 Children and Families Commission, Department of General Services, and State Board of Equalization. If you have any questions regarding this report, please contact Kimberly Tarvin, Manager, or Rebecca McAllister, Supervisor, at (916) 322-2985.

Sincerely,

Richard R. Sierra, CPA
Acting Chief, Office of State Audits and Evaluations

Enclosure

cc: Ms. Camille Maben, Executive Director, First 5 California Children and Families Commission
Ms. Jennifer Clark, Chief, Administrative Services Division, First 5 California Children and Families Commission
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, 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, 2013

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

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

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TABLE OF CONTENTS

Executive Summary	iv
Independent Auditor's Report.....	1
Balance Sheet.....	4
Statement of Revenue, Expenditures and Changes in Fund Balance	5
Notes to Financial Statements	6

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 Children and Families Commission. 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, 2013.
- 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, 2013.
- The audit did not identify any reportable internal control or compliance weaknesses.

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 these specified parties. However, this report is a matter of public record and its distribution is not limited.

INDEPENDENT AUDITOR'S REPORT

Mr. George C. Halvorson, Chair
First 5 California Children and Families Commission
2389 Gateway Oaks Drive, Room 260
Sacramento, CA 95833

We have audited the accompanying financial statements of the governmental activities of the First 5 California Children and Families Trust Fund (Fund) and related accounts for the year ended June 30, 2013, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit 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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities of the Fund and related accounts as of June 30, 2013, and the respective changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements of the Fund and related accounts are intended to present the financial position and the changes in financial position of only that portion of the governmental activities of the State of California that is attributable to the transactions of the Fund and related accounts. They do not purport to, and do not, present fairly the financial position of the State of California as of June 30, 2013, the changes in its financial position, or where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

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, 2013, in accordance with auditing standards generally accepted in the United States of America, we considered the internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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 Fund and related accounts' 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. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did

not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund and related accounts' financial statements 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.



Richard R. Sierra, CPA
Acting Chief, Office of State Audits and Evaluations

October 29, 2013

BALANCE SHEET

First 5 California Children and Families Commission Children and Families Trust Fund and Related Accounts As of June 30, 2013

	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	\$ 3,211,657	\$ 139	\$ 319	\$ 556	\$ 358	\$ 800	\$ 46,338	\$ 195
Investments	37,866,000	31,621,000	32,405,000	39,492,000	31,768,000	22,787,000	22,056,000	14,365,000
Receivables	39,113,618						8,257	
Due from Other Funds ¹	1,349,071	65,240,410	5,081,027	4,099,073	2,464,730	2,458,923	829,813	37,845,083
Prepaid Expenses							56,181	
Total Assets	\$ 81,540,346	\$ 96,861,549	\$ 37,486,346	\$ 43,591,629	\$ 34,233,088	\$ 25,246,723	\$ 22,996,589	\$ 52,210,278
Liabilities								
Accounts Payable			\$ 2,553,503		\$ 262,068	\$ 100,117	\$ 32,069	\$ 46,402
Due to Other Funds ¹	\$ 81,536,074		14,712,764	\$ 9,564,568	2,354,978	7,355,695	125,139	17,585,410
Due to Other Governments		\$ 96,861,549		78,061	3,828,506	418,998		21,237,128
Total Liabilities	81,536,074	96,861,549	17,266,267	9,642,629	6,445,552	7,874,810	157,208	38,868,940
Fund Balance								
Restricted	4,272	0	20,220,079	33,949,000	27,787,536	17,371,913	22,839,381	13,341,338
Total Fund Balance	4,272	0	20,220,079	33,949,000	27,787,536	17,371,913	22,839,381	13,341,338
Total Liabilities and Fund Balance	\$ 81,540,346	\$ 96,861,549	\$ 37,486,346	\$ 43,591,629	\$ 34,233,088	\$ 25,246,723	\$ 22,996,589	\$ 52,210,278

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

¹ See Note 3

STATEMENT OF REVENUE, EXPENDITURES AND CHANGES IN FUND BALANCE

First 5 California Children and Families Commission Children and Families Trust Fund and Related Accounts For the Fiscal Year Ended June 30, 2013

