



# **Tobacco Indemnification and Community Revitalization Commission**

Financial Statements

Fiscal Year 2007

-TABLE OF CONTENTS-

	<u>Pages</u>
MANAGEMENT'S DISCUSSION AND ANALYSIS	1-4
FINANCIAL STATEMENTS	5-8
NOTES TO FINANCIAL STATEMENTS	9-16
INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS	17
INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS	18

## 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, 2007.

### Financial Highlights

- Through the Tobacco Settlement Financing Corporation, the Commission securitized the remaining half of its future Master Settlement Agreement (MSA) payments and received net proceeds of \$614.0 million, 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 assets of the Commission exceeded its liabilities at the close of fiscal year 2007 by \$1.0 billion (net assets).
- The Commission's unrestricted net assets increased by \$609.5 million over the prior year and restricted net assets decreased by \$8.3 million over the prior year.
- At the end of the fiscal year, the Commission's unreserved fund balance for the special revenue fund was \$674.4 million with \$527.2 million of this amount remaining in the Endowment. The reserved fund balance was \$363.9 million with \$275.6 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 MSA, other revenues deposited to the Tobacco Indemnification and Community Revitalization Fund, and amounts transferred from the Endowment used for community revitalization projects and indemnifying tobacco farmers. 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 3.1-1109.1, *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 2007 since grants are paid on a reimbursement basis and eligibility requirements may not have been met as of June 30, 2007.

#### 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. 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, 2007, the Commission's governmental fund balance was \$1.0 billion, an increase of \$601.2 million over the prior year. Of the total fund balance, \$674.4 million is unreserved, which is available for use at the Commission's discretion, and \$363.9 million is reserved for capital projects. Of the unreserved fund balance, \$147.2 million is in the Special Revenue Fund reflecting MSA and other revenues along with transfers from the Endowment Special Revenue Fund to the Special Revenue Fund. Of the reserved fund balance, \$88.3 million has been transferred from the Endowment to the 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 \$1.0 billion.

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. Most of the Commission's restricted net assets are held in the Endowment for future capital projects. 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

	<u>Governmental Activities</u>	
	<u>Fiscal Year 2007</u>	<u>Fiscal Year 2006</u>
Assets:		
Current and other assets	\$ 1,057,468,745	\$ 459,211,672
Capital assets	<u>6,926</u>	<u>8,292</u>
Total assets	<u>1,057,475,671</u>	<u>459,219,964</u>
Liabilities:		
Current and other liabilities	19,160,837	22,078,724
Long-term liabilities	<u>53,221</u>	<u>46,344</u>
Total liabilities	<u>19,214,058</u>	<u>22,125,068</u>
Net assets:		
Invested in capital assets, net of related debt	6,926	8,292
Unrestricted	674,340,636	64,837,858
Restricted	<u>363,914,051</u>	<u>372,248,746</u>
Total net assets	<u>\$ 1,038,261,613</u>	<u>\$ 437,094,896</u>

The Commission's net assets increased by \$601.2 million, most of which is attributable to the increase in current assets from securitization. The decrease in current and other liabilities is primarily due to a \$5.6 million decrease in the securities lending obligations administered by the Department of the Treasury and a \$2.8 million increase in grants payable.

### Commission's Revenues and Expenditures

	<u>Fiscal Year 2007</u>	<u>Fiscal Year 2006</u>
Revenues:		
Master settlement agreement payments	\$ 31,062,308	\$ 29,907,557
Proceeds from securitization	613,994,236	-
Other income	1,288,367	60,554
Interest, dividends, and other investment income	23,019,504	12,550,659
Unrealized gain on investments held by the Treasurer	<u>399,081</u>	<u>-</u>
Total revenues	<u>669,763,496</u>	<u>42,518,770</u>

Expenditures:

Tobacco settlement expense:		
Administration	1,966,510	1,962,565
Indemnification payments	14,371,268	11,719,091
Community revitalization	51,464,203	62,170,893
Payments for securities lending transactions	793,432	629,706
Unrealized loss on investments held by the Treasurer	-	6,776,209
Depreciation	<u>1,366</u>	<u>2,292</u>
Total expenditures	<u>68,596,779</u>	<u>83,260,756</u>
Change in net assets	<u>\$ 601,166,717</u>	<u>\$ (40,741,986)</u>

Securitization of the remaining half of the Commission's MSA payments accounted for the majority of the revenue increase. The decrease in expenditures is primarily attributable to reduced community revitalization grant disbursements.

