TOBACCO USE PREVENTION AND CONTROL FOUNDATION
FRANKLIN COUNTY

REGULAR AUDIT

FOR THE YEAR ENDED JUNE 30, 2002

JIM PETRO
AUDITOR OF STATE

STATE OF OHIO

TOBACCO USE PREVENTION AND CONTROL FOUNDATION
FRANKLIN COUNTY

TABLE OF CONTENTS

THIS PAGE INTENTIONALLY LEFT BLANK

STATE OF OHIO
OFFICE OF THE AUDITOR

JIM PETRO, AUDITOR OF STATE

35 North Fourth Street
Columbus, Ohio 43215
Telephone 614-466-3402
800-443-9275
Facsimile 614-728-7199
www.auditor.state.oh.us

REPORT OF INDEPENDENT ACCOUNTANTS

Tobacco Use Prevention and Control Foundation
246 North High Street
Columbus, Ohio 43215

To the Foundation:

We have audited the accompanying financial statements of the Tobacco Use Prevention and Control Foundation (the Foundation), State of Ohio, as of and for the year ended June 30, 2002, as listed in the table of contents. These financial statements are the responsibility of the Foundation'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.

As discussed in Note 1, the financial statements present only the activity of the Foundation, a portion of the State of Ohio, and are not intended to present fairly the financial position of the State of Ohio and the results of its operations and cash flows of its enterprise funds in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Tobacco Use Prevention and Control Foundation, State of Ohio, as of June 30, 2002, and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2, during the year ended June 30, 2002, the Foundation adopted the Governmental Accounting Standards Board Statements No. 34, 36, 37, 38 and Interpretation 6.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 16, 2002 on our consideration of the Tobacco Use Prevention and Control Foundation's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Management's Discussion and Analysis is not a required part of the basic financial statements, but is supplementary information the Governmental Accounting Standards Board requires. We applied limited procedures, consisting principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. We did not audit the information and express no opinion thereon.

JIM PETRO
Auditor of State

October 16, 2002

TOBACCO USE PREVENTION AND CONTROL FOUNDATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2002
UNAUDITED

The management of the Ohio Tobacco Use Prevention and Control Foundation (TUPCF), part of the primary government of the State of Ohio, offers readers of the Foundation's financial statements this narrative overview and analysis of the financial activities of the Foundation for the fiscal year ended June 30, 2002. We encourage readers to consider the information presented herein in conjunction with the Foundation's financial statements, which begin on page 6 of this report.

Financial Highlights

- The Foundation's net assets decreased during the Fiscal Year 2002 by $17,388,179 or 5.0%.
- During 2002, the Foundation's investments and investment receivables (all at market value) decreased by $17,491,419 or 5.3%.
- During 2002, there was a net excess of expenditures over revenues of $17,388,179.
- During 2002, investment income was a loss of $8,142,816 or a negative 137% of the amount budgeted. The budgeted amount was an income gain of $21,771,374.
- During 2002, $9,000,000 of cessation grants budgeted for local communities was not spent as a result of timing issues and thus deferred until the Fall of 2002.

Condensed Financial Information

	FY 02	FY 01
Total Assets	334,600,137	350,194,584
Total Liabilities	1,803,515	9,783
Liabilities other than long-term	1,778,018	9,783
Long term liabilities	25,497	0
Total net assets restricted: reduce tobacco use	332,796,622	350,184,801
Total revenues	(8,142,701)	350,194,584
Tobacco settlement	0	330,404,281
Investment income	(8,142,816)	19,790,303
Donations	115	0
Total Operating Expenses	9,245,478	9,783
Change in net assets	(17,388,179)	350,184,801
Ending net assets	332,796,622	350,184,801

Reasons for Significant Changes from the Prior Year

- Investment income was a loss of $8,142,816, which is directly attributable to the decline in the stock market. The Foundation's assets are invested per ORC 183.08 (A) which limits investments to those permitted for the public retirement systems under ORC 145.11.
- There were no tobacco settlement revenues in FY 02 as the funds that were originally designated for the Foundation were diverted to the state's General Revenue Fund to help off-set the deficiencies in the state's overall budget.
- The significant change in "liabilities other than long-term" is directly related to the five year, $50 million counter marketing campaign. This media campaign is designed to counter the advertising done by the tobacco companies and to reduce tobacco use in Ohio.
- Total operating expenses were $9,245,478 in FY 02 and $9,783 in FY 01. In FY 01 the Foundation was being formed and expenses were minor. The expenses in FY 02 represent approximately six months of activity as the Foundation started hiring staff in January 2002. The budget for FY 03 is $27,098,571.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Foundation's basic financial statements. The Foundation's basic financial statements comprise three components: 1) financial statements, 2) notes to the financial statements, and 3) schedules to the financial statements.

