TOBACCO SETTLEMENT FINANCING CORPORATION

(a blended component unit of the Government of The United States Virgin Islands)
Management's Discussion and Analysis and Financial Statements for the year ended September 30, 2011 and 2010 and Independent Auditor's Report

TOBACCO SETTLEMENT FINANCING CORPORATION
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To the Board of Directors of

Tobacco Settlement Financing Corporation

We have audited the accompanying statement of net assets and governmental fund balance sheet, the related statements of activities and governmental fund revenue, expenditures and changes in net assets/fund balance and the statement of fiduciary net asset presented of the government activities fund, the debt service fund of the Tobacco Settlement Financing Corporation (the "Corporation") for as of and for the year ended September 30, 2011, which collectively comprise the Corporation's basic financial statements. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to previously present fairly, in all material respects, the financial position of the Corporation as of September 30, 2011, and the respective changes in financial position for the year ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 10 is not a required part of the basis financial statements but is supplementary information required by the Government Accounting Standards Board. We have applied certain limited procedures which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit or express an opinion on the information.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 13, 2012, on our consideration of Tobacco Settlement Financing Corporation's ("TFSC") internal controls over financial reporting and our test of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal controls over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal controls over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Deloitte & Touche

December 13, 2012

The Board of Directors of the Tobacco Settlement Financing Corporation (the "Corporation") is pleased to present the following discussion and analysis of the Corporation's financial performance during the fiscal years that ended September 30, 2011 and 2010.

The Corporation

The Corporation was formed in September, 2001. On November 1, 2001, the Corporation entered into a Purchase and Sale Agreement with the Government of the U.S. Virgin Islands to purchase the rights, title, and interest in Tobacco Settlement fund litigation awards for the amount of $18.4 million, under the Master Settlement Agreement (the "MSA"). The MSA was entered into on November 23, 1998, among the Attorney Generals of 46 states, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa and the Commonwealth of the Northern Mariana Islands (collectively the "Settling States") and the four largest United States tobacco manufacturers: Philip Morris Incorporated, R. J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, and Lorillard Tobacco Company (collectively the "Original Participating Manufacturers" or "OPMs"). The MSA provides for other tobacco companies, referred to as "Subsequent Participating Manufacturers" or "SPMs" to become parties to the MSA. The four OPMs together with over 30 SPMs are referred to as the "Participating Manufacturers" or "PMs". The MSA resolved cigarette smoking-related litigation among the Settling States and the OPMs, released the OPMs from past and present smoking-related claims by the Settling States, and provides for a continuing release of future smoking-related claims in exchange for certain payments to be made to the Settling States. The MSA also provides for the imposition of certain tobacco advertising and marketing restrictions, among other things. The MSA represents the resolution of a large potential financial liability of the OPMs for smoking-related injuries, the costs of which have been borne and will likely be borne by cigarette consumers. The Corporation is not a party to the MSA.

Initial Payments under the MSA to the Settling States have been received from 1999 to 2003. Annual Payments under the MSA are required if the cigarette market share increases higher than the 1998 level or 125% of the 1997 level. Annual Payments are due on April 15, having commenced April 15, 2000, and continuing in perpetuity. In addition to Initial and Annual Payments, participating cigarette manufacturers are required to make Strategic Contribution Fund Payments in the amount of $861 million, subject to adjustment, annually on April 15, in the years of 2008 through 2017. Each type of payment under MSA is contingent upon future volume of cigarette sales, inflation adjustments, final legal adjustments upon settlement with the four states and other United States jurisdictions not participating in the agreement, and various offsets for miscalculated or disputed payments with the parties. The Government of the Virgin Islands' share of the MSA was .0173593% of Initial and Annual Payments, and .1800232% of Strategic Contribution Fund Payments. In addition, the ability of the PMs to make the tobacco settlement payments is contingent upon many other influences. There have been several multi-million, and a few multi-billion, dollar verdicts against the tobacco companies in the recent years. Additionally, there are certain consumer groups that have introduced litigation against the tobacco manufacturers asserting that the MSA violates certain provisions of the United States Constitution, federal antitrust laws, and others. The Corporation received $2.1 million for the fiscal years ended September 30, 2011 and 2010 pursuant to the rights purchased from the Government of the U.S. Virgin Islands.

On November 20, 2001, the Corporation issued $21.7 million aggregate principal amount of Tobacco Settlement Financing Corporation Asset-Backed Bonds (the "2001 Series Bonds"). The 2001 Series Bonds are secured by, and payable from, collections including all Tobacco Settlement Revenues (the "TSRs") to be received by the corporation, reserves, amounts held in other accounts established by the indenture, and the Corporation's rights under the purchase agreement. The proceeds were used for the purpose of purchasing all rights, title, and interest in certain litigation awards under the MSA entered into by participating cigarette manufacturers, and, ultimately providing funds for hospital and healthcare projects in the United States Virgin Islands.

On March 15, 2006, the Corporation issued $7.3 million aggregate principal amount of Tobacco Settlement Asset-Backed Subordinate Series 2006 A, B, C & D Turbo Capital Appreciation Bonds (the "Series 2006 Bonds") pursuant to an amendment of the indenture between the Corporation and the Trustee, dated November 1, 2001. The Series 2006 Bonds are secured by and are payable solely from the TSRs, investment earnings and amounts held in certain accounts, and the Corporation's rights under the purchase agreement. The proceeds were used for the purpose of financing several capital hospital and health department projects, including the Charlotte Kimelman Cancer Institute on St. Thomas and the construction of the V.I. Cardiac Center on St. Croix, and to fund operating costs of the Corporation.

