

FINANCIAL STATEMENTS

Tobacco Settlement Financing Corporation  
(a blended component unit of the Government of the  
United States Virgin Islands)  
Years Ended September 30, 2012  
With Report of Independent Auditors

Ernst & Young LLP



Tobacco Settlement Financing Corporation  
(a blended component unit of the Government of the United States Virgin Islands)

Financial Statements

Year Ended September 30, 2012

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## Report of Independent Auditors

Board of Directors of  
Tobacco Settlement Financing Corporation

We have audited the accompanying financial statements of the governmental activities, the debt service major fund and the aggregate remaining fund information of the Tobacco Settlement Financing Corporation (the “Corporation”) for as of and for the year ended September 30, 2012, which collectively comprise the Corporation’s basic financial statements as listed in the table of contents. 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 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. We were not engaged to perform an audit of the Corporation’s internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and 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 above present fairly, in all material respects, the respective financial position of the governmental activities, the debt service fund and the aggregate remaining fund information of the Corporation as of September 30, 2012, and the respective changes in financial position for the year then ended in conformity with U.S. generally accepted accounting principles.

The financial statements of the Corporation as of September 30, 2011 and for the year then ended were audited by other auditors. As described in Note 7, the Corporation has recorded adjustments to restate certain balances as of October 1, 2011. We did not apply any audit procedures to such adjustments and, therefore, they are unaudited.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 13, 2015, on our consideration of the Corporation's internal control over financial reporting and on our tests 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 control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control 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 considered in assessing the results of our audit.

Accounting principles generally accepted in the United States require that management's discussion and analysis on pages 3 through 11 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Ernst & Young LLP*

August 13, 2015

**Tobacco Settlement Financing Corporation**  
(a blended component unit of the Government of the United States Virgin Islands)

**Management's Discussion and Analysis**

Year Ended September 30, 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 year that ended September 30, 2012.

**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'

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Management's Discussion and Analysis (continued)

Year Ended September 30, 2012

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, 2012 and 2011, 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 \$48.1 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 Kimmelman 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, 2012 and 2011, the Corporation had outstanding bonds of approximately \$25.3 million and \$25.9 million, respectively.

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Management's Discussion and Analysis (continued)

Year Ended September 30, 2012

**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 assets, 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*. These statements measure 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 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.

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Management's Discussion and Analysis (continued)

Year Ended September 30, 2012

- The current year's *Statement of Fiduciary Net Assets* 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 Deficit*--Table 1 summarizes the Corporation's Statement of Net Deficit as of September 30, 2012 and 2011.

***Table 1: Summary of Statement of Net Deficit***

	<b>September 30</b>	
	<b>2012</b>	<b>2011</b>
	<i>(As restated)</i>	
Current assets		
Restricted	\$ 2,874,893	\$ 2,794,234
Unrestricted	1,600,904	1,600,565
Other assets	13,311,694	14,168,756
Total assets	<u>\$ 17,787,491</u>	<u>\$ 18,563,555</u>
Current liabilities	\$ 1,599,861	\$ 1,654,269
Bonds payable	23,916,156	24,557,837
Other liabilities	-	4,509
Total liabilities	<u>\$ 25,516,017</u>	<u>\$ 26,216,615</u>
Total net deficit	<u>\$ (7,728,526)</u>	<u>\$ (7,653,060)</u>



**Tobacco Settlement Financing Corporation**  
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**Management's Discussion and Analysis (continued)**

Year Ended September 30, 2012

For Fiscal Year 2012, the Corporation's assets amounted to \$17.8 million, of which \$2.9 million represented restricted investments, \$1.6 million represented accrued TSRs, and \$12.3 million representing a deferred charge in connection with the purchase of tobacco settlement rights. Restricted investments increased from the previous year by approximately \$81 thousand mainly due to the net effect of \$2.1 million collected in TSR's in April 2012, interest income of \$169 thousand, bond principal payments of \$1.4 million, interest expense of \$747 thousand, and general and administrative expense of \$82 thousand. Other assets decreased from the previous year due to the amortization of the TSR deferred charge, bond issue costs and original issue discount of \$829 thousand. Total liabilities amounted to \$25.5 million and decreased from the previous year by \$701 thousand. The decrease in total liabilities is mainly due to the net effect of principal payments of \$1.4 million and accretion expense of \$693 thousand.

