TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

(A Component Unit of the State of South Carolina)

Financial Statements

June 30, 2012

(With Independent Auditor's Report Thereon)

State of South Carolina

Office of the State Auditor

1401 MAIN STREET, SUITE 1200
COLUMBIA, S.C. 29201

RICHARD H. GILBERT, JR., CPA
DEPUTY STATE AUDITOR

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September 27, 2012

The Honorable Nikki R. Haley, Governor
and
Members of the Tobacco Settlement Revenue
Management Authority
Columbia, South Carolina

This report on the audit of the financial statements of the Tobacco Settlement Revenue Management Authority for the fiscal year ended June 30, 2012, was issued by The Hobbs Group, P.A., Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

If you have any questions regarding this report, please let us know.

Respectfully submitted,

Richard H. Gilbert, Jr., CPA
Deputy State Auditor

RHGjr/cwc

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY
(A Component Unit of the State of South Carolina)

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INDEPENDENT AUDITORS' REPORT

Mr. Richard H. Gilbert, Jr., CPA,
Deputy State Auditor
State of South Carolina
Columbia, South Carolina

We have audited the accompanying financial statements of the governmental activities and the major fund of the Tobacco Settlement Revenue Management Authority ("the Authority"), a component unit of the State of South Carolina, as of and for the year ended June 30, 2012, which collectively comprise the Authority's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express opinions 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 opinions.

As discussed in Note 1, the financial statements present only the Authority and do not purport to, and do not, present fairly the financial position of the State of South Carolina, as of June 30, 2012, and the changes in its financial position, or where applicable, its cash flows for the year then ended 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 governmental activities and the major fund of the Authority as of June 30, 2012, and the respective changes in financial position 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 26, 2012 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that management's discussion and analysis and budgetary comparison information on pages 3 through 7 and 23 through 24 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with evidence sufficient to express an opinion or provide any assurance.

The Hobbs Group, P.A.

Columbia, South Carolina
September 26, 2012

This section of the annual financial report of the Tobacco Settlement Revenue Management Authority (the "Authority") presents the analysis of the Authority's financial performance during the fiscal year that ended on June 30, 2012. Please read it in conjunction with the financial statements and their accompanying notes, which follow this section.

The Authority

The Authority was created by Act No. 387 of the Acts and Joint Resolutions of the General Assembly of the State of South Carolina, Regular Session of 2000, as codified at South Carolina Code Ann. §§ 11-49-10 et seq. (the "Act"), as an instrumentality of the State of South Carolina (the "State"). The Act created the Authority to receive all of the State's payments under the Master Settlement Agreement (the "MSA"). The MSA was entered into on November 23, 1998, among the attorneys general of 46 states (including South Carolina), the District of Columbia, the Commonwealth of Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa and the Commonwealth of the Northern Mariana Islands (collectively the "Settling States") and the four largest United States tobacco manufacturers: Philip Morris Incorporated, R. J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, and Lorillard Tobacco Company (collectively the "Original Participating Manufacturers" or "OPMs"). The MSA resolved cigarette smoking-related litigation among the Settling States and the OPMs, released the OPMs from past and present smoking-related claims by the Settling States, and provides for a continuing release of future smoking-related claims in exchange for certain payments to be made to the Settling States. The MSA also provides for the imposition of certain tobacco advertising and marketing restrictions, among other things. The Authority is not a party to the MSA.

The State is entitled to certain periodic payments made under the MSA. Pursuant to the Act, the Authority has been assigned all Tobacco Settlement Receipts ("TSRs"), which are the State's right, title and interest in payments due after June 30, 2001 under the MSA. The assignment of the TSRs is irrevocable during any time when bonds are outstanding, plus one year and one day thereafter, and is a part of the contractual obligation owed to the Authority's bondholders.

Overview of the Financial Statements

This analysis is intended to serve as an introduction to the Authority's financial statements. The Authority's financial statements consist of three components: 1) government-wide financial statements, 2) governmental fund financial statements, and 3) notes to the financial statements.

- *The Statement of Net Assets* and *Governmental Fund Balance Sheet* include all of the Authority's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to Authority creditors (liabilities). They also provide the basis for computing rate of return, evaluating the capital structure of the Authority and assessing the liquidity and financial flexibility of the Authority. The *Statement of Net Assets* reports information about the Authority using accounting methods similar to those used by private sector companies and presents all assets and liabilities of the Authority – both current and long-term. The *Governmental Fund Balance Sheet* of the General Fund focuses only on the Authority's resources available for expenditure at the end of the fiscal year.

- All of the current year's activity is accounted for in the *Statement of Activities* and *Governmental Fund Statement of Revenues, Expenditures and Changes in Fund Balance*. These statements measure the success of the Authority's operations over the past year and can be used to determine the Authority's credit-worthiness and ability to meet its financial objectives. The *Statement of Activities* presents information on how the Authority's net assets changed during the most recent 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. *The Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balance* focuses only on the Authority's near-term inflows and outflows of resources available for expenditure for the fiscal year.

Summary of Financial Results

The Authority's financial results are summarized, discussed and compared to the prior fiscal year in the sections following.

