



# **Tobacco Indemnification and Community Revitalization Commission**

Financial Statements  
Fiscal Year 2006

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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, 2006.

### Financial Highlights

- The assets of the Commission exceeded its liabilities at the close of fiscal year 2006 by \$437.1 million (net assets).
- The Commission's unrestricted net assets decreased by \$22.8 million over the prior year.
- At the end of the fiscal year, the Commission's unreserved fund balance for the special revenue fund was \$64.9 million and \$372.2 million in reserved fund balance with \$322.4 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.

The Special Revenue Fund accounts for revenues received from the Master Settlement Agreement and other revenues deposited to the Tobacco Indemnification and Community Revitalization Fund and used for community revitalization projects and indemnifying tobacco farmers. The Endowment Special Revenue Fund reflects proceeds and earnings from the securitization of one-half of the Commission's future Master Settlement Agreement funds, less amounts transferred to the Special Revenue Fund.

The Commission adopts an annual budget within the appropriation set forth in the Appropriation Act. A budgetary comparison statement has been provided to demonstrate compliance with this budget. The Commission approved several transfers and re-distributions 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 2006 since grants are paid on a reimbursement basis and eligibility requirements may not have been met as of June 30, 2006.

### 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 only 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. In particular, the unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

At June 30, 2006, the Commission's governmental fund balance was \$437.1 million, a decrease of \$40.7 million over the prior year. Of the total fund balance, \$64.9 million is unreserved, which is available for spending at the Commission's discretion and \$372.2 million is reserved for capital projects. Of the reserved fund balance, \$49.9 million has been transferred from the Endowment Special Revenue Fund to the Commission's regular Special Revenue Fund.

### 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 \$437.1 million.

Most of the Commission's net assets are restricted and held in the Endowment Special Revenue Fund for future capital projects. The Commission's unrestricted net assets may be used to meet the Commission's ongoing obligations to citizens and creditors. A small portion of the Commission's net assets reflects 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

	<u>Governmental Activities</u>	
	<u>Fiscal Year 2006</u>	<u>Fiscal Year 2005</u>
Assets:		
Current and other assets:	\$459,211,672	\$516,265,026
Capital assets	<u>8,292</u>	<u>10,584</u>
Total assets	<u>459,219,964</u>	<u>516,275,610</u>
Liabilities:		
Long-term liabilities:	46,344	39,650
Current and other liabilities	<u>22,078,724</u>	<u>38,399,078</u>
Total liabilities	<u>22,125,068</u>	<u>38,438,728</u>
Net assets:		
Invested in capital assets, net of related debt	8,292	10,584
Restricted:	372,248,746	390,227,997
Unrestricted	<u>64,884,746</u>	<u>87,598,301</u>
Total net assets	<u>\$437,094,896</u>	<u>\$477,836,882</u>

The Commission's net assets decreased by \$40.7 million. Most of this decrease is attributable to a decrease in cash and investment as a result of a significant increase in community revitalization disbursements combined with the reduction in MSA payment revenue following securitization. The decrease in current and other liabilities is due to lower indemnification payments payable as well as a \$10.3 million decrease in the securities lending obligations administered by the Department of the Treasury.

Commission's Revenue and Expenditures

	<u>Fiscal Year 2006</u>	<u>Fiscal Year 2005</u>
Revenues:		
Master settlement agreement payments	\$ 29,907,557	\$ 65,157,743
Proceeds from securitization	-	389,776,674
Other income	60,554	9,661
Interest, dividends, and other investment income	<u>12,550,659</u>	<u>2,784,779</u>
Total revenues	<u>42,518,770</u>	<u>457,728,857</u>
Expenditures:		
Tobacco Settlement Expense		
Administration	1,962,565	2,142,467
Indemnification payments	11,719,091	22,900,412
Community revitalization	62,170,893	38,011,870
Payments for securities lending transactions	629,706	512,027
Unrealized loss on investments held by the Treasurer	6,776,209	-
Depreciation	2,292	3,587
Total expenditures	<u>83,260,756</u>	<u>63,570,363</u>
Excess/(deficiency) of revenue over/(under) expenditures	<u>\$(40,733,000)</u>	<u>\$394,158,494</u>

Securitization of half of the Commission's master settlement agreement payments accounted for the majority of the revenue decrease. The increase in expenditures is primarily attributable to additional community revitalization grants being awarded and disbursed.