*Statement of Activities*--Table 2 summarizes the Corporation's Statement of Activities for the fiscal years ended September 30, 2012 and 2011.

***Table 2: Summary of Statement of Activities***

	<b>September 30</b>	
	<b>2012</b>	<b>2011</b>
	<i>(As restated)</i>	
General and program revenues	<b>\$ 2,303,980</b>	\$ 2,214,085
Expenses	<b>2,379,446</b>	2,360,110
Change in net deficit	<b>(75,466)</b>	(146,025)
Net deficit - beginning of year	<b>(7,653,060)</b>	(7,507,035)
Net deficit - end of year	<b>\$ (7,728,526)</b>	\$ (7,653,060)

For Fiscal Year 2012, general revenues of \$2.3 million reflect investment earnings of \$169 thousand and TSRs of \$2.1 million. The Corporation's expenses included interest expense of \$747 thousand, general and administrative expenses of \$82 thousand, accretion expense of \$693 thousand, and amortization expense of bond discounts, issuance costs and deferred charges on the purchase of tobacco settlement rights of \$857 thousand. Changes from 2011 were not significant due to similar activities and amounts.

Tobacco Settlement Financing Corporation  
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Management's Discussion and Analysis (continued)

Year Ended September 30, 2012

Governmental Fund Financial Statements

*Governmental Fund Balance Sheet*--Table 3 summarizes the Corporation's Balance Sheet as of September 30, 2012 and 2011.

***Table 3: Summary of Governmental Fund Balance Sheet***

	September 30	
	2012	2011
Current assets		
Restricted assets	\$ 2,868,166	\$ 2,794,234
Other assets	6,727	-
Total assets	2,874,893	2,794,234
Total liabilities	-	-
Total restricted fund balance	\$ 2,874,893	\$ 2,794,234

For Fiscal Year 2012, the Corporation's assets, as reported on the Governmental Fund Balance Sheet, amounted to approximately \$2.9 million, which are restricted investments. The increase in restricted assets is mainly due to the net effect of \$2.1 million collected in TSR's in April 2012, interest income of \$169 thousand, principal payments of \$1.4 million, interest expense payments of \$771 thousand, and general and administrative expense paid of \$82 thousand.

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Management's Discussion and Analysis (continued)

Year Ended September 30, 2012

*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, 2012 and 2011.

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

	September 30	
	2012	2011
General and program revenues	\$ 2,303,641	\$ 2,184,155
Expenses	2,218,473	2,218,341
Excess of revenues (expenses)	85,168	(34,186)
Restricted fund balance - beginning of year	2,789,725	2,823,911
Restricted fund balance - end of year	\$ 2,874,893	\$ 2,789,725

General and program revenues, for the year ending September 30, 2012, of \$2.3 million reflects the receipt of \$2.1 million in TSRs, and investment earnings of \$169 thousand. The Corporation's expenses included interest paid of \$771 thousand, principal expense of \$1.4 million, and \$82 thousand for general and administrative expenses. The increase in revenue is due to an increase in interest income.

*Statement of Fiduciary Net Assets*--Table 5 summarizes the Corporation's Statement of Fiduciary Net Assets as of September 30, 2012 and 2011.

***Table 5: Summary of Statement of Fiduciary Net Assets***

	September 30	
	2012	2011
Restricted assets	\$ 2,293,238	\$ 2,522,168
Total assets	\$ 2,293,238	\$ 2,522,168
Noncurrent liabilities	\$ 2,293,238	\$ 2,522,168
Total liabilities	\$ 2,293,238	\$ 2,522,168

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Management's Discussion and Analysis (continued)

Year Ended September 30, 2012

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, 2012 and 2011 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, 2006 through 2012, resulted in Turbo Redemptions of \$100,000 on May 15, 2012, \$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 ended September 30, 2012 and 2011.

TSFC bond ratings, as assigned by Moody, for the Series 2001 Capital Appreciation Bonds due on May 15, 2014, was Aaa, the Series 2001 Term Bonds, due on May 15, 2021 was A1, and the Series 2001 Term Bonds, due on May 15, 2031, was A3.

TSFC bond ratings, as assigned by Fitch Ratings, for the Series 2006A Bonds, due on May 15, 2035 was B, the Series 2006B Bonds, due on May 15, 2035 was B-, the Series 2006C Bonds, due on May 15, 2035 was B-, and the Series 2006D Bonds, due on May 15, 2035, was not rated.