	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	\$ 481,237,784							
Interest Revenue	93,648	\$ 52,954	\$ 67,788	\$ 113,365	\$ 83,929	\$ 47,690	\$ 66,620	\$ 35,882
Other Revenue			711,165					
Total Revenue	481,331,432	52,954	778,953	113,365	83,929	47,690	66,620	35,882
Expenditures	15,830,475	360,453,719	27,319,986	9,926,388	10,310,850	8,575,133	4,821,671	6,346,213
Excess (Deficiency) of Revenues Over(Under) Expenditures	465,500,957	(360,400,765)	(26,541,033)	(9,813,023)	(10,226,921)	(8,527,443)	(4,755,051)	(6,310,331)
Other Financing Sources & Uses								
Operating Transfers In ²		360,400,765	27,030,057	22,525,048	13,515,029	13,515,029	4,505,010	9,010,019
Operating Transfers Out ²	465,500,957							
Net Change in Fund Balance	0	0	489,024	12,712,025	3,288,108	4,987,586	(250,041)	2,699,688
Fund Balance July 1, 2012	4,272	0	19,731,055	21,236,975	24,499,428	12,384,327	23,089,422	10,641,650
Fund Balance June 30, 2013	\$ 4,272	\$ 0	\$ 20,220,079	\$ 33,949,000	\$ 27,787,536	\$ 17,371,913	\$ 22,839,381	\$ 13,341,338

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

² See Note 3

NOTES TO FINANCIAL STATEMENTS

First 5 California Children and Families Commission Children and Families Trust Fund and Related Accounts For the Fiscal Year Ended June 30, 2013

NOTE 1 Reporting Entity and 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 First 5 California Children and Families Commission (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 Fund and its related accounts are included as a special revenue fund in the State of California's financial statements.

The programs authorized by the 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 2012-13, two seats were vacated and filled by new commissioners; one of these appointments was the Commission Chair.

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, for a total of 87 cents per cigarette pack, as well as a surtax on other tobacco products. Of the 87 cents collected, 50 cents is allocated and deposited into the Fund. The remainder funds Proposition 99 and Breast Cancer programs.

While First 5 California has full responsibility for the program and financial statements, BOE receives, accounts for, and deposits the cigarette and tobacco product 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 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 communications to the general public utilizing television, radio, newspapers, and other mass media furthering the goals and purposes specified in the Act.
0634	Education Account	5%	For funding education goals and purposes as specified in the Act.
0636	Child Care Account	3%	For funding child care goals and purposes as specified in the Act.
0637	Research and Development Account	3%	For funding research and development goals and purposes as specified in the Act.
0638	Administration Account	1%	For funding administrative costs and other purposes as specified in the Act.
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 governmental fund financial statements are prepared using the current financial resources measurement focus and 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, First 5 California records revenues when they are measurable and available within the ensuing 12 months. 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 2012-13 allocations, the 2010 birth vital statistics, compiled by the California Department of Public Health, were used as this was the most recent reporting period available.

D. Budget and Budgetary Control

Under Revenue and Taxation Code section 30131.3, the moneys deposited into the Fund are continuously appropriated for the exclusive purpose of the California Children and Families Program.

E. Investment Basis and Allocation of Investment Income

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 from investments are apportioned to the contributing fund as provided in Government Code. The participant's shares are valued on an amortized cost basis, which approximates fair value. Because the difference between the amortized cost and fair value are not material, no adjustment has been made in the financial statements.

F. Accounts Receivable

Accounts receivable consists of unbilled earned revenues and revenues collected by BOE but not yet transferred to the Fund as of June 30, 2013. Accounts receivable is recorded net of estimated uncollectible amounts.

G. Revenue

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

H. Fund Balance

First 5 California's fund balance classification is restricted according to Governmental Accounting Standard Board Statement Number 54. Restricted fund balances include resources that are subject to constraints that are externally enforceable legal restrictions such as the Act's enabling legislation.

I. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

NOTE 2 Investments

For disclosures related to investment policy and related investment risk categories, see the State of California Comprehensive Annual Financial Report.

NOTE 3 Interfund Transactions

Interfund Balances

These balances result from a time lag between the dates that interfund goods and services are provided or reimbursable expenditures occur, transactions are recorded in the accounting system, and payments are made between funds. The Due From Other Funds general ledger account consists of revenue recorded in the originating fund that is pending transfer to another fund for disbursement purposes. The Unallocated Account (0639) includes the clearing account and related 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)	\$ 1,331,199
	Surplus Money Investment Fund (0681)	<u>17,872</u>
	Total Due From Other Funds	\$ 1,349,071
Account 0585: Counties		
	Children and Families Trust Fund (0623)	\$ 65,228,859
	Surplus Money Investment Fund (0681)	<u>11,551</u>
	Total Due From Other Funds	\$ 65,240,410
Account 0631: Mass Media		
	Children and Families Trust Fund (0623)	\$ 4,892,164
	Health Care Deposit Fund (0912)	170,974
	Surplus Money Investment Fund (0681)	<u>17,889</u>
	Total Due From Other Funds	\$ 5,081,027
Account 0634: Education		
	Children and Families Trust Fund (0623)	\$ 4,076,804
	Surplus Money Investment Fund (0681)	<u>22,269</u>
	Total Due From Other Funds	\$ 4,099,073
Account 0636: Child Care		
	Children and Families Trust Fund (0623)	\$ 2,446,082
	Surplus Money Investment Fund (0681)	<u>18,648</u>
	Total Due From Other Funds	\$ 2,464,730
Account 0637: Research and Development		
	Children and Families Trust Fund (0623)	\$ 2,446,082
	Surplus Money Investment Fund (0681)	<u>12,841</u>
	Total Due From Other Funds	\$ 2,458,923
Account 0638: Administration		
	Children and Families Trust Fund (0623)	\$ 815,361
	Prison Industries Revolving Fund (0675)	818
	Surplus Money Investment Fund (0681)	<u>13,634</u>
	Total Due From Other Funds	\$ 829,813

