Tobacco Indemnification and Community Revitalization Commission

Financial Statements

Fiscal Year 2014

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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, 2014.

Financial Highlights

- The assets of the Commission exceeded its liabilities at the close of fiscal year 2014 by $586.3 million (net position).
- The Commission's unrestricted net position decreased by $45.7 million from the prior year and restricted net position decreased by $22.5 million from the prior year.
- At the end of the fiscal year, the Commission's nonspendable fund balance for the Special Revenue Fund was $4.4 million. The restricted fund balance was $219.6 million with $78.9 million of this amount remaining in the Endowment. The committed fund balance was $123.6 million with $10.1 million of this amount remaining in the Endowment. The assigned fund balance was $236.8 million, all of which remains 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, but potentially as late as 2047 (pursuant to the indenture) 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 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 2014 since grants are paid on a reimbursement basis and eligibility requirements may not have been met as of June 30, 2014.

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 position presents information on all of the Commission's assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position 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 position changed during the most recent fiscal year. All changes in net position 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, 2014, the Commission's governmental fund balance was $584.4 million, a decrease of $70.2 million from the prior year. Of the total fund balance, $4.4 million is classified as nonspendable for prepaid items and grant advances, which are not expected to be converted to cash. $219.6 million is restricted to capital expenditures by the bond indenture pursuant to IRS restrictions on the use of tax-exempt proceeds. Of this restricted fund balance, $47.8 million in the Special Revenue Fund represents grant awards approved by the Commission for capital projects that have not yet been disbursed and $92.9 million that has been reserved for capital projects for future grant awards. The remaining $78.9 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 $123.6 million represents grant awards approved by the Commission that have not yet been disbursed. The assigned fund balance of $236.8 million is intended to be used by the Commission for community revitalization projects and 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 position may serve over time as a useful indicator of the Commission's financial position. Assets for the Commission exceeded liabilities by $586.3 million.

Most of the Commission's net position is unrestricted with amounts held in the Special Revenue Fund available to be used to meet the Commission's ongoing obligations to citizens and creditors.

Commission's Net Position

	Governmental Activities	
	Fiscal Year 2014	Fiscal Year 2013
Assets:		
Current and other assets	$589,542,408	$661,795,892
Capital assets	17,833	44,964
Total assets	589,560,241	661,840,855
Liabilities:		
Current and other liabilities	3,180,833	7,186,756
Long-term liabilities	93,483	120,168
Total liabilities	3,274,316	7,306,924
Net position:		
Net investment in capital assets	0	131
Restricted	221,625,266	244,153,917
Unrestricted	364,660,659	410,379,883
Total net position	$586,285,925	$654,533,931

The Commission's net position decreased by $68.2 million, most of which is attributable to community revitalization disbursements being made from balances transferred out of the Endowment.

Commission's Revenues and Expenditures

	Fiscal Year 2014	Fiscal Year 2013
Revenues:		
Other income	$3,107,474	$450,509
Interest, dividends, and other investment income	16,132,094	28,587,572
Unrealized gain on investments held by the Treasurer	2,977,024	0
Total revenues	22,216,592	29,038,078
Expenditures:		
Tobacco settlement expense:		
Administration	1,960,550	2,781,265
Indemnification payments	0	59,606
Community revitalization	88,503,917	116,969,871
Unrealized loss on investments held by the Treasurer	0	23,458,070
Depreciation	131	785
Total expenditures	90,464,598	143,269,597
Change in net position	- $68,248,006	- $114,231,519

The decrease in total revenues is mostly from lower earnings on investments. The decrease in total expenditures is primarily attributable to a lower amount of community revitalization grants being disbursed this fiscal year and the unrealized loss on investments in the prior fiscal year.

Budget for Fiscal Year 2015

The Commission approved a budget of $48.9 million for fiscal year 2015, an overall decrease of more than 29 percent from the prior year final budget. This decrease is primarily due to the declining funds available in the Endowment to be used for community revitalization projects. The Commission anticipates grant awards in fiscal year 2015 that will obligate a portion of the assigned fund balance in the Endowment Special Revenue Fund.

