

**TOBACCO SETTLEMENT  
PERMANENT TRUST FUND**

Letter on Conduct of Audit

December 31, 2010



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

The Honorable Susan Combs  
Texas Comptroller of Public Accounts  
Texas Treasury Safekeeping Trust Company  
Austin, Texas

This letter is intended to inform you about significant matters related to the conduct of the annual audit of the Tobacco Settlement Permanent Trust Fund (the "Fund") as of and for the year ended December 31, 2010 so you can appropriately discharge your oversight responsibility, and so that we comply with our professional responsibilities.

We have included various matters which must be communicated to you under auditing standards generally accepted in the United States of America.

This report is intended solely for the information and use of the Texas Comptroller of Public Accounts, management of the Texas Treasury Safekeeping Trust Company, and the State Auditor of Texas, and is not intended to be, and should not be, used by anyone other than these specified parties.

We will be pleased to respond to any questions you may have, and we appreciate the opportunity to continue to be of service.

*Padgett, Stratemann & Co., LLP*

Certified Public Accountants  
March 10, 2011

## ***The Auditors' Responsibility Under Auditing Standards Generally Accepted in the United States of America***

As communicated in the arrangement letter dated June 14, 2010, our responsibility, as described by professional standards, is to form and express an opinion about whether the financial statements that have been prepared by management with your oversight are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your respective responsibilities.

Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, as part of our audit, we considered the internal control of the Fund solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are also responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

### ***Planned Scope and Timing of the Audit***

We conducted our audit consistent with the planned scope and timing previously communicated to Paul Ballard.

### ***Qualitative Aspects of Significant Accounting Practices***

#### ***Significant Accounting Policies***

Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the Fund is included in Note 2 to the financial statements. There has been no initial selection of accounting policies and no changes in significant accounting policies or their application during the year ended December 31, 2010. No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

## ***Qualitative Aspects of Significant Accounting Practices (continued)***

### ***Significant Accounting Estimates***

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments.

The most sensitive accounting estimate affecting the financial statements is the estimated fair value of investments. Management's estimates are based on information currently available, and the process used to calculate these estimates should be monitored throughout the year. These estimates were reviewed and it was determined they are reasonable in relation to the basic financial statements taken as a whole.

### ***Financial Statement Disclosures***

Certain financial statement disclosures involve significant judgment and are particularly sensitive because of their significance to financial statement users. The most sensitive disclosure affecting the Fund's financial statements relates to investments.

### ***Significant Difficulties Encountered During the Audit***

We encountered no significant difficulties in dealing with management relating to the performance of the audit.

### ***Other Information in Documents Containing Audited Financial Statements***

We are not aware of any other documents that contain the audited financial statements. If such documents were to be published, we would have a responsibility to determine such financial information was not materially inconsistent with the audited financial statements of the Fund.

### ***Uncorrected and Corrected Misstatements***

For purposes of this communication, professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those we believe are trivial, and communicate them to the appropriate level of management.

In addition, professional standards require us to communicate to you all material, corrected misstatements that were brought to the attention of management as a result of the audit procedures.

In connection with our audit of the financial statements, we did not identify any significant financial statement misstatements or any uncorrected financial statement misstatements.

### ***Disagreements With Management***

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter, which could be significant to the Fund's financial statements or the auditors' report. No such disagreements arose during the course of the audit.

### ***Representations Requested From Management***

We have requested certain written representations from management in our standard representation letter dated March 10, 2011.

### ***Management's Consultations With Other Accountants***

In some cases, management may decide to consult with other accountants about auditing and accounting matters. Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

### ***Other Significant Findings or Issues***

In the normal course of our professional association with the Fund, we generally discuss a variety of matters, including the application of accounting principles and auditing standards, business conditions affecting the Fund, and business plans and strategies that may affect the risks of material misstatement. None of the matters discussed resulted in a condition to our retention as the Fund's auditors.