Government-Wide Financial Statements

Statement of Net Assets. Table 1 summarizes the Authority's Net Assets for the period ending June 30, 2012, along with comparative data for the prior fiscal year.

Table 1: Summary of net assets

	June 30, 2012	June 30, 2011	Difference	%
Assets				
Cash and cash equivalents	$ 5,869,910	$ 5,448,714	$ 421,196	7.7%
Restricted assets	47,833,906	52,011,852	(4,177,946)	-8.0%
Unamortized costs of issuance	-	653,846	(653,846)	-100.0%
Total assets	53,703,816	58,114,412	(4,410,596)	-7.6%
Liabilities				
Accounts payable	239,578	127,100	112,478	88.5%
Accrued interest payable	-	298,750	(298,750)	-100.0%
Long term liabilities	-	63,160,628	(63,160,628)	-100.0%
Total liabilities	239,578	63,586,478	(63,346,900)	-99.6%
Net assets				
Restricted by bond covenant	47,833,906	-	47,833,906	-
Unrestricted	5,630,332	(5,472,066)	11,102,398	202.9%
Total net assets (deficit)	$ 53,464,238	$ (5,472,066)	$ 58,936,304	1077.0%

The Authority's assets include cash and cash equivalents, and accrued earnings on those cash and cash equivalents. Approximately 89% of the Authority's assets are restricted by bond covenants and are comprised of certain receivables and investments held by the bond trustee. The remaining assets are held by the Authority to pay its authorized operating expenses. Total liabilities consist of accounts payable.

The Authority's cash and cash equivalents increased 7.7% over the course of the fiscal year, due primarily to an increase in the Authority's funding for MSA enforcement. Accounts payable increased by 88.5%, and are comprised of certain legal and other professional services provided to the Authority during the current fiscal year but paid subsequent to the close of the fiscal year. The change in unamortized costs of issuance, accrued interest payable and long-term liabilities each reflect the full retirement of the Authority's debt as of June 1, 2012, as more fully described below.

The Authority's restricted assets are comprised of amounts held in the accounts established under the Trust Indenture (as discussed in Note 4 of the Notes to Financial Statements), and the associated investment earnings thereon. Restricted assets also include a portion of the TSRs forecasted to be earned in the current fiscal year to be received in the ensuing fiscal year. The amount of TSRs is dependent on many factors including future tobacco consumption and the financial capability of the OPMs and consequently, except as noted above, do not meet asset recognition criteria under accounting principles generally accepted in the United States of America ("GAAP").

Statement of Activities. Table 2 summarizes the Authority's activities for the period ending June 30, 2012 with comparative amounts for the prior fiscal year.

Table 2: Summary of activities

	June 30, 2012	June 30, 2011	Difference	%
Revenues				
Tobacco settlement revenues	$ 74,121,876	$ 69,808,353	$ 4,313,523	6.2%
Investment earnings	10,179	8,527	1,652	19.4%
Total revenues	74,132,055	69,816,880	4,315,175	6.2%
Expenses				
General government	2,716,283	2,357,118	359,165	15.2%
Debt service	11,825,622	14,349,285	(2,523,663)	-17.6%
Amortization of bond issuance costs	653,846	595,164	58,682	9.9%
Total expenses	15,195,751	17,301,567	(2,105,816)	-12.2%
Change in net assets	58,936,304	52,515,313	6,420,991	12.2%
Net assets (deficit) - beginning of year	(5,472,066)	(57,987,379)	52,515,313	90.6%
Net assets (deficit) - end of year	$ 53,464,238	$ (5,472,066)	$ 58,936,304	1077.0%

General revenues of $74.1 million reflect the receipt of and accrual for $74.1 million in TSRs and investment earnings of $10.2 thousand. Revenues increased year over year by $4.3 million or 6.2% as a result of an increase in TSRs. The decline in interest earnings reflects uncharacteristically low yields on the Authority's investments.

The Authority's expenses primarily consisted of interest on the Series 2008 Bonds totaling $11.8 million, $2.7 million in administrative and operating expenses, including $1.3 million in expenses of other state agencies for diligent enforcement and costs of legal action to determine whether the state has diligently enforced its escrow fund statutes, and $654 thousand in amortization of bond issuance costs. Directed transfers to other state agencies for Fiscal Year 2011 have been reclassified to general government expense to conform to current year presentation. Overall expenses declined year over year principally as a result of a decrease in interest expense following the full retirement of the Authority's debt as of June 1, 2012, as more fully described below.

Governmental Funds

As of the end of the current fiscal year, the ending fund balance in the Authority's governmental fund was $53.5 million, a decrease of $3.9 million by comparison to the prior fiscal year. Of the total fund balance, $47.8 million is restricted by bond covenants. The factors contributing to the change in fund balance year over year are principally the same as those described above in the discussion and analysis of the government-wide financial statements.

Long-Term Debt Activity

On March 18, 2001, the Authority issued $934,530,000 aggregate principal amount of Tobacco Settlement Asset-Backed Bonds (the "Series 2001 Bonds") pursuant to an indenture between the Authority and United States Trust Company of New York (subsequently acquired by the Bank of New York), as trustee, dated as of March 1, 2001, and the Tobacco Settlement Revenue Management Authority Act. Proceeds of the Series 2001 Bonds were used to fund certain endowment trusts established pursuant to the Act and trust accounts established under the Trust Indenture, and to pay costs of issuance of the Series 2001 Bonds.

