



January 19, 2023

INFORMATION ACTION

SUBJECT: FINANCIAL UPDATE

SUMMARY OF THE ISSUE

First 5 California (F5CA) staff will provide an update on the Commission's financial plan and other topics of financial interest.

Revenue Update

Table 1 on page 3 represents the actual and projected cigarette and tobacco tax revenues transferred from the California Department of Tax and Fee Administration (CDTFA) to the California Children and Families Trust Fund. The table includes updated revenue projections received from the Department of Finance (DOF) for the Governor's Proposed Budget released January 10, 2023. The table further displays the statutory distribution of 20% to the First 5 California State Commission and 80% to the county commissions. Revenue transfers are presented as actuals for fiscal year (FY) 2011/12 through FY 2020/21 and projected revenues for FY 2021/22 through FY 2026/27, with the percentage decline from each fiscal year to the next.

Proposition 10

For FY 2022/23, the total Proposition 10 tobacco tax revenue collected by CDTFA for the months of July 2022 through November 2022 (prior to CDTFA adjustments for statewide assessments, administrative costs, and backfill to Proposition 99 and the Breast Cancer Fund) was \$122M. Of this amount, \$116M (after adjustments) was transferred to the California Children and Families Trust Fund. The State Commission's share totaled \$23.2M to administer the Mass Media Communications, Education, Child Care, Research and Development, Unallocated, and Administration accounts.

There is only a slight percentage difference between what was received in FY 2021/22, to what was received in FY 2022/23 for the first 5 months.

FY 22/23 Proposition 10 Revenues Transferred to the California Children and Families Trust Fund

	Total Revenue Transferred (after adjustments)	State Commission Share
FY 21/22 (July - November 2021)	\$116,196,640	\$23,239,328
FY 22/23 (July - November 2022)	\$116,111,816	\$23,222,363

Revenue is received throughout the fiscal year. Therefore, First 5 California does not realize the full fiscal year total until September or October of the following fiscal year. In order to encumber funds (set aside funds for current commitments and obligations of the State Commission), there must be a sufficient carryover cash balance to cover these costs or projected current revenue that would ensure sufficient cash in the given fiscal year to cover the fiscal year obligations.

Proposition 56 Backfill

Proposition 56 was approved by voters in November 2016, increasing the state’s excise tax on cigarettes and other tobacco products. The backfill was intended to maintain the loss of revenues to existing tax funds as a result of the decline of purchases and consumption.

For FY 2022/23, the backfill amount expected to be transferred to the California Children and Families Trust Fund is \$84,712 million, with the State Commission receiving \$16.9 million to administer the state’s funds. The revenue transfer is to backfill funds affected by the changes in consumption during the previous fiscal year. This amount is approximately 6% lower than what the Department of Finance projected in May 2022. In prior years, the funds were transferred into the Trust Fund in late December or early January.

California Electronic Cigarette Excise Tax (CECET)

SB 395 enacted the Healthy Outcomes and Prevention Education (HOPE) Act, which imposes the CECET. Beginning July 1, 2022, retailers of electronic cigarettes, containing or sold with nicotine, are required to collect the CECET at a rate of 12.5% from the purchaser at the time of sale. CDTFA oversees the collection and distribution of the CECET tax. All revenues, interest, and penalties, less refunds, collected from the tax will be distributed accordingly with a portion going to the California Children and Families Trust Fund.

Retailers are required to file separately from any other reports and returns, with the first filing and payment being due by October 31, 2022 (covers reporting period July 1, 2022, through September 30, 2022).

Table 1

	Fiscal Year	F5 Commission Tax Revenue Amount	F5 Counties Tax Revenue Amount	Total Revenue Amount	% Change
Actuals	2011/12	\$93,381,688	\$373,526,751	\$466,908,439	-0.71%
	2012/13	\$90,100,191	\$360,400,766	\$450,500,957	-3.51%
	2013/14	\$86,103,907	\$344,415,629	\$430,519,536	-4.44%
	2014/15	\$86,027,892	\$344,111,568	\$430,139,460	-0.09%
	2015/16	\$85,473,337	\$341,893,349	\$427,366,686	-0.64%
	2016/17	\$79,614,357	\$318,457,428	\$398,071,785	-6.85%
	2017/18	\$70,215,057	\$280,860,227	\$351,075,284	-11.81%
	2018/19	\$67,368,197	\$269,472,787	\$336,840,984	-4.05%
	2019/20	\$80,672,204	\$322,688,815	\$403,361,019	19.75%
Projections	2020/21	\$75,087,606	\$300,350,423	\$375,438,029	-6.92%
	2021/22	\$77,614,028	\$310,456,110	\$388,070,138	3.36%
	2022/23	\$68,505,664	\$274,022,654	\$342,528,318	-11.74%
	2023/24	\$61,976,464	\$247,905,854	\$309,882,318	-9.53%
	2024/25	\$59,300,864	\$237,203,454	\$296,504,318	-4.32%
	2025/26	\$57,667,864	\$230,671,454	\$288,339,318	-6.95%
	2026/27	\$56,040,064	\$224,160,254	\$280,200,318	-5.50%

Note: FY 2019/20 reflects an increase in revenue due to Proposition 56 Backfill being significantly higher than the previous fiscal year. F5CA does not expect a revenue increase such as this to reoccur in the future.

