



Tobacco Indemnification and Community Revitalization Commission

Financial Statements

Fiscal Year 2011

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MANAGEMENT'S DISCUSSION AND ANALYSIS

(Unaudited)

As management of the Tobacco Indemnification and Community Revitalization Commission ("Commission"), we offer readers of the Commission's financial statements this narrative overview and analysis of the financial activities of the Commission for the fiscal year ended June 30, 2011.

Financial Highlights

- The assets of the Commission exceeded its liabilities at the close of fiscal year 2011 by \$830.8 million (net assets).
- The Commission's unrestricted net assets decreased by \$76.9 million from the prior year and restricted net assets decreased by \$16.0 million from the prior year.
- At the end of the fiscal year, the Commission's restricted fund balance for the special revenue fund was \$319.0 million with \$111.9 million of this amount remaining in the Endowment. The committed fund balance was \$120.5 million, and the assigned fund balance was \$391.4 million with \$373.3 million of this amount remaining in the Endowment.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Commission's basic financial statements. The Commission's basic financial statements are comprised of two components: 1) combined fund financial statements and government-wide financial statements, and 2) notes to the financial statements.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Commission uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the Commission are governmental funds.

Governmental Funds

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues,

expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

Through the Tobacco Settlement Financing Corporation, the Commission securitized half of its future Master Settlement Agreement (MSA) payments in 2005 and the remaining half in 2007, receiving total net proceeds of \$1.0 billion, which were deposited into the Tobacco Indemnification and Community Revitalization Endowment (“Endowment”) held by the Treasurer of Virginia. The Commission will no longer receive MSA revenue until the bonds are fully paid, estimated to be in 2032, when the MSA revenue will revert back to the Commission.

The Special Revenue Fund accounts for amounts transferred from the Endowment used for community revitalization projects and indemnifying tobacco farmers and other revenues deposited to the Tobacco Indemnification and Community Revitalization Fund. The Endowment Special Revenue Fund reflects proceeds and earnings from the securitization of the Commission’s future MSA funds, less amounts transferred to the Special Revenue Fund.

The Commission adopts an annual budget within the limits set forth in Section 3.2-3104, *Code of Virginia*. A budgetary comparison statement has been provided. The Commission approved several transfers and redistributions of funds from prior year balances between designated purposes during the year. This statement does not reflect all of the grant award commitments made by the Commission in fiscal year 2011 since grants are paid on a reimbursement basis and eligibility requirements may not have been met as of June 30, 2011.

Government-wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the Commission’s finances, in a manner similar to a private-sector business.

The statement of net assets presents information on all of the Commission’s assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Commission is improving or deteriorating.

The statement of activities presents information showing how the Commission’s net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in the future.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Financial Analysis of the Commission’s Governmental Funds

The focus of the Commission’s governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Commission’s financing requirements.

At June 30, 2011, the Commission's governmental fund balance was \$830.9 million, a decrease of \$92.9 million from the prior year. Of the total fund balance, \$319.0 million is restricted to capital projects by IRS restrictions on the use of tax-exempt proceeds. Of this restricted fund balance, \$207.0 million in the Special Revenue Fund represents grant awards approved by the Commission for capital projects that have not yet been disbursed. The remaining \$111.9 million in restricted fund balance is in the Endowment Special Revenue Fund to be transferred to the Special Revenue Fund, subject to certain annual restrictions on transfers. The committed fund balance of \$120.5 million represents grant awards approved by the Commission that have not yet been disbursed. The assigned fund balance of \$391.4 million is intended to be used by the Commission for community revitalization projects and indemnification payments to tobacco farmers. Of this assigned fund balance, \$373.3 million remains in the Endowment Special Revenue Fund to be transferred to the Special Revenue Fund in the future.

Government-wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of the Commission's financial position. Assets for the Commission exceeded liabilities by \$830.8 million.

Most of the Commission's net assets are unrestricted with amounts held in the Special Revenue Fund available to be used to meet the Commission's ongoing obligations to citizens and creditors. A small portion of the Commission's net assets reflects an investment in capital assets. The Commission uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending.