As of September 30, 2011 and 2010 the Corporation had outstanding bonds of approximately $25.9 million and $26.6 million outstanding, respectively.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Corporation's basic financial statements. The Corporation's basic financial statements consist of four components: 1) government-wide financial statements, 2) governmental fund financial statements, 3) statement of fiduciary net deficit, and 4) notes to the financial statements. Due to the single-purpose nature of the activities of the Corporation, the government-wide and governmental fund financial statements have been presented together with an adjustments column reconciling the differences.

- The *Statement of Net deficit and Governmental Fund Balance Sheet* includes all of the Corporation's assets and liabilities and provides information about the nature and amounts of investments in resources (assets), and the obligations to Corporation creditors (liabilities). It also provides the basis for computing rate of return, evaluating the capital structure of the Corporation, and assessing the liquidity and financial flexibility of the Corporation. The government-wide Statement of Net Deficit column is prepared on an economic resources method and reports information about the Corporation using accounting methods similar to those used by private sector companies (accrual basis of accounting) and presents all assets and liabilities of the Corporation. The Governmental Fund Balance Sheet focuses on the Corporation's balances of spendable resources available for the payment of expenditures, including payment of debt service requirements at the end of the fiscal year.
- All of the current year's activity is accounted for in the *Statement of Activities and Governmental Fund Revenues, Expenditures, and Changes in Net Deficit/Fund Balance.* This statement measures the success of the Corporation's operations over the past year and can be used to determine the Corporation's ability to meet its financial objectives and credit-worthiness. The Statement of Activities column presents information on how the Corporation's net deficit changed during the most recent fiscal year.

All changes in net deficit are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows.

- The current year's *Statement of Fiduciary Net Deficit* reports fiduciary funds held in an agency capacity for the benefit of the Government of the Virgin Islands related to hospital and healthcare projects for residents of the United States Virgin Islands. Fiduciary funds are not reflected in the government-wide financial statements because the resources are not available to support the Corporation's own programs. Agency funds are reported using the economic resources measurement focus on a full accrual basis and only present a statement of assets and liabilities.

Summary of Financial Results

Government-Wide Financial Statements

Statement of Net Assets--Table 1 summarizes the Corporation's Statement of Net Assets as of September 30, 2011 and 2010.

Table 1: Summary of Statement of Net Assets

	September 2011		September 2010	
Restricted assets	$	4,394,799	$	4,399,054
Other assets		14,168,756		14,960,986
Total assets	$	18,563,555	$	19,360,040
Current liabilities	$	-	$	-
Bonds payable		25,922,837		26,573,298
Other liabilities		4,509		4,508
Total liabilities	$	25,927,346	$	26,577,806
Total net assets	$	(7,363,791)	$	(7,217,766)

For Fiscal Year 2011, the Corporation's assets amounted to $18.6 million, of which $2.8 million represented restricted investments, $1.6 million represented accrued TSRs which are restricted in purpose, and $13 million represented a deferred charge in connection with the purchase of tobacco settlement rights. Restricted investments decreased by approximately $34 thousand due to the net effect of $2.1 million collected in TSR's in April 2011, interest income of $90 thousand, principal payments made of $1.3 million, interest expense of $832 thousand, and general and administrative expense paid of $87 thousand. Other assets decreased due to the amortization of the TSR deferred charge, bond issue costs and original issue discount of $792 thousand. Total liabilities amounted to $25.9 million. The decrease in total liabilities is due to the net effect of principal payments of $1.3 million and accretion expense of $650 thousand.

For Fiscal Year 2010, the Corporation's assets amounted to $19.4 million, of which $2.8 million represented restricted investments, $1.6 million represented accrued TSRs which are restricted in purpose, and $13.7 million represented a deferred charge in connection with the purchase of tobacco settlement rights. Restricted investments decreased by approximately $50 thousand due to the net effect of $2.3 million collected in TSR's in April 2010, interest income of $91 thousand, principal payments made of $1.4 million, interest expense of $897 thousand, and general and administrative expense plus accrued expenses paid of $87 thousand. Other assets decreased due to the amortization of the TSR deferred charge, bond issue costs and original issue discount of $796 thousand. Total liabilities amounted to $26.6 million. The decrease in total liabilities is due to the net effect of principal payments of $1.4 million and accretion expense of $609 thousand.

Statement of Activities--Table 2 summarizes the Corporation's Statement of Activities for the periods ending September 30, 2011and 2010.

Table 2: Summary of Statement of Activities

	September 2011	September 2010
General and program revenues	$ 2,214,085	$ 2,226,365
Expenses	2,360,110	2,356,206
Change in net assets	$ (146,025)	$ (129,841)
Net assets - beginning of year	$ (7,217,766)	$ (7,087,925)
Net assets - end of year	$ (7,363,791)	$ (7,217,766)

For Fiscal Year 2011, general revenues of $2.2 million reflect TSRs revenue of $2.1 million and investment earnings of $90 thousand. The Corporation's expenses included interest expense of $832 thousand, general and administrative expenses of $87 thousand, accretion expense of $650 thousand, and amortization expense of bond discounts, issuance costs and deferred charges on the purchase of tobacco settlement rights of $792 thousand.

For Fiscal Year 2010, general revenues of $2.2 million reflect TSRs revenue of $2.1 million and investment earnings of $91 thousand. The decrease in TSRs is mainly driven by the reduction in cigarette consumption which is due to the increase in taxes imposed on the sale of cigarettes as well as global awareness campaigns about the harm caused by their consumption. The Corporation's expenses included interest expense of $897 thousand, general and administrative expenses of $54 thousand, accretion expense of $609 thousand, and amortization expense of bond discounts, issuance costs and deferred charges on the purchase of tobacco settlement rights of $796 thousand.

