

SEED ADVISORY BOARD
California Department of Food and Agriculture
1220 N Street
Sacramento, CA 95832
Meeting
August 2, 2005

Chairman Keithly called the meeting to order at 11:15 am and requested that attendees briefly introduce themselves. The following members and guest were in attendance.

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| Members: | Umesh Kodira |
| Kelly Keithly | Bill Sandige |
| George Hansen | George Deese |
| Cannon Michael | Kari Morrow |
| Ron Tingley | Angela Guzman |
| Gabe Patin | Richard Matteis |
| | David Godfrey |
| Identified Guests: | Deborah Meyer |
| Secretary Kawamura | John Heaton |
| Undersecretary Yates | |
| Robert Wynn | |
| Pat Minyard | |

Chairman Keithly moved to the next item on the agenda and requested George Deese to lead a review and discussion about the pro rata increase experienced by the Seed Services Program. Deese provided a two-page handout. The first page explained what pro rata is, how it is calculated, and also provided a summary of pro rata charges to the Seed Services Program from 2001/02 through 2005/06. The second page provided graphic representations of the pro rata assessment for the department and for the Seed Services Program.

Deese stated that statewide pro rata is a complex formula-based-cost that is given to all special-based programs in the state of California. He explained that all of the general-funded programs such as the Legislature, the State Controller and the Department of Finance are funded through general funds. While these departments provide services to other general-funded programs, they also provide services to special-funded programs throughout the state. Consequently, part of the annual budget of twenty to thirty general funded programs must be pro-rated to cover expenditures incurred when they provide services to special-fund programs. Based on the annual budgets of the general funded programs, the Department of Finance determines a dollar amount that needs to be recovered from the special funds. A complex formula is then used to pro-rate that amount to each state agency. CDFA's share of the statewide pro rata was indicated on the handout as \$2.3 million in 2005/06.

Deese further explained that although statewide pro rata may increase 3% in a given year, it doesn't necessarily mean that CDFA's share will increase exactly 3% because there are so many factors in the formula used to calculate each agency's share. For example, there may be a year when the special funds in the whole state dropped 10%. Since the special funds dropped 10%, and pro rata to the agencies went up 3%, individual special fund programs may end up paying more than 3% because the base for calculating pro rata share has changed.

Two major events in the last few years have affected the pro rata calculation. Prior to 2002/03, the Department of Food and Agriculture had the position that pro rata was based on the total personnel services dollar budget. From 2003/04 to the present, pro rata has been based on total budget.

Matteis asked if this was a decision made by CDFA or the Department of Finance. Deese stated that basing pro rata on total budget was an internal decision at CDFA. He clarified that the reason for this decision was because some agricultural funded (special fund) programs were getting services, such as invoices being paid by the State Controller, but were not being charged a fair share since they had very little or no

personnel services. Consequently, the internal decision was made to calculate fair share for all programs in the department, based on total authorized budget.

Matteis asked if this decision created both winners and losers. Deese replied definitely. He explained that while the bottom line for the department's pro rata wouldn't change because of the internal decision, the fair share paid by individual programs in the department would change. He provided the scenario where a program could be 1% of the department's entire personnel services amount but 12% of the department's total budget. He noted that such a scenario would obviously affect a program's pro rata.

Deese also stated that another factor that affects pro rata in the department is the increase in the total ag fund or special fund base. He noted that in the last five years, the pro rata charged to the Seed Services Program increased 144%. During those same five years the budget for the Seed Services Program increased 38% while the department's total ag fund base increased 19%. Consequently, the Seed Services Program doubled its share of the increase levied on the department's entire ag fund amount.

Minyard asked if it is a fair characterization to say that pro rata is imposed on state agencies by the Department of Finance and that individual agencies have no voice in the matter. Deese agreed and explained that there is a separate unit in the Department of Finance that determines the amounts. He further explained that the amount is based on many determinations and complex formulations. For example, part of the pro rata comes from the State Controller's Office, which determines how many warrants were cut. Another part of pro rata comes from the Department of Finance looking at a total budget. The overall formulation however, is developed and determined by the Department of Finance.