The Authority originally issued its Series 2001 Bonds as thirty-year obligations scheduled to retire in ordinary course on May 15, 2030. On June 26, 2008, the Authority defeased a portion of the outstanding principal amount of the Series 2001 Bonds by depositing a portion of the proceeds of $275,730,000 Tobacco Settlement Revenue Management Authority Tobacco Settlement Revenue Asset-Backed Refunding Bonds, Series 2008 (the "Series 2008 Bonds") issued pursuant to an indenture between The Bank of New York Trust Company, N.A., as trustee, and the Tobacco Settlement Revenue Management Authority, together with other available monies, with The Bank of New York Trust Company, N.A., as Trustee for the Series 2001 Bonds (the "Trustee") pursuant to the terms of an irrevocable Escrow Agreement (the "Escrow Agreement") dated June 26, 2008, by and between the Authority and the Trustee. All of the Series 2001 Bonds are deemed paid within the meaning of and with the effect expressed in the Trust Indenture, and accordingly are no longer outstanding under the Trust Indenture.

The Series 2008 Bonds were issued by the Authority as ten-year obligations scheduled to retire in ordinary course on June 1, 2018. However, under early redemption provisions ("Turbo Redemptions"), any MSA payments exceeding annual debt service requirements of the Series 2008 Bonds were applied to early redemption of principal. On June 1, 2012, the Authority had sufficient funds to redeem as Turbo Redemptions the entire $71,700,000 principal amount then outstanding; accordingly all of the Authority's debt has been fully discharged.

The Authority has no present plans to undertake the issuance of additional debt.

Budgetary Highlights

The Authority annually adopts an operating budget as required by its by-laws and the Trust Indenture. From a budgetary perspective, the Authority realized $9.9 million in excess revenues over expenditures during the fiscal year ended June 30, 2012, which excess arose in connection with the retirement of the Series 2008 Bonds.

Economic Factors and Outlook

As noted above, all of the Authority's debt has been fully discharged and the Authority has no present plans to undertake the issuance of additional debt. Accordingly, the financial impact of various economic factors affecting its receipt of TSRs has been abated.

Contacting the Authority

Persons needing additional information concerning this report or otherwise needing to contact the Authority may do so by writing or telephoning F. Richard Harmon, Jr., Senior Assistant State Treasurer, State of South Carolina, 122 Wade Hampton Office Building, Capitol Complex, Columbia, South Carolina 29201, telephone (803) 734-2114.

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY
(A Component Unit of the State of South Carolina)

Statement of Net Assets

June 30, 2012

	Governmental Activities
Assets	
Cash and cash equivalents	$ 5,869,910
Restricted assets	
Cash and cash equivalents	10,703,642
Tobacco settlement payments receivable	37,130,264
Total assets	53,703,816
Liabilities	
Accounts payable	239,578
Total liabilities	239,578
Net assets	
Restricted by bond covenant	47,833,906
Unrestricted	5,630,332
Total net assets	$ 53,464,238

The Notes to Financial Statements are an integral part of this statement.

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY
(A Component Unit of the State of South Carolina)

Statement of Activities

June 30, 2012

	Governmental Activities
Program expenses	
General government	$ 2,716,283
Debt service	
Interest	11,825,622
Amortization of bond issuance costs	653,846
Total expenses	15,195,751
Net program expense	15,195,751
General revenues	
Tobacco settlement revenues	74,121,876
Investment earnings	10,179
Total general revenues	74,132,055
Change in net assets	58,936,304
Net assets (deficit)	
Beginning of the year	(5,472,066)
End of the year	$ 53,464,238

The Notes to Financial Statements are an integral part of this statement.

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY
(A Component Unit of the State of South Carolina)

Governmental Fund Balance Sheet

June 30, 2012

		General Fund
Assets		
Cash and cash equivalents	$	5,869,910
Restricted assets		
Cash and cash equivalents		10,703,642
Tobacco settlement payments receivable		37,130,264
Total assets	$	53,703,816
Liabilities		
Accounts payable		239,578
Total liabilities		239,578
Fund balance		
Restricted by bond covenant		47,833,906
Committed to operating expense		5,630,332
Total fund balance		53,464,238
Total liabilities and fund balance	$	53,703,816

The Notes to Financial Statements are an integral part of this statement.

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY
(A Component Unit of the State of South Carolina)

Governmental Fund Statement of
Revenues, Expenditures and Changes in Fund Balance

June 30, 2012

		General Fund
Expenditures		
General government	$	2,716,283
Debt service		
Principal		71,700,000
Interest		3,585,000
Total expenditures		78,001,283
Revenues		
Tobacco settlement revenues		74,121,876
Investment earnings		10,179
Total revenues		74,132,055
Deficiency of revenues over expenditures		(3,869,228)
Fund balance		
Beginning of the year		57,333,466
End of the year	$	53,464,238

The Notes to Financial Statements are an integral part of this statement.

