

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

Financial Statements
June 30, 2015
(With Independent Auditor's Report Thereon)

State of South Carolina



Office of the State Auditor

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September 21, 2015

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, 2015, 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,

A handwritten signature in black ink, appearing to read "Richard H. Gilbert Jr.", written in a cursive style.

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

RHGjr/sag

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
Office of the State Auditor
Columbia, South Carolina

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the governmental activities and the major fund of Tobacco Settlement Revenue Management Authority (the "Authority") as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The Authority's management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

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, 2015, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

OTHER MATTERS

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information pages 3 through 7 and 19 through 20 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the 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 sufficient evidence to express an opinion or provide any assurance.

OTHER REPORTING REQUIRED BY *GOVERNMENT AUDITING STANDARDS*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 21, 2015 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* in considering the Authority's internal control over financial reporting and compliance.

Columbia, South Carolina
September 21, 2015

The Hollar Group, P.A.

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

(A Component Unit of the State of South Carolina)

Management's Discussion and Analysis (unaudited)

June 30, 2015

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, 2015. 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 (the "General Assembly"), Regular Session of 2000, as codified at Section 11-49-10 of the South Carolina Code of Laws 1976, as amended (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 Position 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 Position* 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*.

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

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Management's Discussion and Analysis (unaudited)

June 30, 2015

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 position changed during the most recent fiscal year. All changes in net position 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 Position The following table summarizes the Authority's Net Position for the period ending June 30, 2015, along with comparative data for the prior fiscal year.

	June 30, 2015	June 30, 2014	Difference	%
Assets				
Cash and cash equivalents	\$ 5,341,750	\$ 5,387,070	\$ (45,320)	-0.8%
Tobacco settlement payments receivable	35,000,000	34,000,000	1,000,000	2.9%
Total assets	40,341,750	39,387,070	954,680	2.4%
Liabilities				
Accounts payable	-	-	-	0.0%
Total liabilities	-	-	-	0.0%
Net position				
Restricted by statute	35,000,000	34,000,000	1,000,000	2.9%
Unrestricted	5,341,750	5,387,070	(45,320)	-0.8%
Total net position	\$ 40,341,750	\$ 39,387,070	\$ 954,680	2.4%

The Authority's assets include cash and cash equivalents, and accrued earnings on those cash and cash equivalents. Certain of the Authority's assets are classified as restricted by statute because they are subject to external legal constraint for appropriation by the State in accordance with the expenditure provisions of Section 11-11-170 of the South Carolina Code of Laws 1976, as amended (the "Expenditure Act"). The remaining assets are held by the Authority to pay its authorized operating expenses.

The Authority's cash and cash equivalents decreased 0.8% over the course of the fiscal year, due primarily to an increase in operating expenses within the Authority's operating fund. Tobacco settlement payments receivable increased by 2.9% due to an increase in expected receipts under the MSA. Total assets increased 2.4% reflecting these same factors.

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

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Management's Discussion and Analysis (unaudited)

June 30, 2015

Net position restricted by statute is comprised of that portion of TSRs forecasted to be earned in the current fiscal year but received in the ensuing fiscal year. The amount of TSRs is dependent on many factors including future tobacco consumption, certain adjustments, 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 The following table summarizes the Authority's activities for the period ending June 30, 2015 with comparative amounts for the prior fiscal year.

	June 30, 2015	June 30, 2014	Difference	%
General revenues				
Tobacco settlement revenues	\$ 70,418,749	\$ 109,113,495	(38,694,746)	-35.5%
Refunds of prior year expenditures	-	90,191	(90,191)	100.0%
Total general revenues	<u>70,418,749</u>	<u>109,203,686</u>	<u>(38,784,937)</u>	-35.5%
Expenses				
General government	3,573,320	2,065,419	1,507,901	73.0%
Total expenses	<u>3,573,320</u>	<u>2,065,419</u>	<u>1,507,901</u>	73.0%
Excess of general revenues over expenses before transfers	66,845,429	107,138,267	(40,292,838)	-37.6%
Transfers				
Transfers to state funds and programs pursuant to proviso	(65,890,749)	(110,148,605)	44,257,856	-40.2%
Total transfers	<u>(65,890,749)</u>	<u>(110,148,605)</u>	<u>44,257,856</u>	-40.2%
Change in net position	954,680	(3,010,338)	3,965,018	131.7%
Net position - beginning of year	<u>39,387,070</u>	<u>42,397,408</u>	<u>(3,010,338)</u>	-7.1%
Net position - end of year	<u>\$ 40,341,750</u>	<u>\$ 39,387,070</u>	<u>954,680</u>	2.4%

General revenues of \$70.4 million reflect the receipt of and accrual for TSRs and other revenues. Revenues decreased year over year by \$38.8 million or 35.5% as there was a Disputed Payments Settlement received during the fiscal year ended June 30, 2014 which accounted for \$38.8 million in general revenues that were not received during the fiscal year ended June 30, 2015.