Financial Statements

The Foundation follows governmental accounting principles, which means these statements are presented in a manner similar to other governmental units. The financial statements are designed to provide readers with a broad overview of the Foundation's finances in total. These statements offer short and long-term financial information about its activities.

The *Governmental Funds Balance Sheet / Statement of Net Assets* presents information on all of the Foundation's assets and liabilities, including information about the nature and amounts of investments and the Foundation's net assets at June 30, 2002. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Foundation is improving or deteriorating.

The *Statement of Governmental Fund Revenues, Expenditures, and Changes in Fund Balances / Statement of Activities* presents information showing the changes in the Foundation's net assets during the 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 future fiscal periods. (E.g. earned but unused vacation leaves and accrued interest receivable).

Activities of the Foundation

The financial statements highlight the activities of the Foundation that are principally supported by investment income. Programs of the Foundation are intended to reduce and eliminate tobacco use in the State of Ohio. In this regard, the Foundation has five specific goals as follows:

- Prevent youth tobacco use initiation;
- Reduce youth tobacco consumption;
- Reduce tobacco use among minority and regional populations and other populations disproportionately affected by tobacco;
- Reduce tobacco use among pregnant women; and
- Reduce tobacco use among adults.

The financial arrangement of the Foundation is unlike those for most state agencies. The most significant difference is that the Foundation's annual budget is not appropriated by the General Assembly. The monies received from the tobacco master settlement agreement (MSA) are given to the Foundation and are deposited in its endowment fund. The endowment fund is a "custodial fund" a certain type of fund permitted by state law. The fund is held in the custody of the Treasurer of State, but is not, by law, part of the state treasury. The Foundation's assets are managed by the Foundation's governing board. The Foundation's board, not the Governor and not the General Assembly, determines its annual budget. The foundation also must manage the investment of its assets under the limitations established by state law. This is a responsibility most state agencies do not have.

Accomplishments

During its initial biennium that ended June 30, 2002, TUPCF had all its members appointed, organized an Executive Committee, a Grants Committee, a Strategic Planning Committee, Personnel Committee and a Finance Committee. TUPCF hired an Executive Director, an administrative assistant, a Director of Finance, a Director of Programs, and four program managers. TUPCF established benchmarks for measuring Ohio's success in achieving greater levels of tobacco cessation. A counter marketing campaign in the amount of $50 million was awarded in 2002. This is a five year paid media campaign to focus on tobacco cessation and prevention in Ohio. Finally, in late June 2002 TUPCF published two Requests for Proposals (RFP). The first RFP announced the availability of $7,000,000 of Community Grants to prevent and control the use of tobacco in Ohio, with a particular focus on the five specific areas noted above. The grants are to be awarded in October 2002. Finally the second RFP that was actually issued in FY 02 was a minority set aside (MBE) request for TUPCF web hosting and administration services. The proposal selected was awarded in September, 2002.

THE PAGE INTENTIONALLY LEFT BLANK

TOBACCO USE PREVENTION AND CONTROL FOUNDATION
GOVERNMENTAL FUND BALANCE SHEET / STATEMENT OF NET ASSETS
JUNE 30, 2002

	Special Revenue Fund	Adjustments	Statement of Net Assets
ASSETS:			
Cash	$ 1,868,291	$ -	$ 1,868,291
Investments at market value (cost $341,663,961)	332,728,165	-	332,728,165
Deposit for compensated absences	698	-	698
Collateral on lent securities	2,983	-	2,983
Total Assets	$ 334,600,137	$ -	$ 334,600,137
LIABILITIES:			
Accounts payable	$ 1,760,103	$ -	$ 1,760,103
Obligations under lent securities	2,983	-	2,983
Personnel Payable	12,962	-	12,962
Compensated absences:			
Due within one year	-	1,970	1,970
Due after one year	-	25,497	25,497
Total liabilities	1,776,048	27,467	1,803,515
FUND BALANCE / NET ASSETS:			
Fund balance-reserved	332,824,089	(332,824,089)	-
Total liabilities and fund balance	$ 334,600,137		
Net Assets:			
Restricted for programs to decrease tobacco use		332,796,622	332,796,622
Total net assets		$ 332,796,622	$ 332,796,622

The notes to the financial statements are an integral part of this statement.