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 POSITION AND GOVERNMENTAL FUNDS BALANCE SHEET
As of June 30, 2014

	Special Revenue Fund	Endowment Special Revenue Fund (Note 9)	Adjustments (Note 1-F)	Statement of Net Position
ASSETS:				
Cash held by the Treasurer of Virginia (Note 2)	$ 40,274,940	$ -	$ -	$ 40,274,940
Cash equivalents held by the Treasurer of Virginia (unrestr) (Note 2)	3,244,348	-	-	3,244,348
Cash equivalents held by the Treasurer of Virginia (restricted) (Note 2)	6,447,674	-	-	6,447,674
Investments held by the Treasurer of Virginia (unrestricted) (Note 2)	79,686,955	246,880,987	-	326,567,942
Investments held by the Treasurer of Virginia (restricted funds) (Note 2	127,171,999	78,873,111	-	206,045,110
Grants receivable (Note 6)	2,481,521	-	-	2,481,521
Accounts receivable	120,383	-	-	120,383
Prepaid items	4,978	-	-	4,978
Grant advances (Note 6)	4,355,512	-	-	4,355,512
Intangible assets	-	-	17,833	17,833
Total assets	$ 263,788,310	$ 325,754,098	$ 17,833	$ 589,560,241
LIABILITIES:				
Accounts payable	44,581	-	-	44,581
Accrued payroll	60,540	-	-	60,540
Grants payable (Note 6)	3,075,712	-	-	3,075,712
Compensated absences (Note 1)	-	-	75,650	75,650
Other liabilities	-	-	17,833	17,833
Total liabilities	3,180,833	-	93,483	3,274,316
DEFERRED INFLOWS OF RESOURCES				
Unavailable revenue	1,995,110	-	(1,995,110)	-
FUND BALANCES/NET POSITION:				
Fund balances (Note 1-C):				
Nonspendable	4,360,490		(4,360,490)	-
Restricted	140,740,637	78,873,111	(219,613,748)	-
Committed	113,511,240	10,056,658	(123,567,898)	-
Assigned		236,824,329	(236,824,329)	-
Total liabilities, deferred inflows, and fund balances	$ 263,788,310	$ 325,754,098		
Net position:				
Restricted (Note 9)			221,625,266	221,625,266
Unrestricted			364,660,659	364,660,659
Total net position			$ 586,285,925	$ 586,285,925

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, 2014

	Special Revenue Fund	Endowment Special Revenue Fund (Note 9)	Adjustments (Note 1-F)	Statement of Activities
REVENUES:				
Interest, dividends, and other investment income (Note 2)	$ -	$ 16,132,094	$ -	$ 16,132,094
Other income	1,112,364	-	1,995,110	3,107,474
Unrealized gain on investments held by the Treasurer		2,977,024		2,977,024
Total revenues	1,112,364	19,109,118	1,995,110	22,216,592
EXPENDITURES:				
Tobacco settlement expense:				
Administration (Note 7)	1,960,234	-	316	1,960,550
Community revitalization (Note 6)	88,503,917	-	-	88,503,917
Depreciation (Note 1)	-	-	131	131
Total expenditures	90,464,151	-	447	90,464,598
Revenues Over (Under) Expenditures	(89,351,787)	19,109,118	70,242,669	-
OTHER FINANCING SOURCES (USES):				
Transfers In	53,024,249	-	-	53,024,249
Transfers Out	-	(53,024,249)	-	(53,024,249)
Total Other Financing Sources (Uses)	53,024,249	(53,024,249)	-	-
Excess (deficiency) of revenues and transfers in over expenditures and transfers out	(36,327,538)	(33,915,131)		
Change in net position			(68,248,006)	(68,248,006)
Fund balance/net position, July 1, 2013	294,939,905	359,669,229	(75,203)	654,533,931
Fund balance/net position, June 30, 2014	$ 258,612,367	$ 325,754,098	$ 1,919,460	$ 586,285,925

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, 2014

	Original Budget	Final Budget	Actual	Variance Favorable (Unfavorable)
REVENUES:				
Other income	-	-	665,187	665,187
Total revenues	-	-	665,187	665,187
EXPENDITURES:				
Administration	2,328,684	2,393,684	2,138,750	254,934
Community revitalization (Note 6)	64,500,000	66,839,940	85,968,005	(19,128,065)
Total expenditures	66,828,684	69,233,624	88,106,755	(18,873,131)
Revenues over (under) expenditures	(66,828,684)	(69,233,624)	(87,441,568)	(18,207,944)
OTHER FINANCING SOURCES (USES):				
Transfers In	67,615,983	67,615,983	53,024,249	(14,591,734)
Fund balance, July 1, 2013	291,243,236	291,243,236	291,243,236	-
Fund balance, June 30, 2014	$ 292,030,535	$ 289,625,595	$ 256,825,917	$(32,799,678)

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

The Original and Final Budgets for Community Revitalization represent amounts budgeted by the Commission for grants planned to be awarded in fiscal year 2014. Actual amounts reflect disbursements made for current year and prior year grant awards. Since grant disbursements are usually made on a reimbursement basis over several years after the grant award, there can be a large variance when comparing budget to actual amounts.