Budget for Fiscal Year 2008

For the year ended June 30, 2007, the unreserved fund balance in the Special Revenue Fund was \$147.2 million. Of this amount, the Commission has already committed \$53.8 million for community revitalization grant awards and another \$3.5 million for awards made in July 2007 from unreserved funds.

The reserved fund balance in the Special Revenue Fund was \$88.3 million at year end. Of this reserved fund balance, \$21.3 million is committed to community revitalization capital projects awarded in prior years and another \$6.3 million was awarded in July 2007 from reserved funds. In the Endowment Special Revenue Fund, \$275.6 million remains as a reserved fund balance to be transferred in the future for capital projects funded by the Commission, and \$527.2 million remains as unreserved fund balance to be transferred in the future for other projects funded by the Commission.

The Commission anticipates additional grant awards in the fiscal year 2008 that will obligate most of the remaining balances.

The Commission has estimated its remaining obligation to tobacco producers and quota owners to be \$81.3 million at June 30, 2007, and has budgeted \$20.2 million for distribution in fiscal year 2008.

The Commission has approved a budget of \$160.0 million for fiscal year 2008, a 186 percent increase from the final fiscal year 2007 budget. This increase is primarily due to a maximum endowment corpus invasion for a one-time mega-project strategic reserve in cooperation with the Virginia Economic Development Partnership and regional authorities in Southwest Virginia. In addition, repayments on debt financed assets in Southern Virginia and indemnification payments for tobacco farmers have been accelerated.

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, 2007

	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)	\$ 53,998,378	\$ -	\$ -	\$ 53,998,378
Cash equivalents held by the Treasurer of Virginia (Note 2)	2,256,219	\$ 31,821,386	-	34,077,605
Cash equivalents held by the Treasurer of Virginia (unrestricted endowment) (Note 10)	92,099,135	527,162,397		619,261,532
Investments held by the Treasurer of Virginia (Note 2)	8,888,533	-	-	8,888,533
Investments held by the Treasurer (restricted funds) (Note 10)	88,329,045	243,763,620	-	332,092,665
Accounts and loans receivable	35,783	-	-	35,783
Prepaid items	5,200	-	-	5,200
Grant advances (Note 6)	9,109,049	-	-	9,109,049
Capital assets (Note 1)	-	-	6,926	6,926
<b>Total assets</b>	<b>\$ 254,721,342</b>	<b>\$ 802,747,403</b>	<b>6,926</b>	<b>1,057,475,671</b>
<b>LIABILITIES:</b>				
Accounts payable	\$ 10,231	\$ -	\$ -	\$ 10,231
Accrued payroll	48,036	-	-	48,036
Grants payable (Note 6)	7,917,392	-	-	7,917,392
Indemnification payments payable (Note 7)	40,426	-	-	40,426
Obligations under securities lending (Note 2)	11,144,752	-	-	11,144,752
Compensated absences (Note 1)	-	-	53,221	53,221
<b>Total liabilities</b>	<b>19,160,837</b>	<b>-</b>	<b>53,221</b>	<b>19,214,058</b>
<b>FUND BALANCES/NET ASSETS:</b>				
<b>Fund Balances:</b>				
Unreserved	147,231,460	527,162,397	(674,393,857)	-
Reserved (Note 10)	88,329,045	275,585,006	(363,914,051)	-
<b>Total liabilities and fund balances</b>	<b>\$ 254,721,342</b>	<b>\$ 802,747,403</b>		
<b>Net assets:</b>				
Invested in capital assets, net of related debt			6,926	6,926
Unrestricted			674,340,636	674,340,636
Restricted (Note 10)			363,914,051	363,914,051
<b>Total net assets</b>			<b>\$ 1,038,261,613</b>	<b>\$ 1,038,261,613</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, 2007