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**Management's Discussion and Analysis (continued)**

Year Ended September 30, 2012

**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  
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Statement of Net Deficit and Governmental Fund Balance Sheet

September 30, 2012

	<b>Debt Service Fund and Total Government Fund</b>	<b>Reconciliation</b>	<b>Government- Wide Statement of Net Deficit</b>
<b>Assets</b>			
Current assets:			
Restricted investments	\$ 2,868,166	\$ -	\$ 2,868,166
Interest receivable	6,727	-	6,727
Accrued tobacco settlement revenues	-	1,600,904	1,600,904
Total current assets	2,874,893	1,600,904	4,475,797
Noncurrent assets:			
Bond issuance costs, net	-	704,987	704,987
Deferred charge - purchase of settlement rights, net	-	12,291,602	12,291,602
Total noncurrent assets	-	12,996,589	12,996,589
Total assets	\$ 2,874,893	\$ 14,597,493	\$ 17,472,386
<b>Liabilities</b>			
Current liabilities:			
Interest payable	\$ -	\$ 264,861	\$ 264,861
Bonds payable	-	1,335,000	1,335,000
Total current liabilities	-	1,599,861	1,599,861
Noncurrent liabilities:			
Bonds payable	-	23,601,051	23,601,051
Total noncurrent liabilities	-	23,601,051	23,601,051
Total liabilities	-	25,200,912	25,200,912
<b>Fund balance/net deficit</b>			
Restricted fund balance:			
Reserved for debt service	2,874,893	(2,874,893)	-
Total restricted fund balance	2,874,893	(2,874,893)	-
Total liabilities and restricted fund balance	\$ 2,874,893		
Net deficit:			
Restricted for debt service		2,874,893	2,874,893
Unrestricted		(10,603,419)	(10,603,419)
Total net deficit		\$ (7,728,526)	\$ (7,728,526)

See accompanying notes.

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Statement of Activities and Governmental Fund Statement of Revenues,  
Expenditures and Changes in Net Deficit/Fund Balance

Year Ended September 30, 2012

	<b>Debt Service Fund and Total Government Fund</b>	<b>Reconciliation</b>	<b>Government- Wide Statement of Activities</b>
<b>General and program revenues:</b>			
Tobacco settlement revenues	\$ 2,134,087	\$ 339	\$ 2,134,426
Interest income:			
Cash and investments	169,554	-	169,554
Total general and program revenues	2,303,641	339	2,303,980
<b>General and program expenses:</b>			
General and administrative expenses	82,090	-	82,090
Bond principal expense	1,365,000	(1,365,000)	-
Bond interest expense	771,383	(24,408)	746,975
Accretion expense	-	693,319	693,319
Amortization expense	-	857,062	857,062
Total general and program expenses	2,218,473	160,973	2,379,446
Net change in fund balance/net deficit	85,168	(160,634)	(75,466)
<b>Restricted fund balance/net deficit:</b>			
Beginning of year <i>(as restated)</i>	2,789,725	(10,442,785)	(7,653,060)
End of year	\$ 2,874,893	\$ (10,603,419)	\$ (7,728,526)

See accompanying notes.

**Tobacco Settlement Financing Corporation**  
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**Statements of Fiduciary Net Assets**

Year Ended September 30, 2012

**Assets**

Restricted investments	\$ 2,293,238
Total assets	<u>\$ 2,293,238</u>

**Liabilities**

Due to Government of the U.S. Virgin Islands	\$ 2,293,238
Total liabilities	<u>\$ 2,293,238</u>

*See accompanying notes.*



**Tobacco Settlement Financing Corporation**  
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**Financial Statements**

September 30, 2012

**1. Reporting Entity**

The Tobacco Settlement Financing Corporation (the “Corporation”) is a special-purpose, independent, instrumentality of 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 governmental units. The Governmental Accounting Standards Board (“GASB”) is the accepted, standard-setting body for establishing governmental and financial reporting standards.

**Basis of Presentation**

The Corporation’s basic financial statements include both government-wide (reporting on the corporation as a whole) and its only governmental fund financial statement.

**Government-wide Financial Statements**

The government-wide financial statements are prepared using the accrual basis of accounting and the economic resources measurement focus. Government-wide financial statements (i.e., the statement of net assets (deficit) and the statement of activities) do not provide information by fund or account group.

