OHIO TOBACCO USE PREVENTION AND CONTROL FOUNDATION
FRANKLIN COUNTY

REGULAR AUDIT

FOR THE YEAR ENDED JUNE 30, 2003

Auditor of State
Betty Montgomery

Board of Trustees
Ohio Tobacco Use Prevention and Control Foundation
300 East Broad Street, Suite 310
Columbus, Ohio 43215-3704

We have reviewed the Independent Auditor's Report of the Ohio Tobacco Use Prevention and Control Foundation, Franklin County, prepared by Steen & Kennedy LLC, for the audit period July 1, 2002 to June 30, 2003. Based upon this review, we have accepted these reports in lieu of the audit required by Section 117.11, Revised Code. The Auditor of State did not audit the accompanying financial statements and, accordingly, we are unable to express, and do not express an opinion on them.

Our review was made in reference to the applicable sections of legislative criteria, as reflected by the Ohio Constitution, and the Revised Code, policies, procedures and guidelines of the Auditor of State, regulations and grant requirements. The Ohio Tobacco Use Prevention and Control Foundation is responsible for compliance with these laws and regulations.

Betty Montgomery

BETTY MONTGOMERY
Auditor of State

October 15, 2003

88 E. Broad St. / P.O. Box 1140 / Columbus, OH 43216-1140
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OHIO TOBACCO USE PREVENTION AND CONTROL FOUNDATION
FRANKLIN COUNTY

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Steen & Kennedy
Certified Public Accountants | Business & Government Consultants

REPORT OF INDEPENDENT ACCOUNTANTS

Board of Trustees
Ohio Tobacco Use Prevention and Control Foundation
300 East Broad Street, Suite 310
Columbus, Ohio 43215-3704

We have audited the accompanying financial statements of the Ohio Tobacco Use Prevention and Control Foundation (the Foundation), State of Ohio, as of and for the year ended June 30, 2003, which comprise the Foundation's basic financial statements 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 operation 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 respective financial position of the Ohio Tobacco Use Prevention and Control Foundation, State of Ohio, as of June 30, 2003, and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 8, 2003, on our consideration of the 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.

The Management's Discussion and Analysis is not a required part of the Foundation's financial statements, but is supplementary information the Governmental Accounting Standards Board requires. 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 thereon.

Steen & Kennedy LLC

Steen & Kennedy LLC
September 8, 2003

OHIO TOBACCO USE PREVENTION AND CONTROL FOUNDATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2003

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, 2003. 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.

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

- Prevent youth tobacco use initiation
- Reduce youth tobacco use
- Reduce tobacco use among diverse and underserved populations, including those disproportionately affected by tobacco
- Reduce tobacco use among pregnant women
- Reduce exposure to secondhand tobacco smoke
- Reduce adult tobacco use
- Reduce smokeless tobacco use among youth and 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 limitations established by state law. This is a responsibility most state agencies do not have.

FINANCIAL HIGHLIGHTS

Key financial highlights for fiscal year 2003 are as follows:

- The Foundations net assets decreased by $18,146,270 or 5.5%.
- During 2003, the Foundation's cash and investments (all at market value) decreased by $18,936,086 or 5.6%.
- During 2003, there was a net excess of expenditures over revenues of $18,146,270.
- During 2003, investment income was $3,397,544 or 17.6% of the $19,250,000 budgeted.
- During 2003, $7,000,000 of cessation and prevention grants (Community Grants I) were awarded and cash in the amount of $5,166,214 actually disbursed. The remainder will be distributed in fiscal year 2004.
- During 2003, $4,000,000 of additional cessation and prevention grants (Community Grants II) was awarded and will be disbursed in fiscal year 2004. In addition, $3,000,000 of cessation and prevention grants for high risk populations was also awarded and which also will be funded in fiscal year 2004.
- During 2003, the Foundation awarded a $948,000 contract to the National Jewish Medical Center to operate a smoking quitline (1-800-934-4840). Marketing of the quitline is being targeted to the minority communities of Cleveland and Toledo and to the Athens media region. The quitline began operations on August 18, 2003.

