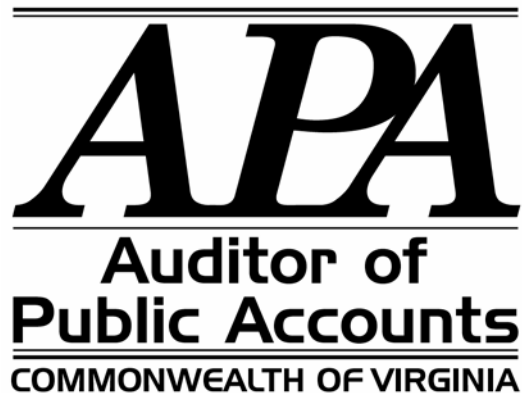


VIRGINIA TOBACCO SETTLEMENT FOUNDATION

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2004**



AUDIT SUMMARY

Our audit of the Virginia Tobacco Settlement Foundation for the year ended June 30, 2004, found:

- proper recording and reporting of transactions, in all material respects, in the Foundation's accounting records and Commonwealth Accounting and Reporting System;
- no matters involving the internal control and its operation that we consider material weaknesses; and
- no instances of noncompliance or other matters that required reporting.

- T A B L E O F C O N T E N T S -

AUDIT SUMMARY

FOUNDATION OVERVIEW

FINANCIAL OPERATIONS

INDEPENDENT AUDITOR'S REPORT

FOUNDATION OFFICIALS

FOUNDATION OVERVIEW

The Virginia Tobacco Settlement Foundation, created in 1999, receives annually ten percent of Virginia's portion of funds from the Master Settlement Agreement 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 efforts to restrict the use of tobacco products by minors through such means as educational awareness programs on the health effects of tobacco use on minors and enforcement of laws restricting the distribution of tobacco products to minors.

The Board also approves members for 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 program grant recipients that receive funding to implement youth tobacco use prevention programs.

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 five regional Grant Program Administrators. These administrators are responsible for managing the program grants issued throughout the Commonwealth. The Foundation manages a marketing campaign and implements various tobacco use prevention programs to discourage tobacco use by minors.

To further support its mission, the Foundation established 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.

FINANCIAL OPERATIONS

The following table shows cash receipts and disbursements for the years ended June 30, 2003 and June 30, 2004.

Summary Analysis of Revenues and Expenditures

	<u>FY 2004</u>	<u>FY 2003</u>
Cash on hand - beginning	<u>\$12,445,901</u>	<u>\$30,958,156</u>
Revenues:		
Master settlement payment	12,839,652	15,002,990
Interest on securities	<u>125,177</u>	<u>915,970</u>
Total revenues	<u>12,964,829</u>	<u>15,918,960</u>
Expenses:		
Personal services	1,043,410	935,556
Contractual services	15,413,181	17,805,062
Supplies and materials	13,539	12,253
Rent and other continuous charges	103,769	78,384
Equipment	<u>9,123</u>	<u>8,299</u>
Total expenses	16,583,022	18,839,554
Cash transfer out	<u>53,690</u>	<u>15,591,661</u>
Total expenses and cash transfer out	<u>16,636,712</u>	<u>34,431,215</u>
Cash on hand - ending	<u>\$ 8,774,018</u>	<u>\$12,445,901</u>

Source: Commonwealth Accounting and Reporting System

The Foundation transferred over \$15 million of its cash balance to the General Fund of the Commonwealth on June 30, 2003 as a result of statewide revenue shortfalls and budget reductions. This amount represented cumulative unspent cash balances due to the delayed implementation of the Foundation's operations. The Foundation is absorbing this reduction through its marketing, program, and research initiatives. Because of obligations established before the transfer, the Foundation expects expenses to exceed revenues through fiscal year 2007.

The Foundation's share of Virginia's portion of the master settlement payment varies annually as it is dependant upon actual tobacco sales. The Foundation received a half million dollars less than its budget of \$13.3 million for fiscal year 2004. The Foundation expects revenues of \$12.6 and \$12.8 million for fiscal years 2005 and 2006, respectively. Further, the Foundation expects expenses of \$13.1 million for both fiscal years 2005 and 2006. The Foundation projects that revenues will exceed budgeted expenses for fiscal year 2008.

Contractual services include expenses for the marketing contract, research partnership agreements, and grants awarded under various agreements. The Foundation's marketing contract with Work, Inc., is the largest expense totaling \$6,982,680, which represents 45 percent of all fiscal year 2004 services.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

March 28, 2005

The Honorable Mark R. Warner
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Lacey E. Putney
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE

We have audited the financial records and operations of the **Virginia Tobacco Settlement Foundation** for the year ended June 30, 2004 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.

Audit Objective, Scope, and Methodology

Our audit's primary objective was to evaluate the accuracy of the Foundation's financial transactions. In support of this objective, we evaluated the accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System and in the Foundation's accounting records, reviewed the adequacy of the Foundation's internal control, and tested for compliance with applicable laws, regulations, contracts, and grant agreements.

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, regulations, contracts, and grant agreements. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances:

Revenue
Expenditures

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.

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, regulations, contracts, and grant agreements. 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 financial records listed in the scope section of this report.

We noted no matters involving internal control and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect the Foundation's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial records.

The results of our tests of compliance with applicable laws, regulations, contracts, and grant agreements 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.

EXIT CONFERENCE

We discussed this with management on April 13, 2005.

AUDITOR OF PUBLIC ACCOUNTS

JP/kva

VIRGINIA TOBACCO SETTLEMENT FOUNDATION

Martha Kilgore, Executive Director

BOARD OF TRUSTEES
As of June 30, 2004

Rickie E. Fulcher, Chairman

Robert Leek, Vice Chairman

Kevin M. Bolling
Ming S. Chiu
Curtis Coleburn
Rebecca Darby
Jose F. Dimas, Jr.
Audrey Douglas-Cooke
Lolly Gilmore
Emmett W. Hanger, Jr.
Barbara Hughes
Patrick Hughes

William Janis
Debra Keith
Robert S. Kelley
Maria D. Kelly
James L. McDaniel
John O'Bannon
Kethandapatti G. Srinivas
Robert B. Stroube
John Watkins
Dixie Wolf