The statement of activities demonstrates the degree to which direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with the Corporation’s program. Program revenues include unrestricted interest income and Tobacco Settlement Rights received under the MSA.

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Financial Statements (continued)

September 30, 2012

**2. Summary of Significant Accounting Policies (continued)**

**Fund Financial Statements**

In addition to the government-wide financial statements, the Corporation presents fund financial statements for the Corporation's debt service fund, its only governmental fund. Governmental fund financial statements are prepared on the modified accrual basis of accounting and the current financial resources measurement focus.

Due to the single-purpose nature of the activities of the Corporation, the government-wide and fund financial statements have been presented together with an adjustments column reconciling the two statements. In addition, the financial statements of the Corporation's only fiduciary (agency) fund, presented on the accrual basis of accounting, are separately presented.

**New and Adopted Accounting Standards**

Effective for the year ended September 30, 2008, 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. In connection with the implementation of this Statement, the Corporation realized a deferred charge for the purchase of tobacco settlement rights from the Government of the Virgin Islands of \$18.4 million. The charge will be amortized over thirty (30) years. The amortized value of the deferred charge at September 30, 2012 was \$12.3 million.

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.

Tobacco Settlement Financing Corporation  
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Financial Statements (continued)

September 30, 2012

**2. Summary of Significant Accounting Policies (continued)**

**New and Adopted Accounting Standards (continued)**

The adoption of GASB Statement No. 64, *Derivative Instruments: Application of Hedge Termination Provisions – an amendment of GASB Statement No. 53*, in the opinion of management, did not have a material effect on the Corporation’s financial statements.

Effective for periods beginning after December 15, 2012, GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, establishes accounting and financial reporting standards that reclassify as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The impact of the adoption of this Statement has not been determined by management.

Effective for periods beginning after December 15, 2012, GASB Statement No. 66, *Technical Corrections – 2012 - An amendment of GASB Statements No. 10 and No. 62*, resolves conflicting accounting and financial reporting guidance provided in Statements No. 10, 54 and 62. The impact of the adoption of this Statement has not been determined by management.

Effective for periods beginning after June 15, 2013, GASB Statement No. 67, *Financial Reporting for Pension Plans – amendment of GASB Statement No. 25*, provides guidance to improve reporting by state and local governmental pension plans. The impact of the adoption of this Statement has not been determined by management, although it is not expected to impact the Corporation since it has no employees.

Effective for periods beginning after June 15, 2014, GASB Statement No. 68, *Accounting and Financial Reporting for Pensions-an amendment of GASB Statement No. 27*, provides guidance to improve reporting of financial support provided by other entities to state and local government pension plans. The impact of the adoption of this Statement has not been determined by management, although it is not expected to impact the Corporation since it has no employees.

Effective for periods beginning after December 15, 2013, GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*, provides financial reporting standards related to government combinations and disposals of government operations. The impact of the adoption of this Statement has not been determined by management.

Tobacco Settlement Financing Corporation  
(a blended component unit of the Government of the United States Virgin Islands)

Financial Statements (continued)

September 30, 2012

**2. Summary of Significant Accounting Policies (continued)**

**New and Adopted Accounting Standards (continued)**

Effective for periods beginning after June 15, 2013, GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, provides financial reporting standards for state and local governments that extend and receive nonexchange financial guarantees. The impact of the adoption of this Statement has not been determined by management.

Effective on periods beginning after June 15, 2014, GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68*, addressed an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The impact of the adoption of this Statement has not been determined by management, although it is not expected to impact the Corporation since it has no employees.

Effective on periods beginning after June 15, 2015, GASB Statement No. 72, *Fair Value Measurement and Application*, addressed accounting and financial reporting issues related to fair value measurements. The impact of the adoption of this Statement has not been determined by management.

Effective on periods beginning after June 15, 2015, GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, improve the usefulness of information about pensions included in the general purpose external financial reports of state and local governments for making decisions and assessing accountability. The impact of the adoption of this Statement has not been determined by management, although it is not expected to impact the Corporation since it has no employees.

Effective on periods beginning after June 15, 2016, GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, improve the usefulness of information about postemployment benefits other than pensions (other postemployment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability. The impact of the adoption of this Statement has not been determined by management, although it is not expected to impact the Corporation since it has no employees.

