



## OFFICE OF MANAGEMENT & BUDGET

### OFFICE OF INTERNAL AUDIT

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December 29, 2020

Mr. Thomas Mullaney  
Chair/State Budget Officer  
Tobacco Settlement Financing Corporation  
c/o State Budget Office  
One Capitol Hill, 4th floor  
Providence, RI 02908

Dear Mr. Mullaney:

The Office of Audit (OIA) has completed its audit of the Tobacco Settlement Financing Corporation. The audit was conducted in conformance with the Institute of Internal Auditors (IIA) International Standards for the Professional Practice of Internal Auditing and by the authority given to the unit as stated in accordance with Rhode Island General Laws (RIGL) §35-7.1. The audit results were discussed with members of management in the preparation of this report.

Rhode Island General Law §35-7.1-10(d), entitled Annual and interim reports, 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 December 29, 2020, and such response is included in this report. Pursuant to this statute, OIA 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 this audit.

Respectfully yours,

*Dorothy Z Pascale*

Dorothy Z. Pascale, CPA, CFF  
Chief Internal Auditor

- c- Internal Audit Advisory Group  
Honorable William Conley, Chairperson, Senate Committee on Finance  
Honorable Marvin Abney, Chairperson, House Finance Committee  
Dennis Hoyle, CPA, Auditor General

## **Audit Executive Summary**

### **Why the Office of Internal Audit Did This Review?**

The Office of Internal Audit conducted a compliance audit as required by Rhode Island General Law § 42-155-7, *Audit of quasi-public corporations*.

### **Background Information**

The Tobacco Settlement Financing Corporation (TSFC) was created during 2002 as a public corporation, having a distinct legal existence from the State of Rhode Island and not constituting a department of state government. The TSFC was created to finance the acquisition of the State right, title, and interest to receive monies due pursuant to the results of legal proceedings against Philip Morris, Incorporated, R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation and Lorillard Tobacco Company.

TSFC has two issuances of bond debt outstanding:

2007 - \$121 million maturing June 1, 2052

2015 - \$498 million maturing June 1, 2050.

### **The Office of Internal Audit recommends:**

- Proposal of a bill that will remove this entity from the requirements of RIGL 42-155 et seq. or comply with all aspects of the Act.
- Comply with RIGL 42-133-16 and remit all required annual reports to elected officials.

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## Introduction

As required by Rhode Island General Law § 42-155-7, *Audit of quasi-public corporations* (Quasi-Public Act), the Office of Internal Audit conducted a performance audit of the Tobacco Settlement Financing Corporation. The Quasi-Public Act states commencing January 1, 2015, and every five years thereafter, each quasi-public corporation be subject to a performance audit by the Office of Internal Audit. 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.

### Tobacco Settlement Financing Corporation

The Tobacco Settlement Financing Corporation (TSFC) was created during 2002 as a public corporation, having a distinct legal existence from the State of Rhode Island and not constituting a department of state government. The TSFC was created to finance the acquisition of the State right, title, and interest 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 money due to it thereunder.

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

The Corporation has not incurred any significant expenses since inception, other than the costs of bond issuance. Annual operating expenses are comprised of:

1. Fees paid to ratings agencies to review and update bond ratings
2. Costs to an accounting firm to maintain financial records
3. Costs for an independent financial statement audit

Bonds issued by the TSFC do not constitute a debt, liability, or obligation to the State, or a pledge of the faith and credit of the State; these debts are payable solely from the tobacco settlement revenues received by the TSFC.

## **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. The bond was refunded and replaced with the 2015 bond issuance so there is no outstanding debt.

## **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. A portion of this bond was paid off with the 2015 bond issuance and the remaining debt of \$121 million will mature on June 1, 2052. There have not been any other payments on this debt as of December 1, 2020 because the bond is subordinate to the 2015 bond and payments cannot be made until the 2015 bond has been paid off.

## **2015 Issuance**

The Corporation issued an additional \$618 million in Tobacco Settlement Asset-Backed Bonds in March 2015 for 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. The outstanding debt as of December 1, 2020 is \$498 million with a maturity date of June 1, 2050.

No bond has been issued since 2015.

## **Findings & Recommendations**

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

RIGL 42-155 Quasi-Public Corporations Accountability and Transparency Act establishes requirements that quasi-public corporations must follow to increase transparency of operations. TSFC exists solely to protect the State of Rhode Island from the legal and financial risks associated with issuing bonds backed by tobacco settlement revenues. It has few transactions during a fiscal year and no employees or other operational projects.

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However, inclusion in the Quasi-Public Corporations Accountability and Transparency act necessitates compliance with the State law. Therefore, the following must be made public and posted directly, or via direct link, online:

- Job descriptions of the executive director and management
- Compensation comparability studies of the executive
- Quarterly financial statements
- Capital improvement plans
- Operating budgets
- Strategic plan
- Agendas and minutes of the open meetings of the board
- Quarterly contracting reports required by RIGL § 42-90-1
- Regulations adopted by the quasi-public corporation
- Enabling legislation
- Mission statement
- Board members
- Organizational chart
- By laws of the quasi-public corporation

Inclusion in the Quasi-Public act necessitates compliance with the State law. TSFC has not published to a website all required information applicable per the RIGL 42-155. The following is not posted:

1. Operating budgets
2. Strategic plan
3. All reports and audits required by this chapter

### **Recommendation:**

1. (A) Propose legislation to the General Assembly to remove the entity from the Quasi-public Act.

**OR**

- (B) Comply with all requirements of the Quasi-public Act.

### **Management's Response**

TSFC Management recognizes that not all sections of RIGL 42-155-6 apply to the Corporation. The Corporation will review the possibility of submitting legislation to remove the entity from this act, but in the meantime will work to comply with those sections that do apply to the entity. The Corporation has not had a website since its inception, but is working with the Division of Information Technology to establish a site and will post all available documents to the site when ready.

### **Responsible Party**

Chair of the Corporation: Thomas A. Mullaney

### **Anticipated Implementation Date**

April 30, 2021

## **Comply with RIGL 42-133-16 Annual Report to Elected Officials**

TSFC did not comply with the authorizing statute RIGL 42-133-16 (Annual Report and Audit) which states in pertinent part:

*Within four (4) months after the end of each fiscal year, the board shall approve and submit an annual report to the governor, the speaker of the house of representatives, the president of the senate, and the secretary of state of its activities during that fiscal year.*

As of the date of this audit, no report was issued since our last audit during 2015.

### **Recommendation:**

2. Comply with RIGL 42-133-16 and distribute all outstanding reports to the elected officials.

### **Management's Response**

TSFC Management has begun to develop prior year annual reports that were not filed as required by RIGL 42-133-16 and will submit reports upon completion to the appropriate officials, as well as post on a soon to be developed website for the Corporation.

### **Responsible Party**

Chair of the Corporation: Thomas A. Mullaney

### **Anticipated Implementation Date**

April 30, 2021

## **Objective, Scope and Methodology**

The purpose of this engagement was to assess whether the TSFC is compliant with the requirements established by the Quasi-Public Corporations Accountability and Transparency 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
- Board minutes for fiscal year 2020
- Master Settlement Agreement signed in 1998
- Draft audited financial statements for fiscal year 2020