Proposition 31 (SB 793)

In November 2022, Proposition 31, Flavored Tobacco Products Ban Referendum (2022), was approved by voters. The passage of Proposition 31 upholds Senate Bill (SB) 793, which was approved and signed by Governor Newsom on August 28, 2020, and put on hold pending the outcome of Proposition 31. This law went into effect December 21, 2022, and prohibits the sale of most flavored tobacco products, including flavored cigarettes and e-cigarettes, and product flavor enhancers.

As a result of the passage, FY 2022/23 will experience a half year impact to revenues and a full year impact beginning in FY 2023/24. The breadth of the fiscal impact depends largely on how consumers respond to the flavor ban.

Updated Budget Projections

The State Commission received updated cigarette and other tobacco product revenue projections which were utilized to update the projected revenue on the financial plan.

These updated projections incorporate the potential flavor ban impact as a result of the passage of Proposition 31. The decline in revenues, as well as the potential impact of the flavor ban, has changed the financial outlook for our current and future investments. Table 2 below displays the comparison between May 2022 projections versus January 2023 with flavor ban impact.

Table 2

Revenue Projections May 2022

	FY 2022-23	FY 2023-24	FY 2024-25	FY 2025-26	FY 2026-27
DOF Projections (1)	393,081,000	374,451,000	357,715,000	348,413,000	339,516,000
Pro Rata Withhold	(1,066,358)	(1,066,358)	(1,066,358)	(1,066,358)	(1,066,358)
CDTFA Administrative Fees (3)	(13,426,000)	(13,426,000)	(13,426,000)	(13,426,000)	(13,426,000)
0623 SMIF Interests	225,055	225,055	225,055	225,055	225,055
Backfill	(11,756,000)	(11,756,000)	(11,756,000)	(11,756,000)	(11,756,000)
Other	(23,000)	(23,000)	(23,000)	(23,000)	(23,000)
SB 84 Assessment (2)	(335,000)	(335,000)	(335,000)	(335,000)	(335,000)
Total Available to Transfer (4)	366,699,697	348,069,697	331,333,697	322,031,697	313,134,697

Revenue Projections January 2023

	FY 2022-23	FY 2023-24	FY 2024-25	FY 2025-26	FY 2026-27
DOF Projections (1)	362,264,000	329,618,000	316,240,000	307,740,000	299,601,000
Pro Rata Withhold	(1,066,358)	(1,066,358)	(1,066,358)	(1,066,358)	(1,066,358)
CDTFA Administrative Fees	(9,000,000)	(9,000,000)	(9,000,000)	(9,000,000)	(9,000,000)
0623 SMIF Interests	142,676	142,676	142,676	142,676	142,676
Backfill	(9,454,000)	(9,454,000)	(9,454,000)	(9,454,000)	(9,454,000)
Other	(23,000)	(23,000)	(23,000)	(23,000)	(23,000)
SB 84 Assessment (2)	(335,000)	(335,000)	(335,000)		
Total Available to Transfer (4)	342,528,318	309,882,318	296,504,318	288,339,318	280,200,318

(1) Total Revenue as forecast by Department of Finance for Proposition 10 and Proposition 56 Backfill

(2) SB 84 assessment expected to end FY 2024-25

(3) CDTFA Administrative Fees were updated for FY 2022-23

(4) Total Available to transfer - 80% to county commissions and 20% to State Commission

**Note: Additions and Subtractions remain the same in future year projections until updates are provided to the department.*

Staff continue to have conversations surrounding the implications attributable to the lower revenue outlook and how to proceed forward with future investments while