TOBACCO USE PREVENTION AND CONTROL FOUNDATION
STATEMENT OF GOVERNMENTAL FUND REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE / STATEMENT OF ACTIVITIES
JUNE 30, 2002

	Special Revenue Fund	Adjustments	Statement of Activities
Revenues			
Donations	$ 115	$ -	$ 115
Investment income (loss)	(8,142,816)	-	(8,142,816)
Total Revenues	(8,142,701)	-	(8,142,701)
Expenditures / Expenses:			
Personnel costs	188,284	27,467	215,751
Contracts	8,855,920	-	8,855,920
Operating costs	160,699	-	160,699
Grants	13,108	-	13,108
Total Expenditures / Expenses	9,218,011	27,467	9,245,478
Excess (Deficit) of Revenues over Expenditures/Expenses	(17,360,712)	17,360,712	-
Change in net assets	-	(17,388,179)	(17,388,179)
Fund Balance / Net Assets:			
Beginning Balance - July 1, 2001	350,184,801	-	350,184,801
Ending Balance - June 30, 2002	$ 332,824,089	$ -	$ 332,796,622

The notes to the financial statements are an integral part of this statement.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Authorizing Legislation

The Tobacco Use Prevention and Control Foundation (the Foundation) was created by amended Senate Bill No. 192, effective June 2000, to develop a plan and to implement programs designed to decrease tobacco use in Ohio with emphasis on reducing the use of tobacco by youth, minority and regional populations, pregnant women, and other populations disproportionately affected by tobacco use. The plan shall cover a period of at least five years and be updated annually. The legislation describes a variety of means by which the Foundation is to develop its plan and carry out its charge.

Pursuant to its legislative mandate, the Foundation's Board was created in Ohio Revised Code (ORC) Section 183.04 and is enabled in ORC 183.04 through ORC 183.09 inclusive. The Foundation's Board is composed of twenty voting and four non-voting members as set forth in Section 183.04 of the Ohio Revised Code. Members include eight health professionals, health researchers, or representatives of health organizations; one person with experience in financial planning and accounting; one person with experience in media and mass marketing; seven individuals recommended one each by the following entities: the American Cancer Society, the American Heart Association, the American Lung Association, the Association of Hospitals and Health Systems, the Ohio State Medical Association, the Association of Ohio Health Commissioners, the Ohio Dental Association; three State officials (Director of Health, Executive Director of the Commission on Minority Health, and the Attorney General) sitting ex officio; and two members each from the House and Senate (non-voting).

Method of Operation

The Foundation shall implement or provide funding through grants to private or public agencies to carry out research and programs related to tobacco use prevention and cessation. The Foundation shall establish an objective process to determine which research and program proposals to fund. The Foundation shall also adopt rules under Chapter 119 of the Ohio Revised Code regarding conflicts of interest in the research and programs which it funds.

To carry out the duties of the Foundation, a separate endowment fund (Tobacco Use Prevention and Control Endowment Fund) was created in the custody of the Treasurer of State but not part of the State Treasury. Legislation requires the endowment fund shall consist of amounts disbursed to it through the Department of Heath's Tobacco Use Prevention and Control Trust Fund, grants and donations made to the Foundation, and investment earnings of the endowment fund. The endowment fund shall be used by the Foundation to carry out its duties. The Foundation is the trustee of the endowment fund and the Treasurer of State shall pay disbursements only upon instruments duly authorized by the Foundation's Board of Trustees or its designee. The endowment fund, however, is not a trust fund.

The endowment fund is to be used to pay all Foundation expenditures such as staff salaries, equipment purchases, rental payments and program expenses. The legislation also defined the Foundation's employees as State employees, which as a result required the State of Ohio to establish an appropriation line item (Central Accounting System Fund 5M8 – Tobacco Use Prevention and Control Operating Expenses fund) to provide for the Foundation's payroll. This amount is then reimbursed by and through the Foundation's endowment fund. An initial appropriation amount of $500,000 was established in anticipation of hiring several employees during the year; as of June 30, 2002, eight employees have been hired. The majority of the Foundation's assets are required to be maintained in the endowment fund, an unappropriated account, which is monitored by the Foundation. Payroll costs were less than 2.5% of the Foundation's total reported expenses and less than 0.07% of the total net assets; therefore, no budgetary comparison information is provided.