Governmental Fund Financial Statements

Governmental Fund Balance Sheet--Table 3 summarizes the Corporation's Balance Sheet as of September 30, 2011 and 2010.

Table 3: Summary of Governmental Fund Balance Sheet

	September 2011	September 2010
Restricted assets	$ 2,794,234	$ 2,828,419
Total assets	$ 2,794,234	$ 2,828,419
Total liabilities	$ 4,509	$ 4,508
Total restricted fund balance	$ 2,789,725	$ 2,823,911

For Fiscal Year 2011, the Corporation's assets, as reported on the Governmental Fund Balance Sheet, amounted to approximately $2.8 million, which are restricted investments. The decrease in restricted assets is mainly due to the net effect of $2.1 million collected in TSR's in April 2011, interest income of $90 thousand, principal payments made of $1.3 million, interest expense payments of $832 thousand, and general and administrative expense paid of $87 thousand. Total liabilities amounted to approximately $5 thousand.

For Fiscal Year 2010, the Corporation's assets, as reported on the Governmental Fund Balance Sheet, amounted to approximately $2.8 million, which are restricted investments. The decrease in restricted assets is mainly due to the net effect of $2.3 million collected in TSR's in April 2010, interest income of $91 thousand, principal payments made of $1.4 million, interest expense payments of $897 thousand, general and administrative expense paid of $87 thousand. Total liabilities amounted to approximately $5 thousand. Decrease in liabilities as compared with fiscal year 2009 is due to the advances made by the Corporation to a related party to pay the accrued expenses (mainly audit fees and accounting services) on behalf of the Corporation.

Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balance--Table 4 summarizes the Corporation's Governmental Fund Revenues, Expenditures, and Changes in Fund Balance for the years ending September 30, 2011 and 2010.

Table 4: Summary of Governmental Fund Revenues, Expenditures, and Changes in Fund Balance

	September 2011		September 2010	
General and program revenues	$	2,184,155	$	2,348,723
Expenses		2,218,341		2,366,468
Excess of expenses	$	(34,186)	$	(17,745)
Restricted Fund balance:				
Beginning of year	$	2,823,911	$	2,841,656
Resticted Fund balance:				
End of year	$	2,789,725	$	2,823,911

General and program revenues for the year ending September 30, 2011 of $2.2 million reflects the receipt of $2.1 million in TSRs, and investment earnings of $90 thousand. The decrease in revenues during fiscal year 2011 is mainly driven by the reduction in cigarette consumption which is due to the increase in taxes imposed on the sale of cigarettes as well as global awareness campaigns about the harm caused by their consumption. The Corporation's expenses included interest paid of $832 thousand, principal expense of $1.3 million, and $87 thousand for general and administrative expenses. The decrease in expense is mainly due to the decrease in principal payments of $115 thousand and the decrease in interest expense of $65 thousand.

General and program revenues for the year ending September 30, 2010 of $2.3 million reflects the receipt of $2.3 million in TSRs, and investment earnings of $91 thousand. The decrease in revenues during fiscal year 2010 is mainly driven by the reduction in cigarette consumption which in turn is due to the increase in taxes imposed on the sale of cigarettes as well as global awareness campaigns about the harm caused by their consumption. The Corporation's expenses included interest paid of $897 thousand, principal expense of $1.4 million, and $54 thousand for general and administrative expenses. The decrease in expense is mainly due to the decrease in principal payments of $265 thousand and the decrease in interest expense of $78 thousand.

Statement of Fiduciary Net Assets--Table 5 summarizes the Corporation's Statement of Fiduciary Net Assets as of September 30, 2011 and 2010.

Table 5: Summary of Statement of Fiduciary Net Assets

	September 2011		September 2010	
Restricted assets	$	2,522,168	$	2,727,092
Total assets	$	2,522,168	$	2,727,092
Noncurrent liabilities	$	2,522,168	$	2,727,092
Total liabilities	$	2,522,168	$	2,727,092

Restricted assets consist of investments held by the Corporation on behalf of the Government of the Virgin Islands for healthcare projects consistent with the single purpose for which it was created. The decrease in total assets as of September 30, 2011 and 2010 is due to disbursements for capital projects. The liabilities consist of unexpended project funds.

Long-Term Debt Activity

The 2001 Series Bonds issued by the Corporation are twenty and thirty-year obligations scheduled to retire in ordinary course on May 15, 2021 and May 15, 2035. However, under early redemption provisions, particularly Turbo Redemptions, any TSR collections exceeding annual debt service requirements of the Bonds must be applied to early redemption of the Series 2001 Term Bonds in order of maturity. No excess shall be applied to the early redemption of the Series 2006 Bonds until full payment of the 2001 Series Bonds. TSRs and earnings on the trust funds during the fiscal years ending September 30, 2011 through 2006, resulted in Turbo Redemptions of $135,000 on May 16, 2011, $315,000 on May 17, 2010, $645,000 on May 15, 2009, $5,000 on November 11, 2008, $495,000 on May 15, 2008, $20,000 on November 15, 2007, $295,000 on May 15, 2007, $5,000 on November 15, 2006.

The 2006 Series Bonds issued by the Corporation are thirty-year obligations maturing on May 15, 2035. The 2006 Series Bonds are subject to mandatory redemption in whole or part on each May 15 and November 15 subsequent to the date on which all Series 2001 Bonds have been paid in full but not before 2016.

