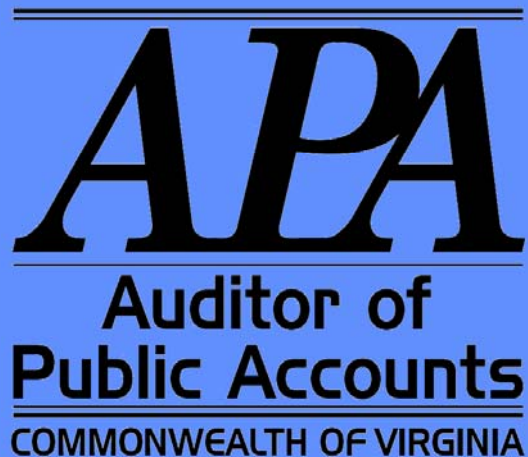


VIRGINIA TOBACCO SETTLEMENT FOUNDATION

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2008**



AUDIT SUMMARY

Our audit of the Virginia Tobacco Settlement Foundation found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- no matters involving internal control and its operations necessary to bring to management's attention; and
- no instances of noncompliance with applicable laws and regulations or other matters that are required to be reported.

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FOUNDATION HIGHLIGHTS

Foundation Overview

The Virginia Tobacco Settlement Foundation (Foundation) annually receives ten percent of the Commonwealth of Virginia's (Commonwealth) portion of funds from the Master Settlement Agreement (MSA) with tobacco manufacturers. A Board of Trustees (Board), comprised of 23 members, governs and administers the Foundation. The Board establishes the Foundation's budget and specific criteria and procedures for distributing money in the Virginia Tobacco Settlement Fund. The Foundation uses its funding to finance educational and awareness programs on the health effects of tobacco use by youth and research related to the prevention of tobacco use among youths.

The Board also approves members of its four Regional Advisory Boards. The Regional Advisory Boards provide a local connection between the Foundation and communities throughout the Commonwealth. The Advisory Boards oversee the review process to select recipients that receive program grants to fund prevention programs that discourage tobacco use by minors. Additionally, the Board funds a statewide marketing campaign to reduce the use of tobacco among youths.

The Department of Health acts as the fiscal agent for the Foundation and provides fiscal and payroll services. The Foundation employs an executive and deputy director, a business manager, and 11 staff members. The staff includes four regional grant program administrators. These administrators are responsible for managing the program grants issued throughout the Commonwealth.

Financial Operations

The following table shows actual revenues and expenses as compared to the Foundation's Board approved budget for fiscal year 2008.

	<u>Actual</u>	<u>Budget</u>	<u>Variance over(under)</u>
Revenues:			
Master Settlement payments	\$12,672,157	\$14,481,658	\$(1,809,501)
Proceeds from Security Transactions	79,390	-	79,390
Interest on Securities	<u>332,424</u>	<u>150,000</u>	<u>182,424</u>
Total Revenues:	<u>13,083,971</u>	<u>14,631,658</u>	<u>(1,547,687)</u>
Expenditures:			
Administration	1,434,237	1,561,658	(127,421)
Inter-Agency Expense	68,993	75,000	(6,007)
Expenses for Securities Lending	79,390	-	79,390
Marketing	4,683,197	5,250,000	(566,803)
Program Expense	3,874,190	5,150,000	(1,275,810)
Research and Evaluation	1,619,866	2,245,000	(625,134)
Regional Priority Projects (Endowment)	-	275,000	(275,000)
State General Fund Transfers Out	<u>74,589</u>	<u>75,000</u>	<u>(411)</u>
Total Expense	<u>\$11,834,462</u>	<u>\$14,631,658</u>	<u>\$(2,797,196)</u>
Revenues over (under) expenditures	<u>\$ 1,249,509</u>	<u>\$ -</u>	<u>\$ 1,249,509</u>

Source: Budget – Board Approved Budget, approved May 22, 2007, Actual – Adjusted Annual Report to the Board

The Board develops the Foundation's budget using an accrual basis of accounting. At year-end, the Foundation had a cash and cash equivalents balance of \$10,125,958 and grants payable of \$408,912. The above schedule includes the grants payable amount in the program expense and research and evaluation lines as an expense. In Fiscal Year 2008, like last year, the Foundation did not use its line of credit to cover expenses due before its April MSA payment. Management is currently not planning on using its credit line in Fiscal Year 2009, but they do know that it is a possibility with the budget cut due to the MSA withholding.