Matteis asked if other departments with special funded programs, also allocate on the basis of total budget rather than on personnel services. He wondered which way is more common to allocate the fair share of pro rata. Deese replied that there are other departments with special funded programs and it's most common to base their share of pro rata on total budget rather than personnel services. Deese further explained that about ten years ago he performed an analysis that determined most departments are using total budgets to calculate fair share of pro rata. He stated that departments use total budgets to calculate the share of pro rata because total budgets provide a more accurate reflection of all services when compared to pro rata share based on personnel services.

Matteis asked if programs that have a large amount budgeted for research, such as IAB in the Nursery Program, are indirectly penalized when pro rata is based on total budget. He noted that such programs don't require much labor input and have low demand for state services. Deese acknowledged that such programs would be paying more when pro rata is based on total budget instead of personnel services, but he also suggested that programs with research contracts actually have considerable labor input when the state has to administer many research contracts, sometimes as many as a hundred contracts sent to the various counties.

Using the information provided on the handout, Matteis inquired if the pro rata for CDFA went from \$1.2 million to \$2.3 million in one year. Deese agreed it did. Matteis wondered how such a large increase could happen in such a brief time. Secretary Kawamura attributed the increase to the fact that many budgets in the state were going backwards. Wynn asked for clarification of why the Seed Services Program only paid \$17,726 in 2002/03 while the department's share was \$2.8 million, however in 2005/06 the department's share is now \$2.3 million and the Seed Services Program is being asked to pay \$38,801; considerably more than the \$17,726 paid by Seed Services when the department was obligated to pay the larger amount of \$2.8 million for pro rata.

Deese explained that pro rata actually takes three years to get caught up. The Department of Finance uses amounts from the future budget year, the current budget year and the actual amounts in the prior year. So the pro rata share in 05/06 is based on three different budgets and actuals. What actually happens for 05/06 won't be known for three years from now. Deese directed attention to the second page of his handout for an example of this lag. He noted that in 02/03 pro rata jumped dramatically but then fell. He attributed the 02/03 pro rata jump to the proposed budget amounts of the two successive years, which were much higher than the prior year. Then when pro rata for 03/04 came in, and the 02/03 and the 01/02 pro rata became actuals, the pro rata self-corrected, mainly due to a lot of general fund cuts in those years. Deese noted,

however, that it actually takes three years for that to happen. This explains why the graph showing pro rata paid by the Seed Services Program doesn't perfectly correlate with pro rata paid by CDFA.

Matteis suggested that if there is a three year lag, the increase in pro rata could be blamed on the previous administration. He noted that the previous governor's administration, increased the general fund costs, or the costs of government overhead such as the cost for the governor's office, the cost of the legislature and other such things. Secretary Kawamura acknowledged that the present administration inherited many problems, including the state being close to bankruptcy. He expressed gratitude that revenues in the last fiscal year were higher and close to expected projections. While he is hopeful for 05/06 he reminded the Board that the governor has stated it will take three to four years to turn the situation around.

Matteis summarized that department overhead nearly doubled and that Seed Service's share of pro rata increased a bit more because of the increase in the Seed Services budget. Deese agreed and clarified that if the Seed Services budget went up higher than all of the ag funds, then its share also went up higher. Matteis noted that funding the UC Seed Biotech Center is a new budget item that would have contributed to the increase in the Seed Services budget.

Wynn recognized that pro rata for 05/06 is an estimate, but he asked Deese if the estimate for pro rata in 06/07 is expected to decrease since it would partially be based on the substantial decreases in actual pro rata paid for 03/04 and 04/05. Deese further stated that pro rata in future years will likely decrease because significant cuts were made to statewide general funds in 02/03, 03/04 and 04/05. He noted that the corresponding decrease in pro rata won't happen until three years after each cut.