FINANCIAL HIGHLIGHTS (CONTINUED)

- During 2003, the Foundation spent $14,418,800 in its counter-marketing efforts. This is an aggressive statewide media and counter-marketing campaign which utilizes youth empowerment messages and images to combat the nearly $500 million dollars in marketing that tobacco manufacturers spend each year in Ohio. The goal is to de-normalize tobacco use among the general public, especially among the group most at risk for starting a tobacco habit – children and teens ages 11-15.

- During 2003, administrative costs of the Foundation were $639,389 or 2.97% of operating expenses.

- During 2003, $1,115,103 was spent with certified Ohio Minority Business Enterprise (MBE) companies.

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 two components: 1) financial statements, and 2) notes to the 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, 2003. 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 Balance / 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).

FINANCIAL ANALYSIS OF THE FOUNDATION

The following is condensed financial information as of June 30:

	2003	2002	% Change
Total Assets	$350,443,655	$334,600,137	4.7%
Total Liabilities	35,793,304	1,803,515	1,884.6%
Total Net Assets	314,650,351	332,796,622	(5.5%)
Revenues			
Investment income	3,397,544	(8,142,816)	-
Donations	0	115	(100.0%)
Total Revenues	3,397,544	(8,142,701)	-
Operating Expenditures	21,543,814	9,245,478	133.0%
Change in Net Assets	(18,146,270)	(17,388,179)	4.4%
Ending Net Assets	$314,650,352	$332,796,622	5.5%

FINANCIAL ANALYSIS OF THE FOUNDATION (CONTINUED)

The reasons for Significant Changes from fiscal year 2002 are as follows:

- Investment income had a small gain in 2003, as compared to a loss in 2002, directly attributable to the recovering financial markets. 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 either fiscal year 2003 or fiscal year 2002 as the funds that were originally designated for the Foundation were diverted to the state's General Revenue Fund to help offset the deficiencies in the State's overall budget.

- The significant change in liabilities is related to "obligations under lent securities." This is a new investing program started by the Foundation in fiscal year 2003, and there is an off-setting asset account entitled "Collateral on lent securities" in the like amount of $34,588,814. Revenues from the program, included in investment income, were $59,082 for 2003.

- Total operating expenditures in fiscal year 2003 were $21,543,814 and, in fiscal year 2002, $9,245,478. The Foundation was formed in fiscal year 2001 and the first staff was hired in fiscal year 2002. Fiscal year 2003 was the first full year of operations with a budget of $27,098,571. The budget for fiscal year 2004 is $38,211,342.

CAPITAL ASSETS

At the end of fiscal year 2003, the Foundation had $193,773 invested in net capital assets, as detailed below:

Capital Assets at June 30

	2003	2002	% Change
Furniture	$ 94,290	$ -	100%
IT Equipment	99,483	-	100%
Total Capital Assets	$193,773	$ -	100%

Total net capital assets for the Foundation increased by $193,773 during fiscal year 2003. Fiscal Year 2003 was the first year the Foundation purchased fixed assets.

ACCOMPLISHMENTS

During its first full year of operation that ended June 30, 2003, the Foundation awarded $14,000,000 in community and high risk grants to prevent and control the use of tobacco (i.e., $7,000,000 for Community I Grants, $4,000,000 for Community II Grants, and $3,000,000 for High Risk Grants). The Foundation awarded a $948,000 contract to establish a tobacco quitline with marketing efforts targeted at the minority populations of Cleveland and Toledo and also the Athens region of the state. The Foundation also entered into a competitively bid contract valued at $839,926 with RTI (Research Triangle Institute) to conduct evaluation studies of the effectiveness of the Foundation's counter-marketing efforts as well as to establish base line data on the tobacco habits of Ohioans. Finally the Foundation spent $14,345,451 in its counter-marketing media campaign which is part of an overall $50 million, five year program. The Foundation at the end of the fiscal year 2003 had a full complement of fourteen staff members.