A majority of the Foundation's revenues are from the MSA payments. This amount varies annually, as it is dependent on actual tobacco sales. The MSA payment for fiscal year 2008 was \$1,809,501 less than originally budgeted. \$1.6 million of this shortfall come from the tobacco companies withholding MSA payments, with the remaining amount coming from smaller than expected tobacco sales. The Foundation expects total revenues of about \$13 million for fiscal year 2009.

Over the past three years, MSA payments have fluctuated due to rises and falls of tobacco sales, requiring the Foundation to adjust its budget accordingly. To handle such unexpected changes in the budget, the Board reviews the budget at every board meeting to discuss and approve any changes needed.

The Staff develops a three year budget plan that the Board considers a year in advance of its effective date so the Board can monitor long-term programs. The Staff developed and presented the next three year budget plan at the May 2008 Board meeting, which will cover fiscal years 2010, 2011 and 2012. The table below compares the Foundation's original budget for fiscal year 2008, which the Board approved on June 15, 2005 to their current operating budget, approved on May 22, 2007 and is part of the 2007 to 2009 three year plan.

	<u>Original</u>	<u>Current</u>	<u>Variance Positive/(Negative)</u>
Revenues:			
Master Settlement payments	\$14,481,658	\$14,481,658	\$ -
Interest on securities	155,000	150,000	(5,000)
Carry forward grants projects	<u>-</u>	<u>-</u>	<u>-</u>
Total projected revenue	<u>14,636,658</u>	<u>14,631,658</u>	<u>(5,000)</u>
Expenses:			
Administration	1,562,930	1,561,658	(1,272)
Marketing campaign	5,250,000	5,250,000	-
Program grants	5,175,000	5,150,000	(25,000)
Research and evaluation	2,245,000	2,245,000	-
Regional Priority Projects (Endowment)	225,000	275,000	50,000
General State Agency expense	<u>150,000</u>	<u>150,000</u>	<u>-</u>
Total budgeted expenses	<u>\$14,607,930</u>	<u>\$14,631,658</u>	<u>\$ 23,728</u>
Budget over/under projected revenue	<u>\$ 28,728</u>	<u>\$ -</u>	<u>\$ (28,728)</u>

Source: Original – Board Approved Budget, approved June 15, 2005, Current, Board Approved Budget, approved May 22, 2007.

The Board reduced the Foundation's fiscal year 2009 budget as a result of tobacco manufacturers continuing to hold ten percent (roughly \$1.7 million) of the MSA payments in escrow. Tobacco manufacturers are withholding the ten percent because they are losing market share to those manufacturers that did not participate in the MSA. Currently, the issue is in litigation; therefore, the Foundation is still unsure whether they will receive these additional funds. The Foundation reduced the amount of program grants awarded and marketing contract amounts in fiscal year 2008 and will follow the same practice for fiscal year 2009 to absorb the reduction in funding.

Marketing Campaign

In 2001, the Foundation launched a statewide multimedia marketing campaign called the Y-Campaign. The mission of the Y-Campaign is to reduce youth tobacco use in the Commonwealth by empowering Virginia youth to choose a healthy lifestyle. The campaign integrates messages through a multimedia marketing effort, including television, and radio commercials, an interactive web site (www.ydouthink.com), internet banner ads, outdoor and cinema advertising, a series of music festivals, and street marketing activities.

In order to achieve the goals of the Y-Campaign the Foundation administers the following contracts. The marketing contracts cover the period of July 1, 2007 through June 30, 2008.

<u>Contract</u>	<u>Amount</u>
Barber Martin Advertising	\$4,000,000
Rescue Social Change Group (Y-Campaign)	800,000
Rescue Social Change Group (web-site/media)	225,000
Southeastern Institute of Research	<u>175,000</u>
Total in Marketing Contracts	<u>\$5,200,000</u>

Source: The Foundation's Marketing Contracts, also can be found in FY2007 Audit Report

Barber Martin Advertising purchases media to place current and new advertisements in various medium outlets, develops new creative concepts and ideas, and produces ideas into finished advertising deliverables. The target market is 10 to 17-year olds across the Commonwealth.