At the request of the Foundation, the Treasurer of State shall select and contract with one or more investment managers to invest all money credited to the fund that is not currently needed for carrying out the functions of the Foundation. The eligible list of investments, as well as limitations and other requirements, shall be the same as for the Public Employees Retirement System under Section 145.11 of the Ohio Revised Code.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The accompanying financial statements of the Tobacco Use Prevention and Control Foundation present the financial position and results of operations of the Foundation. The financial statements, as of June 30, 2002 and for the year then ended, conform with accounting principles generally accepted in the United States of America as applied to governments. The Governmental Accounting Standards Board (GASB) is the standard-setting body for establishing governmental accounting and financial reporting principles. The GASB's Codification of Governmental Accounting and Financial Reporting Standards (GASB Codification) documents these principles. The Foundation's significant accounting policies are as follows:

A. Reporting Entity

Within the State of Ohio's Comprehensive Annual Financial Report, the Foundation is included as part of the primary government. The Foundation's management believes these financial statements present all activities for which the Foundation is financially responsible.

B. Government-Wide And Fund Financial Statements

In accordance with GASB Statement 34, the Foundation has presented government-wide financial statements (the Statement of Net Assets and the Statement of Activities). These statements are required to report all non-fiduciary activities. Government-wide accounting is designed to provide a more comprehensive view of the Foundation's operations and financial position as a single economic entity.

Fund financial statements are also provided for the Foundation's governmental fund. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions relating to certain functions or activities.

As allowed by GASB Statement 34 for entities engaged in a single governmental program, the Foundation has chosen to present its fund financial statements with its government-wide statements. This was accomplished by using a columnar format that reconciles individual line items of fund financial data to government-wide data in a separate column.

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

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Under this measurement focus, operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net assets. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this measurement focus, operating statements present increases (i.e., revenues) and decreases (i.e., expenditures) in net current assets, and unreserved fund balance is a measure of available expendable resources.

Under the modified accrual basis of accounting, the Foundation recognizes revenues when susceptible to accrual (i.e., when they are "measurable and available"). "Measurable" means the amount of the transaction is determinable, and "available" means the amount is collectible within the current period or soon enough thereafter to pay liabilities of the current period. The Foundation considers revenues as available when collected within 60 days after year-end. Under the modified accrual basis, expenditures are recorded when related liabilities are incurred, which are recognized as expenditures when due.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation (Continued)

Significant sources susceptible to accrual under the modified accrual basis of accounting include tobacco settlement revenues, investment income and vendor payables.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

The Foundation uses a special revenue fund to report its financial position and results of operations. The special revenue fund is an independent fiscal and accounting entity with a self-balancing set of accounts, which accounts for revenue sources that are legally restricted to specific purpose expenditures. Two separate accounts exist within the special revenue fund; these are the Tobacco Use Prevention and Control Endowment Fund and the Tobacco Use Prevention and Control Operating Expenses Fund. These accounts were described within Note 1, Method of Operations.

D. Cash

Cash includes amounts held both in the State payroll account at the Treasurer of State (TOS) and in a checking account at a financial institution. Cash with the Treasurer consists of pooled demand deposits and investments carried at fair value. The State's cash pool under the Treasurer of State's administration has the general characteristics of a demand deposit account whereby additional cash can be deposited at any time and can also be effectively withdrawn at any time, within certain budgetary limitations, without prior notice or penalty. As of June 30, 2002, the carrying amounts (balance per Foundation) and the depository balance (balance per bank) of the cash balances and related risk categories required by GASB Statement 3 are shown below.

Deposit Account	Category 1	Category 2	Category 3	Carrying Amount	Bank Balance
Cash with TOS	9,485	-	-	9,485	9,485
Checking Account	100,000	1,758,806	-	1,858,806	1,858,806
Total Deposits	109,485	1,758,806	-	1,868,291	1,868,291

Risk category 1 consists of deposits insured or collateralized with securities held by the foundation or by its agent in the foundation's name.

Risk category 2 consists of deposits collateralized with securities held by the pledging financial institution's trust department or agent in the foundation's name.

Risk category 3 consists of uncollateralized deposits, which includes any bank balance that is collateralized with securities held by the pledging financial institution or by its trust department or agent but not in the foundation's name.

E. Investments

Investments of the Foundation are reported at fair value, which includes accrued interest receivable. Fair value is the amount at which an investment could be exchanged in a current transaction between willing parties other than in a forced or liquidation sale. If a quoted market price is available for an investment, the fair value to be used is the total of the number of trading units of the instrument times the market price per unit.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

E. Investments (Continued)

Realized gains and losses are an independent calculation of the net change in the fair value of investments. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current year were included as a change in the fair value of investments reported in the prior year(s) and the current year.

Ohio Revised Code section 183.08 (A) restricts the types of investments the foundation may purchase to those types of investments permitted for the public employees retirement system under section 145.11 of the Revised Code. All investments shall be subject to the same limitations and requirements as the retirement system under that section and sections 145.112 and145.113 of the

Revised Code.

As of June 30, 2002, the carrying amounts and the fair value of the investments balances and related risk categories required by GASB Statement 3 are shown below.

