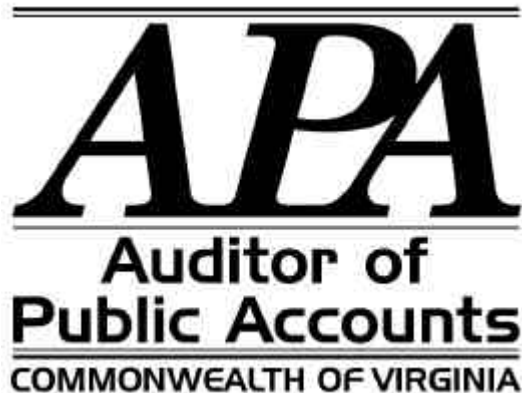


**VIRGINIA TOBACCO SETTLEMENT FOUNDATION
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2001**



AUDIT SUMMARY

Our audit of the Virginia Tobacco Settlement Foundation for the period ended June 30, 2001, found:

- proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- no material weaknesses in the internal control structure; and
- no instances of noncompliance with applicable laws and regulations tested that are required to be reported.

December 4, 2001

The Honorable James S. Gilmore III
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Vincent F. Callahan, Jr.
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited the financial records and operations of the **Virginia Tobacco Settlement Foundation** (the Foundation) for the year ended June 30, 2001. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objectives, Scope, and Methodology

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

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the Foundation's operations. We also tested transactions and performed such other auditing procedures, as we considered necessary to achieve our objectives. We reviewed the overall internal accounting controls, including controls for administering compliance with applicable laws and regulations. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances:

Revenues
Expenditures
Contract Management

We obtained an understanding of the relevant internal control components sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. 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.

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.

Our audit was more limited than would be necessary to provide assurance on internal control or to provide an opinion on overall compliance with laws and regulations. Because of inherent limitations in internal control, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of internal control to future periods is subject to the risk that the controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of controls may deteriorate.

Audit 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 generally accepted accounting principles. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System.

We noted no matters involving internal control and its operation that we consider to be material weaknesses. Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of the specific internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to financial operations may occur and not be detected promptly by employees in the normal course of performing their duties.

The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

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.

We discussed this report with management on December 21, 2001

AUDITOR OF PUBLIC ACCOUNTS

MAM/kva
kva:36

FOUNDATION OVERVIEW

The Virginia Tobacco Settlement Foundation (the Foundation) receives a portion of Virginia's funds from the Master Settlement Agreement with tobacco manufacturers. A Board of Trustees, comprised of 23 members, governs and administers the Foundation. The Board establishes specific criteria and procedures for distributing money in the Fund. The Foundation can use its funding to finance efforts to restrict the use of tobacco products by minors through such means as educational and awareness programs on the health effects of tobacco use on minors and enforcement of laws restricting the distribution of tobacco products to minors.

The Virginia Department of Health acts as a fiscal agent for the Foundation and provides fiscal and other administrative services to the Foundation. The Foundation employs an executive director, a business manager, and 11 staff members.

FINANCIAL HIGHLIGHTS

Below are the fiscal operations for the year ended June 30, 2001.

Revenue:	
Master settlement agreement	\$12,818,938
Interest	<u>1,351,171</u>
Total revenue	14,170,109
Expenses:	
Payroll	331,294
Contractual services	794,371
Supplies	4,518
Fixed assets	42,445
Miscellaneous	<u>17,411</u>
Total expenses	<u>1,190,039</u>
Revenues over expenses	12,980,070
Beginning cash balance	<u>16,970,587</u>
Total ending cash balance	<u>\$29,950,657</u>

Although the Foundation ended fiscal year 2001 with a large cash balance, the Board has approved budgets for the next three years that should spend about \$20 million annually. In addition, the Foundation continues to expect annual revenues around \$12 million. The Board approved more than \$28 million to create and implement marketing and advertising communication plans to discourage tobacco use among underage youth. The Foundation intends to use its efforts in marketing, tobacco use prevention programs, research, and enforcement to discourage minors from using tobacco products.

VIRGINIA TOBACCO SETTLEMENT FOUNDATION
Richmond, Virginia

Marge White, Acting Executive Director

Board of Trustees

Steven J. Danish, Chairman

John M. O'Bannon III, Vice Chairman

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Walter H. Bass III	Robert Leek
Clarence Carter	V. Carole Loughheed
Curtis Coleburn	James Lund McDaniel
Christopher E. Desch	Becky Hartt Minor
Dennis L. Desilvey	E. Anne Peterson
Allen W. Dudley	Scott K. Radow
Jordan Forbes	Frank M. Ruff
Ricki E. Fulcher.	Michael Sloan
Emmett W. Hanger, Jr.	John Watkins

Percy Wootton