Tobacco Settlement Financing Corporation  
(a blended component unit of the Government of the United States Virgin Islands)

Financial Statements (continued)

September 30, 2012

**2. Summary of Significant Accounting Policies (continued)**

**New and Adopted Accounting Standards (continued)**

Effective on periods beginning after June 15, 2017, GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. The impact of the adoption of this Statement has not been determined by management, although it is not expected to impact the Corporation since it has no employees.

Effective on periods beginning after June 15, 2015, GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, identify—in the context of the current governmental financial reporting environment—the hierarchy of generally accepted accounting principles (GAAP). 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 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.

The governmental fund financial statements are presented using the current financial resources measurement focus and the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recorded 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 presented on the accrual basis of accounting and include only a statement of fiduciary net assets. The Corporation has one Agency fund, the Tobacco Settlement Healthcare and Capital Improvement Fund, for capital improvement funds held as restricted assets for the Government of the U.S. Virgin Islands. 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.

Tobacco Settlement Financing Corporation  
(a blended component unit of the Government of the United States Virgin Islands)

Financial Statements (continued)

September 30, 2012

**2. Summary of Significant Accounting Policies (continued)**

**Basis of Accounting (continued)**

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, 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 Receivable**

The Corporation reports a receivable for TSR revenue received after the close of the fiscal year.

Tobacco Settlement Financing Corporation  
(a blended component unit of the Government of the United States Virgin Islands)

Financial Statements (continued)

September 30, 2012

**2. Summary of Significant Accounting Policies (continued)**

**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 Charge**

Under GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, the Corporation recognized the purchase price of tobacco settlement rights from the Government of the Virgin Islands as a deferred charge that is amortized over the life of the sale agreement.

**Bond Discounts, Premiums and Issuance Costs**

Bond discounts and issuance costs are amortized over the life of the bonds using the interest method. Capital appreciation bonds are accreted over the term of the bonds issued.

**3. Restricted Investments**

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

Restricted investments at September 30, 2012 were as follows:

**Debt Service Fund:**

<b><u>Investment Type</u></b>	<b><u>Par value</u></b>	<b><u>Fair value</u></b>	<b><u>Maturity</u></b>
Money Market Fund	\$ 11,190	\$ 11,190	
Federal National Mortgage Association Repurchase Agreement	2,452,000	2,451,976	10/17/2012
	405,000	405,000	05/15/2031
Debt service reserve	<u>\$ 2,868,190</u>	<u>\$ 2,868,166</u>	

Tobacco Settlement Financing Corporation  
(a blended component unit of the Government of the United States Virgin Islands)

Financial Statements (continued)

September 30, 2012

**3. Restricted Investments (continued)**

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

Money Market Fund	\$ 2,293,238
Total Agency Fund	\$ 2,293,238

Activity in the agency fund for 2012 consisted of the following:

Investments: Beginning of period	\$ 2,522,168
Disbursements for capital projects	(229,006)
Earnings	76
Investments: End of period	\$ 2,293,238

**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, 2012, the Corporation's investment in money market funds was rated AAA by Standard & Poor's, and Aaa by Moody's Investors Service. The Corporation's investment in the Federal National Mortgage Association was rated Aaa by Moody's.

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

**Governmental Fund:** At September 30, 2012, more than 5% of the Corporation's Governmental Fund investments were invested in a Federal National Mortgage Association Discount Note (85.49%), and a PSA Master Repurchase Agreement with Bayerische Bank (14.12%).

**Agency Fund:** At September 30, 2012, agency fund investments were invested in Invesco Treasury Cash Management (57.67%) and Goldman Financial Square Money Market Fund (42.33%).



Tobacco Settlement Financing Corporation  
(a blended component unit of the Government of the United States Virgin Islands)

Financial Statements (continued)

September 30, 2012

**3. Restricted Investments (continued)**

**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, 2012, 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.

**4. Deferred Charge on the Purchase of Tobacco Settlement Rights**

On November 1, 2001, the Government of the Virgin Islands 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 was for thirty (30) years ending in 2031. The value attached to the future revenue stream was \$18,453,870. The TSFC issued the 2001 Series Bonds to purchase the rights.

Under GASBS 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, the TSFC recognized the purchase price as a deferred charge that is amortized over the life of the sale agreement. Following is a summary of the amounts reported in fiscal year 2012:

Deferred charge on purchase of tobacco settlement rights (TSR)	\$ 18,453,870
Amortization	<u>(6,162,268)</u>
Net deferred charge on purchase of tobacco settlement rights	<u>\$ 12,291,602</u>

Amortization of the deferred charge amounted to \$670,423 for the year ended September 30, 2012.