ECONOMIC FACTORS

- In June 2003, HB 95 was signed into law. This legislation contained provisions relating to $112,262,375 in funds the Foundation was to receive from the Master Settlement Agreement for fiscal year 2004. HB 95 diverted this fiscal year 2004 payment into the State of Ohio's General Revenue Fund. These diverted dollars are to be repaid to the Foundation from tobacco revenues that the State receives in fiscal year 2015.
- For fiscal year 2004 the Foundation Board has approved $3 million in prevention and cessation grants for high risk populations and has approved $4 million in additional community prevention and cessation grants.
- For fiscal year 2004 the Foundation Board has authorized Request for Proposals for $500,000 for grants targeted for prevention and cessation of smokeless tobacco use and for $1 million for grants to implement local clean indoor air ordinances that would reduce exposure to secondhand smoke (Environmental Tobacco Smoke or ETS).
- For fiscal year 2004 the Foundation and its investment advisors believe there will be a strong economic recovery such that net investment income for fiscal year 2004 will be approximately 7% of the endowment fund balance or approximately $20.4 million dollars. However, it is still expected that operating and program expenditures will be approximately $38.2 million and thus will exceed revenues by $17.8 million dollars.
- For fiscal year 2004 it is anticipated that the Foundation Board will authorize Request of Proposals for $500,000 each for prevention and cessation grants targeting college students, pregnant women, young adults, and those with chronic smoking related illnesses.

CONTACTING THE FOUNDATION'S FINANCIAL MANAGEMENT

This financial report is designed to provide an overview of the Foundation's finances and it's accountability for the money it receives. If you have questions about this report or need additional financial information, contact Marvin Gutter, Ph.D., CPA, Finance Director, Ohio Tobacco Use Prevention and Control Foundation, 300 East Broad Street, Suite 310, Columbus, Ohio 43215-3704.

OHIO TOBACCO USE PREVENTION AND CONTROL FOUNDATION
GOVERNMENTAL FUND BALANCE SHEET / STATEMENT OF NET ASSETS
JUNE 30, 2003

	Special Revenue Fund	Adjustments (See Note 2)	Statement of Net Assets
Assets:			
Cash	$ 1,272,348	$ —	$ 1,272,348
Investments at market value (cost $309,230,787)	314,381,657	—	314,381,657
Deposit for compensated absences	7,064	—	7,064
Collateral on lent securities	34,588,814	—	34,588,814
Capital assets, net of accumulated depreciation	—	193,773	193,773
Total Assets	350,249,883	193,773	350,443,656
Liabilities:			
Accounts payable	1,073,757	—	1,073,757
Personnel payable	41,174	—	41,174
Obligations under lent securities	34,588,814	—	34,588,814
Compensated absences:			
Due within one year	—	22,457	22,457
Due after one year	—	67,102	67,102
Total Liabilities	35,703,745	89,559	35,793,304
Fund Balance/Net Assets:			
Reserved for compensated absences	7,064	(7,064)	—
Fund balance reserved	314,539,074	(314,539,074)	—
Total fund balance	314,546,138	(314,546,138)	—
Total liabilities and fund balance	$ 350,249,883		
Net Assets:			
Invested in net capital assets, net of related debt.		193,773	193,773
Restricted for programs to reduce tobacco use ...		314,456,579	314,456,579
Total Net Assets		$ 314,650,352	$ 314,650,352

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

OHIO TOBACCO USE PREVENTION AND CONTROL FOUNDATION
STATEMENT OF GOVERNMENTAL FUND REVENUES, EXPENDITURES AND CHANGE IN FUND BALANCE / STATEMENT OF ACTIVITIES
JUNE 30, 2003

	Special Revenue Fund	Adjustments (See Note 2)	Statement of Activities
Revenues:			
Investment income (loss)	3,397,544	—	3,397,544
Total Revenues	3,397,544	—	3,397,544
Expenditures/Expenses:			
Personnel costs	796,706	62,092	858,798
Contracts	15,177,208	—	15,177,208
Operating costs	325,578	—	325,578
Depreciation	—	16,016	16,016
Grants	5,166,214	—	5,166,214
Capital outlay	209,789	(209,789)	—
Total Expenditures/Expenses	21,675,495	(131,681)	21,543,814
Excess (deficit) of revenues over expenditures/expenses	(18,277,951)	18,277,951	—
Change in net assets	—	(18,146,270)	(18,146,270)
Fund Balance/Net Assets:			
Beginning Balance - July 1, 2002	332,824,089	(27,467)	332,796,622
Ending Balance - June 30, 2003	$314,546,138	$ 104,214	$ 314,650,352

