

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

Financial Statements
June 30, 2013
(With Independent Auditor's Report Thereon)

State of South Carolina



Office of the State Auditor

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October 1, 2013

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, 2013, 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/trb

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

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and the major fund of the Tobacco Settlement Revenue Management Authority (the "Authority"), component unit of the State of South Carolina, as of and for the year ended June 30, 2013, 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 auditor's 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 Tobacco Settlement Revenue Management Authority, as of June 30, 2013, 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.

Emphasis of Matter

As discussed in Note 1, the financial statements present only the Tobacco Settlement Revenue Management Authority and do not purport to, and do not, present fairly the financial position of the State of South Carolina, as of June 30, 2013, and the changes in its financial position, or where applicable, its cash flows for the year then ended in accordance with accounting principles general accepted in the United States of America. Our opinion is not modified with respect to this matter.

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 on pages 3 through 7 and 20 through 21 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 16, 2013 on our consideration of Tobacco Settlement Revenue Management 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 Tobacco Settlement Revenue Management Authority's internal control over financial reporting and compliance.

Columbia, South Carolina
September 16, 2013

The Hall 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, 2013

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, 2013. 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 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*.

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June 30, 2013

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. Table 1 summarizes the Authority's Net Position for the period ending June 30, 2013, along with comparative data for the prior fiscal year.

Table 1: Summary of net position

	June 30, 2013	June 30, 2012	Difference	%
Assets				
Cash and cash equivalents	\$ 5,358,384	\$ 5,869,910	\$ (511,526)	-8.7%
Tobacco settlement payments receivable	37,072,513	37,130,264	(57,751)	-0.2%
Residual assets held by trustee	-	10,703,642	(10,703,642)	-100.0%
Total assets	<u>42,430,897</u>	<u>53,703,816</u>	<u>(11,272,919)</u>	-21.0%
Liabilities				
Accounts payable	<u>33,489</u>	<u>239,578</u>	<u>(206,089)</u>	-86.0%
Total liabilities	<u>33,489</u>	<u>239,578</u>	<u>(206,089)</u>	-86.0%
Net position				
Restricted by bond covenant	-	47,833,906	(47,833,906)	-100.0%
Restricted by statute	37,072,513	-	37,072,513	100.0%
Unrestricted	5,324,895	5,630,332	(305,437)	-5.4%
Total net position	<u>\$ 42,397,408</u>	<u>\$ 53,464,238</u>	<u>\$ (11,066,830)</u>	-20.7%

The Authority's assets include cash and cash equivalents, and accrued earnings on those cash and cash equivalents. Until June 2, 2013, certain of the Authority's assets were restricted by bond covenants and were comprised of receivables and investments held by the bond trustee. Subsequent to June 2, 2013, assets previously restricted by bond covenants have been 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. Total liabilities consist of accounts payable.

The Authority's cash and cash equivalents declined 8.7% over the course of the fiscal year, due primarily to a decline in the balance of the Authority's operating fund. Tobacco settlement payments receivable also declined slightly by 0.2%. Total assets declined 21.0%, reflecting a non-recurring release and subsequent transfer during the fiscal year ended June 30, 2013 of

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Management's Discussion and Analysis (unaudited)

June 30, 2013

certain residual amounts previously held by the bond trustee as security prior to retirement of the Authority's debt. Accounts payable decreased by 86.0%, 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.

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 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, 2013 with comparative amounts for the prior fiscal year.

Table 2: Summary of activities

	June 30, 2013	June 30, 2012	Difference	%
Revenues				
Tobacco settlement revenues	\$ 73,326,296	\$ 74,121,876	\$ (795,580)	-1.1%
Investment earnings	4,370	10,179	(5,809)	-57.1%
Total earnings	<u>73,330,666</u>	<u>74,132,055</u>	<u>(801,389)</u>	<u>-1.1%</u>
Expenses				
General government	2,472,437	2,716,283	(243,846)	-9.0%
Debt Service	-	11,825,622	(11,825,622)	-100.0%
Amortization of bond issuance costs	-	653,846	(653,846)	-100.0%
Total expenses	<u>2,472,437</u>	<u>15,195,751</u>	<u>(12,723,314)</u>	
Transfers				
Transfer to state fund pursuant to statute	<u>(81,925,059)</u>	-	<u>(81,925,059)</u>	100.0%
Total transfers				
Change in net position	(11,066,830)	58,936,304	(70,003,134)	-118.8%
Net position - beginning of year	53,464,238	(5,472,066)	58,936,304	-1077.0%
Net position - end of year	<u>\$ 42,397,408</u>	<u>\$ 53,464,238</u>	<u>\$ (11,066,830)</u>	<u>-20.7%</u>

General revenues of \$73.3 million reflect the receipt of and accrual for \$73.3 million in TSRs and investment earnings of \$4.4 thousand. Revenues declined year over year by \$801 thousand or 1.1% primarily as a result of a decline in TSRs. The decline in interest earnings reflects uncharacteristically low yields on the Authority's investments as well as a shortened time horizon for investment following retirement of the Authority's debt.