Rescue Social Change Group, previously Rescue Productions, schedules and manages all campaign events, employs personnel to conduct the events, and develops new concepts and ideas for reaching Virginia's youth. The focus of the street marketing effort is to provide strategic support for the Y-Campaign by directly interacting with 10 to 17-year olds across the Commonwealth. Rescue Social Change Group also provides the service of website development and management, interactive media development, and interactive media planning, purchasing, and placement for the Y-Campaign. Southeastern Institute of Research, Inc. evaluates the effectiveness of the Y-Campaign by conducting tracking studies twice a year and preparing the Foundation with reports for each study.

The Foundation monitors the marketing contracts by tracking performance through monthly, quarterly, and annual reviews. Contracts renewals only occur if a vendor achieves the performance standards stipulated in their contracts.

Program Grants

The Foundation awards grants to schools, houses of faith, and other entities located in the Commonwealth for the purpose of implementing tobacco prevention programs. The programs address issues related to tobacco use including prevention education, tobacco cessation, early tobacco intervention and reduction, advocacy, youth empowerment, and social skills building. The Foundation issued a total of \$3,874,190 in grants for fiscal year 2008 to over 50 programs. The Foundation monitors and administers the program grants to ensure recipients meet the program objectives.

Research Grants

Four universities received grants from the Foundation during fiscal year 2007 and continued to receive funding in fiscal year 2008 to implement collaborative research projects for preventing the use of tobacco by youths. The research topics cover areas such as etiology of youth tobacco use, psychosocial aspects, genetic predisposition to nicotine addiction, progression from experimentation to addiction, and specific youth interventions.

As a part of its research efforts, the Foundation formed the Virginia Research Consortium (Consortium). The Consortium is a collaborative network of institutions of higher learning in the Commonwealth that conduct tobacco prevention research and assist the Foundation in ensuring that research methodology and projects are appropriate and scientifically based. The Foundation requires that institutions that receive research funds participate in the Consortium to help promote and ensure collaboration and coalition building between institutions. The following institutions received research grants during 2007: Virginia Commonwealth University (\$2,712,000 over three years), George Mason University (\$741,000 over three years), and the College of William and Mary (\$362,000 over three years).

Enforcement Initiatives

Enforcement of tobacco access laws is another component of the Foundation's comprehensive youth tobacco use prevention program. The Foundation contracted with the Department of Alcoholic Beverage Control (ABC) during fiscal year 2008 to conduct compliance checks. The contract amount was \$350,000 and is included in program expenses. Each month, ABC, at random, tests approximately 400 tobacco retailers to see if they will sell tobacco products to under-age buyers.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

**Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218**

November 14, 2008

The Honorable Timothy M. Kaine
Governor of Virginia
State Capital
Richmond, Virginia

The Honorable M. Kirkland Cox
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

We have audited the financial records and operations of the **Virginia Tobacco Settlement Foundation** (Foundation) for the year ended June 30, 2008. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit Objectives

Our audit's primary objectives were to evaluate the accuracy of recorded financial transactions on the Commonwealth Accounting and Reporting System, review the adequacy of the Foundation's internal controls, and test compliance with applicable laws and regulations.

Audit Scope and Methodology

The Foundation's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances.

Master Settlement Agreement payments
Contract and grant management
Vendor payments
Payroll
Foundation's board approved budget

We performed audit tests to determine whether the Foundation's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, vouchers, payroll files, marketing and research contracts, program grants, and observation of the Foundation's operations. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

Conclusions

We found that the Foundation properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. The Foundation records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting systems and the Foundation's records.

We noted no matters involving internal control and its operation that we consider necessary to be reported to management. The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

Exit Conference and Report Distribution

We discussed this report with management on November 14, 2008.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

CJH:clj

VIRGINIA TOBACCO SETTLEMENT FOUNDATION

Marty Kilgore, Executive Director

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Patrick J. Hughes, Vice Chairman

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Curtis Coleburn

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