

Tobacco Settlement Permanent Trust Fund

Letter on Conduct of Audit

December 31, 2012

The Honorable Susan Combs
Comptroller of Public Accounts of the State of Texas
Austin, Texas

This letter is intended to communicate to you significant matters related to the conduct of the annual audit of the Tobacco Settlement Permanent Trust Fund (the "Fund") for the year ended December 31, 2012, so you can appropriately discharge your oversight responsibility and so that we comply with our professional responsibilities to you.

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

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

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

Padgett, Stratemann + Co., LLP

Certified Public Accountants
March 8, 2013

SAN ANTONIO

100 N.E. LOOP 410, SUITE 1100
SAN ANTONIO, TEXAS 78216
210 828 6281

AUSTIN

811 BARTON SPRINGS ROAD, SUITE 550
AUSTIN, TEXAS 78704
512 476 0717

TOLL FREE: 800 879 4966

WEB: PADGETT-CPA.COM

The Auditor's Responsibility Under Auditing Standards Generally Accepted in the United States of America

As communicated in the arrangement letter dated May 29, 2012, our responsibility, as described by professional standards, is to form and express an opinion about whether the financial statements that have been prepared by management with your oversight are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your respective responsibilities.

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

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

Planned Scope and Timing of the Audit

We conducted our audit consistent with the planned scope and timing previously communicated to Paul Ballard on May 29, 2012.

Qualitative Aspects of Significant Accounting Practices

Significant Accounting Policies

Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the Fund is included in Note 2 to the financial statements. There has been no initial selection of accounting policies and no changes in significant accounting policies or their application during the year ended December 31, 2012, other than as noted below.

As described in Note 2, effective January 1, 2012, the Fund adopted Governmental Accounting Standards Board ("GASB") Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* ("Statement No. 62"), and GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* ("Statement No. 63"). Statement No. 62 incorporates (1) FASB Statements and Interpretations, (2) Accounting Principles Board Opinions, and (3) Accounting Research Bulletins issued on or before November 30, 1989 that do not conflict or contradict GASB pronouncements into GASB's authoritative literature.

Qualitative Aspects of Significant Accounting Practices (continued)

Significant Accounting Policies (continued)

Statement No. 63 renames the statement of net assets as the statement of net position and provides guidance for reporting deferred outflows of resources and deferred inflows of resources within the financial statements of governmental entities.

The adoption of these standards did not have a significant impact on the Fund's financial statements.

No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

Significant Accounting Estimates

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

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

Financial Statement Disclosures

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

Significant Difficulties Encountered During the Audit

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

Other Information in Documents Containing the Audited Financial Statements

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

Uncorrected and Corrected Misstatements

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

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

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

Disagreements With Management

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

Representations Requested From Management

We have requested and received certain written representations from management in our standard representation letter dated March 8, 2013.

Management's Consultations With Other Accountants

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

Other Significant Findings or Issues

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