The Corporation monitors market conditions for circumstances conducive to undertaking a refunding transaction that would result in savings of interest expense over time. No such conditions arose during the fiscal years of 2011 and 2010.

TFSC bond rating, as assigned by Moody, for the series 2001 Capital Appreciation Bonds, due on May 15, 2014 was A1, series 2001 Term Bonds, due on May 15, 2021 was A1, series 2001 Term Bonds, due on May 15, 2031 was A3.

TFSC bond rating, as assigned by Fitch Ratings, for the series 2006A Bonds, due May 15, 2035 was B, series 2006B Bonds, due May 15, 2035 was B, series 2006C Bonds, due May 15, 2035 was C, series 2006D Bonds, due May 15, 2035 was not rated.

Significant Currently-Known Facts

The following are currently known facts that could have a potential significant effect on financial position and changes in financial position in future years:

Payment Collections

TSR collections may vary based on inflation adjustments, volume adjustments of cigarette sales, litigation adjustments from non-settling states, offsets for miscalculated or disputed payments, federal tobacco legislation offsets, litigation releasing parties offsets, and offsets for claims over the amounts of the award.

The ability of the Corporation to make debt service payments on bonds is contingent upon the receipt of Tobacco Settlement payments. The bonds issued by the Corporation do not constitute a claim against the full faith, credit, or taxing powers of the Government of the Virgin Islands.

Contacting the Corporation

This financial report is designed to provide management with a general overview of the Corporation's finances. If you have questions about this report or need additional financial information, contact the Corporation:

Tobacco Settlement Financing Corporation
P.O. Box 430
St. Thomas, VI 00804
340-714-1635

TOBACCO SETTLEMENT FINANCING CORPORATION
(a blended component unit of the Government of the United States Virgin Islands)
Statement of Net Deficit and Governmental Fund Balance Sheet
September 30, 2011

	Debt Service Fund and Total Government Fund	(Note 9) Reconciliation	Government wide Statement of Net Deficit
Assets			
Current assets:			
Restricted investments	$ 2,794,234	$ -	$ 2,794,234
Accrued tobacco settlement revenues	-	1,600,565	1,600,565
Total current assets	2,794,234	1,600,565	4,394,799
Noncurrent assets:			
Bond issuance costs, net	$ -	$ 843,191	$ 843,191
Original issue discount, net	-	335,348	335,348
Deferred charge - purchase of settlement rights, net	-	12,990,217	12,990,217
Total noncurrent assets	-	14,168,756	14,168,756
Total assets	$ 2,794,234	$ 15,769,321	$ 18,563,555
Liabilities			
Noncurrent liabilities:			
Bonds payable	$ -	$ 25,922,837	$ 25,922,837
Other liabilities	4,509	-	4,509
Total liabilities	4,509	25,922,837	25,927,346
Fund Balance/Net Deficit			
Restricted fund balance:			
Reserved for debt service	2,789,725	(2,789,725)	-
Total restricted fund balance	2,789,725	(2,789,725)	-
Total liabilities and restricted fund balance	$ 2,794,234		
Net deficit:			
Restricted for debt service		$ 2,794,234	$ 2,794,234
Unrestricted		(10,158,025)	(10,158,025)
Total net deficit:		$ (7,363,791)	$ (7,363,791)

The accompanying notes are an integral part of these financial statements.

TOBACCO SETTLEMENT FINANCING CORPORATION
(a blended component unit of the Government of the United States Virgin Islands)
Statement of Activities and Governmental Fund Revenues, Expenditures, and Changes in Net Deficit/Fund Balance
For the year ended September 30, 2011

	Debt Service Fund and Total Government Fund	(Note 9) Reconciliation	Statement of Activities
General and Program Revenues			
Tobacco settlement revenues	$ 2,094,180	$ 29,930	$ 2,124,110
Interest income:			
Cash & investments	89,975	-	89,975
Total general and program revenues	2,184,155	29,930	2,214,085
General and Program Expenses			
General and administrative expenses	86,600	-	86,600
Bond principal expense	1,300,000	(1,300,000)	-
Bond interest expense	831,741	-	831,741
Accretion expense	-	649,539	649,539
Amortization expense	-	792,230	792,230
Total general and program expenses	2,218,341	141,769	2,360,110
Net change in Fund Balance/Net Deficit	(34,186)	(111,839)	(146,025)
Restricted Fund Balance/Net Deficit			
Beginning of year	2,823,911	(10,041,677)	(7,217,766)
End of year	$ 2,789,725	$ (10,153,516)	$ (7,363,791)

The accompanying notes are an integral part of these financial statements.

TOBACCO SETTLEMENT FINANCING CORPORATION
(a blended component unit of the Government of the United States Virgin Islands)
Statement of Fiduciary Net Assets
September 30, 2011

		Agency Funds
Assets		
Restricted investments	$	2,522,168
Total assets	$	2,522,168
Liabilities		
Due to Government of the U.S. Virgin Islands	$	2,522,168
Total liabilities	$	2,522,168

The accompanying notes are an integral part of these financial statements.

1. Reporting Entity

The Tobacco Settlement Financing Corporation (the "Corporation") is a special-purpose, independent, instrumentality of, but separate and apart from the United States Virgin Islands, created by Virgin Islands Act No. 6428 for the purposes of managing the Tobacco Settlement Healthcare and Capital Improvement Fund program by (i) purchasing all rights, title, and interest in certain litigation awards under the Master Settlement Agreement entered into by participating cigarette manufacturers, (ii) issuing Tobacco Settlement Asset-Backed Bonds to pay the purchase price for the rights, and (iii) providing funds for hospital and healthcare projects in the United States Virgin Islands. The Board of Directors consists of three members: the Governor, and two independent members—one appointed by the Governor and one appointed by the president of the Legislature.