Investment Type	Category 1	Category 2	Category 3	Fair Value
Treasury & Fed Agency Bonds	57,878,817	-	-	57,878,817
Common and Conv PFD Stock	180,217,250	-	-	180,217,250
Corporate Bonds	53,951,794	-	-	53,951,794
Government Money Market	40,680,304	-	-	40,680,304
Total Investments	332,728,165	-	-	332,728,165

Risk category 1 consists of investments that are insured or registered, or securities held by the foundation or by its agent in the foundation's name.

Risk category 2 consists of investments that are insured or registered, with securities held by the counterparty's trust department or agent in the foundation's name.

Risk category 3 consists of investments that are uninsured or unregistered, with, securities held by the counterparty, or by its trust department or agent but not in the foundation's name.

During the year, the Foundation also held investments on deposit in the Treasurer of State's custodial account. Custodial account deposits are maintained within the State Treasury Asset Reserve of Ohio (STAR Ohio), whereby the deposits are pooled with other deposits and reinvested daily. The investments are considered short-term and are reported at cost, which approximates market values. The pooled deposits at STAR Ohio have the general characteristics of a demand deposit account whereby additional cash can be deposited at any time and can also be effectively withdrawn at any time, without prior notice or penalty. The Treasurer of State is the investment advisor and administrator of STAR Ohio, a statewide external investment pool authorized under Section 135.45, Ohio Revised Code. At June 30, 2002, the Foundation held no investments in STAR Ohio.

F. Securities Lending Transactions

GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transaction*s, requires disclosure of assets and liabilities arising from securities lending transactions. For fiscal year 2002, none of the Foundation's investments were used in securities lending transactions. However, cash on deposit with the Treasurer of State was subject to lending transactions by the Treasurer of State. Under the lending program, which is administered by a custodial agent bank, certain securities are transferred to an independent broker-dealer (borrower) in exchange for cash collateral. The treasurer reinvests the collateral in various investment types, including U.S government and agency obligations, repurchase agreements, commercial paper, corporate bonds, and money market funds.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

F. Securities Lending Transactions (Continued)

The State requires its custodial agents to ensure that the State's lent securities are collateralized at no less than 102 percent of market value. Consequently, as of June, 30, 2002, the State had no credit exposure since the amount the State owed to borrowers exceeded the amount borrowers owed the State. In accordance with paragraph 9 of GASB Statement No. 28, the Foundation's recording of assets and liabilities for securities lending transactions is based on their share of the cash, at the balance sheet date, as calculated by the Office of Budget and Management.

G. Deposit for Compensated Absences

This amount represents the allocated portion of the Foundation's share of the balance in the state Accrued Leave Fund at June 30, 2002, and consists of payroll assessments paid into the Fund by the Foundation during the year. It is an amount pre-funded for compensated absences.

H. Revenues and Receivables

Tobacco settlement revenues comprise the Foundation's primary source of revenue. These revenues are derived from the 1998 Master Settlement Agreement (the Agreement) which was entered into by the State of Ohio, along with numerous other states, against major tobacco product manufacturers. The Agreement stipulates the conditions and calculations to be applied in order for each state to receive its annual allotments. Revised Code Section 183.02 requires all payments received by the State to be deposited into the Treasurer of State's Tobacco Master Settlement Agreement Fund and the payments and related interest are to be distributed by the Office of Budget and Management in accordance with the distribution schedule. Revised Code Section 183.02 (C) stipulates the payments to the Foundation from the Agreement shall be as follows:

Year	Amount or Percentage
2000 (First Payment credited)	$104,855,223
2000 (Net Amount Credited)	70.30%
2001	62.84%
2002	61.41%
2003	63.24%
2004	66.65%
2005	66.24%
2006	65.97%
2012	56.01%

Before fiscal year 2012 begins, the Foundation must report to the Governor and Legislature the progress the Foundation has made towards its goals and whether a need for additional funding still exists. At that point, the Governor and Legislature will decide whether funding to the Foundation will be continued. Funding estimates for receiving monies under the Master Tobacco Settlement Agreement were only projected through the year 2025; however, under the terms of the Agreement payments from the tobacco product manufacturers are to continue into perpetuity.