NOTES TO FINANCIAL STATEMENTS

TOBACCO INDEMNIFICATION AND COMMUNITY REVITALIZATION COMMISSION

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDING JUNE 30, 2014

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 of Virginia. The Commission's major activity is to revitalize tobacco-dependent communities.

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 specific financial activities. Resources were allocated to and accounted for in two funds, the Special Revenue Fund and the Endowment Special Revenue Fund, both of which are considered major funds. The Special Revenue Fund is the "Tobacco Indemnification and Community Revitalization Fund" established under Section 3.2-3106, Subsection B of the Code of Virginia. The Endowment Special Revenue Fund is the "Tobacco Indemnification and Community Revitalization Endowment" established under Section 3.2-3104 of the Code of Virginia and consists of securitization proceeds and earnings on the proceeds. 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 Nonspendable, Restricted, Committed, or Assigned in accordance with Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions.* The Nonspendable fund balance includes prepaid items and grant advances, which are not expected to be converted to cash. The Restricted fund balance includes all spendable funds in the Special Revenue Funds that are restricted to specific purposes by the bond indenture from which those funds were derived pursuant to IRS restrictions on the use of tax-exempt securitization proceeds. The Committed fund balance comprises spendable 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 nonspendable, 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, 2014, is summarized as follows:

	Beginning Balance July 1, 2013	Additions	Deletions	Balance June 30, 2014
Computer equipment	$11,931	$ -	$ -	$11,931
Software licenses	125,000	-	-	125,000
Less Accumulated Depreciation	91,967	27,131		119,098
Ending Balance	$44,964	27,131	$ -	$17,833

E. Compensated Absences

Compensated absences represent the amounts of vacation earned by the Commission's employees, but not taken at June 30, 2014. 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 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, Compensated Absences, and Deferred Inflows for the Statement of Net Position and the related effect of these transactions on the Statement of Activities. Deferred Inflows of Resources reflects the portion of grants receivable due or received after August and are therefore not considered a current financial resource. Since governmental fund financial statements use current financial resources measurement focus and modified accrual, Capital Assets, Compensated Absences, and Deferred Inflows of Resources are not reflected on the governmental funds balance sheet.

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 for the Special Revenue Fund. 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.

The Commission does not establish or legally adopt a budget for the Endowment Special Revenue Fund, and as such, no budgetary information is displayed.

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 $49,966,962 as of June 30, 2014.

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, 2014, the Commission had the following investments and maturities held by the Treasurer of Virginia:

		Investment Maturities (in Years)			
Investment Type	Fair Value	Less Than 1	1-5	6-10	More Than 10
U.S. Treasury and Agency Securities	$78,287,036	$6,094,531	$54,945,271	$10,668,018	$6,579,216
Corporate Bonds	$126,395,660	7,392,216	73,073,964	45,929,480	
Corporate Mortgage Backed Securities	$14,017,776			1,959,490	12,058,286
Municipal Securities	$213,921,521	8,596,146	80,965,010	98,361,896	25,998,469
Asset Backed Securities	$29,523,371		15,633,591	12,823,065	1,066,716
Agency Mortgage Backed Securities	$70,467,688		9,515,379	7,631,330	53,320,979
Money Market Funds	$9,692,023	9,692,023			
Total	$542,305,075	$31,774,915	$234,133,216	$177,373,279	$99,023,665