Commission's Net Assets

	Governmental Activities	
	Fiscal Year 2011	Fiscal Year 2010
Assets:		
Current and other assets	\$840,165,445	\$938,052,519
Capital assets	101,703	2,424
Total assets	840,267,148	938,054,943
Liabilities:		
Current and other liabilities	9,289,427	14,289,154
Long-term liabilities	167,344	60,530
Total liabilities	9,456,771	14,349,684
Net assets:		
Invested in capital assets, net of related debt	1,703	2,424
Restricted	318,969,899	334,938,193
Unrestricted	511,838,775	588,764,642
Total net assets	\$830,810,377	\$923,705,259

The Commission's net assets decreased by \$92.9 million, most of which is attributable to indemnification and community revitalization disbursements being made from balances transferred out of the Endowment. The decrease in current and other liabilities is primarily due to there being no securities lending obligations for FY2011.

Commission's Revenues and Expenditures

	Fiscal Year 2011	Fiscal Year 2010
Revenues:		
Other income	\$504,093	\$293,214
Interest, dividends, and other investment income	40,363,666	37,751,086
Unrealized gain on investments held by the Treasurer	0	20,488,397
Total revenues	40,867,759	58,532,697
Expenditures:		
Tobacco settlement expense:		
Administration	3,117,238	2,402,831
Indemnification payments	9,863,391	19,746,240
Community revitalization	110,950,510	64,483,701
Payments for securities lending transactions	0	3,210
Unrealized loss on investments held by the Treasurer	9,830,781	0
Depreciation	721	1,770
Total expenditures	133,762,641	86,637,752
Change in net assets	- \$92,894,882	- \$28,105,055

The revenue decrease is primarily from the unrealized gain on investments in the prior year. An unrealized loss for the current fiscal year increased total expenditures. The decrease in indemnification payments is from a budgetary and policy decision of the Commission to phase out the final payments for indemnification. The increase in total expenditures is primarily attributable to more community revitalization grant disbursements this fiscal year.

Budget for Fiscal Year 2012

For the year ended June 30, 2011, \$319 million of the total fund balance is restricted for capital projects with \$207 million of this amount in the Special Revenue Fund already awarded by the Commission for capital projects but not yet disbursed. The remaining \$112 million in the Endowment Special Revenue Fund is restricted for future capital projects funded by the Commission.

The committed fund balance in the Special Revenue Fund is \$120 million. This amount reflects community revitalization grants already awarded by the Commission but not yet disbursed. The remaining assigned fund balance of \$391 million includes amounts budgeted for specific grant programs with \$373 million in the Endowment Special Revenue Fund for future community revitalization projects.

The Commission anticipates additional grant awards in fiscal year 2012 that will obligate most of the Special Revenue Fund balances plus a portion of the Endowment Special Revenue Fund.

The Commission has estimated its remaining obligation to tobacco producers and quota owners to be \$10.3 million at June 30, 2011, and has budgeted this amount for distribution in fiscal year 2012.

The Commission originally approved a budget of \$85.1 million for fiscal year 2012. However, the Commission amended its fiscal year 2012 budget at its September 2011 meeting increasing it by \$13.1 million, an overall decrease of 9 percent from the final fiscal year 2011 budget. This decrease is primarily due to the conclusion of the Commission's Reserve grant program related to the federal American Recovery and Reinvestment Act.

Request for Information

This financial report is designed to provide a general overview of the Commission's finances for all those with an interest in the Commission's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Director of Finance, Tobacco Indemnification and Community Revitalization Commission, 701 East Franklin Street, Suite 501, Richmond, Virginia 23219.

