

**TOBACCO SETTLEMENT  
PERMANENT TRUST FUND**

Distribution Policy Compliance  
Attestation Report

Year Ended December 31, 2010



**Padgett Stratemann & Co. LLP**  
CERTIFIED PUBLIC ACCOUNTANTS & BUSINESS ADVISORS

**Independent Accountants' Report**

The Honorable Susan Combs  
Texas Comptroller of Public Accounts:

We have examined management's assertion, included in the accompanying Calculated Distribution Amount, that the Tobacco Settlement Permanent Trust Fund (the "Fund") complied with its Trust Account Distribution Policy (Texas Administrative Code, Part 1, Chapter 18, Rule 18.1 and 18.2) during the year ended December 31, 2010. Management is responsible for the Fund's compliance with those requirements. Our responsibility is to express an opinion on management's assertion about the Fund's compliance based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence about the Fund's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on the Fund's compliance with specified requirements.

In our opinion, management's assertion that the Tobacco Settlement Permanent Trust Fund complied with the aforementioned requirements during the year ended December 31, 2010 is fairly stated, in all material respects.

This report is intended solely for the information and use of the management of the Fund, Texas Comptroller of Public Accounts, Tobacco Settlement Permanent Trust Account Investment Advisory Committee, and State Auditor of Texas and is not to be used by anyone other than these specified parties.

*Padgett, Stratemann & Co., LLP*

Certified Public Accountants  
March 10, 2011  
Austin, Texas

## TOBACCO SETTLEMENT PERMANENT TRUST FUND

Calculated Distribution Amount

December 31, 2010

### Political Subdivisions Distribution:

Average Market Value of the Trust Account	\$ 2,107,514,991	
4.5% of the Average Market Value of the Trust Account	<u>                    x 4.5%</u>	
Political Subdivisions Distribution Amount		<u>\$ 94,838,175</u>

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### Sources for Funding the Distribution:

Political Subdivisions Distribution Amount	\$ 94,838,175	
Current Earnings Less Investment Expenses	<u>(61,145,226)</u>	
Deduction to the Distribution Stabilization Account		<u>\$ 33,692,949</u>

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### Distribution Stabilization Account Balance:

Distribution Stabilization Account at December 31, 2009	\$ 43,958,555	
Deduction to the Distribution Stabilization Account for 2010	<u>(33,692,949)</u>	
Distribution Stabilization Account at December 31, 2010		<u>\$ 10,265,606</u>

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### Net Earnings of the Trust Account:

Market Value at the End of the Year 2010	\$ 2,077,989,732	
Less: Inflation Adjusted Corpus	(2,099,973,815)	
Distribution Stabilization Account at December 31, 2010	<u>(10,265,606)</u>	
Excess Net Earnings in the Trust Account at December 31, 2010		<u>\$ (32,249,689)</u>

# TOBACCO SETTLEMENT PERMANENT TRUST FUND

## Notes to the Calculated Distribution Amount

December 31, 2010

### (1) **Background of the Tobacco Settlement Permanent Trust Fund**

The Tobacco Settlement Permanent Trust Fund (the "Fund"), was established under the authority of House Bill 1161 ("Act") enacted by the 76th Regular Session of the 1999 Texas Legislature. The purpose of the Fund is to collect monies from the tobacco companies and distribute the funds to eligible local governmental units for reimbursement of previous healthcare costs associated with tobacco related illness. The Fund was organized on July 24, 1998, and commenced operations on December 31, 1998.

The Act establishes the Fund with the Texas Comptroller of Public Accounts (the "Comptroller"), who is required to administer and manage the assets of the Fund with the advice of, and in consultation with, the appointed Tobacco Settlement Permanent Trust Account Investment Advisory Committee ("Investment Advisory Committee"). The Investment Advisory Committee consists of 11 members from the largest governmental units affected by the Act. The Comptroller is also required to make annual distributions to eligible governmental units. This annual distribution amount is required to be calculated in accordance with the Trust Account Distribution Policy (the "Policy") as outlined in Texas Administrative Code, Part 1, Chapter 18, Rule 18.1 and 18.2.

### (2) **Summary of Significant Accounting Policies**

#### (a) ***Basis of Accounting***

The State of Texas reports the Fund as a private-purpose trust fund in its basic financial statements. Private-purpose trust funds are accounted for using the economic resources measurement focus and the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when the liability is incurred regardless of the time of the related cash flows.

#### (b) ***Restrictions***

In accordance with the Act, the Fund is composed of money paid to the Fund in accordance with the Tobacco Settlement Agreement, assets purchased with that money, earnings of the fund, and any other contributions made to the Fund. These amounts represent the corpus of the Fund and shall remain in the Fund, and may not be distributed for any purpose that is not in accordance with the approved spending policy. The money and other assets contained in the Fund are not a part of the general funds of the State of Texas.

The Comptroller, with the advice and consultation of the Investment Advisory Committee, may use the earnings of the Fund for investment expenses. Upon certification in accordance with the Health and Safety Code, Subchapter J, Chapter 12, the Comptroller shall make an annual distribution from the net earnings from the Fund to each eligible political subdivision as provided in the agreement regarding disposition of settlement proceeds.

#### (c) ***Basis of Presentation***

A rule revision was adopted by the Comptroller with the advice and approval of the Investment Advisory Committee. This revision became effective for the calculation of the distributed amount ("Distribution") for 2005 which was actually paid in 2006. This revised calculation also resulted in an increase to the existing distribution stabilization account (the "DSA"), the calculation of which is based on the December 31, 2006 audited financial

# TOBACCO SETTLEMENT PERMANENT TRUST FUND

Notes to the Calculated Distribution Amount

December 31, 2010

## (2) Summary of Significant Accounting Policies (continued)

### *Basis of Presentation (continued)*

statements of the Fund. Management of the Fund utilized the following criteria and definitions in its computation of the annual distribution amount as specified in the Policy.

### **Calculated Actual Distribution Amount**

As defined in the Policy, the calculated actual distribution amount shall be 5% of the average market value of the trust account calculated as of the end of the calendar year immediately preceding the distribution. The average market value of the trust account is calculated using the most recent twenty (20) calendar quarter end market values. The calculated actual distribution amount shall be distributed as follows:

- 4.5% to the political subdivisions; and,
- 0.5% to the DSA when the DSA balance is less than the maximum balance. The maximum balance shall be equal to three times the amount actually distributed in the preceding year from the trust account to the political subdivisions. When the DSA balance equals the maximum balance, this 0.5% portion of the calculated actual distribution amount shall not be distributed to the account.

### **Net Earnings of the Trust Account**

As defined in the Policy, the net earnings of the trust account is the year-end market value of the trust account less the inflation adjusted corpus value and the DSA balance. The inflation adjusted corpus value for each year is calculated by applying the average annual percentage change in the United States Consumer Price Index for Urban Consumers (“CPI-U”) for the most recent twelve (12) quarters, to the value of the corpus at the beginning of the year.

If the net earnings of the trust account are less than the calculated actual distribution amount, the actual distribution amount shall not exceed the calculated actual distribution and shall be funded from the sources, until exhausted, in the order provided below:

- current earnings less investment expenses;
- positive net earnings; then,
- the DSA.

The Comptroller reports to the Investment Advisory Committee the performance of the trust account for the preceding calendar year. The Investment Advisory Committee adopts the actual distribution amount to be used by the Comptroller to make the distributions from the trust account to the political subdivisions and to the DSA.