State of Rhode Island and Providence Plantations

Department of Administration
BUREAU OF AUDITS
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May 12, 2015

Mr. Thomas Mullaney
State Budget Officer
State Budget Office
One Capitol Hill, 4th floor
Providence, RI 02908

Dear Mr. Mullaney:

The Bureau of Audits has completed its audit of the Tobacco Settlement Financing Corporation. The audit was conducted in accordance with Rhode Island General Law (RIGL) §35-7-3.

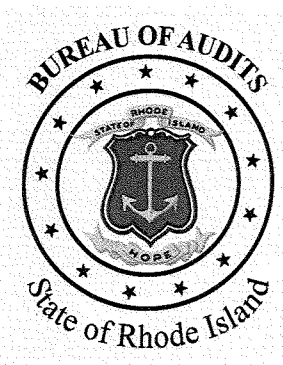
Rhode Island General Law §35-7-3(b), entitled *Audits performed by bureau of audits*, states that, " Within twenty (20) days following the date of issuance of the final audit report, the head of the department, agency or private entity audited shall respond in writing to each recommendation made in the final audit report." Accordingly, management submitted its response to the audit findings and recommendations on May 11, 2015, and such response is included in this report. Pursuant to this statute, the Bureau may follow up regarding recommendations included in this report within one year following the date of issuance.

We would like to express our sincere appreciation to the staff of the Budget Office for the cooperation and courtesy extended to the members of our team during the course of this audit.

Respectfully yours,

Dorothy Z. Pascale, CPA
Chief

c—Internal Audit Advisory Group
Honorable Daniel DaPonte, Chairperson, Senate Committee on Finance
Honorable Raymond Gallison, Chairperson, House Finance Committee
Dennis Hoyle, CPA, Auditor General



Why the Bureau Did This Review

The Bureau of Audits (Bureau) conducted an audit of the Tobacco Settlement Financing Corporation (TSFC), as required by Rhode Island General Law §42-155-7. The purpose of this engagement was to assess whether the Corporation is achieving economy, efficiency, and effectiveness in its employment of its available resources.

Background Information

The Rhode Island General Assembly in 2014 enacted the Quasi-Public Corporations Accountability and Transparency Act, effective January 1, 2015. The law was enacted to improve public oversight and transparency of quasi-public corporations and demonstrate a commitment to protecting the interests of Rhode Island taxpayers.

The Tobacco Settlement Financing Corporation (TSFC) was created in 2002 as a public corporation, having a distinct legal existence from the State and not constituting a department of state government. The TSFC was created to finance the acquisition from the State of the State's right, title and interest and in the State's right to receive the monies due under and pursuant to: (i) the 1998 Master Settlement Agreement (MSA) and (ii) the Consent Decree and Final Judgment of the Rhode Island Superior Court for Providence County.

Audit Executive Summary

The TSFC is a shell corporation established solely to issue bonds backed by the tobacco settlement revenues and to protect the State from the legal and financial risks associated with the bond issue.

It is the Bureau's position that the TSFC has efficiently and effectively employed its available resources in accordance with the entity's mission as defined in RIGL §42-133, *Tobacco Settlement Financing Corporation.* The Bureau has also found that the TSFC has largely fulfilled the requirements of the Quasi-Public Act as outlined in RIGL §42-155, *Quasi-Public Corporations Transparency and Accountability Act,* with the exception of the following parts:

§ 42-155-6, Transparency requirements established

(6) Operating budgets

(7) Strategic plan

(15) All reports and audits required by this chapter

§42-155-4, Role and responsibilities of board members

(3) Adopt a code of ethics.

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Introduction

As required by Rhode Island General Law §42-155-7, *Audit of quasi-public corporations* (Quasi-Public Act), the Bureau of Audits conducted a performance audit of the Tobacco Settlement Financing Corporation. For purposes of the Quasi-Public Act, a performance audit is defined as an independent examination of a program, function, operation, or the management systems and procedures of a governmental entity to assess whether the entity is achieving economy, efficiency, and effectiveness in the employment of available resources.

Quasi-Public Corporations and Transparency Act

The Quasi-Public Corporations and Transparency Act (Quasi-Public Act) requires that commencing January 1, 2015, and every five years thereafter, each quasi-public corporation be subject to a performance audit by the Bureau of Audits. The purpose of the performance audit is to assess whether the entity is achieving economy, efficiency, and effectiveness in its employment of its available resources.