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 which is not part of the State Treasury. Legislation requires the endowment fund to consist of funds disbursed to it through the Department of Health'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 legislative mandate. 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. For the year ended June 30, 2003, the amount appropriated was $833,000. As of June 30, 2003, the number of employees has increased to fourteen. The majority of the Foundation's assets are required to be maintained in the endowment fund, an un-appropriated account, which is monitored by the Foundation. Payroll costs were less than 3.99% of the Foundation's total reported expenses and less than 0.27% 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 mangers to invest all money credited to the fund that is not currently needed for carrying out the functions of the Foundation.

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, 2003, 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.

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The preparation of financial statements in conformity with U.S. 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 Expense Fund. These accounts are 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), cash in an other equity account also held by the TOS, and cash in a checking account at a financial institution. Cash with 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 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, 2003, 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.

Account	Category 1	Category 2	Category 3	Carrying Amt.	Bank Balance
Checking	$100,000	$1,158,308	-	$1,258,308	$1,258,308
Payroll	14,040	-	-	14,040	14,040
Other	7,064	-	-	7,064	7,064
Total	$121,104	$1,158,308	-	$1,279,412	$1,279,412

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.

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 Ohio Revised Code. All investments shall be subject to the same limitations and requirements as the retirement system under that section and Sections 145.112 and 145.113 of the Ohio Revised Code.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

As of June 30, 2003, the carrying amounts and fair value of the investment balances and related risk categories required by GASB Statement 3 are shown below.

Investment Type	Category 1	Category 2	Category 3	Fair Value
Cash	$1,604,135	-	-	$1,604,135
Treasury & Federal Agency Bonds	$52,875,495	-	-	$52,875,495
Corporate Bonds	$59,148,634	-	-	$59,148,634
Equities	$160,553,314	-	-	$160,553,314
Governmental Money Market	$27,054,875	-	-	$27,054,875
Commercial Paper	$13,145,204	-	-	$13,145,204
Total Investments	$314,381,657	-	-	$314,381,657

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.

F. Capital Assets and Depreciation

It is the Foundation's policy to capitalize all assets with an initial cost of $1,000 or more. Capital assets are reported in the "Statement of Net Assets" column, but are not reported in the "Special Revenue Fund" column on the accompanying Governmental Fund Balance Sheet/Statement of Net Assets. All capital assets are capitalized at cost (or estimated historical cost) and updated for additions and retirements during the year.

All reported capital assets of the Foundation are depreciated. Depreciation is computed using the straight-line method of depreciation over the applicable useful life of the asset. One half year of depreciation is recorded in both the year of acquisition and the final year of useful life.

G. Securities Lending Transactions

GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, requires disclosure of assets and liabilities arising from securities lending transactions. Both Foundation investments and cash on deposit with the Treasurer of State were subject to lending transactions. 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 Foundation (for investments) and the Treasurer (for cash on deposit with the Treasurer of State) reinvests the collateral in various investments (types), including U.S. government and agency obligations, repurchase agreements, commercial paper, corporate bonds, and money market funds.

The lending agreements require the custodial agents to ensure that the lent securities are collateralized at no less than 102 percent of their market value. As of June 30, 2003, the Foundation and State had no credit exposure since the amount owed to borrowers exceeded the amount borrowers owed either the Foundation or 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 and/or the Treasurer of State.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

H. 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, 2003, and consists of payroll assessments paid into the Fund by the Foundation during the year. It is an amount pre-funded for compensated absences.

I. Revenues and Receivables

Tobacco settlement revenues comprise one of the Foundation's primary sources of revenues. These revenues are derived from the 1998 Master Settlement Agreement (MSA) which was entered into by the State of Ohio, along with numerous other states, against major tobacco product manufacturers. The MSA stipulates the conditions and calculations to be applied in order for each state to receive its annual allotments. Ohio 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 Settlement Agreement were only projected through the year 2025; however, under the terms of the MSA payments from the tobacco product manufacturers are to continue into perpetuity.