Fund/Account	Fund/Account Due From	Amount
Account 0639: Unallocated		
	Children and Families Trust Fund (0623)	\$ 1,630,721
	Mass Media Communications Account (0631)	14,712,764
	Education Account (0634)	9,424,826
	Child Care Account (0636)	2,354,978
	Research and Development Account (0637)	7,355,695
	Unallocated Account (0639)	2,357,962
	Surplus Money Investment Fund (0681)	<u>8,137</u>
	Total Due From Other Funds	\$ 37,845,083

The Due To Other Funds general ledger account represents 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 To Fund/Account	Amount
Fund 0623: Trust Fund		
	Counties' Account (0585)	\$ 65,228,859
	Mass Media Communications Account (0631)	4,892,165
	Education Account (0634)	4,076,804
	Child Care Account (0636)	2,446,082
	Research and Development Account (0637)	2,446,082
	Administration Account (0638)	815,361
	Unallocated Account (0639)	<u>1,630,721</u>
	Total Due To Other Funds	\$ 81,536,074
Account 0631: Mass Media		
	Due To Unallocated Account (0639)	\$ 14,712,764
Account 0634: Education		
	General Fund	\$ 139,742
	Due To Unallocated Account (0639)	<u>9,424,826</u>
	Total Due To Other Funds	\$ 9,564,568
Account 0636: Child Care		
	Due To Unallocated Account (0639)	\$ 2,354,978
Account 0637: Research and Development		
	Due To Unallocated Account (0639)	\$ 7,355,695
Account 0638: Administration		
	General Fund	\$ 66,893
	Various other funds	<u>58,246</u>
	Total Due To Other Funds	\$ 125,139
Account 0639: Unallocated		
	General Fund	\$ 15,227,448
	Due to Unallocated Account (0639)	<u>2,357,962</u>
	Total Due To Other Funds	\$ 17,585,410

Interfund Transfers

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

The Transfers In for the seven related accounts are calculated based on the applicable allocation percentages specified in Note 1.

Table 4: Transfers In

Transfers in from Fund 0623 Trust Fund to:	
Account 0585: Counties	\$ 360,400,765
Account 0631: Mass Media	27,030,057
Account 0634: Education	22,525,048
Account 0636: Child Care	13,515,029
Account 0637: Research and Development	13,515,029
Account 0638: Administration	4,505,010
Account 0639: Unallocated	<u>9,010,019</u>
Total Operating Transfers In	\$ 450,500,957

Table 5: Transfers Out

Transfers Out from Fund 0623 Trust Fund to:	
Related Accounts	\$ 450,500,957
Backfill	<u>15,000,000</u>
Total Operating Transfers Out	\$ 465,500,957

The Fund's Transfers Out represents the sum of the Transfers In to the seven related accounts and the statutorily required backfill of \$15 million for Proposition 99 and Breast Cancer programs. 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 (Tobacco Tax and Health Protection Act of 1988) and Breast Cancer Fund programs to offset the revenue loss from declining cigarette and tobacco product consumption resulting from the imposition of additional taxes on cigarettes and tobacco products by the Act. BOE makes the fiscal determination of the backfill amount and transfers the appropriate funds.

NOTE 4 Department of Developmental Services

On April 25, 2013, the First 5 California commissioners approved funding in the amount \$15 million (\$10 million from the Mass Media Account and \$5 million from the Research and Development Account) for the Department of Developmental Services to fund new Early Start services.

NOTE 5 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. Specifically, a distributor has filed claims for the periods January 2008 through October 2010, and is anticipated to continue filing claims as the statute of limitations periods approach for each reporting period. Claims filed to date total \$36,529,671. The claims are being prepared for appeals conferences. At this time, it is not possible to predict the ultimate outcome concerning these claims or the amount of any future claims filed on this issue. Therefore, no provision for the potential liability has been made in the financial statements.