FINANCIAL STATEMENTS

TOBACCO INDEMNIFICATION AND COMMUNITY REVITALIZATION COMMISSION
STATEMENT OF NET ASSETS AND GOVERNMENTAL FUNDS BALANCE SHEET
As of June 30, 2011

	Special Revenue Fund	Endowment Special Revenue Fund (Note 10)	Adjustments (Note 1-F)	Statement of Net Assets
ASSETS:				
Cash held by the Treasurer of Virginia (Note 2)	\$ 40,185,315	\$ -	\$ -	\$ 40,185,315
Cash equivalents held by the Treasurer of Virginia (unrestr endwmt) (Note 2)	2,043,479	-	-	2,043,479
Cash equivalents held by the Treasurer of Virginia (restricted funds) (Note 2)	5,094,535	-	-	5,094,535
Investments held by the Treasurer of Virginia (unrestricted) (Note 2)	107,809,263	373,270,710	-	481,079,973
Investments held by the Treasurer of Virginia (restricted funds) (Note 2)	186,593,711	111,922,741	-	298,516,452
Other receivables	114,242	-	-	114,242
Prepaid items	4,519	-	-	4,519
Grant advances (Note 6)	13,126,930	-	-	13,126,930
Intangible assets	-	-	100,000	100,000
Capital assets (Note 1)	-	-	1,703	1,703
Total assets	<u>\$ 354,971,994</u>	<u>\$ 485,193,451</u>	<u>\$ 101,703</u>	<u>\$ 840,267,148</u>
LIABILITIES:				
Accounts payable	329,030	-	-	329,030
Accrued payroll	59,463	-	-	59,463
Grants payable (Note 6)	8,807,487	-	-	8,807,487
Indemnification payments payable (Note 7)	93,447	-	-	93,447
Other Liabilities	-	-	100,000	100,000
Compensated absences (Note 1)	-	-	67,344	67,344
Total liabilities	<u>9,289,427</u>	<u>-</u>	<u>167,344</u>	<u>9,456,771</u>
FUND BALANCES/NET ASSETS:				
Fund Balances:				
Restricted (Note 10)	207,047,158	111,922,741	(318,969,899)	-
Committed	120,459,509	-	(120,459,509)	-
Assigned	18,175,901	373,270,710	(391,446,611)	-
Total liabilities and fund balances	<u>\$ 354,971,995</u>	<u>\$ 485,193,451</u>		
Net assets:				
Invested in capital assets, net of related debt			1,703	1,703
Restricted (Note 10)			318,969,899	318,969,899
Unrestricted			511,838,775	511,838,775
Total net assets			<u>\$ 830,810,377</u>	<u>\$ 830,810,377</u>

The accompanying notes are an integral part of the financial statements.

TOBACCO INDEMNIFICATION AND COMMUNITY REVITALIZATION COMMISSION
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCE
For the Fiscal Year Ended June 30, 2011

	Special Revenue Fund	Endowment Special Revenue Fund (Note 10)	Adjustments (Note 1-F)	Statement of Activities
REVENUES:				
Interest, dividends, and other investment income (Note 2)	\$ -	\$ 40,363,666	\$ -	\$ 40,363,666
Other income	504,093	-	-	504,093
Total revenues	504,093	40,363,666	-	40,867,759
EXPENDITURES:				
Tobacco settlement expense:				
Administration (Note 8)	3,110,423	-	6,815	3,117,238
Indemnification payments (Note 7)	9,863,391	-	-	9,863,391
Community revitalization (Note 6)	110,950,510	-	-	110,950,510
Unrealized loss on investments held by the Treasurer	-	9,830,781	-	9,830,781
Depreciation (Note 1)	-	-	721	721
Total expenditures	123,924,324	9,830,781	7,536	133,762,641
Revenues Over (Under) Expenditures	(123,420,231)	30,532,885	92,887,346	-
OTHER FINANCING SOURCES (USES):				
Transfers In	121,119,531	-	-	121,119,531
Transfers Out	-	(121,119,531)	-	(121,119,531)
Total Other Financing Sources (Uses)	121,119,531	(121,119,531)	-	-
Excess (deficiency) of revenues and transfers in over expenditures and transfers out	(2,300,700)	(90,586,646)		
Change in net assets			(92,894,882)	(92,894,882)
Fund balance/net assets, July 1, 2010	347,983,268	575,780,097	(58,106)	923,705,259
Fund balance/net assets, June 30, 2011	\$ 345,682,568	\$ 485,193,451	\$ (65,642)	\$ 830,810,377

The accompanying notes are an integral part of the financial statements.

