



Agenda Item 7
September 2, 2015

DATE: August 24, 2015

TO: Children and Families Commission of Orange County

FROM: Christina Altmayer, Executive Director 

SUBJECT: Board of Equalization Administrative Fees

ACTION: Receive Report on Legislative Actions regarding the Board of Equalization's Increasing Administrative Fees

SUMMARY:

The Children and Families Commission of Orange County, in partnership with the First 5 Association and First 5 LA, has been leading statewide efforts to address the rising administrative fees associated with the Board of Equalization's (BOE) monitoring and collection of Proposition 10 tobacco taxes. The BOE administrative costs charged to the Children and Families Trust Fund have increased by 600 percent statewide in the past 10 years at the same time that tobacco tax revenue has decreased by nearly 30 percent. For the last fiscal year ended June 30, 2014, the BOE charges were \$16.6 million, a cost of over \$1 million to the Children and Families Commission of Orange County.

As reported to the Commission in July, several actions are being considered by the Legislature and First 5 California to address the rising of the BOE administrative fees. This agenda item provides an update on four related actions:

- Assembly Budget Subcommittee
- Joint Legislative Audit Committee
- Special Session Legislation
- First 5 CA Financial Review.

DISCUSSION:

As previously reported to the Commission, this year marked the first time that the Legislature took any action related to the BOE administrative fees imposed on Proposition 10 funds. The efforts were prompted with language included in the Supplemental Report of the FY 2014/15 State Budget requiring the BOE to convene a stakeholder meeting to discuss potential approaches for future funding of the Cigarette and Tobacco Products License Program and then to submit a report to the Joint Legislative Budget Committee and related subcommittees by April 1, 2015. Following the BOE actions, the State Assembly Budget Subcommittee No. 4 held hearings on the matter followed by a report by the State Legislative Analyst Office (LAO). The LAO report documented how licensing fee revenue has been insufficient to support the licensing program expenditures, resulting in the increased demand on Proposition 10 and made several recommendations to move the licensing program to self-sustaining revenue.

Assembly Budget Committee

The Assembly Budget Subcommittee recommended language that was included in the final FY 2015/16 State Budget that requires several agencies, including the BOE, to develop solutions to address the deficit in tobacco licensing and enforcement:

By February 1, 2016, the Department of Justice (DOJ), in consultation with the State Board of Equalization (BOE) and the Department of Finance, shall submit a report to the fiscal committees of the Legislature describing options for reducing the administrative costs of the BOE's and the DOJ's cigarette and tobacco programs while maintaining the effectiveness of those programs. Each option shall include a timeline for implementation. Each option shall also include estimates of the effects of implementing that option on the BOE's and the DOJ's administrative costs. At least one option shall be designed to increase the rate of electronic filing of various forms related to the licensing program, the excise tax program, or the tobacco programs administered by the DOJ. The report shall also include options for creating a self-sustaining licensing program.

Staff will monitor implementation of the budget action.

Joint Legislative Audit Committee

On Tuesday, August 25th, the Joint Legislative Audit Committee will consider a request to audit the enforcement costs related to the State Board of Equalization's tobacco programs. The request was submitted by Assemblyman Adrin Nazarian of Los Angeles and requests that the audit focus on addressing three questions and be completed by March 2016:

- Understanding enforcement costs
- Appropriate level of funding for enforcement
- Administrative costs.

I will attend the Audit Committee hearing and make comments in support of the audit request. I will have a report on the audit results at the September meeting. A copy of the request from Assemblyman Nazarian is provided as Attachment 1.

Special Session Legislation

The Governor has convened a special legislative session to discuss healthcare financing. Several tobacco related bills have been submitted including an additional \$2 per pack excise tax of each 20 count pack of cigarettes sold and distributed in California on or after January 1, 2016. The proposed tax does include a backfill provision for Proposition 10 revenue. Additionally, SBX2 10 (Beall) and AB X2 11 (Nazarian) would establish BOE licensing fees to cover the annual costs of enforcement and licensing. Retail locations would be charged an annual fee of \$265 and the annual distributor/wholesaler licensing fees would be \$1,200 annually. The Senate Public Health and Development Services Committee heard the item on August 19th and it was voted out of committee. The bill is pending in the Senate Appropriations Committee. We will continue to closely monitor this action.

First 5 California Financial Review

First 5 California has engaged Blue Sky Consulting to conduct a financial review of the Board of Equalization (BOE) administrative fees charged to the Children and Families Commission Trust Fund. First 5 California has asked the Orange County Commission Executive Director to serve on the Steering Committee to oversee the consultant's work and the project was launched this week. The consultant's scope will include an independent review of the costs charged as well as determining the subsidy that commissions support for tobacco enforcement and licensing. The financial analysis will support our briefings and the Legislature's consideration of Assemblyman Nazarian's bill (referenced above).

A full update on all these related actions will be presented at the September meeting. Curt Pringle and I will be available to address any Commissioner questions.