ORC Section 183.02 (1) further states that future year revenues from the MSA 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 it is probable the amount will be transferred to the Foundation. The Foundation's tobacco settlement receivable at June 30, 2003 was $0.

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 fiscal year 2002 and fiscal year 2003 to be transferred to the GRF, if it is needed to help balance the GRF budget. Of the $260 million total, $221,195,998 would have gone to the Foundation at the rate of $105,678,188 for fiscal year 2002 and $115,517,810 for fiscal year 2003. As a result, in fiscal year 2002 and fiscal year 2003 no funds were transferred to the Foundation as the monies were diverted to the GRF. In addition, HB 405 stated the dollars diverted to help offset reduced revenues to the GRF in fiscal year 2002 and fiscal year 2003 will be repaid to the Foundation from tobacco revenue that the state receives in fiscal year 2013 and fiscal year 2014.

In June 2003, HB 95 was signed into law. This legislation contained provisions relating to $112,262,375 in funds the Foundation was to receive from the MSA for fiscal year 2004. HB 95 diverted this fiscal year 2004 payment into the GRF. These diverted dollars are to be repaid to the Foundation from tobacco revenues that the state receives in fiscal year 2015.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

J. Interest Income

The Foundation receives interest income from the State of Ohio for any earnings resulting from the time the State receives the MSA 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 at June 30, 2003.

K. Expenditures and Accounts Payable

Grants

In fiscal year 2002, $7,000,000 per year, for three years of community based grants (I) were awarded. In fiscal year 2003, $5,166,214 of the first year amount was actually funded. In fiscal year 2003 the Foundation made additional awards for community based grants (II) in the amount of $4,000,000 per year, for three years. Funding was to begin in July, 2003 (fiscal year 2004). The Foundation, in fiscal year 2003, also awarded $3,000,000 per year, for three years, in grants to community based organizations for high risk populations. Funding for these grants will also start in fiscal year 2004.

Administrative Expenditures

Administrative expenditures include expenditures not directly attributable to the programmatic aspect of the Foundation. These include salary and wages of non-program personnel, and the proportionate share of all expenses related to the general administration of the Foundation. Ohio Revised Code Section 183.30 (A) requires that no more than five percent of the total expenditures within a fiscal year shall be for administrative purposes. Actual administrative expenditures for fiscal year 2003 were 2.97% of total expenditures.

L. 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 state 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 current full rate, 100% of unused vacation leave, personal leave, and, in certain cases, compensatory time and 50% of unused sick leave.

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.

J. Fund Balance/Net Assets

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.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

K. 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. EXPLANATION OF DIFFERENCES BETWEEN THE GOVENMENTAL 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.

The following is a detailed description of the amounts included in the "Adjustments" column of the accompanying financial statements:

Governmental Fund Balance Sheet/Statement of Net Assets

<u>Capital Assets</u> Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the special revenue fund; however, capital assets are reported in the Statement of Net Assets column……………………………………………………………………….	$193,773
<u>Compensated Absences</u> No liability for compensated absences is reported in the special revenue fund because the liability is not expected to be liquidated with expendable available financial resources. However, long-term liabilities are reported in the Statement of Net Assets column……………………………………………………………………………………………….	$89,559

Statement of Revenues, Expenditures, and Change in Fund Balance/Statement of Activities

<u>Capital Outlay</u> The special revenue fund reports capital outlays as expenditures. However, for the Statement of Activities column, the cost of those assets is allocated over their estimated useful lives as depreciation expense………………………………………………………………………………	($209,789)
<u>Depreciation</u> For the Statement of Activities column, the cost of capital assets is allocated over the assets' estimated useful lives as depreciation expense. No depreciation expense is recorded for the special revenue fund……………………………………………………………………………….	$16,016
<u>Personnel Costs</u> Some expenses reported in the Statement of Activities, such as compensated absences, do not require the use of current financial resources and, therefore, are not reported as expenditures in the special revenue fund………………………………………………………………..	$62,092

3. 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 upon percentages of covered employee's gross salaries, with the contribution rate percentages being calculated annually by the Retirement Board's actuaries. In fiscal year 2003 and fiscal year 2002 the employee and the employer contribution were 8.50% and 13.31% respectively, for all Foundation employees. The Foundation's required contributions to PERS for the years ended June 30, 2003 and 2002 were $81,719 and $12,433 respectively. The total payrolls for employees of which all employees are covered by PERS were $613,967 in fiscal year 2003 and $93,411 in fiscal year 2002.