2. Summary of Significant Accounting Policies

The financial statements of the corporation have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"), as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted, standard-setting body for establishing governmental and financial reporting standards.

Basis of Presentation

The Corporations basic financial statements include both government wide (reporting on the corporation as a whole) and its only government fund financial statements.

Government-wide

The government-wide financial statement, i.e. the statement of net deficit and the statement of activities, display information about the Corporation as a whole. These statements include the financial activities of the overall government. All of the activities of the Corporation are considered governmental activities.

The government wide statement of net deficit and statement of activities are prepared on the accrual basis of accounting and the economic resources measurement focus.

This government-wide focus is more on the sustainability of the Corporation as an entity and the change in the Corporations net deficit resulting from the current year's activities.

Fund Financial Statements

The Corporation has prepared financial statements for the Corporation's only governmental fund. Governmental fund financial statements continue to use the modified accrual basis of accounting and the current financial resources measurement focus.

Due to the single-purpose nature of the activities and as permitted by GASB Statement No. 34 the Corporation's financial statements include separate statement of net deficit and statement of activities columns using the accrual basis of accounting, in addition to the general fund column reporting the financial activities using the modified accrual basis of accounting, the financial statements have been presented together with a reconciliation column.

New and Adopted Accounting Standards

Effective for the year ended September 30, 2008, with restatements of prior fiscal years, the Corporation implemented GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. This Statement addresses common transactions in which a government exchanges an interest in its expected cash flows from collecting specific receivables or specific future revenues for immediate cash payments and provides guidance as to whether the transaction should be regarded as a sale or as a collateralized borrowing. The statement establishes criteria that a transferor government will use to make this determination generally based on the extent to which the government either retains or relinquishes control over the receivables or future revenues through its continuing involvement with them. The future collection of Tobacco Settlement Revenue (TSRs) is dependent on many factors, including future cigarette consumption and the domestic shipment of cigarettes (sales). As such, the future collection of TSR due to future sales is not reasonably estimable and is not recorded as an asset in either the government-wide financial statements or the governmental fund financial statements as the funds are not yet available and such sale has not occurred.

The adoption of GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* and GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, in the opinion of management, did not have a material effect on the Corporation's financial statements.

The adoption of GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, and Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*, in the opinion of management, did not have a material effect on the Corporation's financial statements.

Effective for periods beginning after June 15, 2010, GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, establishes accounting and financial reporting standards for all governments that report governmental funds. It establishes criteria for classifying fund balances into specifically defined classifications and clarifies definitions for governmental fund types. The implication of this Statement is that the Corporation's fund balances that are restricted to debt service are reported as restricted fund balances.

Effective for periods beginning after June 15, 2010, GASB Statement No. 59, *Financial Instruments Omnibus*, updates and improves financial reporting and disclosure requirements of certain financial instruments (financial guarantee contracts) and external investment pools that operate in conformity with Security and Exchange Commission 2a7 -like pools. In the opinion of management, this Statement did not have a material effect on the Corporation's financial statements, as the Corporation did not hold any financial guarantee contracts or external investment pools.

Effective for periods beginning after December 15, 2011, GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, provides guidance for financial reporting of deferred outflows of resources (consumption of net assets by the government that is applicable to a future reporting period) and deferred inflows of resources (an acquisition of net assets by the government that is applicable to a future reporting period) and standardizes their effects on the government's net position. The impact of the adoption of this statement has not been determined by management.

Effective for periods beginning after June 15, 2011, GASB Statement No. 64, *Derivative Instruments: Application of Hedge Termination Provisions – an amendment of GASB Statement No. 53*, provides criteria that establishes when the effective hedging relationship, with respect to an interest rate swap agreement, continues after the replacement of a swap counterparty or a swap counterparty's credit support provider, in order to enhance comparability and improve financial reporting The impact of the adoption of this statement has not been determined by management.

Basis of Accounting

The government-wide financial statements are presented using the economic resources measurement focus and are presented using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

In the fund, the financial statements government fund use a current financial resources measurement focus and are accounted for using the modified accrual basis of accounting. Revenues are recognized as soon as they are considered measurable and available. Revenues are considered available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period.

For this purpose, the Corporation considers revenues to be available if they are collected within 90 days after the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred.

Fiduciary financial statements are reported on a full accrual basis and only present a statement of assets and liabilities. The Corporation has one Agency fund, the Tobacco Settlement Healthcare and Capital Improvement Fund, for capital improvement funds held for the Government of the U.S. Virgin Islands and for which assets are reflected as restricted in the Statement of Fiduciary Assets. The fund is used by the Government of the United States Virgin Islands to provide funds for hospital and healthcare projects for the residents of the United States Virgin Islands.

The Corporation reports one governmental fund—the Debt Service Fund. As a blended component unit of the U.S. Virgin Islands Government, the Corporation's financial statements are combined into the basic financial statements of the U.S. Virgin Islands Government. When both restricted and unrestricted resources are available for use, it is the Corporation's policy to use restricted resources first, then unrestricted resources as they are needed.

Cash and Cash Equivalents

Cash includes cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date acquired by the Corporation.

Investments

The Corporation reports investments at fair value. Investment fair values are based on quoted market prices.