The Authority's expenses primarily consisted of costs of legal action to determine whether the state has diligently enforced its escrow fund statutes, and directed transfers to other state agencies for diligent enforcement. Total expenses decreased by \$12.7 million reflecting reductions in interest and bond issuance costs following retirement of the Authority's debt. The change in net position reflects the previously described non-recurring release and subsequent transfer during the fiscal year of certain residual amounts previously held by the bond trustee as security prior to retirement of the Authority's debt.

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Management's Discussion and Analysis (unaudited)

June 30, 2013

Governmental Funds

As of the end of the current fiscal year, the ending fund balance in the Authority's governmental fund was \$42.4 million, a decrease of \$11.1 million by comparison to the prior fiscal year. Of the total fund balance, \$37.1 million is committed to 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 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. 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, 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 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. From a budgetary perspective, the Authority realized an \$11.9 million deficiency of revenues over expenditures during the fiscal year ended June 30, 2013, which deficiency arose due to factors described in the Summary of Financial Results contained herein.

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.

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(A Component Unit of the State of South Carolina)

Management's Discussion and Analysis (unaudited)

June 30, 2013

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

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Statement of Net Position

June 30, 2013

	<u>Governmental Activities</u>
Assets	
Cash and cash equivalents	\$ 5,358,384
Restricted assets	
Tobacco settlement payments receivable	<u>37,072,513</u>
Total assets	<u>42,430,897</u>
Liabilities	
Accounts payable	<u>33,489</u>
Total liabilities	<u>33,489</u>
Net position	
Restricted by statute	37,072,513
Unrestricted	<u>5,324,895</u>
Total net position	<u>\$ 42,397,408</u>

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

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

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Statement of Activities

June 30, 2013

	<u>Governmental Activities</u>
Program expenses	
General government	\$ 2,472,437
Total expenses	<u>2,472,437</u>
Net program expense	<u>2,472,437</u>
General revenues	
Tobacco settlement revenues	73,326,296
Investment earnings	<u>4,370</u>
Total general revenues	<u>73,330,666</u>
Change in net position before transfers	<u>70,858,229</u>
Transfers	
Transfer to state fund pursuant to statute	<u>(81,925,059)</u>
Total transfers	<u>(81,925,059)</u>
Change in net position	(11,066,830)
Net position	
Beginning of the year	<u>53,464,238</u>
End of the year	<u>\$ 42,397,408</u>

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, 2013

	<u>General Fund</u>
Assets	
Cash and cash equivalents	\$ 5,358,384
Tobacco settlement payments receivable	<u>37,072,513</u>
Total assets	<u>\$ 42,430,897</u>
Liabilities	
Accounts payable	<u>33,489</u>
Total liabilities	<u>33,489</u>
Fund balance	
Restricted by statute	37,072,513
Committed to operating expense	<u>5,324,895</u>
Total fund balance	<u>42,397,408</u>
Total liabilities and fund balance	<u>\$ 42,430,897</u>

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, 2013

	<u>General Fund</u>
Expenditures	
General government	\$ 2,472,437
Total expenditures	<u>2,472,437</u>
Revenues	
Tobacco settlement revenues	73,326,296
Investment earnings	<u>4,370</u>
Total revenues	<u>73,330,666</u>
Excess of revenues over expenditures before transfers	70,858,229
Transfers	
Transfer to state fund pursuant to statute	<u>(81,925,059)</u>
Total transfers	<u>(81,925,059)</u>
Excess (deficiency) of revenues over expenditures	(11,066,830)
Fund balance	
Beginning of the year	<u>53,464,238</u>
End of the year	<u>\$ 42,397,408</u>

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)

Notes to Financial Statements

June 30, 2013

(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.

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Notes to Financial Statements

June 30, 2013

(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) Invested in capital assets, net of related debt 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, 2013

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:

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- (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 and the Trust Indenture contains 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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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) Financial Reporting of Deferred Outflow of Resources, Deferred Inflows of Resources, and Net Position; Items Previously Reported as Assets and Liabilities. The Authority implemented for the fiscal year ended June 30, 2013, GASB Statement No. 63, Financial Reporting of Deferred Outflow of Resources, Deferred Inflows of Resources, and Net Position. Among other things, this Statement amends net asset reporting requirements by incorporating deferred inflows and outflows of resources into the definitions of the required components presented in a statement of financial position, with the residual measure identified as net position. The Authority has incorporated the term “net position” from this Statement into its financial statements but has determined that no amounts were required to be reclassified or otherwise recognized as deferred inflows or outflows of resources for the year ended June 30, 2013.
- (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

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, 2013, 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.