	Special Revenue Fund	Endowment Special Revenue Fund (Note 10)	Adjustments (Note 1-F)	Statement of Activities
<b>REVENUES:</b>				
Master settlement agreement payments	\$ 31,062,308		\$ -	\$ 31,062,308
Proceeds from securitization	-	\$ 613,994,236		613,994,236
Other income	1,288,367	-	-	1,288,367
Interest, dividends, and other investment income (Note 2)	2,816,132	20,203,372	-	23,019,504
Unrealized gain on investments held by the Treasurer	-	399,081		399,081
<b>Total revenues</b>	<b>35,166,807</b>	<b>634,596,689</b>	<b>-</b>	<b>669,763,496</b>
<b>EXPENDITURES:</b>				
Tobacco settlement expense:				
Administration (Note 8)	1,959,633	-	6,877	1,966,510
Indemnification payments (Note 7)	14,371,268	-	-	14,371,268
Community revitalization (Note 6)	51,464,203	-	-	51,464,203
Payments for securities lending transactions (Note 2)	793,432	-	-	793,432
Depreciation (Note 1)	-	-	1,366	1,366
<b>Total expenditures</b>	<b>68,588,536</b>	<b>-</b>	<b>8,243</b>	<b>68,596,779</b>
<b>Revenues Over (Under) Expenditures</b>	<b>(33,421,729)</b>	<b>634,596,689</b>	<b>(601,174,960)</b>	<b>-</b>
<b>OTHER FINANCING SOURCES (USES):</b>				
Transfers In	154,202,435	-	-	154,202,435
Transfers Out	-	(154,202,435)	-	(154,202,435)
<b>Total Other Financing Sources (Uses)</b>	<b>154,202,435</b>	<b>(154,202,435)</b>	<b>-</b>	<b>-</b>
<b>Excess (deficiency) of revenues and transfers in over expenditures and transfers out</b>	<b>120,780,706</b>	<b>480,394,254</b>		
<b>Change in net assets</b>			<b>601,166,717</b>	<b>601,166,717</b>
Fund balance/net assets, July 1, 2006	114,779,799	322,353,149	(38,052)	437,094,896
Fund balance/net assets, June 30, 2007	\$ 235,560,505	\$ 802,747,403	\$ (46,295)	\$ 1,038,261,613

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, 2007

	Original Budget	Final Budget	Actual	Variance Favorable (Unfavorable)
<b>REVENUES:</b>				
Master settlement agreement payments	\$ 33,551,410	\$ 33,551,410	\$ 31,062,308	\$ (2,489,102)
Interest, dividends, rents and other investment income	1,200,000	1,200,000	2,022,701	822,701
Other income	-	1,200,000	1,288,367	88,367
<b>Total revenues</b>	<b>34,751,410</b>	<b>35,951,410</b>	<b>34,373,375</b>	<b>(1,578,035)</b>
<b>EXPENDITURES:</b>				
Administration	2,082,101	2,082,101	1,953,000	129,101
Indemnification payments (Note 7)	10,711,000	15,125,905	14,510,295	615,610
Community revitalization (Note 6)	38,677,353	38,677,353	51,979,811	(13,302,458)
<b>Total expenditures</b>	<b>51,470,454</b>	<b>55,885,359</b>	<b>68,443,106</b>	<b>(12,557,747)</b>
<b>Revenues over (under) expenditures</b>	<b>(16,719,044)</b>	<b>(19,933,949)</b>	<b>(34,069,731)</b>	<b>(14,135,782)</b>
<b>OTHER FINANCING SOURCES (USES):</b>				
Transfers In	3,764,000	3,764,000	154,202,435	150,438,435
Fund balance, July 1, 2006	114,293,854	114,293,854	114,293,854	-
Fund balance, June 30, 2007	\$ 101,338,810	\$ 98,123,905	\$ 234,426,558	\$ 136,302,653

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, 2007

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 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 3.1-1111, 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, 2007, is summarized as follows:

	Beginning Balance July 1, 2006	Additions	Deletions	Balance June 30, 2007
Office and computer equipment	\$24,767	\$ -	\$ -	\$24,767
Less Accumulated Depreciation	<u>16,475</u>	<u>1,366</u>	<u>-</u>	<u>17,841</u>
Ending Balance	<u>\$ 8,292</u>	<u>\$1,366</u>	<u>\$ -</u>	<u>\$ 6,926</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, 2007. 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 2006 Appropriation Act. Payments from the MSA 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 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

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>2007</u>
Treasurer of Virginia	\$ 146,097,513
Securities Lending	2,256,219
Endowment	<u>558,983,783</u>
Total	<u>\$ 707,337,515</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, 2007, the Commission had the following investments and maturities held by the Treasurer of Virginia:

Investments	Fair Value	Investment Maturities (In Years)			
		Less than 1	1 to 5	6 to 10	Greater than 10
Mutual and Money Market Funds (Includes SNAP)	\$ 31,821,386	\$31,821,386	\$ -	\$ -	\$ -
Securities Lending	8,888,533	8,888,533			
Municipal Securities	332,092,665	17,335,697	79,787,500	90,138,085	144,831,383
<b>Total</b>	<b>\$372,802,584</b>	<b>\$58,045,616</b>	<b>\$79,787,500</b>	<b>\$90,138,085</b>	<b>\$144,831,383</b>

### 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, 2007. 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, 91 percent of which were invested in Municipal Securities.