Taxes

The Corporation is exempt from the payment of all U.S. Virgin Islands taxes on all its assets and income.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Accounts Receivables

Accounts receivable is for amounts due which pertains to revenues expected from the TSRs.

Restricted Assets

The use of certain assets of the Corporation is restricted by specific provisions of bond resolutions. Assets so designated are identified as restricted assets on the statement of net deficit.

Deferred Revenue

Under GASBS 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, the Corporation recognized the purchase price as a deferred charge that is amortized over the life of the sale agreement.

Bond Costs

Bond discounts and issuance costs are amortized over the life of the bonds using the interest method.

3. Restricted Investments

The Corporation maintains restricted investments for the purpose of Debt Service. The Corporation also manages the Tobacco Settlement Health Care & Capital Improvement Fund for the Government of the Virgin Islands (the "Government") in an agency capacity.

Restricted investments at September 30, 2011 were as follows:

Debt Service Fund:

Investment Type	Par value	Fair value	Maturity
Money Market Fund	$ 577,727	$ 577,727	
Federal National Mortgage Assoc.	1,744,908	1,781,964	11/09/2011
Repurchase Agreement	434,543	434,543	05/15/2031
Debt service reserve	$ 2,757,178	$2,794,234	

Tobacco Settlement Health Care and Capital Improvement Fund (Agency Fund):

	Fair Value
Money Market Fund	$ 2,522,168
Agency Fund	$ 2,522,168

Activity in the agency fund for 2011 consisted of the following:

Investments: Beginning of period	$ 2,727,092
Disbursements for capital projects	(204,935)
Earnings	11
Investments: End of period	$ 2,522,168

Interest Rate Risk. Interest rate risk is the risk that changes in an interest rate will adversely affect the fair value of an investment. The Corporation does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair market value losses arising from increasing interest rates.

Credit Risk. Authorizing legislation of the Corporation does not limit investments by credit rating categories. The Corporation does not have an investment policy that limits its investment choices. At September 30, 2011, the Corporation's investment in money market funds was rated A- and A-1 by Standard & Poor's, and P-1 and A3 by Moody's Investors Service. The Corporation's investment in a Federal National Mortgage Association note was rated P-1 by Moody's Investors Service and F1+ by Fitch Ratings. The credit ratings of the securities underlying the repurchase agreement consisted of the following securities:

			Ratings		
Investment	Coupon	Maturity date	Standards & poors	Moody	Fitch
US Treasury	4.50	August 15, 2039	AA+	Aaa	AAA
US Treasury	4.38	November 15, 2039	AA+	Aaa	AAA
Fannie Mae	2.63	November 20, 2014	No ratings	Aaa	AAA
Freddie Mac	5.13	November 17, 2017	No ratings	Aaa	AAA

Concentration of Credit Risk. The Corporation places no limit on the amount that may be invested in one issuer.

Governmental Fund: At September 30, 2011, more than 5% of the Corporation's Governmental Fund investments were invested in: Invesco Treasury Cash Management (20.7%), a PSA Master Repurchase Agreement with Bayerische Bank (15.6%), and Federal National Mortgage Association Discount Note (63.8%).

Agency Fund: At September 30, 2011, agency fund investments were invested in Invesco Treasury Cash Management (54.0%) and Goldman Financial Square Money Market Fund (46.0%).

Custodial Credit Risk. The Corporation does not have a custodial credit risk policy. This is the risk that the Government will not be able to recover the value of its investments that are in the possession of an outside party. At September 30, 2011, all investments of the Corporation were held in the name of The Bank of New York Trust Company, N.A. as Trustee for the Corporation.

The security underlying the repurchase agreement to resell, which consists of a Federal National Mortgage Association Discount Note is held by the Custodian in its own name for the benefit of the trustee. This note collateral has a maturity date of November 9, 2011. This investment is rolled over at maturity with similar investments to the extent funds remain in the debt service fund after payment of amount due. The long-term repurchase agreement bears a fixed interest rate of 4.25%.

4. Deferred Charge on the Purchase of Tobacco Settlement Rights

On November 1, 2001, the Government entered into a purchase and sale agreement with the Corporation. Under the terms of the Agreement, the Government sold 100% of its right to receive future revenues in connection with the Master Settlement Agreement between tobacco companies and participating states and territories.

The term of the Agreement is for thirty (30) years ending in 2031. The value attached to the future revenue stream was $18,453,870. The Corporation issued the 2001 Series Bonds to purchase these rights.

Following is a summary of the amounts reported in fiscal year 2011:

Deferred charge on purchase of tobacco settlement rights (TSR)	$	18,453,870
Amortization		(5,463,654)
Net deferred charge on purchase of tobacco settlement rights	$	12,990,217

Amortization of the deferred charge amounted to $667,183 for the year ended September 30, 2011.

5. Bonds Payable

	September 30, 2011					
Series	**Date of Issue**		**Original Issuance**	**Interest Rate**		**Ultimate Maturity Value**
Series 2001, Capital Appreciation	November 20, 2001	$	6,234,862	4.62%	$	8,210,000
Series 2001, Term Bond	November 20, 2001		7,430,000	4.95%		7,430,000
Series 2001, Term Bond	November 20, 2001		8,045,000	5.13%		8,045,000
2006 Series A	March 15, 2006		4,764,710	6.00%		28,550,000
2006 Series B	March 15, 2006		512,471	7.00%		3,295,000
2006 Series C	March 15, 2006		867,690	7.00%		6,200,000
2006 Series D	March 15, 2006		1,145,138	8.00%		10,100,000
Subtotal		$	28,999,871		$	71,830,000
Unamortized accretion interest on capital appreciation bonds						(37,767,163)
Bond principal payments						(4,205,000)
Turbo redemptions						(3,935,000)
Total bonds payable outstanding as of September 30, 2011					$	25,922,837

On March 15, 2006, the Corporation issued the 2006 Tobacco Settlement Financing Corporation Asset-Backed Bonds, Subordinated Series 2006 (Turbo and Capital Appreciation Bonds) amounting to $48,145,000, with an issue value of $7,290,009 net of accretion of $40,854,991.