The Authority's expenses primarily consisted of its administrative expenses and directed transfers to other state agencies for diligent enforcement. Total expenses increased by \$1.5 million reflecting an increase in payments to state agencies, primarily the Department of Agriculture, as directed by the State's Appropriations Act. Transfers to the state fund decreased by \$44.3 million, as a result of the Disputed Payments Settlement being received during the year ended June 30, 2014.

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

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Management's Discussion and Analysis (unaudited)

June 30, 2015

Governmental Funds

As of the end of the current fiscal year, the ending fund balance in the Authority's governmental fund was \$40.3 million, an increase of \$955 thousand by comparison to the prior fiscal year. Of the total fund balance, \$35.0 million is restricted for statutory expenditures. The factors contributing to the change in fund balance year over year are the same as those described above in the discussion and analysis of the government-wide financial statements.

Long-Term Debt Activity

On March 22, 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. On June 26, 2008, the Authority defeased the Series 2001 Bonds with certain cash funds and 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. All of the Series 2001 Bonds are deemed paid within the meaning of and with the effect expressed in, and accordingly are no longer outstanding under, the Trust Indenture.

The Series 2008 Bonds were 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 principal amount of the Series 2008 Bonds 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. From a budgetary perspective, the Authority realized a \$955 thousand surplus of revenues over expenditures during the fiscal year ended June 30, 2015, which arose due to factors described in the Summary of Financial Results contained herein.

Economic Factors and Outlook

As noted above, the amount of TSRs is dependent on many factors including future tobacco consumption, certain adjustments, and the financial capability of the OPMs; accordingly, the amount of future TSRs, and particularly the financial effects of the Disputed Payments Settlement thereon, cannot be presently determined with precision. Since all of the Authority's debt has been fully discharged and the Authority has no present plans to undertake the issuance of additional indebtedness, the effects of these factors on the Authority's debt profile have been abated. The Authority's continuing responsibility thereafter is limited to the receipt and distribution of future TSRs as prescribed by law.

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

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Management's Discussion and Analysis (unaudited)

June 30, 2015

Contacting the Authority

Persons needing additional information concerning this report or otherwise needing to contact the Authority should address requests to:

South Carolina Office of the State Treasurer
P.O. Box 11778
Columbia, South Carolina 29211

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

(A Component Unit of the State of South Carolina)

Statement of Activities

June 30, 2015

	Governmental Activities
Program expenses	
General government	\$ 3,573,320
Total expenses	3,573,320
Net program expense	3,573,320
General revenues	
Tobacco settlement revenues	70,418,749
Total general revenues	70,418,749
Change in net position before transfers	66,845,429
Transfers	
Transfers to state funds and programs pursuant to proviso	(65,890,749)
Total transfers	(65,890,749)
Change in net position	954,680
Net position	
Beginning of the year	39,387,070
End of the year	\$ 40,341,750

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

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

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Governmental Fund Balance Sheet

June 30, 2015

	General Fund
Assets	
Cash and cash equivalents	\$ 5,341,750
Tobacco settlement payments receivable	35,000,000
Total assets	\$ 40,341,750
 Liabilities	
Accounts payable	\$ -
Total liabilities	-
 Fund balance	
Restricted by statute	35,000,000
Committed to operating expense	5,341,750
Total fund balance	40,341,750
Total liabilities and fund balance	\$ 40,341,750

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

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

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

June 30, 2015

	General Fund
Revenues	
Tobacco settlement revenues	\$ 70,418,749
Total revenues	70,418,749
Expenditures	
General government	3,573,320
Total expenditures	3,573,320
Excess of revenues over expenditures	66,845,429
Transfers	
Transfers to state funds and programs pursuant to proviso	(65,890,749)
Total transfers	(65,890,749)
Net change in fund balance	954,680
Fund balance	
Beginning of the year	39,387,070
End of the year	\$ 40,341,750

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

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

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Notes to Financial Statements

June 30, 2015

(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 1976, 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 that it qualifies as a primary entity, it is a component unit of the State of South Carolina, and it has no component units.

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 the State’s 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.