#### Budget for Fiscal Year 2007

For the year ended June 30, 2006, the unreserved fund balance in the Special Revenue fund was \$64.9 million. Of this amount, the Commission has already committed \$51.5 million for previous community revitalization grant awards and another \$1.6 million for awards made in July 2006 from unreserved funds.

The reserved fund balance in the special revenue fund was \$49.9 million at year end. Of this reserved fund balance, \$34.7 million is committed to community revitalization capital projects awarded in fiscal year 2006 and another \$4.0 million was awarded in July 2006 from reserved funds. In the Endowment special revenue fund, \$322.4 million remains as a reserved fund balance to be transferred in the future for capital projects funded by the Commission.

The Commission anticipates additional grant awards in the first half of fiscal year 2007 that will obligate most of the remaining balances.

The Commission has approved a budget of \$51.5 million for fiscal year 2007, a 49 percent decrease from the final fiscal year 2006 budget. This decrease is primarily due to an unprecedented corpus invasion included in the fiscal year 2006 budget allocated, to accelerate progress on a major technology initiative.

#### 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, 2006

	Special Revenue Fund	Endowment Special Revenue Fund (Note 10)	Adjustments (Note 1-F)	Statement of Net Assets
<b>ASSETS:</b>				
Cash held by the Treasurer of Virginia (Note 2)	\$ 64,398,257	\$ -	\$ -	\$ 64,398,257
Cash equivalents held by the Treasurer of Virginia (Note 2)	8,412,648	9,452,217	-	17,864,865
Investments held by the Treasurer of Virginia (Note 2)	8,325,281	-	-	8,325,281
Investments held by the Treasurer (restricted funds) (Note 10)	49,895,597	312,900,932	-	362,796,529
Accounts and loans receivable	36,924	-	-	36,924
Prepaid items	5,039	-	-	5,039
Grant advances (Note 6)	5,784,777	-	-	5,784,777
Capital assets (Note 1)	-	-	8,292	8,292
<b>Total assets</b>	<b>\$ 136,858,523</b>	<b>\$ 322,353,149</b>	<b>8,292</b>	<b>459,219,964</b>
<b>LIABILITIES:</b>				
Accounts payable	\$ 15,683	-	-	15,683.00
Accrued payroll	15,931	-	-	15,931
Grants payable (Note 6)	5,129,728	-	-	5,129,728
Indemnification payments payable (Note 7)	179,453	-	-	179,453
Obligations under securities lending (Note 2)	16,737,929	-	-	16,737,929
Compensated absences (Note 1)	-	-	46,344	46,344
<b>Total liabilities</b>	<b>22,078,724</b>	<b>-</b>	<b>46,344</b>	<b>22,125,068</b>
<b>FUND BALANCES/NET ASSETS:</b>				
Fund balances:				
Unreserved	64,884,202	-	(64,884,202)	-
Reserved (Note 10)	49,895,597	322,353,149	(372,248,746)	-
<b>Total fund balances</b>	<b>114,779,799</b>	<b>322,353,149</b>		
<b>Total liabilities and fund balances</b>	<b>\$ 136,858,523</b>	<b>\$ 322,353,149</b>		
<b>Net assets:</b>				
Invested in capital assets, net of related debt			8,292	8,292
Unrestricted			64,837,858	64,837,858
Restricted (Note 10)			372,248,746	372,248,746
<b>Total net assets</b>			<b>\$ 437,094,896</b>	<b>\$ 437,094,896</b>