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY
(A Component Unit of the State of South Carolina)

Governmental Fund Statement of
Revenues, Expenditures and Changes in Fund Balance

June 30, 2012

(Continued)

Reconciliation to the statement of activities		
Excess (deficiency) of revenues over expenditures	$	(3,869,228)
Amounts reported for government activities in the statement of activities are different because:		
Repayment of bond principal is reported as an expenditure in the governmental fund and as a reduction in liabilities in the statement of net assets		71,700,000
Interest expense in the statement of activities differs from the amount reported in the governmental fund due to the change in accrued interest between fiscal year ends on bonds payable		298,750
Amortized discounts are reported as expenses in the statement of activities		(2,145,066)
Amortized loss on defeased debt is reported as expense in the statement of activities		(6,394,306)
Amortized bond issuance costs are reported as expenses in the statement of activities		(653,846)
Change in net assets	$	58,936,304

The Notes to Financial Statements are an integral part of this statement.

(1) Reporting Entity

The Tobacco Settlement Revenue Management Authority (the "Authority") is a public body and an instrumentality of the State of South Carolina (the "State") established in 2001 pursuant to Section 11-49-10 et seq. of the South Carolina Code of Laws as amended. The State transferred to the Authority all of its rights and interests under the Master Settlement Agreement (the "MSA") and the Consent Decree and Final Judgment (the "Decree") between all participating States and the participating Tobacco manufacturers. These rights include the State's share of all Tobacco Settlement revenue received after June 30, 2001 and in perpetuity to be received under the MSA.

The core of a financial reporting entity is the primary government which has a separately elected governing body. As required by accounting principles generally accepted in the United States of America, the financial reporting entity includes both the primary government and all of its component units. Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. In turn, component units may have component units.

An organization other than a primary government may serve as a nucleus for a reporting entity when it issues separate financial statements. That organization is identified herein as a primary entity. The Authority has determined it has no component units and that the Authority qualifies as a primary entity.

In accordance with Governmental Accounting Standards Board ("GASB") Statement No. 14, The Financial Reporting Entity, a primary government or entity is financially accountable if its officials or appointees appoint a voting majority of an organization's governing body including situations in which the voting majority consists of the primary entity's officials serving as required by law (e.g., employees who serve in an ex-officio capacity on the component unit's board are considered appointments by the primary entity) and (1) it is able to impose its will on that organization or (2) there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary entity. The primary entity also may be financially accountable if an organization is fiscally dependent on it even if it does not appoint a voting majority of the board. An organization is fiscally independent if it holds all of the following powers:

(1) Determines its budget without another government having the authority to approve and modify that budget.

(2) Levies taxes or sets rates or charges without approval by another government.

(3) Issues bonded debt without approval by another government.

The organization is fiscally dependent on the primary government or entity that holds one or more of the above powers. Based on these criteria, the Authority is a blended component unit of the primary government of the State. Accordingly, the financial statements are blended in the State's special revenue funds in its Comprehensive Annual Financial Report.

The Authority is governed by a board, which consists of five members. The members are the Governor or her designee, the State Treasurer, the Comptroller General, the Chairman of the Senate Finance Committee, and the Chairman of the House Ways and Means Committee. The

Governor serves as chairman; in the absence of the Governor, the meeting is chaired by the State Treasurer. All members of the Board serve ex officio.

(2) Summary of Significant Accounting Policies

(a) General. In its accounting and financial reporting in conformity with accounting principles generally accepted in the United States of America, the Authority follows the pronouncements of the GASB.

(b) Measurement Focus, Basis of Accounting, and Financial Statement Presentation. GASB Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments, requires government-wide financial statements to be prepared using the accrual basis of accounting and the economic resources measurement focus. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Government-wide financial statements (i.e., the statement of net assets and the statement of activities) do not provide information by fund. Significantly, the statement of net assets includes non-current liabilities, which are not included in the fund statements.

The statement of activities demonstrates the degree to which direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include (1) charges to customers who purchase, use, or benefit from the services provided by a given function or segment and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Unrestricted interest income and other items not properly included among program revenues are reported as general revenues. The Authority has no program revenues.

In addition to the government-wide financial statements, the Authority has prepared financial statements for the Authority's only governmental fund. Governmental fund financial statements use the modified accrual basis of accounting and the current financial resources measurement focus. Tobacco Settlement Revenues ("TSRs") are recognized as soon as they are considered measurable and available. Revenues are considered available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Authority considers revenues to be available if they are collected within one year after the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred.

The Authority reports one governmental fund – the General Fund – which is the general operating fund of the Authority. It is used to account for all financial resources of the Authority. As a blended component unit of the State, the Authority's General Fund is reported as a special revenue fund in the financial statements of the State.

When both restricted and unrestricted resources are available for use, it is the Authority's policy to use restricted resources first, then unrestricted resources as they are needed.