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

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Notes to Financial Statements

June 30, 2015

(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 Governmental Accounting Standards Board (“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 position and the statement of activities) do not provide information by fund. Significantly, the statement of net position may include non-current assets and liabilities, which generally are not included in the fund statements. The statement of net position includes three components of net position.
 - (1) Net investment in capital assets consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net position component as the unspent proceeds. The Authority does not have any capital assets, thus this classification is not used.
 - (2) Restricted net position consists of net position subject to external constraints imposed by creditors (such as through debt covenants), contributors, or laws or regulations of other governments, or constraints imposed by law through constitutional provisions or enabling legislation. The Authority reports that portion of its net position restricted by statutory constraints as restricted net position.
 - (3) Unrestricted net position consists of net position that does not meet the definition of restricted net position or invested in capital assets, net of related debt. The Authority reports that portion of its net position not externally constrained, primarily funds available for payment of its authorized operating expenses, as unrestricted net position.

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.

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

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Notes to Financial Statements

June 30, 2015

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.

- (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 Position 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) Fund Balance. The Authority reports fund balance in accordance with 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.

The Authority conforms its fund balance reporting to the classification and hierarchy structure of the State, generally as follows:

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

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Notes to Financial Statements

June 30, 2015

- (1) Restricted. Fund balance is reported as restricted when constraints placed on resource use are either (a) externally imposed by creditors, grantors, contributors, laws or regulation of other governments, or (b) imposed by law through constitutional provisions or enabling legislation. Enabling legislation authorizes the State to assess, levy, charge, or otherwise mandate payments of resources from resource providers and includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation. A legally enforceable requirement is one that an outside party can compel the government to honor.
- (2) Committed. Fund balance is reported as committed if the Authority's by-laws or official actions, including adoption of its annual budget, constrain the use of its resources. Committed constraints can be removed only through similar action that created the constraint.
- (3) Assigned. Fund balance is reported as assigned if the fund balance is constrained by the Authority's intent to expend resources for specific purposes. Such intent may be expressed by an official or body pursuant to delegation by the Authority.
- (4) Non-spendable. Fund balance is reported as non-spendable if the balance has a lack of availability in form or substance of the assets and liabilities reported in the fund to meet its obligations in the near future.
- (5) Unassigned. Fund balance is reported as unassigned for all residual amounts not otherwise classified.

The Authority has no assigned, non-spendable or unassigned fund balance.

The Authority's bond enabling act provides a covenant for the irrevocable assignment of certain of the Authority's assets during any time bonds are outstanding, plus one year and one day thereafter. All of the Authority's outstanding bonds were retired on June 1, 2012. Accordingly, until June 2, 2013, certain of the Authority's assets were classified as restricted by bond covenants because they were subject to a legally enforceable external constraint by the terms of the Trust Indenture.

Subsequent to June 2, 2013, assets previously restricted by bond covenants are available to the State in accordance with the expenditure provisions of Section 11-11-170 of the South Carolina Code of Laws 1976, as amended (the "Expenditure Act"). The Authority classifies all TSRs held at, or received or receivable subsequent to June 2, 2013, as restricted by statute, since the Expenditure Act constrains the use of that portion of the Authority's resources. The remaining portion of net position is reported as unrestricted.

Likewise, in the Governmental Fund Balance Sheet, the portion of fund balance that is subject to the Expenditure Act is reported as restricted by statute; however, 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.

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Notes to Financial Statements

June 30, 2015

The Authority classifies the expenditure of funds when incurred based on the nature of the expenditure, with externally directed expenditures generally made from restricted funds, and expenditures made within the discretion of the Authority or subject to its own budget, primarily its authorized operating expenditures, made from committed funds.

- (g) 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.
- (h) 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

Prior to June 2, 2013, the Authority’s cash deposits and investments held by the trustee were held in several restricted accounts in the name of the Authority, subject to investment restrictions imposed by the Trust Indenture. The Authority has not adopted a formal policy for these investments because the Trust Indenture contains these restrictions.

Subsequent to June 2, 2013, all of the Authority’s cash deposits and investments 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, who must correct any deficiencies in collateral within two days. At June 30, 2015, 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.

The following schedule reflects the Authority’s deposits and investments at their fair and reported values at June 30, 2015, and reconciles the amounts reported in the statement of net position to the notes.

	Notes		Statements
Deposits			
Held by State Treasurer	\$ 5,341,750	Cash and cash equivalents	\$ 5,341,750
Totals	\$ 5,341,750		\$ 5,341,750

Further information concerning among other things values and risks of deposits and investments under the control of the State Treasurer, including disclosure under GASB Statement No. 40, Deposits and Investments - Risk Disclosures, is disclosed in the Comprehensive Annual Financial Report of the State of South Carolina, which may be accessed at www.cg.sc.gov.

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

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Notes to Financial Statements

June 30, 2015

(4) Bonds Payable

On March 22, 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. On June 26, 2008, the Authority defeased the Series 2001 Bonds with certain cash funds and 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.