The bonds are secured and payable from collections including all Tobacco Settlement Revenues to be received by the Corporation, reserves, amounts held in other accounts established by the indenture and the Corporation's rights under the purchase agreement. The proceeds have been used for the purpose of (i) financing several capital, hospital and health development projects for the benefit of the Virgin Islands and its residents, (ii) pay certain costs of issuance relating to the Series 2006 Bonds, and (iii) the Corporation's operating costs.

On November 20, 2001, the Corporation issued the 2001 Tobacco Settlement Financing Corporation Asset-Backed Bonds (Term and Capital Appreciation Bonds) amounting to $23,685,000, with an issue value of $21,709,862 net of accretion of $1,975,138. The bonds are secured and payable from collections including all Tobacco Settlement Revenues to be received by the Corporation, reserves, amounts held in other accounts established by the indenture and the Corporation's rights under the purchase agreement. The proceeds have been used for the purpose of (i) purchasing all rights, title, and interest in certain litigation awards under the MSA entered into by participating cigarette manufacturers, (ii) issuing Tobacco Settlement Asset-Backed Bonds to pay the purchase price for the rights, and (iii) providing funds for hospital and healthcare projects in the United States Virgin Islands.

Interest on the Series 2001 Bonds is payable semi-annually on each May and November 15, beginning with May 2002 for the Term Bonds. The Corporation is responsible for all principal and interest payments on the bonds. The convertible Capital Appreciation Bonds will accrete interest prior to November 15, 2007 and will accrue interest subsequent to that date. Interest will compound on May and November 15.

Interest on the Series 2006 Bonds is not paid currently but accretes from the date of delivery, compounded every May 15 and November 15, commencing May 15, 2006 and is paid at maturity or upon prior redemption, provided however that the 2001 Series Bonds have been paid in full.

Interest paid during the year ended September 30, 2011 was $832 thousand.

Future maturity dates and debt service requirements for the 2001 Term Bonds and 2006 Capital Appreciation Bonds are as follows:

Future Debt Service Requirements

	Principal	Interest	Total
2012	$ 1,265,000	$ 771,383	$ 2,036,383
2013	1,335,000	711,295	2,046,295
2014	1,405,000	646,548	2,051,548
2015	-	577,000	577,000
2016	-	577,000	577,000
2017-2021	3,495,000	2,885,000	6,380,000
2022-2026	-	2,011,250	2,011,250
2027-2031	8,045,000	2,011,250	10,056,250
2032-2035	48,145,000	-	48,145,000
Less: Future accretion	(37,767,163)	-	(37,767,163)
	$ 25,922,837	$ 10,190,725	$ 36,113,562

Change in Outstanding Debt

	Total Series	Series 2001	Series 2006
Balance at September 30, 2010	$ 26,573,298	$ 16,845,000	$ 9,728,298
Principal payments	(1,300,000)	(1,300,000)	-
Accretion	649,539	-	649,539
Balance at September 30, 2011	$ 25,922,837	$ 15,545,000	$ 10,377,837

Other Information

The Series 2006 Bonds are subordinated in right of payment and lien priority to the Senior Bonds and so long as any Senior Bond remains outstanding, no payment on the Series 2006 Bonds may be made.

The Indenture Trustee, the Bondholders, and the Beneficial Owners cannot exercise any rights or remedies with respect to the Series 2006 Bonds, and no default or event default can exist or be declared. The Series 2006 Bonds do not pay any current interest. All interest on this series accretes until both the principal and accreted interest are paid.

The Series 2001 Tobacco Bonds became subject to optional redemption on May 15, 2011. The Series 2001 Tobacco Bonds maturing after May 15, 2012, are redeemable at the option of the Authority, in whole or in part, at a redemption price of 100% of the principal amount thereof, plus accrued interest to the date of redemption.

The Corporation has covenanted to apply 100% of any surplus collections under the MSA to the special mandatory par redemption of the Term Bonds in order of maturity.

"Turbo Redemptions" represent the requirement contained in the Indenture to apply 100% of all collections that are in excess of the requirements in the Indenture for the funding of the operating expenses; the deposits to the "Debt Service Account" for the funding of interest, sinking fund installments, and Term Bond maturities; maintenance of the Liquidity Reserve Account and the "Operating Contingency Account" (such excess, surplus collections); to the redemption of Series 2001 Term Bonds on each distribution date (each a Turbo Redemption Date) in ascending order of maturity. Such surplus collections will be deposited in an account established and maintained by the trustee under the Indenture (the Turbo Redemption Account). Turbo Redemptions will be credited against sinking fund installments for any particular Series 2001 Term Bonds in ascending order of sinking fund installment dates. Turbo Redemptions are not scheduled amortization payments and are to be made only from surplus collections, if any, and from amounts on deposit in the "Partial Lump-Sum Payment Account" with confirmation from each rating agency that no rating then in effect, with respect to the Series 2001 Term Bonds, from such rating agency will be withdrawn, reduced, or suspended.