(c) Asset Recognition Criteria for TSRs. The Authority implemented GASB Technical Bulletin No. 2004-1: Tobacco Settlement Recognition and Financial Reporting Entity Issues (the "Bulletin"), effective July 1, 2003. The Bulletin requires the Authority to recognize TSRs when the event giving rise to recognition occurs (the domestic shipment of cigarettes by the tobacco manufacturers) in the government-wide financial statements, and when the event occurs and the TSRs become available in the fund financial statements. Other than the asset recognition criteria required by the Bulletin, future collections are not measurable and are therefore not recorded as assets in either the government-wide financial statements or the government fund financial statements.

(d) Cash and Cash Equivalents. Cash includes cash on hand, demand deposits, and short term investments with original maturities of three months or less from the date acquired by the Authority.

(e) Investments. Investments, if any, are recorded on the Statement of Net Assets and the Governmental Fund Balance Sheet at fair value. All investment income, including changes in the fair value of investments, is reported as revenue in the Statement of Activities and the Statement of Revenues, Expenditures, and Changes in Fund Balance.

(f) Restricted Assets. The Trust Indenture (as discussed in Note 4 of the Notes to Financial Statements) requires the use of certain receivables, cash and cash equivalents, investments and earnings thereon as payment of or security for the Authority's debt service obligations. Moreover, the Authority's bond enabling act provides and the Trust Indenture contains a covenant for the irrevocable assignment of these assets during any time bonds are outstanding, plus one year and one day thereafter. Accordingly, these assets have been reflected in the restricted portion of the accompanying statements. These assets are comprised of TSRs receivable and accrued income receivable, along with certain amounts held in the following segregated trust accounts established and maintained by the trustee in the issuer's name:

(1) the Collections Account, into which are deposited all Collections (as defined in the Trust Indenture), including all TSRs, Lump Sum Payments, Partial Lump Sum Payments, Total Lump Sum Payments and investment earnings;

(2) the Debt Service Account, into which are deposited those sinking fund and interest amounts due in the two payment periods immediately following an MSA Payment Date (as that term is defined in the Trust Indenture);

(3) the Partial Lump Sum Payment Account, into which are deposited any payments received from a Participating Manufacturer that results in, or is due to, a release of a portion, but not all, of that Participating Manufacturer's future payment obligations under the MSA;

(4) the Liquidity Reserve Account, which holds the Liquidity Reserve Requirement and is more fully described below;

(5) the Turbo Redemption Account, into which all surplus Collections are deposited to effect Turbo Redemptions; and

(6) the Cost of Issuance Account which holds amounts to pay any item of expense directly or indirectly payable or reimbursable by the Authority and related to the authorization, sale, issuance, retirement or defeasance of bonds.

The following schedule reflects the balance at June 30, 2012 in each of the trust accounts maintained by the trustee:

	Balance
Collections account	$ -
Debt service account	-
Partial lump sum payment account	-
Liquidity reserve account	-
Turbo redemption account	10,703,642
Costs of issuance account	-
Total	$ 10,703,642

The Turbo Redemption Account has a balance at June 30, 2012 of $10,703,642, which amount represents excess collections following retirement of the Series 2008 Bonds.

The Liquidity Reserve Account has a balance at June 30, 2012 of $0. For as long as the Series 2008 Bonds are outstanding, the Authority is required to maintain a balance in the Liquidity Reserve Account equal to one year's interest on the Series 2008 Bonds, to the extent of available funds. Inasmuch as the Authority's Series 2008 Bonds were discharged on June 1, 2012, the balance requirement for the Liquidity Reserve Account is $0.

(g) Net Assets and Fund Balance. For the fiscal year ended June 30, 2012, the Authority implemented GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions. This Statement establishes fund balance classifications for governmental funds that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported therein. The Statement requires governments to disclose information in the notes about the processes through which constraints are imposed, as well as accounting policies that determine whether restricted, committed, assigned, and unassigned amounts are considered to be spent.

As described in Note (2)(f), the Authority's bond enabling act provides and the Trust Indenture contains a covenant for the irrevocable assignment of certain assets during any time bonds are outstanding, plus one year and one day thereafter.

(1) In the government-wide Statement of Net Assets, the portion of the Authority's net assets that is legally restricted by the Trust Indenture is reported as Restricted by bond covenant. The remaining portion of net assets is reported as Unrestricted.

(2) In the Governmental Fund Balance Sheet, the portion of fund balance that is legally restricted by the Trust Indenture is reported as Restricted by bond covenant. The remaining portion of fund balance is reported as Committed to

operating expense inasmuch as that portion of fund balance is constrained by the Authority's annually adopted budget. The Authority has full statutory power to adopt, revise and rescind its budget, and to expend funds for the costs of administering its operations.

The Authority expends restricted and committed funds when expenditures are incurred based on the nature of the expenditure.

(h) Administrative Expenses. The State of South Carolina and certain of its agencies perform certain accounting, administrative, legal and enforcement services for the Authority, and the value of these services is accounted for as general government expenses in the financial statements. Note 6 – Related Party Transactions contains descriptions of and amounts expended for these purposes.