**Tobacco Settlement Financing Corporation**  
(a blended component unit of the Government of the United States Virgin Islands)

**Financial Statements (continued)**

September 30, 2012

**5. Bonds Payable**

Bonds payable consisted of the following as of September 30, 2012:

<b>Series</b>	<b>Date of Issue</b>	<b>Original Issuance</b>	<b>Interest Rate</b>	<b>Ultimate Maturity Value</b>
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		<u>\$ 28,999,871</u>		<u>71,830,000</u>
Unamortized accretion interest on capital appreciation bonds				(37,073,844)
Bond principal payments				(5,470,000)
Turbo redemptions				(4,035,000)
Unamortized bond discounts				<u>(315,105)</u>
Total bonds payable outstanding as of September 30, 2012				<u>\$ 24,936,051</u>

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) to finance several capital, hospital and health development projects for the benefit of the Virgin Islands and its residents, (ii) to pay certain costs of issuing the Series 2006 Bonds, and (iii) to fund operating costs associated with the Series 2006 Bonds.

**Tobacco Settlement Financing Corporation**  
(a blended component unit of the Government of the United States Virgin Islands)

**Financial Statements (continued)**

September 30, 2012

**5. Bonds Payable (continued)**

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, 2012 was \$747 thousand.

**Tobacco Settlement Financing Corporation**  
(a blended component unit of the Government of the United States Virgin Islands)

**Financial Statements (continued)**

September 30, 2012

**5. Bonds Payable (continued)**

**Future Debt Service Requirements**

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

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2013	\$ 1,335,000	\$ 706,295	\$ 2,041,295
2014	1,405,000	641,548	2,046,548
2015	–	572,000	572,000
2016	–	572,000	572,000
2017	–	572,000	572,000
2018-2022	3,395,000	2,690,250	6,085,250
2023-2027	–	2,011,250	2,011,250
2028-2032	8,045,000	1,609,000	9,654,000
2033-2035	48,145,000	–	48,145,000
Less: Future accretion	(37,073,844)	–	(37,073,844)
	<u>\$ 25,251,156</u>	<u>\$ 9,374,343</u>	<u>\$ 34,625,499</u>

**Change in Outstanding Debt**

	<u>Total Series</u>	<u>Series 2001</u>	<u>Series 2006</u>
Balance at September 30, 2011	\$ 25,922,837	\$ 15,545,000	\$ 10,377,837
Principal payments	(1,365,000)	(1,365,000)	–
Accretion	693,319	–	693,319
Balance at September 30, 2012	<u>\$ 25,251,156</u>	<u>\$ 14,180,000</u>	<u>\$ 11,071,156</u>

**Tobacco Settlement Financing Corporation**  
(a blended component unit of the Government of the United States Virgin Islands)

**Financial Statements (continued)**

September 30, 2012

**5. Bonds Payable (continued)**

**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 interests 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.

Tobacco Settlement Financing Corporation  
(a blended component unit of the Government of the United States Virgin Islands)

Financial Statements (continued)

September 30, 2012

**5. Bonds Payable (continued)**

**Other Information (continued)**

The Tobacco Settlement Financing Corporation exercised its optional redemption on Term Bonds in the amounts of \$100 thousand in May 2012, \$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 2012 through 2006).

**6. Contingencies on Bonds Payable**

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 of the United States Virgin Islands, 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.

Tobacco Settlement Financing Corporation  
(a blended component unit of the Government of the United States Virgin Islands)

Financial Statements (continued)

September 30, 2012

**7. Prior Period Adjustment (Unaudited)**

During 2012, the Corporation identified an error in the 2011 government-wide financial statements whereby it had understated the interest expense accrual and net deficit balance by \$289,269.

The Corporation's net deficit at September 30, 2011 has been restated as follows:

Beginning net deficit, as previously reported	\$ (7,363,791)
Prior period adjustment ( <i>unaudited</i> )	<u>(289,269)</u>
Beginning net assets, as restated ( <i>unaudited</i> )	<u><u>\$ (7,653,060)</u></u>

**8. Contingencies**

The assets of the Corporation are not available to pay any creditor of the Government of the United States 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.