At June 30, 2015, a total of \$64,890,000 of the Authority's legally and economically defeased Series 2001 Bonds remained outstanding; however, all of the Series 2001 Bonds are deemed paid within the meaning of and with the effect expressed in, and accordingly are no longer outstanding under, the Trust Indenture.

The Series 2008 Bonds were 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 principal amount of the Series 2008 Bonds then outstanding; accordingly, all of the Authority's debt has been fully discharged.

(5) Disputed Payments

During the periods ending June 30, 2006 through June 30, 2014, a number of participating manufacturers ("PMs") deposited a portion of their tobacco settlement payments 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 certain calendar years. 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 since 2006.

In May, 2013, the State joined 21 other states and the PMs in a global settlement of the NPM adjustment disputes for the years 2003 through 2012. The settlement provides that the State will receive during the fiscal year ended June 30, 2014, certain payments released from the disputed payments account, and that the PMs will be entitled to take certain credits from MSA payments due in the fiscal years ending June 30, 2014 through June 30, 2017. Moreover, the PMs will not withhold disputed funds during 2014 and 2015, and have agreed to reduce withholding amounts for disputed funds thereafter. In addition to the financial terms of the settlement, the 22 settling states have agreed to a modification of future NPM adjustment disputes.

The State estimated that it would initially receive approximately \$60 million in payments released from the disputed payments account, and the General Assembly determined to receive the settlement in two parts, in September, 2013, and in April, 2014, and made provision under Part

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

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Notes to Financial Statements

June 30, 2015

IB, Section 118.17 in the fiscal year 2013-14 appropriation act for certain of the settlement funds to be transferred to the State's general fund. The Authority received the first of these settlement payments totaling \$21.7 million in October, 2013, and received the remainder of the settlement payments totaling \$48.7 million in April, 2014.

The Authority expects that credits taken by PMs from MSA payments due in the fiscal years ending June 30, 2015 through June 30, 2017 as described above will result in a reduction of TSRs in those fiscal years, the financial impact of which cannot be presently determined with precision.

(6) Related Party Transactions

The State of South Carolina, through the Office of Attorney General, the State Law Enforcement Division, the South Carolina Department of Agriculture, and the South Carolina Department of Revenue, provides certain legal and enforcement services to the Authority. During the fiscal year ended June 30, 2015, the Authority made or provided for \$3,528,000 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; however, no reimbursements were made by the Authority during the fiscal year ended June 30, 2015 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, 2015.

(8) Subsequent Events

The Authority has evaluated all events subsequent to the statement of net position date of June 30, 2015 through the date of issuance of these financial statements, September 21, 2015, 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, 2015

	Budgeted Amounts		Actual	Variance Positive/(Negative)
	Original	Final		
Revenues				
Tobacco settlement receipts	\$ 68,000,000	\$ 68,000,000	\$ 70,418,749	\$ 2,418,749
Funds carried forward from prior year	50,000	50,000	-	(50,000)
Total revenues	<u>68,050,000</u>	<u>68,050,000</u>	<u>70,418,749</u>	<u>2,368,749</u>
Expenditures				
Contractual services	45,000	45,000	3,570,830	(3,525,830)
Fixed charges and contributions	3,000	3,000	2,490	510
Miscellaneous administrative	2,000	2,000	-	2,000
Total expenditures	<u>50,000</u>	<u>50,000</u>	<u>3,573,320</u>	<u>(3,523,320)</u>
Transfers				
Transfers to other state agencies	-	-	(65,890,749)	(65,890,749)
Total transfers	<u>-</u>	<u>-</u>	<u>(65,890,749)</u>	<u>(65,890,749)</u>
Excess (deficiency) of revenues over expenditures	<u>\$ 68,000,000</u>	<u>\$ 68,000,000</u>	<u>\$ 954,680</u>	<u>\$ (67,045,320)</u>

See accompanying notes to required supplementary information.

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

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Notes to Required Supplementary Information (unaudited)

Budgetary Comparison Schedule

General Fund

Year ended June 30, 2015

(1) Basis of Presentation

Section 11-49-60 of the South Carolina Code of Laws 1976, as amended 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 may 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. No such differences were reflected in the budgetary comparison schedule for the fiscal year ended June 30, 2015.

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INDEPENDENT AUDITORS' 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 H. Gilbert, Jr., CPA,
Deputy State Auditor
Office of the State Auditor
Columbia, South Carolina

We have audited, 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, the financial statements of the governmental activities and the major fund of Tobacco Settlement Revenue Management Authority (the "Authority") as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated September 21, 2015.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit of the financial statements, we considered the Authority's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control.

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 a 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of 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 material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the Authority's financial statements are free from 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*.

PURPOSE OF THIS REPORT

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Columbia, South Carolina
September 21, 2015

The Holla Group, P.A.