(i) Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

(3) Deposits and Investments

Deposits. Other than incidental amounts held by the Trustee pending permanent investment or distribution, the Authority's cash deposits are under the control of the State Treasurer who, by law, has sole authority for investing State funds. State law requires full collateralization of all bank balances under the control of the State Treasurer. The State Treasurer must correct any deficiencies in collateral within two days. At June 30, 2012, all bank balances under the control of the State Treasurer were fully insured or collateralized with securities held by the State's agent in the name of the State Treasurer.

Investments. All of the Authority's investments are held by the trustee in several restricted accounts in the name of the Authority. The Trust Indenture provides the circumstances under which money in the accounts held by the trustee may be invested in Eligible Investments (as defined in the Trust Indenture and hereinafter described). Included in the Trust Indenture's definition of Eligible Investments are obligations of FHLMC, FNMA, or Federal Farm Credit System, demand and time deposit accounts and certificates of deposit, general obligations of states and guaranteed state obligations, commercial or finance company paper, repurchase obligations, corporate securities bearing interest or sold at discount, taxable money market funds, investment agreements or guaranteed investment contracts, and other obligations or securities that are investment agreements or guaranteed investment contracts and other obligations or securities that are non-cancelable; provided, however, that such investments must be permitted under the laws of the State of South Carolina. The Authority has not adopted a formal investment policy because the Trust Indenture contains these investment restrictions.

The following schedule reflects the Authority's deposits and investments at their fair and reported values at June 30, 2012, and reconciles the amounts reported in the statement of net assets to the notes.

Notes		Statements	
Deposits		Cash and cash equivalents	$ 16,573,552
Held by State Treasurer	$ 5,869,910		
Total Deposits	5,869,910		
Investments			
Treasury Tri-Party Repurchase Agreements	10,703,642		
Total Investments	10,703,642		
Totals	$ 16,573,552		$ 16,573,552

Custodial Credit Risk. Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, the Authority will not be able to recover the value of the investments or collateral securities that are in the possession of an outside party. At June 30, 2012, all of the Authority's investments were insured and registered.

The following table presents the fair value of investments as of June 30, 2012.

	Fair Value
Short Term Investments:	
Repurchase Agreements	10,703,642
Total	$ 10,703,642

Interest Rate Risk. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. This risk is managed within the portfolio using effective duration. Effective duration is a measure of the price sensitivity of a bond or a portfolio of bonds to interest rate movements given a 50 basis point change in interest rates. It takes into account that expected cash flows will fluctuate as interest rates change and provides a measure of risk that changes proportionately with market rates. As more fully described below, at June 30, 2012, all of the Authority's investments were invested in overnight repurchase agreements with an effective duration of zero.

The following schedule presents the Authority's interest rate risk.

	Fair Value	Effective Duration
Short Term Investments:		
Repurchase Agreements	10,703,642	-
Total	$ 10,703,642	-

Credit Risk. Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation to the Authority. Credit risk ratings are not required for obligations of the U.S. government or those obligations explicitly guaranteed by the U.S. government. As of June

30, 2012, all of the Authority's investments were obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government.

Concentration of credit risk is the risk of loss attributed to the magnitude of the government's investment in a single issuer. At June 30, 2012, all of the Authority's investment assets were invested in an overnight repurchase agreement with the Bank of New York, which was fully collateralized by United States Treasury obligations.

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. At June 30, 2012, the Authority did not have any deposits or investments denominated in foreign currencies.

(4) Bonds Payable

On March 22, 2001, the Authority issued asset backed bonds pursuant to an indenture between the Authority and United States Trust Company of New York, as trustee, dated as of March 1, 2001. The State transferred to the Authority all of its rights and interests under the MSA and the Decree. These rights include the State's share of all Tobacco Settlement revenue received after June 30, 2001 and in perpetuity to be received under the MSA.

The MSA is an industry wide settlement of litigation between the Settling States and the Original Participating Manufacturers (the "OPMs") and was entered into between the attorneys general of the Settling States and the OPMs on November 23, 1998. The MSA provides for other tobacco companies, referred to as Subsequent Participating Manufacturers (the "SPMs"), to become parties to the MSA. The four OPMs together with the SPMs are referred to as the Participating Manufacturers (the "PMs"). The settlement represents the resolution of a large potential financial liability of the PMs for smoking related injuries, the costs of which have been borne and will likely continue to be borne by cigarette consumers. Pursuant to the MSA, the Settling States agreed to settle all their past, present, and future smoking related claims against the PMs in exchange for agreements and undertakings by the PMs concerning a number of issues. These issues include, among others, making payments to the Settling States, abiding by more stringent advertising restrictions, and funding educational programs, all in accordance with the terms and conditions set forth in the MSA. Distributors of PMs' products are also covered by the settlement of such claims to the same extent as the PMs.

In 2001, the Authority issued $934,530,000 of Tobacco Settlement Asset Backed Bonds consisting of $200,000,000 Series 2001A (Taxable) Term Bonds and $734,530,000 Series 2001B (Tax Exempt) Term Bonds (collectively, the "Series 2001 Bonds"). The Series 2001 Bonds were issued by the Authority pursuant to a Trust Indenture between the Authority and United States Trust Company of New York, as trustee, dated as of March 1, 2001.