TOBACCO INDEMNIFICATION AND COMMUNITY REVITALIZATION COMMISSION
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
BUDGETARY COMPARISON - CASH BASIS
SPECIAL REVENUE FUND
For the Fiscal Year Ended June 30, 2011

	Original Budget	Final Budget	Actual	Variance Favorable (Unfavorable)
REVENUES:				
Other income	-	-	543,904	543,904
Total revenues	-	-	543,904	543,904
EXPENDITURES:				
Administration	3,022,676	3,322,676	2,829,187	493,489
Indemnification payments (Note 7)	10,259,353	10,259,353	9,883,228	376,125
Community revitalization (Note 6)	85,000,000	94,068,022	109,026,454	(14,958,432)
Total expenditures	98,282,029	107,650,051	121,738,869	(14,088,818)
Revenues over (under) expenditures	(98,282,029)	(107,650,051)	(121,194,965)	(13,544,914)
OTHER FINANCING SOURCES (USES):				
Transfers In	106,140,882	106,140,882	121,119,531	14,978,649
Fund balance, July 1, 2010	341,801,737	341,801,737	341,801,737	-
Fund balance, June 30, 2011	<u>\$ 349,660,590</u>	<u>\$ 340,292,568</u>	<u>\$ 341,726,303</u>	<u>\$ 1,433,735</u>

The accompanying notes are an integral part of the financial statements.

NOTES TO FINANCIAL STATEMENTS

TOBACCO INDEMNIFICATION AND COMMUNITY REVITALIZATION COMMISSION

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDING JUNE 30, 2011

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Tobacco Indemnification and Community Revitalization Commission (Commission) was established on July 1, 1999, by Chapters 880 and 962 of the 1999 Virginia Acts of Assembly, and operates as a body corporate and political subdivision of the Commonwealth. The Commission's major activities are to compensate tobacco farmers in the Commonwealth for the decline of tobacco quota and to revitalize tobacco-dependent communities.

The Commission is a component unit of the Commonwealth of Virginia. A separate report is prepared for the Commonwealth, which includes all agencies, boards, commissions, and authorities over which the Commonwealth exercises or has the ability to exercise oversight authority. The Commission is an integral part of the reporting entity of the Commonwealth; accordingly, the financial statements of the Commission are included in the financial statements of the Commonwealth as a part of the reporting entity.

B. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

Government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grant awards and similar items are recognized as expenditures as soon as the recipient has met all eligibility requirements.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available.

- Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Commission considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Interest associated with the current fiscal period is reported on an accrual basis. All other revenue items are considered to be measurable and available only when cash is received by the Commission.
- Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, expenditures related to compensated absences, claims, and judgments are recorded only when payment is due.

The cash basis of accounting is used during the year.

C. Fund Accounting

The accounts of the Commission were developed to account for specific financial activities. Resources were allocated to and accounted for in a special revenue fund, the "Tobacco Indemnification and Community Revitalization Fund," established under Section 3.2-3106, Subsection B of the Code of Virginia. Special revenue funds account for transactions related to resources received and used for restricted or specific purposes.

Fund balances on the fund financial statements are classified as Restricted, Committed, or Assigned in accordance with Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. The Restricted fund balance includes all funds in the Tobacco Indemnification and Community Revitalization Special Revenue Funds that are restricted to specific purposes by IRS restrictions on the use of tax-exempt securitization proceeds. The Committed fund balance comprises unrestricted funds that have been approved by the Commission for specific grants that have not yet been disbursed. The Assigned fund balance includes funds that have been approved by the Commission through the annual budgeting process for specific project areas, such as Education, Economic Development, or Agribusiness, that have not yet been awarded for specific grants, and any other funds not restricted or committed.

D. Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure assets, are reported in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Capital assets also include intangible assets, such as software licenses, that cost more than \$100,000 and have a benefit period exceeding one year. Such assets are recorded at the total cost of the contractual agreement and depreciated over the contract period.