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, 2006

	Special Revenue Fund	Endowment Special Revenue Fund (Note 10)	Adjustments (Note 1-F)	Statement of Activities
<b>REVENUES:</b>				
Master settlement agreement payments	\$ 29,907,557	\$ -	\$ -	\$ 29,907,557
Other income	60,554	-	-	60,554
Interest, dividends, and other investment income (Note 2)	3,001,631	9,549,028	-	12,550,659
<b>Total revenues</b>	<b>32,969,742</b>	<b>9,549,028</b>	<b>-</b>	<b>42,518,770</b>
<b>EXPENDITURES:</b>				
Tobacco settlement expense:				
Administration (Note 8)	1,955,871	-	6,694	1,962,565
Indemnification payments (Note 7)	11,719,091	-	-	11,719,091
Community revitalization (Note 6)	62,170,893	-	-	62,170,893
Payments for securities lending transactions (Note 2)	629,706	-	-	629,706
Unrealized loss on investments held by the Treasurer	-	6,776,209	-	6,776,209
Depreciation (Note 1)	-	-	2,292	2,292
<b>Total expenditures</b>	<b>76,475,561</b>	<b>6,776,209</b>	<b>8,986</b>	<b>83,260,756</b>
Revenues over/(under) expenditures	(43,505,819)	2,772,819	40,733,000	-
<b>OTHER FINANCING SOURCES/(USES):</b>				
Transfers in	31,670,000	-	-	31,670,000
Transfers out	-	(31,670,000)	-	(31,670,000)
<b>Total other financing sources/(uses)</b>	<b>31,670,000</b>	<b>(31,670,000)</b>	<b>-</b>	<b>-</b>
Excess/(deficiency) of revenues and transfers in over expenditures and transfers out	(11,835,819)	2,772,819		
Change in net assets			(40,741,986)	(40,741,986)
Fund balance/net assets, July 1, 2005	126,615,618	351,250,330	(29,066)	477,836,882
Fund balance/net assets, June 30, 2006	\$ 114,779,799	\$ 322,353,149	\$ (38,052)	\$ 437,094,896

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, 2006

	Original Budget	Final Budget	Actual	Variance Favorable (Unfavorable)
<b>REVENUES:</b>				
Master settlement agreement payments	\$ 31,942,547	\$ 29,541,568	\$ 29,907,556	\$ 365,988
Interest, dividends, rents and other investment income	750,000	1,257,985	2,371,925	1,113,940
Other income	-	-	60,554	60,554
<b>Total revenues</b>	<b>32,692,547</b>	<b>30,799,553</b>	<b>32,340,036</b>	<b>1,540,483</b>
<b>EXPENDITURES:</b>				
Administration	2,151,420	2,226,420	2,028,574	197,846
Indemnification payments (Note 7)	13,710,000	13,710,000	16,193,766	(2,483,766)
Community revitalization (Note 6)	47,947,815	84,929,391	65,069,903	19,859,488
<b>Total expenditures</b>	<b>63,809,235</b>	<b>100,865,811</b>	<b>83,292,243</b>	<b>17,573,568</b>
Revenues over/(under) expenditures	(31,116,688)	(70,066,258)	(50,952,207)	19,114,051
<b>OTHER FINANCING SOURCES/(USES):</b>				
Transfers In	30,406,000	27,906,000	31,670,000	3,764,000
Net change in fund balance	(710,688)	(42,160,258)	(19,282,207)	22,878,051
Fund balance, July 1, 2005	133,576,061	133,576,061	133,576,061	-
Fund balance, June 30, 2006	\$ 132,865,373	\$ 91,415,803	\$ 114,293,854	\$ 22,878,051

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

AS OF JUNE 30, 2006

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 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 or elimination of tobacco quota, to promote economic growth and development in tobacco-dependent communities, and to assist such communities in reducing their dependency on tobacco and tobacco-related business.

The Commission is a component unit of the Commonwealth. 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 specified financial activities. Resources were allocated to and accounted for in a special revenue fund, "Tobacco Indemnification and Community Revitalization Fund," established under Section 3.1-1111, Subsection B of the Code of Virginia. Special Revenue funds account for transactions related to resources received and used for restricted or specific purposes.

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 assets lives are not capitalized.