On June 26, 2008, the Authority defeased the outstanding principal amount of the Series 2001 Bonds by depositing a portion of the proceeds of $275,730,000 Tobacco Settlement Revenue Management Authority Tobacco Settlement Revenue Asset-Backed Refunding Bonds, Series 2008 (the "Series 2008 Bonds") issued pursuant to an indenture between The Bank of New York Trust Company, N.A., as trustee, and the Tobacco Settlement Revenue Management Authority (the "Trust Indenture"), together with other available monies, with The Bank of New York Trust Company, N.A., as Trustee for the Series 2001 Bonds (the "Trustee") pursuant to the terms of an irrevocable Escrow Agreement (the "Escrow Agreement") dated June 26, 2008, by and between the Authority and the Trustee. As of June 30, 2012, a total of $64,890,000 defeased Series 2001 Bonds remained outstanding.

Bond discounts, costs of issuance, and the loss on refunded debt have been deferred and amortized over the term of the Series 2008 Bonds using the outstanding method, which results in amortization being computed using the percentage of bonds retired to total bonds issued. Amortization of bond discounts and loss on refunded debt are included in expenses as an addition to interest expense. The Authority expensed all of the remaining $2,145,066 and $6,394,306 relating to amortization of bond discounts and loss on refunded debt, respectively, for the year ended June 30, 2012, since all of the Authority's remaining long-term debt was retired on June 1, 2012. Accordingly, the long-term debt of the Authority was $0 at June 30, 2012.

Turbo Redemptions represent the requirement contained in the Trust Indenture to apply 100% of all collections that are in excess of the requirements in the Trust Indenture for the funding of the operating expenses, the deposits to the Debt Service Account for the funding of interest, sinking fund installments, and term bond maturities, maintenance of the Liquidity Reserve Account and the Operating Contingency Account (such excess, surplus collections), to the redemption of Series 2008 Bonds on each distribution date (each a Turbo Redemption Date) in ascending order of maturity. Such surplus collections have been deposited into the Turbo Redemption Account, established and maintained by the trustee under the Trust Indenture. Turbo Redemptions are credited against sinking fund installments for any particular Series 2008 Bonds in ascending order of sinking fund installment dates. Turbo Redemptions are not scheduled amortization payments and are made only from surplus collections, if any, and from amounts on deposit in the Partial Lump Sum Payment Account with confirmation from each rating agency that no rating then in effect, with respect to the Series 2008 Bonds, from such rating agency will be withdrawn, reduced, or suspended.

The following table reflects expected and actual Turbo Redemptions and sinking fund payments on the Series 2008 Bonds through June 30, 2012:

Twelve months	Turbo Redemptions		Sinking Fund
ended	Expected	Actual	Payments
2009	$ 56,755,000	$ 52,725,000	$ 23,005,000
2010	84,805,000	63,035,000	-
2011	90,260,000	65,265,000	-
2012	20,905,000	71,700,000	-
Total	$ 252,725,000	$ 252,725,000	$ 23,005,000

The Authority's long-term liability activity for the year ended June 30, 2012, was as follows:

	Balance June 30, 2011	Additions	Reductions	Balance June 30, 2012	Due Within one year
Bonds:					
Series 2008 bonds	$ 71,700,000	$ -	$ 71,700,000	$ -	$ -
Unamortized discounts	(2,145,066)	-	(2,145,066)	-	-
Unamortized loss on refunded debt	(6,394,306)	-	(6,394,306)	-	-
Total	$ 63,160,628	$ -	$ 63,160,628	$ -	$ -

(5) Disputed Payments

During the periods ending June 30, 2006 through June 30, 2012, a number of participating manufacturers (“PMs”) deposited a portion of their tobacco settlement payments due on or about April 15 into a disputed payments account, incidental to findings by an independent arbitrator that MSA disadvantages were a significant factor in market share losses experienced by the PMs in calendar years 2003 through 2007. Under the provisions of the MSA, PMs are potentially entitled to an adjustment of their required payments under the MSA (a Non-Participating Manufacturer or NPM Adjustment) in the event that all of the PMs, in the aggregate, lose more than two percentage points of market share compared to the market share of the PMs in 1997. However, the adjustment cannot be applied against settling states that have enacted and diligently enforced an escrow fund statute under the MSA.

As a result of the PMs’ deposit into the disputed payments account, South Carolina’s share of payments under the MSA has been reduced for the past seven fiscal years. While these payment reductions impacted Turbo Redemptions, the reductions did not impact the Authority’s ability to meet its payment obligations when due. A summary of these disputed payments follows:

Twelve months ended June 30	Total Payments Expected by the Authority	Actual Receipts	Estimated Impact of NPM Adjustment at the State's Allocation Percentage	Estimated Impact of Factors Other than the NPM Adjustment
2006	$ 76,829,052	$ 68,612,916	$ 9,197,098	$ (980,962)
2007	77,834,167	71,406,465	8,189,888	(1,762,186)
2008	91,427,527	83,474,567	6,191,878	1,761,082
2009	91,979,199	84,866,705	1,296,101	5,816,393
2010	92,553,878	76,308,650	6,777,105	9,468,123
2011	93,678,502	72,001,411	10,392,432	11,284,659
2012	94,782,263	73,416,493	9,165,062	12,200,708
Total	$ 619,084,588	$ 530,087,207	$ 51,209,564	$ 37,787,817

Factors other than the NPM Adjustment principally reflect declines in cigarette consumption and variances in forecasts and actual results.