Matteis noted that he sits with several advisory committees and they have all seen substantial increases in the amount of pro rata they must pay to cover the total increase to the department.

Undersecretary Yates asked Deese if he sees potential for the pro rata share to decline after 05/06. Deese replied "Yes". Matteis added that such a scenario depends on the cost of state government. He expressed hope that the present administration can continue to rectify the state's financial problems. Secretary Kawamura offered the example of State Compensation Insurance as one of the additional costs that impacts the cost of government. He noted that the state government must also pay workers compensation and that self-funded entities have already received some money back, in terms of what they were paying before. He stated that it appears there is a leveling out in terms of the increases that most operators have been paying for workers compensation. He expressed hope that a more competitive market will push the amount paid for workers compensation to lower levels. He was relieved that workers compensation was no longer spiraling out of control to higher levels.

Deese added that if proposals in the California Performance Review are implemented, such as the 21st Century Project at the State Controller's Office, there may be additional cuts to pro rata.

Chairman Keithly summarized that at the last meeting, the Board was concerned because pro rata had jumped from \$14,000 one year to \$39,000 the next year. Obviously the Board wanted some answers to this situation. While he accepted the explanations provided at the present meeting, he wondered how running three years behind helps the Board to manage their money into the future.

Deese explained that it takes three years for an appropriation to be totally expended. He summarized that state law says an appropriation is good for one year plus two prior years before all encumbrances can be paid and it drops off of the books. He explained that there is no way to change the three year lag. He further explained that once money is encumbered, the program has two years to actually write the checks or pay the encumbrance before the money actually reverts back to the program. He noted that this arrangement is actually built into the accounting system of the state of California.

Hansen inquired about the possibility of the Seed Lab being moved to UC Davis. He expressed concern that this would create a new expenditure and he asked how it would impact the pro rata for the Seed Services budget. Wynn asked Minyard if those plans are still going forward. Minyard replied that CDFA is currently in discussion with UC Davis about moving the entire laboratory, including the seed lab, to Davis. Preliminary discussions are being conducted about personnel issues and related topics. Minyard

suspects however, that when the topic changes to the need for a large infusion of money, someone will have to make a decision as to whether the move is going to happen or not. Currently the discussions are mainly exploratory. He predicted that a move is at least five years away because it will take that long to negotiate and decide the critical points. He further explained that while the discussions appear to be moving forward, there is still the possibility that a move will not happen because of funding. He noted however, that there is a possibility that the university could produce funding that makes the move happen.

Matteis stated that he didn't believe a move would impact pro rata because payment to the university for services would still be part of Seed Services budget. Minyard stated that he did not know how the university would conduct their accounting. He did acknowledge however, that sometimes the overhead at the university is extremely high but he wasn't sure if it would exacerbate the current pro rata situation for the Seed Services budget.

Chairman Keithly advanced the meeting to agenda item number four. He requested David Godfrey to lead a review and discussion of the Bond Debt Repayment by the Seed Lab Ag Fund.

Godfrey explained that in 94/95 all of the laboratories moved to the new facilities located on Meadowview Road. The construction of the facilities on Meadowview Road was paid by a bond. The seed laboratory was the only ag-funded program moved to the Meadowview facility. The amounts of prior year budgets were used to calculate an amount for bond debt repayment by the Seed Lab Ag Fund. Over the years, the budget of the Seed Lab Ag Fund has been decreasing. The current situation is that the budget for the Seed Lab Ag Fund will go into the red very soon. There will not be enough money to pay the obligations. The bond debt repayment is around \$30,000 per year while the revenue from service samples is only about \$28,000 per year, even though the laboratory recently increased their fees. Godfrey explained that the program used to have a reserve, but the reserve has dwindled as expenditures have been larger than revenue in the Seed Lab Ag Fund.