The State of Ohio received in FY 2001 approximately 7.1 percent less than the pre-adjusted base pay amount contained in the Agreement, resulting in the Foundation receiving less tobacco settlement revenues than anticipated due to adjustment factors such as inflation and volume. ORC Section 183.02(1) further states that future year revenues from the Agreement are contingent upon sufficient proceeds being received to cover designated revenues set asides for the Education Facilities Trust and Endowment Funds. The Foundation recognizes a receivable for tobacco settlement revenues on the date the payment is received by the State and land it is probable the amount will be transferred to the Foundation. The Foundation's tobacco settlement receivable at June 30, 2002 was $0.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

H. Revenues and Receivables (Continued)

HB 405, which was signed into law in December 2001, contained several provisions to address a projected shortfall in the State's General Revenue Fund (GRF) for fiscal years 2002 and 2003. Section 32 of the act allows for $260 million in tobacco revenue that Ohio receives in FY 2002 and FY 2003 to be transferred to the GRF, if it is needed to help balance the GRF budget. Of the $260 million total, $240 million that would otherwise go to the Foundation may be transferred to the GRF at the rate of $120 million per year. As a result, in FY 2002 no funds were transferred to the Foundation. In addition, HB 405 stated the dollars diverted to help offset reduced revenues to the GRF in FY 2002 and 2003 will be repaid to the Foundation from tobacco revenue that the State receives in FY 2013 and FY 2014.

Interest Income

The Foundation receives interest income from the State of Ohio for any earnings resulting from the time the State receives the master tobacco settlement monies until the time in which the monies are paid into the Foundation's custodial account. The Foundation recognizes this revenue in the period in which it is measurable and available. The Foundation's interest receivable was $0 and $4,898,481 at June 30, 2002 and 2001, respectively.

I. Expenditures and Accounts Payable

Grants

During fiscal year 2002 and 2001 no grants were disbursed as a result of the Foundation being in a start-up mode. The costs shown on the financial statements are grant related costs such as postage and printing incurred in preparing and mailing the Request for Proposal (RFP) document. Currently, the Foundation has developed guidelines to oversee the implementation and monitoring of future grant activity. An RFP to award grants was published in June 2002 and the board has approved a plan to award $7,000,000 of community based grants by November 2002 and a total of $9,000,000 by June 30, 2003.

Administrative Expenditures

Administrative expenditures include operating and overhead items such as travel, advertising, start-up costs incurred by the Department of Health personnel, and other miscellaneous expenditures. Accounts payable were $1,760,103 and $9,783 at June 30, 2002 and 2001 respectively. ORC Section 183.30 (A) requires no more than five percent of total expenditures within a fiscal year shall be for administrative purposes; however, HB 94 eliminated this requirement in fiscal years 2002 and 2001, provided the Foundation has submitted a spending plan to the Controlling Board and the Controlling Board has approved the plan. Such plan was submitted and approved in FY 2002. However, it should be noted that actual administrative expenditures were 4.2% of the total expenditures for FY 2002 and thus met the statute limitation.

J. Compensated Absences

The State of Ohio has established laws governing employee leave benefits and policies. Under these policies, Foundation employees earn vacation leave, sick leave, and personal leave at various rates within limits specified under law. Generally, employees accrue vacation leave at a rate of 3.1 hours every two weeks for the first five years of employment, up to a maximum rate of 9.2 hours every two weeks after 25 years of employment. Employees may accrue a maximum of three years vacation leave credit. At termination or retirement, the State pays employees, at their full rate, 100 percent of unused vacation leave, personal leave, and, in certain cases, compensatory time and 50 percent of unused sick leave.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

J. Compensated Absences (Continued)

The Foundation accrues vacation, compensatory time, and personal leaves as liabilities when an employee's right to receive compensation is attributable to services already rendered and it is probable that the employee will be compensated through paid time off or some other means, such as at termination or retirement. Compensatory time is not subject to pay off at termination or retirement; it must be used in paid time off or it will be lost. Leave time that has been earned, but is unavailable for use as paid time off or as some other form of compensation because an employee has not met a minimum service time requirement, is accrued to the extent that it is considered to be probable that the conditions for compensation will be met in the future.

The Foundation accrues sick leave using the vesting method. Under this method, the liability is recorded on the basis of leave accumulated by employees who are eligible to receive termination payments, as of the balance sheet date, and on leave balances accumulated by other employees who are expected to become eligible in the future to receive such payments.

K. Fund Balance

In accordance with reporting requirements associated with GASB Statement No. 33's purpose restrictions, fund balances will be reported as reserved and net assets will be reported as restricted, for the purpose for which the resources are required to be used.

L. Self-Insurance

The State of Ohio serves as the Foundation's primary government and is self-insured for claims covered under its traditional healthcare plan, vehicle liability, public fidelity blanket bonds, property losses, and tort liability. Additionally, the State of Ohio participates in a public entity risk pool that covers liabilities associated with claims submitted to the Bureau of Workers' Compensation.