4. 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. 2, *Disclosure of Information on Post Employment 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% of covered payroll) is set aside for the funding of post retirement health care. For the year ended June 30, 2003 that portion was 5.0% for all Foundation employees.

The related assumptions and calculations were based on the PERS's latest actuarial review performed as of December 31, 2001. 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 2001 was 8.00%. Finally an annual increase of 4.0 %, 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 4.0% base increase, were assumed to range from 0.50% to 6.30%. Health care costs were assumed to increase 4.0% annually.

OPEB are advance funded on an actuarially determined basis. There are approximately 402,041 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 0.3757 or in the Foundation's case is equal to $30,702. The actuarial value of the Retirement System's net assets available for OPEB at December 31, 2001 was $11.6 billion. Finally, PERS' actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method used, were $16.4 billion and $4.8 billion, respectively.

5. CONTINGENCIES

As of June 30, 2003 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.

6. COMPENSATED ABSENCES

The current portion of the liability for compensated absences consists of the amount of compensated absences that is due to be paid within one year of the balance sheet date, as estimated by the State of Ohio's Office of Budget and Management by analyzing trend data from the previous three fiscal years.

Changes in compensated absences for the year ended June 30, 2003 are as follows:

Balance at 6/30/02	Increase	Decrease	Balance at 6/30/03	Amounts Due in One Year
$27,467	$62,092	-	$89,559	$22,457

7. FIXED/CAPITAL ASSETS

A summary of capital asset activity during the fiscal year follows:

Asset Category	Balance at 6/30/02	Additions	Deletions	Balance at 6/30/03
Furniture	$ -	$ 99,252	$ -	$ 99,252
IT Equipment	-	110,537	-	110,537
Subtotal	-	209,790	-	209,790
Accumulated Depreciation	-	(16,016)	-	(16,016)
Net Capital Assets	$ -	$193,773	$ -	$193,773

Depreciation is calculated using the straight-line basis over the estimated useful lives of the assets. The useful life for Furniture is 10 years and, for IT Equipment, 5 years.

8. LEASES

During fiscal year 2003, the Foundation entered into a lease agreement for office and storage space. Leased properties not having elements of ownership are classified as operating leases and likewise are recorded as expenditures when payable. Total operating lease expense for fiscal year 2003 was $54,870.

According to the Foundation's lease agreement, after the initial lease term ended on June 30, 2003, the Foundation has the option to renew the lease for up to five (5) successive and continuous terms of two (2) years each upon the same terms and conditions of the original lease agreement, except that the base rent will increase as of July 1, 2007 and July 1, 2011. Renewal of the lease is contingent upon the Foundation being in compliance with the existing terms of the contract. Future minimum lease payments under this lease agreement are as follows:

Year	Amount
2004	$109,740
2005	109,740
2006	109,740
2007	115,092
2008	115,092
2009-2013	586,668
Total Lease Payments	$1,146,072

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

Board of Trustees
Ohio Tobacco Use Prevention and Control Foundation
300 East Broad Street, Suite 310
Columbus, Ohio 43215-3704

We have audited the basic financial statements of the Ohio Tobacco Use Prevention and Control Foundation, (the Foundation), State of Ohio, as of and for the year ended June 30, 2003, as listed in the table of contents, and have issued our report thereon dated September 8, 2003. 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, contracts and grants, 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 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 could 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. We noted one other matter involving the internal control over financial reporting and its operation that does not require inclusion in this report, that we have reported to the management of the Foundation in a separate letter dated September 8, 2003.

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 those specified parties.

Steen & Kennedy LLC

Steen & Kennedy LLC
September 8, 2003

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OHIO 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 6, 2003