Computer equipment is depreciated using the straight-line method over an estimated useful life of five years. Capital asset activity for the year ended June 30, 2011, is summarized as follows:

	Beginning Balance July 1, 2010	Additions	Deletions	Balance June 30, 2011
Computer equipment	\$11,931	\$ -	\$ -	\$11,931
Software licenses	0	125,000	-	125,000
Less Accumulated Depreciation	9,507	25,721		35,228
Ending Balance	\$ 2,424	\$99,279	\$ -	\$101,703

E. Compensated Absences

Compensated absences represent the amounts of vacation, sick, and compensatory leave earned by the Commission's employees, but not taken at June 30, 2011. Compensated absences were calculated in accordance with Governmental Accounting Standards Board (GASB) Statement No. 16, *Accounting for Compensated Absences*. This statement requires the accrual of the following: (1) Sick leave earned by employees who, while not currently vested for payment, will probably attain the years of service required to vest, and (2) Social Security and Medicare taxes to be paid by the Commission on all accrued compensated absences.

F. Adjustments

The adjustments column represents the recording of Capital Assets and Compensated Absences for the Statement of Net Assets and the related effect of these transactions on the Statement of Activities. Governmental fund statements do not reflect Capital Assets and Compensated Absences.

G. Budgets and Budgetary Accounting

The Commission's budget was established by the Commission based on investment earnings and allowable withdrawals from the Tobacco Indemnification and Community Revitalization Endowment.

The budget is prepared principally on a cash basis. Since a cash basis budget differs from generally accepted accounting principles (GAAP), a reconciliation of actual data reported on a cash basis to actual data reported on a GAAP (modified accrual) basis is presented in Note 3.

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS

Cash, Cash Equivalents and Investments

The GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, an amendment to GASB No. 3, modified previous disclosure requirements related to investment risk. This statement requires investment risk disclosures for credit risk, including custodial credit risk and concentrations of credit risk, interest rate risk, and foreign currency risk.

A. Cash and Cash Equivalents

Cash deposits are covered by the Federal Deposit Insurance Corporation (FDIC) and collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-4400 et seq. of the Code of Virginia (1950), as amended. Restricted and unrestricted cash equivalents of the special revenue fund are held in the name of the Commission with the Treasury Board serving as trustee and total \$47,323,329 as of June 30, 2011.

B. Investments

Authorized Investments

In accordance with the State Treasurer and the Treasury Board investment policy, the funds held by the Treasurer of Virginia are invested in accordance with Sections 3.2-3104 and 55-268.11 et seq. of the Code of Virginia.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Commission has elected the Segmented Time Distribution method of disclosure. As of June 30, 2011, the Commission had the following investments and maturities held by the Treasurer of Virginia:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Investment Maturities (in Years)</u>			
		<u>Less Than 1</u>	<u>1-5</u>	<u>6-10</u>	<u>More Than 10</u>
U.S. Treasury and Agency Securities	\$89,983,750	\$16,848,668	\$53,606,400	\$14,682,292	\$4,846,389
Corporate Bonds	205,033,125	33,631,895	95,142,202	72,656,184	3,602,844
Corporate Mortgage Backed	13,840,402	-	-	478,084	13,362,318
Municipal Securities	306,730,482	21,464,526	103,454,192	119,928,783	61,882,981
Asset Backed Securities	37,994,790	-	17,114,598	10,906,157	9,974,035
Agency Unsecured Bonds and Notes	7,081,722	4,417,247	2,664,475	-	-
Agency Mortgage Backed Securities	118,932,155	1,498,031	1,320,691	6,972,305	109,141,128
Money Market Funds	7,138,014	7,138,014	-	-	-
Total	<u>\$786,734,439</u>	<u>\$84,998,382</u>	<u>\$273,302,558</u>	<u>\$225,623,805</u>	<u>\$202,809,694</u>

Credit Risk

Credit risk is the risk that obligations to the Commission will not be fulfilled by an issuer or other counterparty to an investment. The State Treasurer and Treasury Board investment guidelines place emphasis on securities of high credit quality and marketability.

