

BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY

Minutes of June 24, 2010 Meeting

The Buckeye Tobacco Settlement Financing Authority (the Authority) held a meeting commencing at 11:00 a.m. on Thursday, June 24, 2010, in the 35th Floor Conference Room, Office of Budget and Management, James A. Rhodes State Office Tower, 30 East Broad Street, Columbus, Ohio, pursuant to notice of meeting given by the Secretary of the Authority pursuant to section 4.2 of Bylaws.

[Copies of the items marked * are attached hereto and made a part of these minutes.]

The Chairman called the meeting to order.

Mr. Kauffman, the Assistant Secretary, reported that no new designations, pursuant to Section 183.52 of the Revised Code, were filed since the last meeting of the Authority.

Pursuant to Section 3.1 of the Bylaws, Mr. Markus presided as Chair of the meeting. Upon roll call, the Chairman declared a quorum to be present. The following member and designees of the Authority, eligible to vote at the meeting, were present:

Kent Markus, Office of the Governor

Amer Ahmad, Treasurer of State

J. Pari Sabety, Director of Budget and Management

Also present were Kurt Kauffman (Assistant Secretary), Gary Taylor (Attorney General's office), Larry Scurlock, Liberty Ziegahn and Cassie Sanfrey (Office of Budget and Management), Greg Stype (Squire Sanders & Dempsey) and Bill Kennedy (Kennedy Cottrell Richards).

The Assistant Secretary filed the certificate* of compliance with the public meeting notice provisions of Section 121.22 of the Revised Code.

Mr. Ahmad then moved, seconded by Ms. Sabety, to approve the minutes of the March 18, 2009 Commission meeting. There being no discussion, the motion was approved upon roll call as follows: Ayes – Ahmad, Markus, Sabety; Nays – None. The Chair declared the motion passed.

Mr. Kauffman provided an overview of the role of the Authority's staff in the financial statement preparation and audit process and presented a brief summary of FY 2009 audit results.*

Following this presentation, the Chairman requested a motion to approve renewal of the contract with Kennedy Cottrell Richards LLC (KCR) for preparation of the Authority's financial statements for fiscal years 2010 and 2011. The Secretary then moved, seconded by Mr. Ahmad, to approve renewal of the KCR contract. Mr. Ahmad asked whether a Request for Proposals or similar process had been completed for this contract. Mr. Kauffman explained that the Authority concluded an RFP process two years ago for which KCR was the sole respondent. Mr. Kauffman said that contract with KCR was for a six-year term and is subject to renewal every two years. The motion was approved upon roll call as follows: Ayes – Ahmad, Markus, Sabety; Nays - None. The Chair declared the motion passed.

Mr. Kauffman presented an update on the tobacco settlement receipts (TSRs) received in calendar year 2010.*

Mr. Ahmad provided a brief update on the investment of the debt service reserve fund. Mr. Ahmad explained how the guaranteed investment contract with Lehman Brothers provided a

guaranteed return of 4.6% on the reserve fund balance of \$389 million until their bankruptcy in 2008. Mr. Ahmad further explained the Authority received back all invested principal and that the Treasurer now directs the investments held by the Trustee. Mr. Ahmad noted the reserve fund is currently invested in highly rated commercial paper instruments maturing in six-month increments and yielding a 0.63% annualized rate of return. Mr. Ahmad said his office is evaluating alternative investment strategies, including investing a portion of the reserve over a longer time horizon. In response to a question from the Chairman, Mr. Ahmad acknowledged the conundrum of investing over a longer time horizon now when the expectation is that interest rates will rise in the near term.

The Chairman asked for an overview of Resolution No. 2010-1 prior to its motion for adoption. Mr. Kauffman explained that Resolution No. 2010-1 delegated to OBM staff the authority to assist with the development of the Authority's annual operating budget including working with the Attorney General's office to determine the proper amount of enforcement expenses to be included in the annual Officer's Certificate. The resolution also authorized OBM staff to review and approve invoices pursuant to that budget and to submit approved invoices to the bond trustee for payment. There was then presented Resolution 2010-1, entitled "Resolution Authorizing OBM Staff to Assist with the Preparation of the Annual Operating Expenses Budget, and the Processing and Approval of Payments Under that Budget, all as Provided in the Trust Indenture dated as of October 1, 2007, between the Authority and U.S. Bank National Association". It was moved by Mr. Ahmad, and seconded by the Chairman, that Resolution No. 2010-1 be adopted. There being no discussion, the motion was approved upon roll call, as follows: Ayes – Ahmad, Markus, Sabety; Nays - None. The Chair declared the motion passed and Resolution No. 2010-1 adopted.

Mr. Scurlock then presented the Authority's operating budget for fiscal year 2010 and proposed budget for 2011. He began by reviewing the fiscal year 2010 year-to-date expenses, noting a negative variance of \$10,569 from the budgeted amount. Mr. Scurlock explained this variance was largely due to lower-than-expected legal costs for disclosure and reporting requirements. Mr. Scurlock also explained that projected fiscal year 2011 operating expenses include funds for arbitrage calculations that will be completed once proceeds of the Authority's Series 2007 Tobacco Settlement Asset-Backed Bonds are fully expended.

There being no further business, the meeting was adjourned.