STRATEGIC PLAN & FISCAL SUMMARY:

No funding action is proposed for this item.

PRIOR COMMISSION ACTIONS:

- July and May 2015 – Received report on Legislative Strategies and the Board of Equalization's Increasing Administrative Fees
- February 2014 – Approved Proposed Legislative Strategy to Address Board of Equalization Administrative Fees
- December 2013 – Executive Officer's Report
- February 2013 – First 5 California/Board of Equalization Administrative Fees

RECOMMENDED ACTION:

Receive report on Legislative Actions and the Board of Equalization's increasing administrative fees; and provide direction to the Commission Executive Director on recommend alternatives.

ATTACHMENT:

1. Request from Assemblyman Nazarian

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ADRIN NAZARIAN
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JOINT LEGISLATIVE AUDIT COMMITTEE

August 3, 2015

The Honorable Mike Gipson
Chair, Joint Legislative Audit Committee
P.O. Box 94249-0137
Sacramento, CA 95814

Dear Assemblymember Gipson,

I respectfully submit a request for the Joint Legislative Audit Committee to approve an audit the enforcement costs related to the State Board of Equalization's (BOE) tobacco programs while maintaining program effectiveness for the purpose of the Master Settlement Agreement.

Background. AB 71 of 2003 (Horton) established the Cigarette and Tobacco Products Licensing Program, administered by the BOE. Initially, fees on licensed businesses were the only source of funding for the program. However, these fees did not provide enough funding revenue to fund the program on an ongoing basis. To address the resulting structural deficit, the 2006-07 Budget Act appropriated cigarette and tobacco excise tax revenue for the licensing program. As a result, revenue from those excise taxes now provides funding for the two programs administered by BOE: the licensing program and the Cigarette and Tobacco Products Program.

Most cigarette and tobacco excise tax revenue is devoted to specific programmatic purposes, primarily early childhood programs (Proposition 10) and health programs (Prop. 99). Revenue used to administer BOE's tobacco programs is not available for these programmatic purposes. By using excise tax revenue to support the licensing program, the state has reduced the revenue available for early childhood programs, health programs, breast cancer research and the General Fund.

In 2013, the Assembly Budget Subcommittee No. 4 began exploring options for reducing the costs of BOE's tobacco programs. Under the Tobacco Master Settlement Agreement, the state has certain enforcement and recordkeeping obligations regarding businesses that sell cigarettes. As a result, cost reduction requires detailed information about potential cost savings that would not compromise the effectiveness of these programs.



The 2014 Budget Act included supplemental reporting language from that BOE that required BOE to submit a report on the administrative costs of the cigarette and tobacco excise tax and licensing programs, hold a stakeholder meeting, and submit a report on alternative approaches for funding the licensing program. The information by the BOE was insufficient in order to answer the Legislative questions of what are the costs of enforcement, what is the appropriate level of enforcement for California, who should bear the costs of the enforcement programs, and what can the BOE do to make improvements in their program?

As follow up to the supplemental reporting language, the committee asked the LAO to put together a report on the program and also provide recommendations on how to proceed with addressing the funding shortfall. Despite these efforts, there is still an overall need to have more information on the costs of the program.

Audit. The purpose of the audit is to provide accurate and reliable information to the Legislature to understand and evaluate the enforcement costs of the Cigarette and Tobacco Products Program. The goal is to understand how much the BOE spends on enforcement and identify the funding sources used to pay for enforcement activities.

The audit should address the following questions:

- **Understanding enforcement costs.** The BOE estimates that the cost of the licensing program established by AB 71 was about \$9.6 million in the 2013-14 fiscal year. Is this figure accurate? Over the past five years, identify the funding sources and amounts on the Cigarette and Tobacco Products Tax Program paid for any AB 71 activities? How does BOE determine which enforcement costs are part of the tax program versus the licensing program? How much discretion does BOE have to assign costs to one of the programs versus the other? Does BOE's cost allocation system make sense? Is the current system of enforcement funding consistent with the provisions of Proposition 99 and Proposition 10?
- **What should the appropriate level of funding for enforcement?** Is the staff time for all of the budgeted PYs being used for cigarette and tobacco programs, or is some of the funding being used for other purposes? What are other states doing to enforce their cigarette and tobacco programs?
- **Streamlining Administrative Costs to reduce overall program costs.** How can the state reduce the administrative costs of BOE's tobacco programs while maintaining program effectiveness for the purpose of the Master Settlement Agreement? The LAO report discusses one method to reduce administrative costs, are there other ways that BOE can do this?

Timing. In order to be prepared for the next budget fiscal year, I would request that the audit be prepared by March 1, 2016. This would allow the subcommittee to review the information in conjunction with the annual review of the BOE's budget at the beginning of next year.

For these reasons, I respectfully submit my letter for an audit of the BOE Cigarette and Tobacco Products Licensing Program.

Sincerely,

A handwritten signature in blue ink that reads "Adrin Nazarian". The signature is written in a cursive style with a large initial "A".

Adrin Nazarian