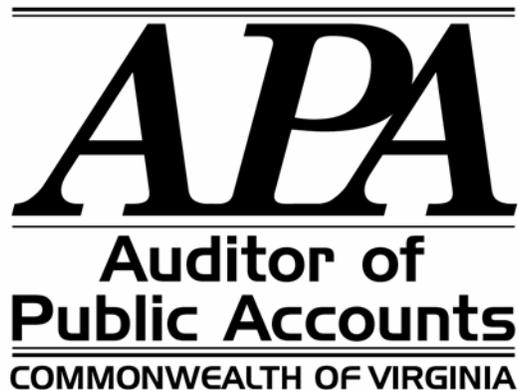


**TOBACCO INDEMNIFICATION
AND REVITALIZATION COMMISSION**

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





Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

September 21, 2005

The Honorable Mark R. Warner
Governor of Virginia

The Honorable Lacey E. Putney
Chairman, Joint Legislative Audit
and Review Commission

Commission Members
Tobacco Indemnification and
Community Revitalization Commission

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

We have audited the financial statements of the **Tobacco Indemnification and Revitalization Commission** as of and for the year ended June 30, 2005, and have issued our report thereon dated September 21, 2005. 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.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Commission's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable condition, entitled "Contract Management" is described in the section titled Internal Control Finding and Recommendation.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their

assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we do not consider the reportable condition described above to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

The Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters is intended solely for the information and use of the Governor and General Assembly of Virginia, the Board of the Tobacco Indemnification and Revitalization Commission, and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

EXIT CONFERENCE

We discussed this report with management at an exit conference held on October 4, 2005.

AUDITOR OF PUBLIC ACCOUNTS

/kva

INTERNAL CONTROL FINDING AND RECOMMENDATION

Contract Management

The Commission has a contract with a legal firm to accumulate and prepare information for the indemnification payments. In connection with this process the legal firm maintains and uses an automated database. This database is the fundamental source of information to the indemnification payments.

The Commission's contract includes provisions for a Service Organization review, SAS 70. A Service Organization Review has the service provider, in this case, the legal firm, employ an independent organization to review and determine the adequacy of the internal controls that the policies and procedures provide and to test that the service organization is following those policies and procedures. In the past, the legal firm employed another legal organization to review their processing of claims. However, the report did not indicate whether the review included the legal firm's policies and procedures for handling the Commission's activities and if the review included automated controls such as general and access controls.

The Commission should work with the legal firm to ensure that the independent organization reviews and comments on all of the policies and procedures surrounding the Commission's activities, including the internal controls over the automated processes. We recommend that the Commission consider a two-year cycle approach to future SAS 70 reviews. The first year, the independent organization would review the legal firm's policies and procedures surrounding the Commission's activities and determine if they are sufficient to provide adequate internal controls. In the second year, the independent organization would test the controls for compliance. This second year review would not reach the point of issuing an opinion on the design of internal controls. By adopting this approach, the Commission would control the cost of the Service Organization Review.

The Honorable Charles R. Hawkins
Chairman

The Honorable Terry G. Kilgore
Vice Chairman

Carthan F. Currin, III
Executive Director



804-225-2027
Phone

1-877-807-1086
Toll Free

804-786-3210
Fax

Virginia Tobacco Indemnification and Community Revitalization Commission

701 E. Franklin Street, Suite 501 • Richmond, Virginia 23219

October 4, 2005

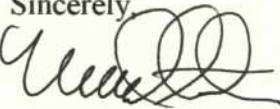
Commission Members
Tobacco Indemnification and Community Revitalization Commission

Re: Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters – letter dated 09/21/05 from the Auditor of Public Accounts

I received a copy of the subject letter this week, indicating that a *reportable condition* was noted in the annual audit of internal controls related to indemnification payment processing. Today, I wish to report my plan of action to resolve this condition promptly and thereby provide the Commission and the Commonwealth with the high level of confidence to which they are accustomed.

The essence of the reportable condition is that our indemnification claims processor has not conducted a *satisfactory* audit of its internal controls. Although a review of claims has been conducted, such review was found by the Auditor of Public Accounts (APA) to be inadequate in scope. I plan to cure this by requiring that the claims processor supply the Commission with an audit letter, prepared in accordance with APA's recommendations, and issued by an independent, professional audit firm. This process will span two fiscal years, as recommend by APA, with the first year being devoted to a review of policies and procedures, and the second year being devoted to testing the controls for compliance.

While the choice of an audit firm has not yet been made, and is technically the duty of the claims processor, it is my intent to require the firm's selection within 60 days, and that work begin within 90 days. I will periodically advise the Commission of my progress on this effort, and welcome your inquiry at anytime.

Sincerely,


Ned Stephenson
Executive Director (acting)

cc: Mr. Walter J. Kucharski, Auditor of Public Accounts