Wynn asked if Deese would explain how a revenue bond works and how the costs are allocated to the different programs.

Deese explained that in 94/95 the chemistry lab and plant labs moved to the Meadowview facility. Initially the Department put together a budget change proposal (BCP) to ask for funding. At the time there was a shortage of general funds and the only way to get the laboratory up and running was to sell bonds. He explained that many capital outlay projects are done this way. The Department proceeded with the BCP and a 20-year bond note in the amount of \$1.864 million was issued. He described payment as comparable to making monthly mortgage payments on a house. He stated that payments will continue for the remainder of this year plus seven more years. The original BCP requested money for general funds. The Department of Finance noted that the operations at the Meadowview Facility are not 100% financed by general funds because there are ag-funded programs also located at Meadowview. Consequently they determined what share of the total facility cost should be paid by the Seed Lab Ag Fund. The amount originally determined was approximately \$40,000 but is now around \$30,000. Deese stated that the Seed Lab Ag Fund has about seven more years to annually pay approximately \$30,000 before the debt is paid off.

Ron Tingley asked what would happen if the amount of money in the Seed Lab Ag Fund declined to zero. Deese replied that there was the possibility that a short term loan could be arranged to extend the loan through the Ag Building Fund or the Ag Fund, however he noted that at some point in time the Seed Lab Ag Fund would have to pay off the debt. He further noted that it is not permissible to use one ag fund to pay another ag fund's expenditures. Consequently he thought that a loan would probably be the only viable option.

Undersecretary Yates asked if anyone has ever determined if the debt assigned to the Seed Lab Ag Fund is an accurate amount. Wynn asked Godfrey to confirm that there are actually two ag-funded programs at the lab, the regulatory side and the services side. He further noted that the regulatory side is actually funded through a combination of general funds and money from the assessments or ag funds. Godfrey agreed. Wynn then inquired if the regulatory side of the seed lab has to absorb part of the cost of the bond debt repayment. Kodira replied that they do not and he explained that the bond debt repayment is charged to the

Seed Lab Ag Fund which is identified as the 20.30.16 fund. He explained that two funds were set up for tracking purposes. The fund designated as 20.30.15 is the general fund and the fund designated as 20.30.16 is the Seed Lab Ag Fund. Money collected for service samples is tracked in the lab Ag Fund (20.30.16). He noted that the fee for processing service samples was not necessarily tied to the cost of processing the samples in the lab. He explained that the processing of service samples was simply a service to the industry and is not intended to generate money or to compete with other laboratories. The idea is to provide a backup service if the private labs are not able to provide the service. He further noted that fees charged for service samples were increased last year so that the state seed lab does not compete with the private labs.

Kodira explained that even though money collected for service samples is tracked in the Ag Fund, it was not originally set up to recover all direct costs. Consequently we now have a problem where the revenue collected is lower than the cost of operating the part of the lab that does the service samples. While it's true that the Board pays half the operating cost of the seed laboratory, that operating cost is determined after revenue from service samples is subtracted from the overall operating cost.

Undersecretary Yates commented that he didn't believe the explanations answered his original question, which was if anyone has ever determined if the debt assigned to the Seed Lab Ag Fund is an accurate amount.

Matteis asked if the bond repayment only comes from the Ag Fund part and not the General Fund.

Wynn explained that the arrangement is an internal distribution. He stated that the Board is paying fifty percent of the cost of the seed lab to run the official samples. That share is approximately three hundred and some thousand dollars. The other program that the Board wants to exist for seed certification purposes is the fee for services program, which generates about twenty-eight thousand dollars per year. He noted that the bond debt repayment is being charged completely to that side of the program. Consequently a twenty-nine thousand dollar bond payment is being charged to a program that generates twenty-eight thousand dollars. In addition, the certification program (fee for services program) has additional expenditures beyond the bond payment.

