

Tobacco Settlement Permanent Trust Fund

Distribution Policy Compliance
Attestation Report

December 31, 2015



Padgett Stratemann

Independent Accountant's Report

To the Honorable Glenn Hegar
Comptroller of Public Accounts of the State of Texas
Austin, Texas

We have examined management's assertion, as represented by the accompanying Calculated Distribution Amount, that the Tobacco Settlement Permanent Trust Fund ("Fund") complied with its Trust Account Distribution Policy (Texas Administrative Code, Part 1, Chapter 18, Rule 18.1 and 18.2) as of December 31, 2015. Management of the Texas Treasury Safekeeping Trust Company 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 the specified requirements.

In our opinion, management's assertion that the Tobacco Settlement Permanent Trust Fund complied with the aforementioned requirements as of December 31, 2015 is fairly stated, in all material respects.

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

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Austin, Texas
March 9, 2016

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TOBACCO SETTLEMENT PERMANENT TRUST FUND

Calculated Distribution Amount

December 31, 2015

Calculated Actual Distribution Amount (Rule 18.2(b))*:

Average Market Value of the Trust Account	\$ 2,188,612,806
4.5% of the Average Market Value of the Trust Account	<u>x 4.5%</u>
Calculated Actual Political Subdivisions Distribution Amount	\$ 98,487,576
0.5% of the Average Market Value of the Trust Account	<u>x 0.5%</u>
Calculated Actual Distribution Stabilization Account Distribution Amount	<u>10,943,064</u>
Total Calculated Actual Distribution Amount	<u><u>\$ 109,430,640</u></u>

Net Earnings of the Trust Account (Rule 18.1(b)(11))*:

Market Value of the Trust Account at December 31, 2015	\$ 2,258,135,516
Less:	
Inflation Adjusted Corpus	(2,292,374,986)
Distribution Stabilization Account at December 31, 2015	<u>(32,671,339)</u>
Net Earnings of the Trust Account at December 31, 2015	<u><u>\$ (66,910,809)</u></u>

Actual Distribution (Rule 18.2(c))*:

Total Calculated Actual Distribution Amount	\$ 109,430,640
Net Earnings of the Trust Account at December 31, 2015	<u>(66,910,809)</u>
Net Earnings of the Trust Account are Less Than the Total Calculated Actual Distribution	
Lesser of Average or Year-End Market Value of the Trust Account	\$ 2,188,612,806
4.5% of the Market Value of the Trust Account	<u>x 4.5%</u>
Actual Distribution	<u><u>\$ 98,487,576</u></u>

* References refer to Texas Administrative Code, Title 34, Part 1, Chapter 18

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Calculated Distribution Amount

December 31, 2015

(Continued)

Sources for Funding the Distribution (Rule 18.2(c))*:

Actual Distribution	\$ 98,487,576	
Adjusted Current Earnings:		
Current Earnings Less Investment Expenses		14,090,150
Positive Net Earnings		-
Deduction of up to 50% of the Distribution Stabilization Account		<u>32,671,339</u>
Maximum Amount of Distribution		<u>\$ 46,761,489</u>

Distribution Stabilization Account Balance:

Distribution Stabilization Account at December 31, 2014	\$ 65,342,678	
Deduction From the Distribution Stabilization Account for 2015	<u>(32,671,339)</u>	
Distribution Stabilization Account at December 31, 2015		<u>\$ 32,671,339</u>

* References refer to Texas Administrative Code, Title 34, Part 1, Chapter 18

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Notes to the Calculated Distribution Amount

December 31, 2015

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

The Tobacco Settlement Permanent Trust Fund (“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 (“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. The accompanying Calculated Distribution Amount schedule is calculated in accordance with the Trust Account Distribution Policy (“Policy”), as outlined in Texas Administrative Code, Part 1, Chapter 18, Rule 18.1 and 18.2 (“Code”).

After the calculations, which determine the maximum dollar amount available for distribution in accordance with the Code, an annual meeting of the Investment Advisory Committee shall be held on or before April 1 of each calendar year. The Comptroller is required to report the performance of the Fund for the preceding calendar year to the Investment Advisory Committee. The Investment Advisory Committee shall then adopt the actual dollar amount to be distributed by the Comptroller.

(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 (“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.

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Notes to the Calculated Distribution Amount

December 31, 2015

(2) Summary of Significant Accounting Policies (continued)

(b) *Restrictions (continued)*

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 of the Fund to each eligible political subdivision, as provided in the Agreement regarding disposition of settlement proceeds.

(c) *Basis of Presentation*

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.
- 0.5% to the Distribution Stabilization Account (“DSA”) when the DSA balance is less than the maximum balance. The maximum balance shall be equal to three (3) 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 from the trust account to the DSA.

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 for the most recent 12 quarters, to the value of the corpus at the beginning of the year.

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Notes to the Calculated Distribution Amount

December 31, 2015

(2) Summary of Significant Accounting Policies (continued)

(c) *Basis of Presentation (continued)*

Maximum Amount Eligible for Distribution

If the net earnings of the trust account are less than the calculated actual distribution amount, the actual distribution amount shall not exceed the lesser of 4.5% of the average market value or 4.5% of the year-end market value. The distribution shall be funded from the sources, until exhausted, in the order provided below:

- 1) Adjusted current earnings
- 2) Positive net earnings
- 3) Up to 50% of the balance of the distribution stabilization account

Any or all positive net earnings, not otherwise distributed, may be distributed to the distribution stabilization account.