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The following schedule reflects the Authority’s deposits and investments at their fair and reported values at June 30, 2013, and reconciles the amounts reported in the statement of net position to the notes.

	Notes		Statements
Deposits			Cash
Held by State Treasurer	\$ 5,358,384	and cash equivalents	\$ 5,358,384
Totals	\$ 5,358,384		\$ 5,358,384

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.

(4) Bonds Payable

On March 22, 2001, the Authority issued \$934,530,000 of Tobacco Settlement 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, including the State’s share of all Tobacco Settlement revenue received after June 30, 2001 and in perpetuity to be received under the MSA. 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.

At June 30, 2013, all of the Authority’s Series 2008 Bonds had been retired. A total of \$64,890,000 of the Authority’s legally and economically defeased Series 2001 Bonds remained outstanding; however, all of the Authority’s 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.

(5) Disputed Payments

During the periods ending June 30, 2006 through June 30, 2013, 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

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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 eight fiscal years. 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
2013	95,871,931	73,336,798	9,766,336	12,768,797
Total	<u>\$ 714,956,519</u>	<u>\$ 603,424,005</u>	<u>\$ 60,975,900</u>	<u>\$ 50,556,614</u>

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

In May 2013, South Carolina joined 21 other states and the PMs in a global settlement of the NPM adjustment disputes for the years 2003 to 2012, under which the State will initially receive approximately \$60 million. The legislature has determined to receive the settlement in two parts, in September 2013, and in April 2014, and made provision under Part IB, Section 118.17 in the fiscal year 2013-14 appropriation act for the settlement funds to be transferred to the State general fund.

Under the settlement agreement, the PMs will take certain credits from MSA payments due in the years 2014 to 2017. The PMs will not withhold disputed funds in 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 Authority has not recorded in its financial statements any amounts due pursuant to the settlement agreement because (i) it is not a party to the agreement; (ii) it is unable to determine with precision the amounts and timing of payments to be received thereunder; and (iii) the fiscal year 2013-14 appropriation act provides for any payments received thereunder to be transferred to the State general fund without reference to the Authority.

(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, 2013, the Authority made or provided for \$1,200,000 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.

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Reimbursements totaling \$100,000 were made by the Authority during the fiscal year ended June 30, 2013 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, 2013.

(8) Subsequent Events

The Authority has evaluated all events subsequent to the statement of net position date of June 30, 2013 through the date of issuance of these financial statements, September 16, 2013, and has determined that there are no subsequent events requiring disclosure.

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Required Supplementary Information (unaudited)

Budgetary Comparison Schedule
General Fund

Year ended June 30, 2013

	Budgeted Amounts		Actual	Variance
	Original	Final		
Revenues				
Tobacco settlement receipts	\$ 72,849,763	\$ 72,849,763	\$ 73,326,296	\$ 476,533
Investment income	89,156	89,156	4,370	(84,786)
Total revenues	<u>72,938,919</u>	<u>72,938,919</u>	<u>73,330,666</u>	<u>391,747</u>
Expenditures				
Contractual services	219,600	219,600	2,469,947	(2,250,347)
Fixed charges and contributions	3,000	3,000	2,490	510
Miscellaneous administrative	2,400	2,400	-	2,400
Total expenditures	<u>225,000</u>	<u>225,000</u>	<u>2,472,437</u>	<u>(2,247,437)</u>
Transfers				
Transfers to other state agencies	(1,300,000)	(1,300,000)	(81,925,059)	(80,625,059)
Total transfers	<u>(1,300,000)</u>	<u>(1,300,000)</u>	<u>(81,925,059)</u>	<u>(80,625,059)</u>
Excess (deficiency) of revenues over expenditures	<u>\$ 71,413,919</u>	<u>\$ 71,413,919</u>	<u>\$(11,066,830)</u>	<u>\$(82,480,749)</u>

See accompanying notes to required supplementary information.

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Notes to Required Supplementary Information (unaudited)

Budgetary Comparison Schedule
General Fund

Year ended June 30, 2013

(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, 2013.

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INDEPENDENT AUDITOR'S 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
State of 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 the Tobacco Settlement Revenue Management Authority (the "Authority") as of and for the year ended June 30, 2013, 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 16, 2013.

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 our 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 was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control 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 16, 2013

The Halle Group, P.A.