Tobacco Settlement Financing Corporation  
(a blended component unit of the Government of the United States Virgin Islands)

Financial Statements (continued)

September 30, 2012

**8. Contingencies (continued)**

In addition, some of the cigarette companies have withheld a portion of their April 15, 2006, 2007 and 2008 payments, asserting that they lost market share to the Non-Participating Manufacturers (NPMs) in prior years (2003, 2004 and 2005, respectively). These withholdings reduced the MSA payments received by the Settling States by approximately 12% in 2006, 10% in 2007 and 7% in 2008. Estimated TSR withholdings by the Corporation amounted to approximately \$140,000 for 2006, \$120,000 for 2007 and \$100,000 for 2008. Certain states have subsequently begun legal proceedings to have the withheld funds released with interest. In June 2010, a three person arbitration panel was selected to begin state-specific hearings as to whether the states diligently enforced their state laws with regard to NPM. In November 2011, the U.S. Virgin Islands, and fifteen (15) other jurisdictions were advised that the PMs were not contesting diligent enforcement for their jurisdictions. Effective December 17, 2012, the PMs entered into a “term sheet” with twenty (20) settling states. In May 2013, two additional states joined the settlement. Hearings before the arbitration committee were completed in June 2013, and in September 2013 final determinations were issued to the remaining states as to whether they had diligently enforced their NPM laws. It is anticipated there will be ongoing legal disputes and negotiations about how moneys that were withheld are distributed between the PMs. Further, each year after 2003 is subject to a separate arbitration panel decision.

**9. Related Party Transactions**

The Corporation reimbursed administrative fees to another blended component unit of the USVI Government amounting to \$75,000 in fiscal years 2012. The Corporation disbursed capital project funds to Government hospitals and health organizations amounting to \$229,006 for the fiscal year ended September 30, 2012.

**10. Subsequent Events**

The Corporation has performed a review of subsequent events from October 1, 2013 through August 13, 2015, the date the financial statements were available to management, and concluded there were no events or transactions that occurred during this period that required recognition or disclosure in the financial statements.



## Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Board of Directors of  
Tobacco Settlement Financing Corporation

We have audited the financial statements of governmental activities, the debt service major fund and the aggregate remaining fund information of Tobacco Settlement Financing Corporation (the “Corporation”) as of and for the year ended September 30, 2012, and have issued our report thereon dated August 13, 2015. We conducted our audit in accordance with auditing standards generally accepted in the United States 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**

Management of the Corporation is responsible for establishing and maintaining effective 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 auditing 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 control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Corporation’s internal control over financial reporting.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as noted below, we identified a deficiency in internal control that we consider to be a material weakness.

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

**Finding Number: 12-01**

***Topic***

Bond Interest Payable

***Category***

Internal Controls

***Condition Found***

As a result of our audit procedures over bond interest payable, we noted that the Corporation failed to accrue approximately \$289,000 of interest for the year ended September 30, 2011. As a result, the Corporation's financial statements have been restated to correct this error.

***Criteria***

A fundamental element of a sound system of internal control is an effective financial statement close process. This process helps ensure that all financial transactions are properly recorded appropriately supported and subjected to supervisory review. The financial statement closing process includes performing proper accrual of interest expense in the recording of liabilities at the statement of net deficit date in the government-wide financial statements.

***Cause***

Proper controls were not in place to detect unrecorded liabilities as of September 30, 2011.

***Effect***

The Corporation's lack of control over the recording of interest payable and expense led to a post-closing adjustment being recorded in the financial statements, including a correction of a prior period error which resulted in the restatement of the beginning of year net deficit. Due to the nature and magnitude of this control deficiency, such control deficiency is considered to be a material weakness.

***Recommendation***

Management should improve the annual closing process including more effective controls over interest payable accrual, including proper review of the financial statements. Proper preventive procedures to ascertain proper inter-period allocation of expenditures and to determine whether all significant liabilities have been recorded should be implemented.

***Management's Response***

The Corporation concurs with this finding and will implement the recommendation provided.

Contact person for corrective action: Executive Director

Anticipated completion date: 09/30/13

## **Compliance and other matters**

As part of obtaining reasonable assurance about whether the Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

The Corporation's response to the finding identified in our audit is described above. We did not audit the Corporation's response and accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the Corporation's Board of Directors, others within the entity and is not intended to be and should not be used by anyone other than these specified parties.

*Ernst + Young LLP*

August 13, 2015

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