The following table presents the credit ratings for investments as of June 30, 2011. The ratings presented below are using Standard & Poor's (S&P) and Moody's Investors Service (Moody's) rating scales.

Investment	Amount	Rating Agency	Rating	% of Portfolio
Agency Mortgage Backed Securities	\$118,932,155	Standard & Poor's	AAA	15.15%
Municipal Securities	84,701,529	Standard & Poor's	AAA	10.79%
U.S. Treasury and Agency Securities	83,507,489	Standard & Poor's	AAA	10.64%
Municipal Securities	65,390,509	Standard & Poor's	AA	8.33%
Corporate Bonds	51,831,008	Standard & Poor's	A	6.60%
Municipal Securities	44,024,787	Standard & Poor's	AA+	5.61%
Corporate Bonds	33,164,009	Standard & Poor's	A-	4.23%
Municipal Securities	27,958,028	Moody's	Aa2	3.56%
Asset Backed Securities	26,462,281	Standard & Poor's	AAA	3.37%
Corporate Bonds	26,370,270	Standard & Poor's	AAA	3.36%
Corporate Bonds	18,078,522	Standard & Poor's	A+	2.30%
Municipal Securities	17,686,078	Moody's	Aa1	2.25%
Municipal Securities	14,983,655	Moody's	Aa3	1.91%
Corporate Bonds	14,462,562	Standard & Poor's	AA-	1.84%
Municipal Securities	13,298,640	Standard & Poor's	AA-	1.69%
Corporate Bonds	12,910,129	Moody's	A3	1.64%
Municipal Securities	12,312,703	Standard & Poor's	A	1.57%
Corporate Bonds	11,087,316	Moody's	A1	1.41%
Corporate Mortgage Backed Securities	9,569,717	Standard & Poor's	AAA	1.22%
Corporate Bonds	9,091,635	Standard & Poor's	AA	1.16%
Municipal Securities	8,557,471	Standard & Poor's	A+	1.09%
Corporate Bonds	8,361,083	Moody's	Aa2	1.07%
Money Market Funds	7,138,014	Moody's	Aaa	0.91%
Asset Backed Securities	7,098,864	Standard & Poor's	A+	0.90%
Agency Unsecured Bonds and Notes	7,081,722	Standard & Poor's	AAA	0.90%
Corporate Bonds	7,032,353	Moody's	Baa1	0.90%
Municipal Securities	6,714,078	Standard & Poor's	A-	0.86%
U.S. Treasury and Agency Securities	6,476,261	Standard & Poor's	Not Rated	0.83%
Corporate Bonds	5,983,093	Moody's	A2	0.76%
Municipal Securities	4,745,304	Moody's	Aaa	0.60%
Corporate Mortgage Backed Securities	3,792,601	Moody's	Aaa	0.48%
Municipal Securities	3,204,199	Moody's	A1	0.41%
Asset Backed Securities	2,993,820	Standard & Poor's	A-	0.38%
Corporate Bonds	2,566,226	Standard & Poor's	Not Rated	0.33%
Corporate Bonds	2,166,674	Standard & Poor's	BBB+	0.28%
Municipal Securities	2,152,570	Standard & Poor's	BBB	0.27%
Corporate Bonds	1,928,245	Moody's	Aa3	0.25%
Asset Backed Securities	1,439,825	Moody's	Aaa	0.18%
Municipal Securities	1,000,930	Moody's	MIG1	0.13%
Corporate Mortgage Backed Securities	478,084	Standard & Poor's	A+	0.06%
	<u>\$786,734,439</u>			<u>100%</u>

Concentration of Credit Risk

Concentration of credit risk is related to the risk of loss that may be attributed to the magnitude of a government's investment in a single issuer. The Treasury Board investment guidelines require each portfolio be diversified with no more than five percent of the total market value of its investments invested in the securities of any single issuer. This limitation does not apply to the U.S. Government, or agency thereof, or U.S. Government sponsored corporation securities and fully insured and/or collateralized certificates of deposit. There is no concentration of investments in any one organization that represents more than five percent of the market value of the endowment as of June 30, 2011.