(6) Related Party Transactions

The State of South Carolina, through the Office of Attorney General, the State Law Enforcement Division, and the South Carolina Department of Revenue, provides certain legal and enforcement services to the Authority. During the fiscal year ended June 30, 2012, the Authority made or provided for $1,213,808 in expenditures from its general fund to these state agencies to cover costs of providing these services. The Office of State Treasurer provides administrative, investment, operations, record keeping, and other support services to the Authority. Reimbursements totaling $100,000 were made by the Authority during the fiscal year ended June 30, 2012 to cover costs of providing these services.

(7) Risk Management

The Authority is exposed to risks of loss from torts and maintains State coverage for these risks. Management believes such coverage is sufficient to preclude any significant uninsured losses for the covered risks. There were no significant reductions in insurance coverage from coverage in the prior year. The insurer promises to pay to or on behalf of the insured for covered economic losses sustained during the policy period in accord with insurance policy and benefit program limits except for the deductibles. The Authority and other entities pay premiums to the State's Insurance Reserve Fund ("IRF") which issues policies, accumulates assets to cover the risks of loss, and pays claims incurred for covered losses related to torts.

The IRF is a self-insurer whose rates are determined actuarially.

No payments for uninsured losses were made during the fiscal year ended June 30, 2012.

(8) Subsequent Events

The Authority has evaluated all events subsequent to the statement of net assets date of June 30, 2012 through the date of issuance of these financial statements, September 26, 2012, and has determined that there are no subsequent events requiring disclosure.

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

(A Component Unit of the State of South Carolina)

Required Supplementary Information (unaudited)

Budgetary Comparison Schedule
General Fund

Year ended June 30, 2012

	Budgeted Amounts			
	Original	Final	Actual	Variance
Revenues				
Tobacco settlement receipts	$ 78,145,905	$ 78,145,905	$ 74,121,876	$ (4,024,029)
Release of liquidity reserve	13,786,500	13,786,500	13,799,615	13,115
Investment income	17,233	17,233	10,179	(7,054)
Total revenues	91,949,638	91,949,638	87,931,670	(4,017,968)
Expenditures				
Debt Service	67,957,500	67,957,500	75,285,000	(7,327,500)
Contractual services	219,500	1,719,500	2,713,793	(994,293)
Fixed charges and contributions	3,000	3,000	2,490	510
Miscellaneous administrative	2,500	2,500	-	2,500
Total expenditures	68,182,500	69,682,500	78,001,283	(8,318,783)
Transfers				
Transfers to other state agencies	(1,300,000)	(1,300,000)	-	1,300,000
Total transfers	(1,300,000)	(1,300,000)	-	1,300,000
Excess of revenues over expenditures	$ 22,467,138	$ 20,967,138	$ 9,930,387	$(11,036,751)

See accompanying notes to required supplementary information.

(1) Basis of Presentation

Section 11-49-60 of the South Carolina Code of Laws requires the Authority to adopt an annual budget for its operational expenditures. The accompanying budgetary comparison schedule compares the Authority's legally adopted budget to actual results on the budgetary basis.

(2) Budgetary Revisions

The Authority maintains budgetary control at the object category of expenditure and must approve any transfer of appropriations between the object categories.

(3) Differences in Budgetary and GAAP Reporting

The accompanying budgetary comparison schedule compares the Authority's legally adopted budget with actual results in accordance with the Authority's basis of budgeting. The Authority's primarily cash basis budgetary accounting principles, however, differ significantly from GAAP. These different accounting principles result in basis differences in the excess (deficiency) of revenues over (under) expenditures. Basis differences arise because the basis of budgeting differs from the GAAP basis used to prepare the governmental fund statement of revenues, expenditures and changes in fund balance. Those differences for the fiscal year ended June 30, 2012, were as follows:

	Actual Amounts
Excess of revenues over expenditures, budgetary basis	$ 9,930,387
Basis differences	
Release of the liquidity reserve fund is reported as revenue and applied to debt service on final redemption	(13,799,615)
Deficiency of revenues under expenditures, GAAP basis	$ (3,869,228)

The Authority budgets amounts to be transferred to other state agencies as a separate line item but accounts for those transfers in its financial statements as expenditures. This difference has no effect on the Authority's financial position.

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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Mr. Richard Gilbert, Jr., CPA,
Deputy State Auditor
Columbia, South Carolina

We have audited the financial statements of the governmental activities and the major fund of the Tobacco Settlement Revenue Management Authority ("the Authority") as of and for the year ended June 30, 2012, which collectively comprise the Authority's basic financial statements and have issued our report thereon dated September 26, 2012. 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.

Internal Control over Financial Reporting

Management of the Authority is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards.*

This report is intended solely for the information and use of management, the State Auditor, and others within the entity, and is not intended to be and should not be used by anyone other than these specified parties.

The Hobbs Group, P.A.

Columbia, South Carolina
September 26, 2012