2. CHANGES IN ACCOUNTING PRINCIPLES

Starting in fiscal year 2001, the Foundation implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 33, *Accounting and Financial Reporting for Non-exchange Transactions*, which became effective for fiscal years beginning after June 15, 2000. GASB Statement No. 33 requires the Foundation to report non-exchange transactions involving financial or capital resources. Non-exchange transactions occur when an entity gives (or receives) value without directly receiving (or giving) equal value in return.

Implementation of GASB Statement No. 33 during the Foundation's initial year of existence resulted in the recognition of voluntary non-exchange transactions associated with tobacco settlement revenues received from the Tobacco Master Settlement Agreement in the amount of $330,404,281 and $19,790,303 in related interest earnings during fiscal year 2001.

For the Fiscal Year 2002, the Foundation implemented the provisions of GASB Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*, which became effective for all component units of the State of Ohio, including the Foundation, with fiscal years beginning after June 30, 2001. The statement requires the inclusion of a Management's Discussion and Analysis. The implementation of GASB Statement No. 34 did not require the Foundation to restate any prior year balances.

2. CHANGES IN ACCOUNTING PRINCIPLES (Continued)

During 2002, the Foundation also implemented the provisions of the following GASB statements: No. 36, *Recipient Reporting for Certain Shared Nonexchange Revenues,* No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus*, No. 38, *Certain Financial Statement Note Disclosures,* and GASB interpretation 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Government and Fund Financial Statements*. Each of these statements requires simultaneous implementation with Statement No. 34. The implementation of these GASB Statements did not require the Foundation to restate any prior year balances.

3. EXPLANATION OF DIFFERENCES BETWEEN THE GOVERNMENTAL FUND AND GOVERNMENT-WIDE FINANCIAL STATEMENTS

Total "Fund balance" of the Foundation's governmental fund on the Governmental Fund Balance Sheet differs from "Total net assets" of the governmental activities reported in the Statement of Net Assets. The "Excess (deficit) of Revenues over Expenditures/Expenses" of the Foundation's governmental fund on the Statement of Governmental Fund Revenues, Expenditures, and Changes in Fund Balance differs from the Foundation's change in net assets on the Statement of Activities. This difference primarily results from the long-term economic focus of the government-wide statements versus the current financial resources of the governmental fund statements.

Recognition of compensated absences differs between the two statements. No expense or liability for compensated absences was accrued on the fund statement because the related liability was not expected to be liquidated with expendable available financial resources. No event had occurred whereby a liability for compensated absences had matured or come due for payment as of the balance sheet date. However, compensated absences were accrued on the government-wide statements. Amounts are shown for compensated absences due within one year and those due after one year. These amounts are shown net of the amount the Foundation paid during the current year into a state account used to provide compensated absences paid upon termination and for the annual conversion when employees exercise their option to be paid for their unused compensated absence balances within allowable limits. In essence, this is a pre-funded amount. A detailed reconciliation of the differences between the statements is shown below.

Statement of Net Assets	332,796,622
Governmental Fund Balance	332,824,089
Difference	(27,467)
Statement of Activities	(17,388,179)
Statement of Governmental Fund Revenues, Expenditures, and Changes in Fund Balance	(17,360,712)
Difference	27,467
Compensated absences due within one year	1,970
Compensated absences due after one year	25,497
Compensated absences expense	27,467

4. PENSION PLAN

All employees of the Foundation participate in the Public Employees Retirement System of Ohio (PERS), a cost-sharing multiple-employer defined pension plan administered by the Public Employees Retirement Board. PERS provides retirement and disability benefits, annual cost of living adjustments, and death benefits to plan members and beneficiaries. Chapter 145 of the Ohio Revised Code assigns the authority to establish and amend benefit provisions to the PERS Board The PERS issues a stand-alone financial report, which may be obtained by writing to the Public Employees Retirement System, 277 East Town Street, Columbus, Ohio 43215-4642 or by calling (614) 466-2085 or 1-800-222-PERS (7377).

Employee and employer contributions to PERS are established under the Ohio Revised Code and are based on percentages of covered employees' gross salaries, with the contribution rate percentages being calculated annually by the Retirement Board's actuaries. In Fiscal Years 2002 the employee and employer contribution rates were 8.50% and 13.31% respectively, for all Foundation employees. The Foundation's required contributions to PERS for the years ended June 30, 2002 and 2001 were $12,433 and $0, respectively. The full amount has been contributed for both years. The total payroll for employees of which all employees are covered by PERS was $93,411 in FY 2002. There were no employees in the prior year.

5. OTHER POST EMPLOYMENT BENEFITS

PERS provides post retirement health care coverage to age and service retirees with ten or more years of qualifying Ohio service credit. Health care coverage for disability recipients and primary survivor recipients is also available.

