

**VIRGINIA TOBACCO SETTLEMENT FOUNDATION
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2003**



AUDIT SUMMARY

Our audit of the Virginia Tobacco Settlement Foundation for the year ended June 30, 2003, found:

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

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

AUDIT SUMMARY

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FOUNDATION OVERVIEW

The Virginia Tobacco Settlement Foundation (the Foundation), created in 1999, receives annually 10 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 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 of Trustees 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 Virginia Department of Health acts as the fiscal agent for the Foundation and provides fiscal and payroll services to the Foundation. The Foundation employs an executive and deputy director, a business manager, and eleven staff members. The staff includes five regional Grant Program Administrators. These Administrators are responsible for managing the program grants issued throughout the Commonwealth. During fiscal year 2002, the Foundation began a marketing campaign and implemented various tobacco use prevention programs to discourage tobacco use by minors.

During fiscal year 2003, to further support its mission, the Foundation began efforts to establish a non-profit entity through which it could become eligible for grants and other funds available only to non-profit 501(c) 3 tax-exempt organizations. The Foundation created the non-profit organization, Prevention Connections, in October 2003. The Foundation Board approved \$2,500 start-up funding, of which \$500 was used to apply to the Internal Revenue Service for 501(c) 3 status in December 2003. If approved, Prevention Connections would receive provisional status on an annual basis for three to five years.

FINANCIAL OPERATIONS

The following table shows cash receipts and disbursements for the years ended June 30, 2002 and June 30, 2003.

Summary Analysis of Revenues and Expenditures

	<u>FY2002</u>	<u>FY2003</u>
Cash on hand - beginning	\$ 29,950,657	\$ 30,958,156
Revenues:		
Master settlement payment	14,961,389	15,002,990
Interest on securities	<u>1,296,185</u>	<u>915,970</u>
Total revenues	<u>16,257,574</u>	<u>5,918,960</u>
Expenditures:		
Personal services	\$ 761,867	\$ 935,556
Contractual services	14,279,698	17,805,062
Supplies and materials	64,019	12,253
Continuous charges	66,687	78,384
Equipment	<u>45,438</u>	<u>8,299</u>
Total expenditures	15,217,709	18,839,554
Cash transfer out	<u>32,366</u>	<u>15,591,661</u>
Total expenditures and cash transfer out	<u>15,250,075</u>	<u>34,431,215</u>
Cash on hand - ending	<u>\$ 30,958,156</u>	<u>\$ 12,445,901</u>

Source: Commonwealth Accounting and Reporting System for the year ended June 30, 2002 and 2003.

The Foundation transferred \$15,514,648 of its cash balance to the state general fund 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.

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 \$1.7 million more than its budget of \$13.3 million for fiscal year 2003.

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 \$10,084,546, which represents 57 percent of all fiscal year 2003 services.

The Foundation expects annual revenues from the Master Settlement Agreement of approximately \$13.3 million, while the Board has approved budgets for the next three years to spend

approximately \$13.1 million annually. Projected expenses include adjustments for operational expenses resulting from the fiscal year 2003 cash reversion.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

February 13, 2004

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

The Honorable Lacey E. Putney
Vice 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 (Foundation) for the year ended June 30, 2003. 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 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:

Expenditures
Revenues

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 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 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.

EXIT CONFERENCE

We discussed this with management on February 26, 2004.

AUDITOR OF PUBLIC ACCOUNTS

MAM: cam
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VIRGINIA TOBACCO SETTLEMENT FOUNDATION
Richmond, Virginia

Martha Kilgore, Executive Director

BOARD OF TRUSTEES
As of June 30, 2003

Steven J. Danish, Chairman

John M. O'Bannon III, Vice Chairman

Kevin M. Bolling	Patrick Hughes
George E. Broman	William Janis
Ming S. Chiu	Maria D. Kelly
Curtis Coleburn	Robert S. Kelley
Rebecca Darby	Robert Leek
Jose F. Dimas, Jr.	V.Carole Loughheed
Rickie E. Fulcher	James L. McDaniel
Lolly A. Gilmore	Kethandapatti G. Srinivas
Emmett W. Hanger, Jr.	Robert B. Stroube
Barbara Hughes	John Watkins

Percy Wootton, MD