

VIRGINIA TOBACCO SETTLEMENT FOUNDATION

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2005**



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.

- TABLE OF CONTENTS -

	<u>Pages</u>
AUDIT SUMMARY	
FOUNDATION HIGHLIGHTS	1-5
INDEPENDENT AUDITOR'S REPORT	6-7
FOUNDATION OFFICIALS	8

FOUNDATION HIGHLIGHTS

Foundation Overview

The Virginia Tobacco Settlement Foundation (Foundation) annually receives ten percent of Virginia's 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 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 youths and research related to the prevention of tobacco use among youths.

The Board also approves members of its nine 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 other staff members. The staff includes five 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 2005.

	<u>Budget</u>	<u>Actual</u>	<u>Variance Positive/ (Negative)</u>
Revenues:			
Master Settlement payments	\$12,618,960	\$13,031,549	\$ 412,589
Interest on securities	125,000	143,143	18,143
Proceeds from security transactions	<u>-</u>	<u>32,669</u>	<u>32,669</u>
Total revenues	<u>12,743,960</u>	<u>13,207,361</u>	<u>463,401</u>
Expenses:			
Administration	1,456,000	1,368,342	87,658
Program grants	5,553,488	4,938,539	614,949
Marketing	4,742,889	4,917,493	(174,604)
Research and evaluation	2,105,000	1,857,180	247,820
State general fund transfers out	150,000	73,624	76,376
Depreciation expense	-	2,222	(2,222)
Expenses for securities Lending	<u>-</u>	<u>31,305</u>	<u>(31,305)</u>
Total expenses	<u>\$14,007,377</u>	<u>13,188,705</u>	<u>818,672</u>
Revenues over/(under) expenses	<u>\$ (1,263,417)</u>	<u>\$ 18,656</u>	<u>\$1,282,073</u>

Source: Budget – Board Approved Budget, Actual – Annual Report Adjusted

The Board develops the Foundation's budget using an accrual basis of accounting. This allows the Foundation to apply some expenses paid in July and August to the prior year's budget. At year-end, the Foundation had a cash balance of \$7,908,583 and grants payable of \$803,856, which the above schedule reflects as an expense.

A majority of the Foundation's revenues are from the Master Settlement Agreement (Agreement) payments. This amount varies annually, as it is dependent on actual tobacco sales. The Agreement payments for fiscal year 2005 totaled \$13,031,960; \$412,589 more than originally budgeted. The Foundation had budgeted for expenses to exceed revenues in fiscal year 2005. However, because of the unexpected increase in the Agreement payments and the Board awarding less Program and Research Grants than originally budgeted, the Foundation's fund balance increased by \$18,656 during fiscal year 2005.

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 Virginia by empowering Virginia youth to choose a healthy lifestyle. The campaign integrates messages through a multi-media 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, 2004 through June 30, 2005 and have four renewal one-year periods.

Contract:	Annual Contract Amount
Barber Martin Advertising	\$4,000,000
Free Radical, LLC	175,000
Rescue Productions	500,000
Southeastern Institute of Research Inc.	<u>175,000</u>
Total	<u>\$4,850,000</u>

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 ten to 17-year-olds across the Commonwealth of Virginia

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.

Free Radical, LLC 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. Contract renewals only occur if the 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 of Virginia 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 95 grants in fiscal year 2005 totaling \$5,125,733. 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 2005 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 institutions that receive research funds to participate in the Consortium to help promote and ensure collaboration and coalition building between institutions. The following table shows the amount of research grants that the Foundation awarded to each university during fiscal year 2005.

Research Grant Recipient :	<u>Amount</u>
Virginia Commonwealth University	\$ 499,817
George Mason University	390,000
James Madison University	240,000
University Of Virginia	<u>487,500</u>
Total	<u>\$1,617,317</u>

Prevention Connections

To further support its mission, the Foundation helped establish Prevention Connections in October 2003 to act as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code eligible to receive certain grants and funding not available to the Foundation. The Board approved \$2,500 in start-up funding, of which \$500 related to the application to the Internal Revenue Service for 501(c)(3) status in December 2003. In November 2004, the Internal Revenue Service granted Prevention Connections provisional status as a tax-exempt organization on an annual basis for up to five years.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

March 10, 2006

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

The Honorable Lacey E. Putney
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** for the year ended June 30, 2005 as mandated by the Code of Virginia. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

INDEPENDENT AUDITOR'S REPORT

Audit Objectives

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

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. We performed audit tests to determine whether the Foundation's controls were adequate, had been placed in operation, and were being followed. 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
- Foundation's budget set by the Board

Our audit also included tests of compliance with provisions of applicable laws and regulations. We tested transactions and performed such other auditing procedures, as we considered necessary to achieve our objectives. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, vouchers, marketing contracts and 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 Foundation's accounting system.

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 April 6, 2006.

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, its distribution is not limited.

AUDITOR OF PUBLIC ACCOUNTS

GDS/sks
sks: 43

FOUNDATION OFFICIALS

Marty Kilgore, Executive Director

BOARD OF TRUSTEES As of June 30, 2005

Rickie E. Fulcher, Chairman

Robert Leek, Vice Chairman

Richard L. Bennett	Patrick J. Hughes
Kevin M. Bolling	Delegate William R. Janis
Daniel J. Cawley	Debra E. Keith
Ming S. Chiu, M.D.	Maria D. Kelly
Curtis Coleburn	Rakesh C. Kukreja
Audrey Douglas-Cooke	James L. McDaniel
Jose Dimas	Delegate John O'Bannon, III
Lolly A. Gilmore	Tobin G. Van Ostern
Senator Emmett W. Hanger, Jr.	Robert B. Stroube
Barbara Hughes	Senator John Watkins
Dixie Wolf	