Wynn suggested there are several options the Board can consider. He asked the Board if they want to continue with the fee for services program. He stated that he assumes that program is a valuable service to the industry because considerable legislative work was done to allow CDFA to collect revenue for that service. He noted that the revenue is used to offset the expenditures for the whole lab program, which are the general fund program and the fifty percent supported by the assessment. Since this is the case, he suggested that we charge the bond debt repayment (~\$29,000) to the whole ag fund program, which not only encompasses the revenue generated from Seed Services but also money collected from the assessments.

Matteis asked what the bottom line or impact of that scenario is for the Seed Services Program. Would the service side of the program have to pay more by increasing the fees?

Wynn agreed that increasing fees for services is one option but he clarified that he was suggesting the costs be absorbed in the assessment since the \$28,000 revenue from service samples is currently being used to offset the entire \$750,000 budget for the lab. He explained that the assessment currently pays half of the resulting figure from lab costs minus revenue [i.e. $\sim(\$750,000 - \$28,000)/2$]. He felt that the simplest way to handle the expense for bond debt repayment is to simply absorb that payment into the program as a whole and to continue to treat the revenue from seed services as an offset to total expenditure.

Minyard asked if half of the bond repayment would then be picked up by the general fund.

Wynn disagreed and stated that the bond repayment can not be picked up by the general fund. He explained that the bond debt repayment would be picked up by a combination of the assessment and revenue from industry.

Minyard clarified that the expense for the bond debt repayment would have to be rolled into the industry's side of the lab's entire budget, otherwise the arrangement would be violating the law by having the general fund side of the program paying the bond debt.

Wynn asked Godfrey to clarify if the \$29,000 is not part of the total \$750,000. Godfrey agreed it is not and explained that the \$29,000 has always been subtracted before determination of the total lab expenditures. Wynn then clarified that if \$29,000 is added to the \$750,000 the total expenditure for the lab would now be approximately \$779,000. This amount can then be offset by the revenue from seed services, which brings expenditures back down to approximately \$751,000. This means then that industry would pick up half of \$751,000 instead of half of \$721,000. Consequently, the assessment payment would actually go up to cover that additional cost. He noted that since there is only about \$82,000 in reserve in the lab ag fund, pretty soon there won't be any money in that program to pay the bond debt repayment anyway. Short of getting a loan, as Deese described, using assessment money appears to be the only way to fund the repayment.

Patin asked if the bond debt repayment is the same every year. Deese explained that it fluctuates based on the reduction in principle as you make payments and based on current market rates. He stated that those numbers are provided by the Department of Finance every year. Patin wanted to be sure that the amount for the bond debt repayment had nothing to do with the industry's income as a percentage or an assessment. Deese answered that it was not. He further explained that the \$40,000 repayment was based on the Board's total budget compared to the whole plant's budget and the funding sources available, which were general fund and ag fund. These were all considered at the time of borrowing to determine the splits for repayment.

Undersecretary Yates asked Deese to clarify if he was saying that the split was based on the initial year's budget. Deese agreed it was. Yates asked what the Ag Fund Budget amount was for the initial year. Godfrey estimated that it was around seventy to eighty thousand in 1994/95. He estimated that it is currently running around fifty five thousand. Godfrey noted that since the budgeted amount is so much lower than in 94/95, perhaps the repayment amount is too high when considered as a percentage of the budget.

Wynn acknowledged that the scenario Godfrey described is a problem with bonds, as is the assumption that a program will be in operation twenty years later.

Matteis pointed out that we are in year thirteen and that we will run out of money before we run out of years. He noted that by law, the Board is only required to pay for a third of the program but by agreement the industry has agreed to pay fifty percent. He stated that the industry agreed to this arrangement when the general fund allotment to the lab was reduced. He asked if this arrangement wouldn't justify changing the repayment figures.

Deese answered that the arrangement does not have an impact since the decision to buy a bond for "x" amount of dollars was made in 1994/95.