The Tobacco Settlement Financing Corporation exercised its optional redemption on Term Bonds in the amounts of $135 thousand in May 2011, $315 thousand in May 2010, $645 thousand in May 2009, $5 thousand in November 2008, $495 thousand in May 2008, $20 thousand in November 2007, $295 thousand in May 2007, $5 thousand in November 2006, $265 thousand in May 2006, and $10 thousand in November 2005 (in fiscal years 2011 through 2006).

6. Concentration of Credit Risk

The payment of the Series 2001 Term Bonds and 2006 Capital Appreciation Bonds is dependent on the receipt of TSRs. The amount of TSRs collected is dependent on many factors, including cigarette consumption and the continued financial capability of the OPMs. Such bonds are secured by and payable solely from TSRs and investment earnings pledged under the Bond Indenture and amounts established and held in accordance with the Bond Indenture.

The Series 2001 Term Bonds and 2006 Capital Appreciation Bonds are payable only from the assets of the Corporation. In the event that the assets of the Corporation have been exhausted, no amounts will thereafter be paid on the Series 2001 Term Bonds.

The Series 2001 Term Bonds are not legal or moral obligations of the Government and no recourse may be had thereto for payment of amounts owing on the Series 2001 Term Bonds. The Corporation's only source of funds for payments on the Series 2001 Term Bonds is the TSRs. The Corporation has no taxing power.

Because of the many adjustments included in the MSA, it is not possible to know the exact future collections under the MSA.

7. Contingencies

The assets of the Corporation are not available to pay any creditor of the Government of the Virgin Islands. The Bonds issued by the Corporation do not constitute a claim against the full faith, credit and taxing power of the General Funds of the Government.

The ability of the Corporation to meet debt service payments of bonds is contingent upon the receipt of Tobacco Settlement awards. There have been several multi-million, and a few multi-billion, dollar verdicts against the tobacco companies in the recent years. Consumer groups have introduced litigation against the tobacco manufacturers asserting that the MSA violates certain provisions of the United States Constitution, federal antitrust laws, and others. Increases in sales and excise taxes by states, cities and other local governmental units may reduce cigarette consumption. In addition, some of the cigarette companies have withheld a portion of their April 15, 2006, 2007, 2009 and 2010 payments, asserting that they lost market share to the Non-Participating Manufacturers (NPMs) in prior years (2003, 2004, 2005, 2006 and 2007, respectively). These withholdings reduced the MSA payments received by the Settling States by approximately 12% in 2006, 10% in 2007, 7% in 2008 and 12% in 2009 and 2010. Estimated TSR withholdings by the Corporation amounted to approximately $140,000 for 2006, $120,000 for 2007 and $100,000 for 2008 to 2010. Certain states have subsequently begun legal proceedings to have the withheld funds released with interest.

8. Related Party Transactions

The Corporation reimbursed administrative fees to another blended component unit of the USVI Government amounting to $75,000 in fiscal years 2011. The Corporation disbursed capital project funds to Government hospitals and health organizations from the tobacco settlement Health Care and Capital Improvement Fund amounting to $204,935 in fiscal year 2011.

9. Reconciliation

Total Fund Balance - Governmental Fund	$ 2,789,725
Amounts reported for governmental activities in the statement of net deficit are different because:	
The Corporation's Tobacco Settlement revenues are collected after year end	1,600,565
Govermental funds report debt issuance cost and purchase cost of future TSRs as expenditures when those costs are first incurred because they require the use of current financial resources. However, debt issuance costs, original issuance discount and purchase cost of future TSRs must be included as a deferred charge in government wide financial statements:	
Unamortized balance of deferred charge for bond issue cost	843,191
Unamortized balance of deferred charge for original issue discount	335,348
Unamortized balance of deferred charge for purchase of TSRs	12,990,217
Long term liabilities applicable to the Corporation’s governmental activities are not due and payable in the current period and accordingly are not reported in the fund. However, these liabilities are included in the statement of net deficit:	
Bonds payable	(25,922,837)
Net deficit	$ (7,363,791)

Net Change in Fund balance	$	(34,186)
Govermental funds report bond principal repayments, debt issuance costs and purchase cost of future TSRs as expenditure when those costs are first incurred because they require the use of current financial resources. However, bond principal repayment, debt issuance costs and purchase cost of future TSRs must be included as a deferred charges in government wide financial statements and amortized in the statements of activities:		(141,769)
TSRs are recorded as revenue on the fund statement when it is received and on the statement of activities when it is incurred		29,930
Net change in deficit	$	(146,025)

10. Subsequent Events

The Corporation has performed a review of subsequent events from October 1, 2011 through December 13, 2012, the date the financial statements were available to be issued, and concluded there were no events or transactions that occurred during this period that required recognition or disclosure in the financial statements.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors of
Tobacco Financing Settlement Corporation:

We have audited the financial statements of Tobacco Financing Settlement Corporation the (TFSC), as of September 30, 2011, and for the year then ended, and have issued our report thereon dated December 13, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Corporation's internal control over financial reporting as a basis for designing our audit procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal controls over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal controls over financial reporting.

A *deficiency in control* exists when the design or operation of a control does not allow management or employees, in normal course of performing their assigned functions, to detect or prevent and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal controls, such that there is a reasonable possibility that a material misstatement of the financial statements will not be detected or prevented and corrected on a timely basis.

Our consideration of internal controls over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal controls over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and other matters

As part of obtaining reasonable assurance about whether the Corporation's financial statements are free from material misstatements, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Directors and management and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche

December 13, 2012