FIRST THINGS FIRST
Ready for School. Set for Life.

Sustaining Arizona's Commitment to Young Kids

Summary of FY16 Budget, Finance and Program Considerations

Tobacco taxes are a declining source of revenue; in fact, funding for First Things First has decreased from almost $171 million in fiscal year 2008 to $132 million in FY2013, a 23% drop in five years. By statute, the Board is ultimately responsible for ensuring that FTF funds are used as Arizona voters intended. Therefore, one of the Board's primary responsibilities is to set a fiscal policy that allows FTF to: sustain program funding for the longest term possible; maximize current and future revenues; and, promote thoughtful and proactive planning for future funding reductions so as to minimize the impact to children and families statewide.

In setting a fiscal policy direction, the Board has focused specifically on trends in tobacco tax collections – which led to revenue projection models researched by Arizona State University – and analysis of expenditures. The initiative that created FTF was written so that an organizational fund balance would accrue for a period of time before expenditures began. This was an intentional, strategic move on the part of the initiative's authors to ensure that funds would be available to sustain FTF's efforts over a longer period of time.

What were not anticipated were sizeable regional carry-forward balances. The Board noted the reasons for and monitored the regional carry-forward balances in fiscal years 2010 and 2011. In 2012, when the total regional carry-forward balance exceeded $90 million – the Board looked more closely at the regional carry-forward balance and set fiscal policy that focused on spending down that balance. This included a reduction in the amount of organizational fund balance drawn down to support regional allocations in fiscal years 2013, 2014, and 2015 in the hopes that this would result in a significant spend-down of regional carry-forward balances.

While fiscal year 2013 was the first year in which the regional fund balance did not grow, the reduction was minimal. As regions complete the last year in the current funding cycle (FY13-15) and begin planning for the next three years (FY16-18), it was a logical next step for the Board – through its Finance Committee and with support from FTF staff – to undertake a deeper review of revenue, organizational fund balance and regional carry forward and to establish the fiscal policy direction that regional councils can use as a basis for discussion of the next three-year strategic direction and budgeting.

Recommendation of the Finance Committee

To expand the discussion and ensure a diverse set of views on the matter, the Chair of the Finance Committee, member Nadine Mathis Basha, invited special guests to both meetings to participate in the conversations. The additional participants represented both Board and regional council members.

Over the course of two meetings the Finance Committee reviewed how allocations are set; discussed the variables involved in the allocation process; examined how future allocations would support current spending budgets; looked at how regional fund balance is related to and impacts spending; reviewed how the organizational fund balance can be used to support a targeted spending level; and, developed recommendations for the Board on future program spending budgets and how the regional fund balance should be used.

Two formal recommendations have been made to the Board. These will be discussed at the April 2014 Board meeting and voted on at the June 2014 Board meeting. They include:

1) Beginning in FY16, the start of the new three-year Funding Plan Cycle, allocate $126.6 million in revenues to support Program spending (statewide and regional combined), and keep this amount constant for successive years.
2) In FY16, the total means of financing available to support regional allotments should equal the targeted $126.6 million level, and so regional allocations should be adjusted such that each region's projected fund balance (regional carry forward) is part of the allocation level rather than being in addition to.

These recommendations are based on reasonable (neither overly optimistic nor pessimistic) revenue projections and will allow FTF to maintain its program spending at a consistent level for an estimated 9-15 years.

The alternatives reviewed included the following:

1. Allow regional councils to spend down their carry forward, hitting fiscal cliffs at varying points between fiscal years 2015 to 2018. Under this proposal, regional councils would need to initiate a round of cuts because – even with their carry forward balance spread out over the next several years – their total revenue would be less than their projected FY15 allotments. Then, regional councils would need to initiate another round of cuts when their carry forward is fully exhausted and only the base-level allocation (based on the $126.6 million recommended amount) is available.
2. Using large-scale draw-downs of organizational fund balance to maintain spending levels that have been set using regional carry-forward balances. The organizational fund balance would be exhausted within three years and, therefore, resulting in radical reductions in services at that point.

The Finance Committee acknowledged that moving to the recommended allocation methodology will raise questions from regional councils as it will mean an almost 30% reduction in total regional funds available for spending in FY16 (impact to individual regions will vary around this average amount). While this will be a challenge for regional councils to absorb initially, the following points were discussed by the Committee and include:

1. All regions are looking at significant funding reductions in the near future (as a result of spending down carry-forward), and in most cases, would need to make those cuts in FY16 or shortly thereafter.
2. Updating the fiscal policy at the beginning of a three-year planning cycle gives regional councils time to thoughtfully and proactively plan spending that reflects available revenues at the onset of a strategic planning process.
3. The funding available for each region will be very stable over time (with population and/or regional boundary changes being the only real drivers for change).
4. The recommendation sets a targeted spending level and, in FY16, uses regional carry forward in combination with new Board-allocated revenues to achieve that targeted spending level. Therefore, regions will be spending their regional carry-forward balances. In futures years, the targeted spending level will be fully achieved with new Board-allocated revenues.
5. Regions may still experience carry-forward balances, but these will be significantly lower and much more easily managed.

Program Committee Considerations

The Finance Committee observed it would be useful for Regional Councils to have in advance any guidance the Board might provide on how any spending reductions should be accommodated. However, the Committee had no specific guidance beyond observing if there were parameters which would result in the Board not being able to support and accept a Funding Plan recommendation, then those boundaries should be known at the start of the process. Additionally, the Finance Committee believed it was important for the Board to hear from its Program Committee on this issue. Janice Decker, Program Committee Chair, participated in the Finance Committee's discussion on this topic as a special guest at the meetings.

The Board's Policy and Program Committee will examine this issue at its April 3 and May 15 meetings and will make any recommendations necessary to the Board at its June 2014 meeting, so that complete guidance can be provided to the regional councils as they begin their three-year planning cycle. Finance committee representatives will support the Program Committee's discussions with information about the FY16 recommendation and the Finance Committee's deliberations.

Considerations for the Program Committee discussion include, but are not limited to the following questions:

- Should guidance come from the Board on how regional councils plan to align funded programming to available revenues – for example, Board preferred strategy(ies) or School Readiness Indicator priorities.?

- To date, regional Funding Plan recommendations are entirely regionally driven/focused. If and when the Board has concerns with a funding plan presented for approval, they address these concerns on an individual basis and final approval is held until both Board and Regional Council concerns are resolved. As such,
    - Should this practice continue?
    - Should all Regional Councils be allowed to prioritize independent of each other, and/or Board priorities?

- Should the Board provide parameters for how a Funding Plan should be constructed? For example:
    - Should the number of strategies be limited?
    - Are there School Readiness Indicators which should be prioritized?
        - Should X% have to be committed to the Board's signature Quality First strategy?
        - Should only Y% be committed to strategies that other state agencies have a mission central responsibility?

- The Quality First program and Quality First Scholarships comprise the largest funding investment of FTF. Should FTF determine how the QF model may be adjusted in simple ways to lower the cost but preserve the overall design and policy intent?
    - One such example would be reducing the number of scholarships made available to providers receiving them by some amount. If that amount were 1/3, a potential savings of $15.7 million could be yielded.
    - Looking at the current QF funding analysis, a Regional Council decision to fund additional scholarships is a significant investment of resources beyond that "required" under the Quality First model. As Regional Councils make choices to fund additional scholarships, it impacts the total investment and in many cases, these additional scholarships are under-utilized.