Office and computer equipment, the only capital assets owned by the Commission, are depreciated using the straight-line method over an estimated useful life of five years. Capital asset activity for the year ended June 30, 2006, is summarized as follows:

	Beginning Balance <u>July 1, 2005</u>	<u>Additions</u>	Balance <u>Deletions</u>	<u>June 30, 2006</u>
Office and computer equipment	\$24,767	\$ -	\$ -	\$24,767
Less Accumulated Depreciation	<u>14,183</u>	<u>2,292</u>	-	<u>16,475</u>
Ending Balance	<u>\$10,584</u>	<u>\$2,292</u>	<u>-</u>	<u>\$ 8,292</u>

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, 2006. 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 within the appropriation set forth in the 2005 Appropriation Act. Payments from the Master Settlement Agreement were deposited into the state treasury's general account in accordance with the provisions of Chapter 46 of Title 3.1 of the Code of Virginia and expended for purposes stated in those provisions.

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 Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*, an amendment to GASB No3, 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

Unrestricted cash and cash equivalents of the Commission are held by the Treasurer of Virginia and are entirely insured under the Virginia Security for Public Deposits Act, Section 2.2-4400 et seq. of the Code of Virginia (1950), as amended, which provides for an assessable multiple financial institution collateral pool. Restricted cash equivalents of the Endowment special revenue fund are held in the name of the Commission with oversight from the Treasurer of Virginia.

	<u>2006</u>
Treasurer of Virginia	\$64,398,257
Endowment	<u>9,452,217</u>
Total	<u>\$73,850,474</u>

B. Investments

Authorized Investments

In accordance with the State Treasurer and the Treasury Board investment policy, the endowment is invested in accordance with Section 3.1-1109.1 and 55-268.1 of the Code of Virginia.

Interest Rate Risk

Interest rate risk is the risk of adversely affecting the fair value of an investment as a result of the changes in interest rates. As of June 30, 2006, the Commission had the following investments and maturities held by the Treasurer of Virginia:

Debt Securities:	Fair Value	Investment Maturities (In Years)			
		Less than 1	1 to 5	6 to 10	Greater than 10
Mutual and Money Market Funds (Include SNAP)	\$ 9,452,217	\$ 9,452,217	\$ -	\$ -	\$ -
Municipal Securities	<u>362,796,529</u>	<u>26,905,505</u>	<u>92,445,061</u>	<u>85,423,062</u>	<u>158,022,902</u>
Total	<u>\$372,248,746</u>	<u>\$36,357,722</u>	<u>\$92,445,061</u>	<u>\$85,423,062</u>	<u>\$158,022,902</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, 2006. The ratings presented below are using Standard & Poor's (S&P) and Moody's Investor Service (Moody's) rating scales. The investments presented in the table below represent 100 percent of debt securities, 97 percent of which were invested in Municipal Securities.

Investment:	Amount	Rating	Percent of Portfolio
Municipal Securities	\$244,470,351	AAA	66%
Mutual and Money Market Funds (Include SNAP)	4,975,970	AAA	1%
Mutual and Money Market Funds (Include SNAP)	1,110,696	Aaa	-%
Municipal Securities	13,271,204	AA+	4%
Municipal Securities	41,748,944	AA	11%
Mutual and Money Market Funds (Include SNAP)	3,365,551	AA	1%
Municipal Securities	12,697,541	AA-	3%
Municipal Securities	10,756,696	A+	3%
Municipal Securities	2,594,047	A	1%
Municipal Securities	410,524	A-	0%
Municipal Securities	10,103	A-1+	0%
Municipal Securities	36,837,119	NR	10%

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 market value of the endowment 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 five percent of the market value of the endowment as of June 30, 2006.

Custodial Credit Risk

Custodial credit risk is the risk that, in the event of failure of the counterparty, the Commission will 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, 2006.

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 endowment as of June 30, 2006.

Securities Lending Transactions

Cash equivalents of \$8,412,648 and investments of \$8,325,281 held by the Treasurer of Virginia in the Special Revenue Fund represent the Commission’s allocated share of securities received for securities lending transactions held in the General Account of the Commonwealth. Information related to the credit risk of these investments and securities lending transactions held in the General Account is available on a statewide level in the Commonwealth of Virginia’s Comprehensive Annual Financial Report (CAFR).