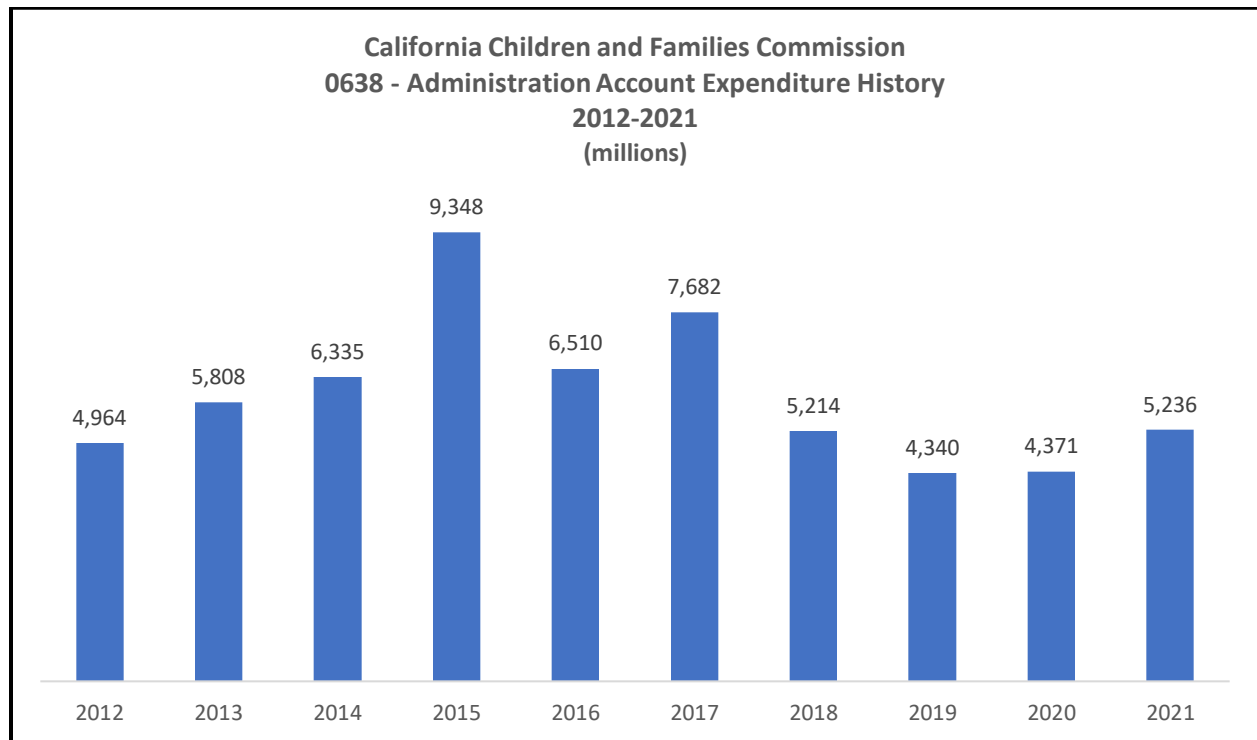
keeping the State Commission financially solvent. As F5CA spends down carryover balances, it is vital to have sufficient funding to meet current contracted and mandated obligations. F5CA staff will provide an update to Commissioners on those conversations at the January meeting.

Administration Account

The Administration account receives 5% of the 20% allocated to the State Commission to administer the state funds. As per Health and Safety Code 130105 (1) (E), funds not expended for administrative functions may be transferred to the Unallocated account upon approval of the Commission; however, funds from the Unallocated account may not be transferred to the Administration account.

Chart 1 below displays the expenditure history for the Administration account from 2012 to 2021. Data captured in this chart varies from what was previously presented in the State Commission’s financial plan. The chart below utilizes expenditure data taken from the financial statements submitted to the State Controller’s Office (SCO), whereas the financial plan acts as an aid in financial planning for future investments.

Chart 1



The past several years, the administration account’s expenditures have exceeded incoming revenues. Certain unanticipated events can cause the expenditures to fluctuate, such as the pandemic. In addition, rising costs attributable to statewide assessments or salaries and wages can cause the variation. As employees receive increases to salary or benefits, the Commission absorbs these costs from the cigarette

and tobacco tax revenues received. There is no additional funding received to supplement the increase.

In FY 2018/19, the Commission began distributing a fraction of overall labor to other fund accounts. This reduced the amount expended. Based on FY 2021/22 expenditure data, approximately 43% of salaries and wages, \$2,367,149.73, were allocated out. The remaining administrative expenditures were expended as follows:

Personal Services (58%) – Salaries and Wages, Staff Benefits

Statewide Assessments (24%) – Pro Rata (Recovery of Centralized Administrative Assessment) and SB 84 Supplemental Pension Payment

Operating Expense and Equipment (18%) – Facilities (rent), General Administrative Costs such as utilities, office supplies, office equipment and maintenance, etc., Interdepartmental consulting and professional services and Information Technology such as hardware, software, archival and security services, etc.

Staff have been committed to finding ways to cut administrative costs and will present possible courses of action(s) at the next commission meeting. Staff looks forward to working with the Fiscal Advisory committee to help brainstorm fiscal strategies to achieve this.

Financial Plan

F5CA tracks actual and projected revenues and expenditures by FY for the following six Proposition 10 accounts for use by the State Commission: Mass Media Communications, Education, Child Care, Research and Development, Unallocated, and Administration. This information is captured in F5CA's Financial Plan (Attachment A), which includes actual and projected revenue and expenditures by account for the current year and four subsequent fiscal years. Currently, the financial plan is reflecting six years as we work to completely close FY 2021/22. Attachment B, entitled Fund Condition Summary, provides additional detail of the Financial Plan for each of F5CA's accounts.

Audit Update

DOF, Office of State Audits and Evaluation completed audit testing in August 2019 for FYs 2015/16 and 2016/17. F5CA has not received preliminary findings to date.

ATTACHMENTS

- A. First 5 California Financial Plan FY 2021/22 through 2026/27
- B. First 5 California Fund Condition Summary 2021/22 through 2026/27