



# STATE OF NORTH CAROLINA

## FISCAL CONTROL AUDIT REPORT ON TOBACCO TRUST FUND RALEIGH, NORTH CAROLINA

FOR THE PERIOD MARCH 1, 2001 THROUGH FEBRUARY 28, 2002

OFFICE OF THE STATE AUDITOR

RALPH CAMPBELL, JR.

STATE AUDITOR

**FISCAL CONTROL AUDIT REPORT ON  
TOBACCO TRUST FUND**

**RALEIGH, NORTH CAROLINA**

**FOR THE PERIOD MARCH 1, 2001 THROUGH FEBRUARY 28, 2002**

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## AUDITOR'S TRANSMITTAL

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The Honorable Michael F. Easley, Governor  
The General Assembly of North Carolina  
Members of Commission, Tobacco Trust Fund  
William B. Upchurch, Executive Director

This report presents the results of our fiscal control audit of the Tobacco Trust Fund for the period March 1, 2001 through February 28, 2002. Our work was performed by authority of Article 5A of G.S. §147 and was conducted in accordance with the standards contained in *Government Auditing Standards* issued by the Comptroller General of the United States. The objective of the audit was to gather and evaluate evidence about selected internal control policies and procedures designed to ensure reliable financial accounting and reporting and compliance with finance-related laws, regulations, and contract provisions.

The results of our tests disclosed no significant weaknesses in internal control or significant instances of noncompliance or abuse that require disclosure under *Government Auditing Standards*.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

A handwritten signature in black ink that reads "Ralph Campbell, Jr." in a cursive style.

Ralph Campbell, Jr.  
State Auditor

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## BACKGROUND INFORMATION

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In 1998 a Master Settlement Agreement (MSA) was entered into between the nation's largest tobacco companies and forty-six other states, including North Carolina. The agreement settles claims of the states for damages arising from the use of tobacco products of the companies. Under the MSA, the tobacco companies are required to adhere to a variety of marketing, advertising, lobbying, and youth access restrictions; support smoking cessations and prevention programs; and provide payments to the states in perpetuity. The amount that North Carolina will receive from this settlement remains uncertain, but the projections are that the State will receive approximately \$4.6 billion through the year 2025.

In 2000, the State enacted legislation that created the Tobacco Trust Fund. The Fund will receive 25% of the tobacco settlement funds or approximately \$1.15 billion through 2025. The MSA is expected to cause significant economic hardship upon the tobacco-related segment of the agricultural economy in North Carolina in that it is expected to result in reduced demand, sales, and prices for tobacco as an agricultural product. The legislation states, in part, that tobacco producers, tobacco allotment holders, and persons engaged in tobacco-related businesses are entitled to indemnification and compensation for certain economic losses and for the adverse economic effects from the MSA. The legislation also provided for the funding of qualified agricultural programs that support and foster a strong agricultural economy in North Carolina.

As established by General Statute 147-717, the Tobacco Trust Fund Commission administers the Fund. The Commission, by statute, is administratively located within the Department of Agriculture and Consumer Services, but exercises its powers independently of the Commissioner of Agriculture and the Department.

The Commission consists of 18 members and is appointed as follows: six members by the Governor, six members by the President Pro Tempore of the Senate, and six members by the Speaker of the House of Representatives. It was the intent of the General Assembly that the members of the Commission represent the geographic, political, gender, and racial diversity of the State and that at least one-half of the members be tobacco farmers.

General Statute 143-719 established in the Department of State Treasurer a Tobacco Trust Fund account into which the funds are deposited and invested by the State Treasurer. All investment earnings are credited to the Fund and become part of the Fund. Any balance remaining in the Fund at the end of any fiscal year is carried forward in the Fund for the next fiscal year.

In April 2002 and by executive order, Governor Mike Easley redirected \$32 million in payments due to the Fund. Further, in June 2002, the Governor withdrew \$50 million directly from the Fund. The intended use of the seized funds is to balance the State's Budget at June 30, 2002.

# OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS

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## OBJECTIVES

As authorized by Article 5A of G.S. §147 and in accordance with the standards contained in *Government Auditing Standards* issued by the Comptroller General of the United States, we have conducted a fiscal control audit at the Tobacco Trust Fund. The objective of the audit was to gather and evaluate evidence about selected internal control policies and procedures designed to ensure reliable financial accounting and reporting and compliance with finance-related laws, regulations, and contract provisions for the period March 1, 2001 through February 28, 2002.

Management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that relevant objectives are achieved. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

## SCOPE

Our audit scope included selected internal controls in the following areas:

### General

*Control Environment* - The control environment consists of the actions, policies, and procedures that reflect the overall attitude of top management about control and its importance to the entity. The control environment sets the tone of the organization, influencing the control consciousness of its employees.

### Financial Accounting and Reporting

*Revenue Cycle* - An entity's revenue cycle generally consists of the activities associated with the receipt of cash and billing for amounts due from other parties. The Fund's financial statement accounts impacted by this cycle include cash, transfers in (tobacco settlement funds), accrued investment income, and investment earnings.

*Expenditure Cycle* - An entity's expenditure cycle generally consists of the activities associated with disbursing cash. The Fund's financial statement accounts impacted by this cycle include cash, personal services, purchased services, general office supplies, contracts and grants, and other expenses.

## **OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS**

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### Finance-related Compliance

*Special Provisions* - Laws, regulations, and/or contracts commonly impose specific requirements on particular entities or activities. For example, an entity may be required to develop and submit a strategic plan to be approved prior to using funds of a particular type. We designed our tests to verify compliance with the General Statutes relating to the Fund.

### **METHODOLOGY**

To accomplish our audit objective, we gained an understanding of internal control, performed tests of control effectiveness, and performed corroborating direct tests of the accounting records, reports, and/or compliance, as we considered necessary in the circumstances. Specifically, we performed procedures such as interviewing personnel, observing operations, reviewing policies, analyzing accounting records, and examining documentation supporting recorded transactions and balances. Our procedures were more limited than would be necessary to give an opinion on internal control, and accordingly, we do not express such an opinion.

### **RESULTS**

The results of our tests disclosed no significant weaknesses in internal control or significant instances of noncompliance or abuse that require disclosure under *Government Auditing Standards*.

The purpose of this report is to provide management and oversight organizations recommendations needed to improve internal control over financial accounting and reporting and compliance with finance-related laws, regulations, and contract provisions. Consequently, reporting on accomplishments in areas that appear to be functioning properly is beyond the scope of this audit.

## DISTRIBUTION OF AUDIT REPORT

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In accordance with G.S. § 147-64.5 and G.S. § 147-64.6(c)(14), copies of this document have been distributed to the public officials listed below. Additional copies are provided to other legislators, state officials, the press, and the general public upon request.

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Mr. Robert L. Powell  
Mr. William B. Upchurch

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Director, Fiscal Research Division

June 25, 2002

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