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, 2006	\$114,293,854
Deduct: accrued expenses	(5,340,795)
Add: receivables, advances, and prepaid items	<u>5,826,740</u>
Fund balance, GAAP basis, June 30, 2006	<u>\$114,779,799</u>

4. PENSION PLAN AND OTHER RETIREMENT BENEFITS

Employees of the 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 employees participate in a defined benefit pension plan administered by the VRS. The VRS also administers life insurance and health related



plans for retired employees. Information relating to these plans is available at the statewide level only in the CAFR. The Commonwealth, not the Commission, has overall responsibility for contributions to these plans.

5. OPERATING LEASES

The Commission has entered into two agreements to lease equipment. The operating leases contain the provision that the Commission may renew the operating leases at the expiration date of the lease on a month-to-month basis. Management expects that in the normal course of business, the leases will be renewed or replaced by other leases of a similar nature. Rental expense for the Commission under these operating leases for the year ended June 30, 2006, was \$9,046. The Commission has, as of June 30, 2006, \$5,712 in minimum rental payments due under the above leases for 2007.

6. COMMUNITY REVITALIZATION EXPENDITURES

The Commission awarded grants totaling \$99,350,004 in fiscal year 2006 to various localities and other entities for community revitalization projects, including regional economic development projects, educational programs, technology initiatives, and other special projects in Southside and Southwest Virginia. Of the total amount awarded since the inception of the Commission, \$81,022,833 is not reflected in these statements since eligibility requirements were not met as of June 30, 2006, 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. The Commission awarded an additional \$5,663,520 in grants in fiscal year 2007 that are not reflected in these statements. Grants payable includes amounts awarded to grantees with all contingencies met but unpaid as of June 30, 2006. Grant advances include amounts disbursed to grant recipients who have not incurred expenses as of June 30, 2006.

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 met the eligibility requirement of submitting by the initial deadline the appropriate verification form as of June 30, 2006.

8. ADMINISTRATION

Indemnification Costs

Administration expenditures include \$410,000 of Indemnification Costs paid to Troutman Sanders, L.L.P., representing the contract cost to validate payees and update the database for calculating payment amounts related to the indemnification payments.

### MSA Enforcement

Pursuant to the 2005 Appropriation Act, administration expenditures include \$215,401 for the Commission's proportionate share of the Office of the Attorney General's and Tax Department's expenses related to the enforcement of the 1998 Master Settlement Agreement and Section 3.1-336.2, Code of Virginia.

### Central Service Agencies Charge

Administration expenditures include \$165,997 for expenses incurred by central service agencies on behalf of the Commission, pursuant to the 2005 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

The Governor, with the Commission's endorsement, authorized the sale of one-half of the Commission's allocation of revenues derived from the Master Settlement Agreement to the Tobacco Settlement Financing Corporation, pursuant to Chapters 482 and 488 of the 2002 Virginia Acts of Assembly. The Corporation sold bonds resulting in net proceeds to the Tobacco Indemnification and Community Revitalization Endowment of \$389,776,674 on May 16, 2005. These funds are restricted to the purpose of promoting the goals of the Commission as enumerated by §3.1-1107 of the Code of Virginia. The Commission is allowed to transfer annually all interest income and ten 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 2006, the Commission requested a transfer of \$31,670,000, including \$5,549,158 in interest earnings through February 2006, from the Endowment to the Tobacco Indemnification and Community Revitalization Fund. The remaining Endowment balance includes interest earned on the Endowment from March 1, 2006, through June 30, 2006.



# Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

September 21, 2006

The Honorable Timothy M. Kaine  
Governor of Virginia

The Honorable Thomas K. Norment, Jr.  
Chairman, Joint Legislative Audit  
And Review Commission

Commission Members  
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 the Special Revenue fund and Endowment Special Revenue fund, the two major funds of the **Tobacco Indemnification and Community Revitalization Commission**, a component unit of the Commonwealth of Virginia, as of and for the year ended June 30, 2006, 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 Tobacco Indemnification and Community Revitalization Commission as of June 30, 2006, and the respective changes in its financial position thereof, 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.

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

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 opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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.

Status of Prior Findings

The Commission has taken adequate corrective action with respect to audit findings reported in the prior year.

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 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 September 27, 2006.

AUDITOR OF PUBLIC ACCOUNTS

WJK:sks  
sks:56