The health care coverage provided by the retirement system is considered an Other Post Employment Benefit (OPEB) as described in GASB Statement No. 12, *Disclosure of Information on Postemployment Benefits Other Than Pension Benefits by State and Local Government Employers.* The Ohio Revised Code provides statutory authority for employer contributions and requires public employers to fund post retirement healthcare through their contributions to PERS. A portion of each employer contribution to PERS (13.31 percent of covered payroll) is set aside for the funding of post retirement health care. For the year ended June 30, 2002 that portion was 4.3% for all Foundation employees.

The related assumptions and calculations were based on the System's latest actuarial review performed as of December 31, 2000. Included in the assumptions is the entry age normal actuarial cost method of valuation to determine the present value of the OPEB with the difference between assumed and actual experience (actuarial gains and losses) becoming part of the unfunded actuarial accrued liability. Also all investments are carried at market value, and for valuation purposes include the smooth market approach. Under this approach assets are adjusted annually to reflect 25% of unrealized market appreciation or depreciation on investment assets. In addition the investment assumption rate for 2000 was 7.75%. Finally an annual increase of 4.75%, compounded annually, is the base portion of the individual pay increase assumption. This assumes no change in the number of active employees. Additionally, annual pay increases, over and above the 4.75% base increase, were assumed to range from 0.54% to 5.1%. Health care costs were assumed to increase 4.75% annually.

OPEBs are advance funded on an actuarially determined basis. There are approximately 411,076 active contributing participants. The portion of the employer contribution actually made to fund post employment benefits can be determined by multiplying actual employer contributions times .3231 or in the Foundation's case is equal to $4,017. The actuarial value of the Retirement System's net assets available for OPEB at December 31, 2000 was $11,736 million. Finally the System's actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method used, were $14,365 billion $2,629 billion, respectively.

6. CONTINGENCIES

As of June 30, 2002 the Foundation's management, in consultation with the Attorney General's office, was unaware of any pending litigation which could result in a material unfavorable outcome requiring amounts to be reported or disclosed in the Foundation's financial statements.

7. COMPENSATED ABSENCES

Changes in compensated absences for the year ended June 30, 2002, are as follows:

Balance at 6/30/01	Increase	Decrease	Balance at 6/30/02	Amounts Due In One Year
$ 0	$ 27,467	$ 0	$ 27,467	$ 1,970

STATE OF OHIO
OFFICE OF THE AUDITOR

JIM PETRO, AUDITOR OF STATE

35 North Fourth Street
Columbus, Ohio 43215
Telephone 614-466-3402
800-443-9275
Facsimile 614-728-7199
www.auditor.state.oh.us

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL REQUIRED BY *GOVERNMENT AUDITING STANDARDS*

Tobacco Use Prevention and Control Foundation
246 North High Street
Columbus, Ohio 43215

To the Foundation:

We have audited the accompanying financial statements of the Tobacco Use Prevention and Control Foundation (the Foundation), State of Ohio, as of and for the year ended June 30, 2002, as listed in the table of contents, and have issued our report thereon dated October 16, 2002 wherein we noted the Foundation adopted GASB Statements 34, 36, 37, 38 and Interpretation 6. 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.

Compliance

As part of obtaining reasonable assurance about whether the Foundation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, 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. Our test results disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Foundation'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 assurance 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 over financial reporting that might be material weaknesses. A material weakness is a 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 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. However, we noted other matters involving the internal control over financial reporting that do not require inclusion in this report, that we have reported to the management of the Foundation in a separate letter dated October 16, 2002.

This report is intended for the information and use of the Foundation, the Foundation's Board which serves as the equivalent to an audit committee, management of the State of Ohio and the Ohio Legislature, and is not intended to be and should not be used by anyone other than these specified parties.

JIM PETRO
Auditor of State

October 16, 2002

STATE OF OHIO
OFFICE OF THE AUDITOR

JIM PETRO, AUDITOR OF STATE

88 East Broad Street
P.O. Box 1140
Columbus, Ohio 43216-1140

Telephone 614-466-4514
800-282-0370

Facsimile 614-466-4490

TOBACCO USE PREVENTION AND CONTROL FOUNDATION

FRANKLIN COUNTY

CLERK'S CERTIFICATION

This is a true and correct copy of the report which is required to be filed in the Office of the Auditor of State pursuant to Section 117.26, Revised Code, and which is filed in Columbus, Ohio.

Susan Babbitt

CLERK OF THE BUREAU

CERTIFIED
NOVEMBER 14, 2002