Matteis asked what is the expected burden on the program for another seven years. Deese replied it was approximately \$240,000.

Wynn suggested that CDFA provide some alternatives to the industry.

Yates asked Wynn how long it would take to develop the options and get back to the Board.

Wynn felt that CDFA staff could develop the alternatives to present to the board in about one week.

Chairman Keithly asked if there were any more comments or questions.

Secretary Kawamura asked the Board members how they felt that the seed industry was doing in general.

Tingley commented that the industry is tightly linked to the growers and does well when the growers do well.

Matteis asked Board members if they wouldn't agree that business was better today than four years ago. Members concurred.

Secretary Kawamura applauded growers and industry for taking advantage of markets that have developed as a result of new eating habits. He expressed hope that the public will continue on the path to healthy eating. He noted that during September the Governor will be encouraging people to improve their diets by consuming five fruits and vegetables a day. If the projections are fulfilled, these changes should help to significantly develop markets. He also encouraged members to continue to develop new plant varieties that help to differentiate their products. As an example he noted the recent market demand for Clementine citrus which has caused an increase in Clementine plantings.

Matteis informed the Secretary that some of the money from the Seed Service Program is used to fund the administration of the UC Davis Seed Biotechnology Program. A recent survey by the Seed Biotechnology Program found that the seed industry is approximately \$1.1 billion, with about \$340 million of sales in California and the rest occurring outside of the state. The seed industry therefore brings a significant amount of money into the state and is a very important contributor to the state's balance of trade.

Undersecretary Yates recalled that when the program was originally put into place, the hope was to increase opportunities for international trade. Since many markets did not accept certification or results from independent labs, it became apparent to industry that they needed state or federal certification. He asked Matteis if this situation has changed or if it is still a significant issue for the industry.

Matteis stated that he believed Yates was referring to Bill Callison's effort to have an accreditation program as part of the National Seed Health Program. Yates agreed. Matteis explained that the regulations to implement that program have been pending for some time. While a package to implement those regulations has been prepared, it has not been moved forward. Matteis suggested that this is something interested parties may wish to explore.

Wynn noted that the Seed Services lab still provides certification for seed export. Matteis agreed.

Heaton commented that he recently attended a meeting of the American Association of Seed Control Officials. He noted that part of the seed health initiative the USDA is considering is a proposal to require government and university seed samplers to become accredited.

Matteis explained that the accreditation program would enable CDFA to accredit private labs to do official work. This is part of a nationwide effort to reduce burden on government and to also make the process more efficient. The proposals would allow the Department to charge fees to cover the cost of accreditation.

Secretary Kawamura asked if there is a consensus in the industry for this strategy.

Matteis replied "absolutely."

Secretary Kawamura reiterated that he continues to be concerned with efforts of pest exclusion by CDFA. He noted five consecutive years of cuts to the Department have impacted the infrastructure and capacity to keep diseases and pests out. He stated that although the Governor increased the Department's budget this year, there are still some unallocated cuts to be made. He explained that during the budget procedure the legislature chose to take more dollars from funds the Governor had granted the Department, all of which were in the arena of emerging pest control. He expressed some frustration about why the legislature fails to understand the Department has a role beyond agriculture. He noted that CDFA is important in the effort to protect the food supply, the environment and public health. He was grateful for the help provided by the industry and encouraged attendees to do anything they can to educate the public.

Matteis noted that Secretary Kawamura and Undersecretary Yates organized efforts to have industry representatives assist in the identification of key issues. The group recently met to prioritize and identify the top ten issues they want to present to the Governor's Office. He noted that Pest Exclusion was at the top of the list.

Chairman Keithly called for any additional public discussion or comments. None were made.

Tingley made a motion to adjourn. Motion was seconded by Hansen. Motion carried.

The meeting adjourned at 12:10 pm

Respectfully submitted,
John Heaton