The Quasi- Public Act also outlines transparency requirements for quasi-public corporations, including requiring the Corporation's financial activities, employee compensation, and meeting minutes be made publicly available and posted on the Corporation's website. The Act also outlines roles and responsibilities of the Board members of each quasi-public corporation, including requiring Board members to:

(1) Execute oversight.
(2) Understand, review, and monitor the implementation of fundamental financial and management controls and operational decisions.
(3) Adopt a code of ethics that, at a minimum, includes the standards established in chapter 14 of title 36 ("Code of Ethics").
(4) Adopt a mission statement.
(5) Establish and maintain written policies and procedures for internal accounting and administrative controls in accordance with the provisions of chapter 20 of title 35, the "Public Corporation Financial Integrity and Accountability Act of 1995."

Tobacco Settlement Financing Corporation

The Tobacco Settlement Financing Corporation (TSFC) was created in 2002 as a public corporation, having a distinct legal existence from the State and not constituting a department of state government. The TSFC was created to finance the acquisition of the State's right, title, and interest and right to receive any and all monies due pursuant to: (i) the Master Settlement Agreement (MSA), dated November 23, 1998, among the Attorneys General of 46 states and Philip Morris, Incorporated, R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation and Lorillard Tobacco Company; and (ii) the Consent Decree and Final Judgment of the Rhode Island Superior Court for

Providence County dated December 17, 1998, as the same has been and may be corrected, amended or modified, in the class action styled State of Rhode Island v. American Tobacco, Inc., et. al. (Docket No. 97-3058), including, without limitation, the rights of the State to receive the moneys due to it thereunder.

The Corporation is managed by a four-member Board of Governors, including the State Budget Officer who serves as Chairman of the Board. There are no employees of the Corporation, and any necessary administrative support is provided by the State Budget Office.

Name	Post
Thomas Mullaney	State Investment Commission
Robert Cusack	Public Member
James Thorsen	Public Member
Andrew Reilly	State Investment Commission

The Corporation has not incurred any significant expenses since inception, other than the costs of bond issuance; annual operating expenses are comprised of fees paid to ratings agencies annually to review and update the bond ratings and the costs of the independent financial statement audit. Bonds issued by the TSFC do not constitute a debt, liability, or obligation of the State, or a pledge of the faith and credit of the State, and are payable solely from the tobacco settlement revenues received by the corporation.

2002 Issuance

The Corporation issued $685 million of its Tobacco Settlement Asset-Backed Bonds, Series 2002A, in June 2002 to finance the costs of acquisition of the right, title, and interest to one hundred percent (100%) of the "state's tobacco receipts," as defined in the Act, after December 31, 2003.

2007 Issuance

In June 2007, the Corporation issued $197 million of its Tobacco Settlement Asset-Backed Bonds, Series 2007 A, B, and C, which are structurally subordinate to the payment in full of the 2002 Series Bonds. The Trustee is entitled to receive the "Residual" tobacco settlement revenues pledged to pay the 2007 Series A, B, and C Bonds upon full payment of the 2002 Series A Bonds.

2015 Issuance

The Corporation issued an additional $618 million in Tobacco Settlement Asset-Backed Bonds in March 2015 for: (i) payment of the redemption price and/or the tender price of outstanding bonds of the Corporation that are to be retired; (ii) for payment to the state of Rhode Island in the amount of $36.3 million dollars to be utilized for general fund expenditures, information technology investment, and municipal roads and bridges; and (iii) to establish reserves to secure the bonds, and pay the costs of issuance of the bonds and all other expenditures of the Corporation incident to and necessary to carry out the Corporation's purposes and powers.

Summary

The TSFC is a shell corporation established solely to issue bonds backed by the tobacco settlement revenues and to protect the State from the legal and financial risks associated with the bond issue. It is the Bureau's position that the TSFC has efficiently and effectively employed its available resources in accordance with the entity's mission as defined in RIGL §42-133, *Tobacco Settlement Financing Corporation.* The Bureau has also found that the TSFC has largely fulfilled the requirements of the Quasi-Public Act as outlined in RIGL §42-155, *Quasi-Public Corporations Transparency and Accountability Act,* with the exception of the following parts detailed in the chart below.