Investment:	Amount	Rating	Percent of Portfolio
Municipal Securities	\$224,497,222	AAA	62%
Municipal Securities	9,142,523	Aaa	3%
Mutual and Money Market Funds (Includes SNAP)	31,821,386	Aaa	9%
Municipal Securities	18,748,011	AA+	5%
Municipal Securities	10,582,533	Aa1	3%
Municipal Securities	17,615,952	AA	5%
Municipal Securities	5,503,303	Aa2	2%
Municipal Securities	14,846,335	AA-	4%
Municipal Securities	11,216,193	Aa3	3%
Municipal Securities	3,718,009	A+	1%
Municipal Securities	6,687,661	A1	2%
Municipal Securities	4,363,957	A	1%
Municipal Securities	856,276	A2	0%
Municipal Securities	773,475	A-	0%
Municipal Securities	2,900,000	A-1+	1%
Municipal Securities	507,425	Baa1	0%
Municipal Securities	133,790	Baa3	0%

### 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 5 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 more than five percent of the market value of the endowment as of June 30, 2007.

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, 2007.

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, 2007.

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, 2007	\$234,426,558
Deduct: accrued expenses	(8,016,086)
Add: receivables, advances, and prepaid Items	<u>9,150,033</u>
Fund balance, GAAP basis, June 30, 2007	<u>\$235,560,505</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 Commonwealth of Virginia’s Comprehensive Annual Financial Report (CAFR). The Commonwealth, not the Commission, has overall responsibility for contributions to these plans.

5. OPERATING LEASES

The Commission entered into two agreements to lease equipment that expired during the fiscal year and has entered into two new agreements. 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, 2007, was \$10,564. The Commission has, as of June 30, 2007, \$12,638 in minimum rental payments due under the above leases for 2008.

## 6. COMMUNITY REVITALIZATION EXPENDITURES

The Commission awarded grants totaling \$54,831,432 in fiscal year 2007 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, \$75,106,407 is not reflected in these statements since eligibility requirements were not met as of June 30, 2007, 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 \$9,790,142 in grants in fiscal year 2008 that are not reflected in these statements. Grants payable includes amounts awarded to grantees with all contingencies met but unpaid as of June 30, 2007. Grant advances include amounts disbursed to grant recipients who have not incurred expenses as of June 30, 2007.

## 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, 2007, met the eligibility requirement of submitting the appropriate verification form by the initial deadline.

## 8. ADMINISTRATION

### Indemnification Costs

Administration expenditures include \$336,084 paid to Troutman Sanders, L.L.P., to validate payees and update the database for calculating payment amounts related to the indemnification payments.

### MSA Enforcement

Pursuant to the 2006 Appropriation Act, administration expenditures include \$223,506 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 3.1-336.2, *Code of Virginia*.

### Central Service Agencies Charge

Administration expenditures include \$147,085 for expenses incurred by central service agencies on behalf of the Commission, pursuant to the 2006 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.

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 Master Settlement Agreement. 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 §3.1-1107 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, in its sole discretion, has estimated its remaining obligation to tobacco producers and quota owners to be \$81.3 million at June 30, 2007. This amount will be paid from taxable bond proceeds over the course of time to be determined by the Commission through its annual budget process.

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 2007, the Commission transferred \$154,202,435, including \$13,401,575 in interest earnings through February 2007, from the Endowment to the Tobacco Indemnification and Community Revitalization Fund. The remaining Endowment balance includes interest earned on the Endowment from March 1, 2007, through June 30, 2007.



# Commonwealth of Virginia

**Walter J. Kucharski, Auditor**

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

October 26, 2007

The Honorable Timothy M. Kaine  
Governor of Virginia

The Honorable Thomas K. Norment, Jr.  
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) as of and for the year ended June 30, 2007, which collectively comprise the Commission's basic financial statements. These financial statements are the responsibility of the Commission's management. Our responsibility is to express an opinion 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 opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects the respective financial position of governmental activities and each major fund of the Tobacco Indemnification and Community Revitalization Commission as of June 30, 2007, and the respective changes in its financial position thereof and the respective budgetary comparison thereof 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 on pages one through four is not a required part of the basic financial statements, but is 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.

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, but not for the purpose of expressing an opinion on the effectiveness of the Commission's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Commission's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control over financial reporting.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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 Commission members, 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 23, 2007.

A handwritten signature in black ink, appearing to read "Walt J. Kucharik". The signature is fluid and cursive, with a prominent initial "W".

AUDITOR OF PUBLIC ACCOUNTS