Secretary



THE BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY

KEVIN L. BOYCE, Treasurer
Treasurer of State

TED STRICKLAND, Chairman
Governor

J. PARI SABETY, Secretary
Director of Budget and Management

**CERTIFICATION REGARDING NOTIFICATION OF MEETING
TO THE PUBLIC AND NEWS MEDIA**

The undersigned, Assistant Secretary of the Buckeye Tobacco Settlement Financing Authority, hereby certifies that the notice of the time, place and purposes of the meeting of the Authority of June 24, 2010 at 11:00 a.m. was posted on Tuesday, June 22, 2010 in the State House press room, the Office of Budget and Management (34th Floor, 30 East Broad Street), and the Office of the Treasurer of State (9th Floor, 30 East Broad Street), all in accordance Section 121.22 of the Revised Code and the Open Meetings Rule for notification of meetings to the public and news media adopted by the Authority July 2, 2007.

Dated: June 24, 2010

Kurt Kauffman
Assistant Secretary of the
Buckeye Tobacco Settlement Financing Authority



*** **Public Meeting Notice** ***

June 22, 2010

TO: Members of the Buckeye Tobacco Settlement Financing Authority and their designees

Ted Strickland, Governor
Kevin L. Boyce, Treasurer of State

Kent Markus
Amer Amhad
David Ellis (my designee)

FROM: J. Pari Sabety, Secretary of the Buckeye Tobacco Settlement Financing Authority

SUBJECT: **Meeting on Thursday, June 24, 2010, at 11:00 a.m. in Conference Room A of the Office of Budget and Management (35th Floor, Rhodes State Office Tower)**

Pursuant to the Bylaws of the Buckeye Tobacco Settlement Financing Authority, I am notifying you of the meeting of the Authority to be held on Thursday, June 24, 2010, commencing at 11:00 a.m. in Conference Room A of the Office of Budget and Management (35th Floor, Rhodes State Office Tower, 30 East Broad Street, Columbus, Ohio). The Authority will receive a presentation regarding the Authority's fiscal year 2009 audited financial statements, and will consider and act on a motion to renew the contract with Kennedy Cottrell Richards LLC for preparation of the Authority's financial statements for fiscal years 2010 and 2011. The Authority will also consider and act on a resolution authorizing OBM staff to assist with the preparation of the annual operating budget, and to review and approve payments under that budget. Staff will also present an update on the 2010 tobacco settlement receipts, investment of the debt service reserve fund, and the Authority's operating budget for fiscal years 2010 and 2011.

Enclosed are a meeting agenda, the March 18, 2009 meeting minutes, copies of the fiscal year 2009 audited financial statements, the resolution regarding OBM staff assistance, and the operating budget for fiscal years 2010 and 2011, all as referred to in that agenda.

If you or members of your staff have any questions, please contact me or Kurt Kauffman of my staff at 466-0691.

cc. Richard Cordray, Attorney General
Chris Glaros, First Assistant Attorney General
Jake Wozniak, Director of Debt Management Office, Treasurer of State

BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY
MEETING AGENDA
June 24, 2010

FY2009 Financial Statement Preparation and Audit Process

- Preparation of the FY2009 financial statements began in July and ran through mid-September.
- Staff and U.S. Bank (tobacco bond trustee) provided Kennedy Cottrell Richards (KCR) with the information, reports, and account statements needed to compile the financial statements.
- Once the financial statements were compiled, we meet with KCR to review, verify all cash based numbers in the report, and ask questions.
 - Moving forward, AOS recommended that BTSFA members be directly involved in the initial review of the financial statements and that any changes or comments be documented.
- Audit began in late September and ended in November. Staff held an exit conference with the Auditor's office in December in which they reviewed the audit and conveyed their findings.
- The FY2009 Audit Opinion was 'unqualified' and the financial statements were found to present fairly, in all material aspects, BTSFA's financial position.
 - However, the Audit did identify a significant deficiency in internal controls resulting in the failure to record \$26.4 million in deferred tobacco settlement receivables (primarily amounts withheld by RJ Reynolds) which resulted in an understatement of tobacco settlement revenues.
 - This misstatement was immediately corrected and the proper amount was reflected in the financial statements. Moving forward, the Authority will identify and examine all line-items that experience a variance of 5% or more from their prior year values (5% is a common materiality threshold).
- The FY2009 Audit did not include a Management Letter.
 - All of last year's management recommendations were remedied (SAS-70 from US Bank; adoption of a travel policy; pre-approval of investment purchases; approval of minutes).

FY2010 Financial Statement Preparation and Audit Timeline

- Under the ARRA reporting requirements, the timeline for the State's CAFR and, thus, the timeline for completion of the FY2010 BTSFA audited financial statements has been accelerated.
 - Financial Statements must be completed for submission to the Auditor of State by August 16, 2010. The audit of those financial statements and the audit opinions are scheduled to be completed by October 1, 2010.

Calendar Year 2010 Tobacco Settlement Receipts (TSRs)

- Pledged Tobacco Settlement Receipts (TSRs) for CY2010 totaled \$305.6 million, a decline of 9.5% from CY2009 TSRs after adjusting for the release of \$27.2 million from prior year disputed accounts.
 - The significant decrease in CY 2010 receipts resulted from near 9% decline in domestic cigarette shipments attributable to a federal tax increase tobacco products and the national recession.
- According to Moody's industry outlook, cigarette volume declines should ease in 2010 and 2011 with volume declines expected to be in the 3-4 percent range.
 - This easing in volume decline in conjunction with the inflation factor in the MSA TSR payment formula are expected to result in a leveling of receipts in the next couple of years.