RIGL §42-155-6 Transparency requirements established

Statute Section	Description	TSFC Compliance
(1)	Job descriptions of the executive director and management	Not applicable - no employees.
(2)	Compensation comparability studies of the executive	Not applicable- no employees.
(3)	Quarterly financial statements	Not applicable - no quarterly activity.
(4)	Capital improvement plans	Not applicable- no capital assets.
(5)	Operating budgets	Recommendation #1
(6)	Strategic plan	Recommendation #1
(7)	Agendas and minutes of the open meetings of the board	Filed with the Secretary of State.
(8)	Quarterly contracting reports required by §42-90-1	Not applicable.
(9)	Regulations adopted by the quasi-public corporation	Not applicable - refer to RIGL §42-133.
(10)	Enabling legislation	Not applicable- refer to RIGL §42-133.
(11)	Mission statement	Not applicable- refer to RIGL §42-133.
(12)	Board members	Filed with the Secretary of State.
(13)	Organizational chart	Not applicable - refer to RIGL §42-133.
(14)	By laws of the quasi-public corporation	Not applicable - refer to RIGL §42-133.
(15)	All reports and audits required by this chapter	Recommendation #1

§42-155-4 Role and responsibilities of board members.

Statute Section	Description	TSFC Compliance
(3)	Adopt a code of ethics that includes the standards established in chapter 14 of title 36	Recommendation #2

Objective, Scope and Methodology

The purpose of this engagement was to assess whether the TSFC is achieving economy, efficiency, and effectiveness in its employment of its available resources and to assess the Corporation's implementation of the requirements established by the Quasi-Public Act. The audit included reviewing and gaining an understanding of the:

- Quasi-Public Corporations Accountability and Transparency Act, RIGL Chapter 42-155
- Tobacco Settlement Financing Corporation Act, RIGL Chapter 42-133
- Fiscal Year 2016 Budget Article 12 Relating to Tobacco Settlement Financing Trust
- Financial performance of the fund
- Status of the August 2014 through February 2015 litigation involving Oppenheimer Funds and the issuance of the 2015 series bonds and the refunding of the 2002 and 2007 bonds
- State's right to receive the moneys due under and pursuant to the MSA and the Consent Decree and Final Judgment of the Rhode Island Superior Court for Providence County
- Independent consultant's *Forecast of U.S. Cigarette Consumption (2015-2060)* and related effects on tobacco settlement revenues

Findings & Recommendations

Comply with the transparency requirements established by RIGL §42-155-6

RIGL §42-155-6 established sets transparency requirements for quasi-public corporations, including requiring certain information about the organization to be made publicly available on the Corporation's web site. TSFC does not have a web site and, therefore, has not posted or made publicly available all the financial and organizational information established by the transparency requirements of RIGL §42-155-6.

TSFC exists solely as a shell corporation to protect the State of Rhode Island from the legal and financial risks associated with issuing bonds backed by tobacco settlement revenues. It is the Bureau's position that it would not be cost-effective for the Corporation to develop and maintain a web site solely to fulfill the compliance requirements of RIGL §42-155-6 when other avenues to meet this mandate are available.

TSFC is not compliant with all of the transparency requirements established by RIGL §42-155-6; however, information is available to the public upon request.

Recommendation 1

Coordinate with the Secretary of State to make all information required by the RIGL §42-155-6 transparency requirements publicly available through the Secretary of State's web site.

Management's Response

Staff to the Corporation has contacted the Secretary of State's Office to determine the process for posting Corporation documents on its web site. Copies of prior annual financial reports have been provided to the Office and have or are in the process of being posted to the web site. Future reports will be submitted for posting in the future as they are completed.

The Corporation will also explore the option of creating its own web site.

Responsible Party

Suzanne Amerault

Anticipated Implementation Date

Completed

Adopt an ethics policy for the TSFC that meets the standards established in RIGL §36-14, Code of Ethics

As of the date of the audit, the TSFC Board has not adopted an ethics policy for the Corporation. RIGL §42-155-4, Roles and Responsibilities of board members, requires the members of the TSFC Board to:

> *"Adopt a code of ethics ... that, at a minimum, includes the standards established in chapter 14 of title 36 (Code of Ethics)."*

The statute became effective January 1, 2015. The Corporation is not compliant with the Quasi-Public Act RIGL §42-155-4, *Role and Responsibilities of board members.*

Recommendation 2

Adopt a code of ethics that meets the minimum standards established by RIGL §36-14 *Code of Ethics*.

Management's Response

The Corporation will adopt the Rhode Island Ethics Code RIGL 36-14 et seq as its ethics policy. The code will be presented at the next board meeting for approval.

Responsible Party

Thomas A. Mullaney

Anticipated Implementation Date

June 2015