Custodial Credit Risk

Custodial credit risk is the risk that, in the event of failure of the counterparty, the Commission may not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. All securities are held in the name of the Commission with oversight from the Treasurer of Virginia. There is no custodial credit risk in the endowment as of June 30, 2011.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. There is no foreign currency risk exposure in the Commission's investments as of June 30, 2011.

3. RECONCILIATION OF BUDGETARY FUND BALANCE TO GAAP FUND BALANCE

The accompanying Statement of Revenues, Expenditures, and Changes in Fund Balance – Budgetary Comparison – Cash Basis – Special Revenue Fund presents a comparison of the legally adopted budget prepared on a cash basis with actual data prepared on a cash basis. To enhance this comparison, actual data on a cash basis is reconciled to actual data on a GAAP basis as follows:

Fund balance, Budgetary basis, June 30, 2011	\$341,726,303
Deduct: accrued expenses	(9,289,426)
Add: receivables, advances, and prepaid Items	<u>13,245,691</u>
Fund balance, GAAP basis, June 30, 2010	<u>\$345,682,568</u>

4. PENSION PLAN AND OTHER RETIREMENT BENEFITS

Employees of the Tobacco Indemnification and Community Revitalization Commission are treated as state employees for purposes of participation in the Virginia Retirement System (VRS), health insurance, and all other employee benefits offered by the Commonwealth to its classified employees. The VRS also administers life insurance and health related plans for retired employees. Information relating to these plans is only available at the statewide level in the CAFR. The Commonwealth, not the Commission, has overall responsibility for contributions to these plans.

5. OPERATING LEASES

The Commission entered into a new 36-month agreement in June 2010 to lease office equipment beginning in fiscal year 2011. The operating lease contains the provision that the Commission may renew the operating lease at the expiration date of the lease on a month-to-month basis. Rental expense for the Commission under these operating leases for the year ended June 30, 2011, was \$6,420. The Commission has, as of June 30, 2011, \$7,704 in minimum rental payments due under these new leases for 2012.

6. COMMUNITY REVITALIZATION EXPENDITURES

The Commission awarded grants totaling \$142,572,261 in fiscal year 2011 to various localities and other entities for community revitalization projects, including regional economic development projects, educational programs, research and development initiatives, megapark development, and other special projects in Southside and Southwest Virginia. Of the total amount awarded since the inception of the Commission, \$220,805,974 is not reflected in these statements since eligibility requirements were not met as of June 30, 2011, in accordance with GASB Statement No. 33, *Accounting and Financial Reporting for Non-exchange Transactions*. This amount not reflected in the statements includes grants awarded in prior years that have not yet been paid. Grants payable includes amounts awarded to grantees with all contingencies met but unpaid as of June 30, 2011. Grant advances include amounts disbursed to grant recipients who have not incurred expenses as of June 30, 2011.

7. INDEMNIFICATION PAYMENTS

Indemnification payments represent amounts paid to tobacco producers and quota owners as compensation for the adverse economic effects resulting from the loss in tobacco production opportunities associated with a decline in tobacco quota. Indemnification Payments Payable includes amounts payable to recipients who as of June 30, 2011, met the eligibility requirement of submitting the appropriate verification form by the initial deadline. The Commission's remaining obligation to tobacco producers and quota owners is \$10.3 million at June 30, 2011, and expects to fulfill this obligation in calendar year 2012.

8. ADMINISTRATION

Indemnification Costs

Administration expenditures include \$331,500 paid to Troutman Sanders, L.L.P., to validate payees and update the database for calculating payment amounts related to the indemnification payments.

Master Settlement Agreement (MSA) Enforcement

Pursuant to the 2010 Appropriation Act, administration expenditures include \$244,268 for the Commission's share of the Office of the Attorney General's and Tax Department's expenses related to the enforcement of the 1998 MSA and Section 3.2-4201, Code of Virginia.

