

Tobacco Settlement Permanent Trust Fund

Distribution Policy Compliance
Attestation Report

December 31, 2016



Padgett Stratemann

Independent Accountant's Report

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

We have examined management's assertion, as represented by the accompanying Calculated Distribution Amount, that the Tobacco Settlement Permanent Trust Fund ("Fund") complied with its Trust Account Distribution Policy (Texas Administrative Code, Title 34, Part 1, Chapter 18, Rules 18.1 and 18.2) as of December 31, 2016. Management of the Texas Treasury Safekeeping Trust Company is responsible for the Fund's compliance with those requirements. Our responsibility is to express an opinion on management's assertion about the Fund's compliance based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether management's assertion is fairly stated, in all material respects. An examination involves performing procedures to obtain evidence about management's assertion. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of management's assertion, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

Our examination does not provide a legal determination on the Fund's compliance with the specified requirements.

In our opinion, management's assertion that the Tobacco Settlement Permanent Trust Fund complied with the aforementioned requirements as of December 31, 2016 is fairly stated, in all material respects.

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

Padgett, Stratemann & Co., L.L.P.

Austin, Texas
March 13, 2017

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Tobacco Settlement Permanent Trust Fund

Calculated Distribution Amount

December 31, 2016

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

Average Market Value of the Trust Account	\$ 2,238,529,207
3.0% of the Average Market Value of the Trust Account	<u>x 3.0%</u>
Total Calculated Actual Distribution Amount	<u>\$ 67,155,876</u>

Calendar Year-End Market Value of the Trust Account (Rule 18.2(c))*:

Market Value of the Trust Account at December 31, 2016	\$ 2,373,286,425
Less Cumulative Value of all Contributions at December 31, 2016 (corpus)	<u>(1,682,964,904)</u>
Calendar Year-End Market Value is Greater Than or (Less Than) corpus	<u>\$ 690,321,521</u>

Adjusted Current Earnings of the Trust Account (Rule 18.1(b)(2))*:

Current Earnings Less Investment Expenses	<u>\$ 73,641,651</u>
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*References refer to Texas Administrative Code, Title 34, Part 1, Chapter 18

Tobacco Settlement Permanent Trust Fund

Notes to the Calculated Distribution Amount

December 31, 2016

(1) Background of the Tobacco Settlement Permanent Trust Fund

The Tobacco Settlement Permanent Trust Fund (“Fund”) was established under the authority of House Bill 1161 (“Act”) enacted by the 76th Regular Session of the 1999 Texas Legislature. The purpose of the Fund is to collect monies from the tobacco companies and distribute the funds to eligible local governmental units for reimbursement of previous healthcare costs associated with tobacco-related illness. The Fund was organized on July 24, 1998 and commenced operations on December 31, 1998.

The Act establishes the Fund with the Texas Comptroller of Public Accounts (“Comptroller”), who is required to administer and manage the assets of the Fund with the advice of, and in consultation with, the appointed Tobacco Settlement Permanent Trust Account Investment Advisory Committee (“Investment Advisory Committee”). The Investment Advisory Committee consists of 11 members from the largest governmental units affected by the Act. The Comptroller is also required to make annual distributions to eligible governmental units. The accompanying Calculated Distribution Amount schedule is calculated in accordance with the Trust Account Distribution Policy (“Policy”), as outlined in Texas Administrative Code, Title 34, Part 1, Chapter 18, Rules 18.1 and 18.2 (“Code”).

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

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

The state of Texas reports the Fund as a private-purpose trust fund in its basic financial statements. Private-purpose trust funds are accounted for using the economic resources measurement focus and the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when the liability is incurred regardless of the time of the related cash flows.

Tobacco Settlement Permanent Trust Fund

Notes to the Calculated Distribution Amount

December 31, 2016

(2) Summary of Significant Accounting Policies (continued)

(b) Restrictions

In accordance with the Act, the Fund is composed of money paid to the Fund in accordance with the Tobacco Settlement Agreement (“Agreement”), assets purchased with that money, earnings of the Fund, and any other contributions made to the Fund. These amounts represent the corpus of the Fund and shall remain in the Fund, and may not be distributed for any purpose that is not in accordance with the approved spending policy. The money and other assets contained in the Fund are not a part of the general funds of the state of Texas.

The Comptroller, with the advice and consultation of the Investment Advisory Committee, may use the earnings of the Fund for investment expenses. Upon certification, in accordance with the Health and Safety Code, Subchapter J, Chapter 12, the Comptroller shall make an annual distribution from the net earnings of the Fund to each eligible political subdivision, as provided in the Agreement regarding disposition of settlement proceeds.

(c) Basis of Presentation

Management of the Fund utilized the following criteria and definitions in its computation of the annual distribution amount, as specified in the Policy.

Calculated Actual Distribution Amount (Rule 18.2(b))

As defined in the Policy, the calculated actual distribution amount shall be 3% of the average market value of the trust account calculated as of the end of the calendar year immediately preceding the distribution. The average market value of the trust account is calculated using the most recent twenty (20) calendar quarter-end market values.

Calendar Year-End Market Value of the Trust Account (Rule 18.2(c))

If the calendar year-end market value of the trust account is equal to or less than the corpus, the actual distribution amount shall be limited to no more than adjusted current earnings.

Adjusted Current Earnings of the Trust Account (Rule 18.1(b)(2))

As defined in the Policy, adjusted current earnings are current earnings less investment expenses. Current earnings of the trust account is the sum of interest and dividend income, income from real estate and private equity investments, and total returns produced by investments designated by the governing investment policy as substitutes for fixed income earned by the trust account during the calendar year.