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, 2014. 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
U.S. Treasury and Agency Securities	$78,287,036	Standard & Poor's	AA+	14.44%
Agency Mortgage Backed Securities	70,467,688	Standard & Poor's	AA+	12.99%
Municipal Securities	39,600,715	Standard & Poor's	AA+	7.30%
Municipal Securities	29,771,765	Standard & Poor's	AAA	5.49%
Corporate Bonds	28,829,012	Standard & Poor's	A	5.32%
Municipal Securities	25,726,165	Standard & Poor's	AA	4.74%
Corporate Bonds	25,247,165	Standard & Poor's	A-	4.66%
Municipal Securities	18,875,407	Moody's	A1	3.48%
Asset Backed Securities	17,058,379	Standard & Poor's	AAA	3.15%
Municipal Securities	16,046,139	Moody's	Aa3	2.96%
Corporate Bonds	15,603,880	Standard & Poor's	A+	2.88%
Municipal Securities	15,598,269	Standard & Poor's	A	2.88%
Municipal Securities	12,647,565	Moody's	Aa2	2.33%
Municipal Securities	11,053,124	Standard & Poor's	A+	2.04%
Corporate Mortgage Backed Securities	10,274,841	Standard & Poor's	AAA	1.89%
Corporate Bonds	10,220,506	Moody's	Baa2	1.88%
Municipal Securities	10,058,352	Moody's	A2	1.85%
Money Market Funds	9,692,023	Moody's	Aaa-mf	1.79%
Corporate Bonds	9,616,627	Moody's	A3	1.77%
Municipal Securities	9,467,061	Standard & Poor's	AA-	1.75%
Corporate Bonds	9,441,381	Standard & Poor's	AA	1.74%
Municipal Securities	8,844,273	Standard & Poor's	A-	1.63%
Corporate Bonds	8,737,438	Moody's	Baa1	1.61%
Municipal Securities	7,940,796	Moody's	Aa1	1.46%
Corporate Bonds	7,814,393	Standard & Poor's	AA-	1.44%
Asset Backed Securities	6,991,988	Moody's	Aaa	1.29%
Corporate Bonds	6,739,434	Moody's	A1	1.24%
Municipal Securities	3,878,098	Moody's	A3	0.72%
Municipal Securities	2,543,046	Moody's	Aaa	0.47%
Asset Backed Securities	2,503,985	Standard & Poor's	AA+	0.46%
Asset Backed Securities	2,346,719	Standard & Poor's	A+	0.43%
Corporate Mortgage Backed Securities	1,959,490	Standard & Poor's	AA+	0.36%
Municipal Securities	1,795,239	Standard & Poor's	A-1+	0.33%
Corporate Bonds	1,737,632	Moody's	A2	0.32%
Corporate Bonds	1,312,625	Moody's	Aa3	0.24%
Corporate Bonds	1,095,569	Standard & Poor's	AAA	0.20%
Corporate Mortgage Backed Securities	1,005,297	Standard & Poor's	AA	0.19%
Corporate Mortgage Backed Securities	778,148	Moody's	Aaa	0.14%
Asset Backed Securities	622,300	Standard & Poor's	AA-	0.11%
Municipal Securities	75,508	Moody's	Baa1	0.01%
	$542,305,075			100%

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 three 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 three percent of the market value of the endowment as of June 30, 2014.

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, 2014.

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, 2014.

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, 2014	$256,825,917
Deduct: accrued expenses	(3,180,833)
Add: receivables, advances, and prepaid Items	6,962,393
Fund balance, GAAP basis, June 30, 2014	$260,607,477

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 continued on a month-to-month basis for part of fiscal year 2014 a lease for office equipment originally entered into in June 2010. The Commission entered into a new 36-month lease agreement in November 2013 to replace this office equipment. 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 this and the previous operating leases for the year ended June 30, 2014, was $7,931. The Commission has, as of June 30, 2014, $4,980 in minimum rental payments due under this lease for 2015.

6. COMMUNITY REVITALIZATION EXPENDITURES

The Commission awarded grants totaling $88,553,028 in fiscal year 2014 to various localities and other entities for community revitalization projects, including regional economic development projects, educational programs, research and development initiatives, megasite development, and other special projects in Southern and Southwest Virginia. Of the total amount awarded since the inception of the Commission, $173,361,050 is not reflected in these statements since eligibility requirements were not met as of June 30, 2014, 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 receivable includes amounts owed to the Commission for unfulfilled contractual obligations and refunds due as of June 30, 2014. Grant advances include amounts disbursed to grant recipients who have not incurred expenses as of June 30, 2014. Grants payable includes amounts awarded to grantees with all contingencies met but unpaid as of June 30, 2014.

7. ADMINISTRATION

Master Settlement Agreement (MSA) Enforcement

Pursuant to the 2013 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 $193,222 for expenses incurred by central service agencies on behalf of the Commission, pursuant to the 2013 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.

8. 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 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.

9. 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's 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, but potentially as late as 2047 (pursuant to the indenture) 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 2014, the Commission transferred $53,024,249, including $18,179,221 in interest earnings through February 2014, from the Endowment to the Tobacco Indemnification and Community Revitalization Fund. The remaining Endowment balance includes interest earned on the Endowment from March 1, 2014, through June 30, 2014.

Commonwealth of Virginia

Auditor of Public Accounts

Martha S. Mavredes, CPA
Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

June 3, 2015

The Honorable Terence R. McAuliffe
Governor of Virginia

The Honorable John C. Watkins
Chairman, Joint Legislative Audit
And Review Commission

Commission Members
Virginia Tobacco Indemnification and
Community Revitalization Commission

INDEPENDENT AUDITOR'S REPORT

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, 2014, and the related notes to the financial statements, which collectively comprise the Commission's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall financial statement presentation.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a reasonable basis for our audit opinions.

Opinion

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, 2014, and the respective changes in financial position and the respective budgetary comparison for the Special Revenue Fund for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages one through four be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with Government Auditing Standards, we have also issued our report dated June 3, 2015, 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 in considering the Commission's internal control over financial reporting and compliance.

Martha S. Mavredes

AUDITOR OF PUBLIC ACCOUNTS

EMS/alh