Central Service Agencies Charge

Administration expenditures include \$88,077 for expenses incurred by central service agencies on behalf of the Commission, pursuant to the 2010 Appropriation Act.

Agency Service Costs

Administration expenditures include \$50,000 of Agency Service Costs paid to the Virginia Department of Agriculture and Consumer Services (DACS). DACS serves as the fiscal agent for the Commission. Agency Service Costs consist of the amounts DACS charges the Commission for the costs DACS incurs to provide fiscal and administrative services to the Commission.

9. RISK MANAGEMENT

The Commission is exposed to various risks of loss related to torts; theft, or damage to, and destruction of assets; errors and omissions; non-performance of duty; injuries to employees; and natural disasters. The Commission has purchased Virginia Local Government Risk Management Plan liability insurance through the Department of the Treasury, Division of Risk Management. Commercial insurance for property coverage and worker's compensation plans have been purchased from private insurers through the Department of the Treasury since the Commonwealth does not provide such coverage for the Commission. The Commission participates in the state employee health care plan administered by the Department of Human Resource Management. The Commission pays premiums to each of these Departments for its insurance coverage. Information relating to the Commonwealth's insurance plans is available at the statewide level in the CAFR.

10. SECURITIZATION

In May 2005, the Governor, with the Commission's endorsement, authorized the sale to the Tobacco Settlement Financing Corporation (the Corporation) of one-half of the Commission's allocation of revenues derived from the MSA, pursuant to Chapters 482 and 488 of the 2002 Virginia Acts of Assembly. The Corporation sold tax-exempt bonds, the proceeds of which are restricted to the purchase of capital assets. The net proceeds to the Tobacco Indemnification and Community Revitalization Endowment were \$389,776,674 on May 16, 2005.

In 2007, the Governor, with the Commission's endorsement, authorized the sale to the Corporation of the other half of the Commission allocation of revenues derived from the MSA. The Corporation sold taxable bonds and restructured the previously issued tax-exempt bonds such that all proceeds from the 2007 sale are not restricted to the purchase of capital assets. However, all of these funds are restricted to the purpose of promoting the goals of the Commission as enumerated by §3.2-3101 of the Code of Virginia. The net proceeds to the Tobacco Indemnification and Community Revitalization Endowment from the bond sale and restructuring were \$613,994,236 on May 3, 2007. The Commission will no longer receive MSA revenue until the bonds are fully paid, estimated to be in 2032, when the MSA revenue will revert back to the Commission. The Commission and the Commonwealth did not guarantee in any aspect the future MSA revenue to the bondholders.

The Commission is required to transfer annually all interest income from the Endowment and may transfer up to 15 percent of the corpus of the Endowment into the Tobacco Indemnification and Community Revitalization Fund, which is reflected under the Special Revenue Fund column. In fiscal year 2011, the Commission transferred \$121,119,531, including \$40,738,843 in interest

earnings through February 2011, from the Endowment to the Tobacco Indemnification and Community Revitalization Fund. The remaining Endowment balance includes interest earned on the Endowment from March 1, 2011, through June 30, 2011.



Commonwealth of Virginia

Auditor of Public Accounts

Walter J. Kucharski
Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

October 25, 2011

The Honorable Robert F. McDonnell
Governor of Virginia

The Honorable Charles J. Colgan
Chairman, Joint Legislative Audit
And Review Commission

Commission Members
Virginia Tobacco Indemnification and Community Revitalization Commission

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the governmental activities and each major fund of the **Virginia Tobacco Indemnification and Community Revitalization Commission** (Commission), a component unit of the Commonwealth of Virginia, as of and for the year ended June 30, 2011, which collectively comprise the Commission's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Commission's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Commission as of June 30, 2011, the respective changes in financial position, and the respective budgetary comparison for the special revenue fund for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis are not a required part of the basic financial statements, but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with Government Auditing Standards, we have also issued our report dated October 25, 2011, on our consideration of the Commission's internal control over financial reporting, and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.


AUDITOR OF PUBLIC ACCOUNTS

AWP/clj