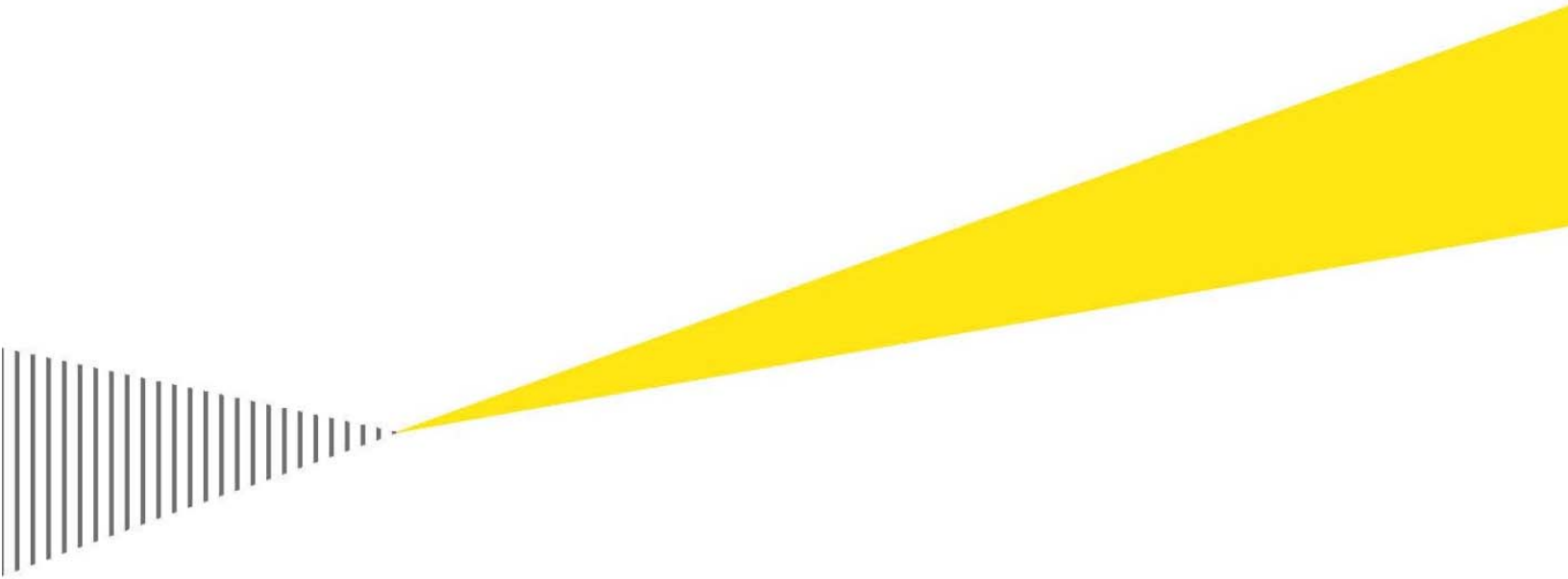


FINANCIAL STATEMENTS

Tobacco Settlement Financing Corporation
(a blended component unit of the Government of the
United States Virgin Islands)
Year Ended September 30, 2015
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, 2015

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Report of Independent Auditors

Board of Directors of
Tobacco Settlement Financing Corporation

Report on the Financial Statements

We have audited the accompanying financial statements of the 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, 2015, which collectively comprise the Corporation’s basic financial statements as listed in the table of contents, and the related notes to the financial statements.

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor’s Responsibility

Our responsibility is to express an opinion 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.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

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 major fund and the aggregate remaining fund information of the Corporation as of September 30, 2015, and the respective changes in financial position, for the year then ended in conformity with U.S. generally accepted accounting principles.

Required Supplementary Information

U.S. generally accepted accounting principles require that the 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 which 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our report dated July 27, 2016, 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* in considering the Corporation's internal control over financial reporting and compliance.

Ernst & Young LLP

July 27, 2016

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, 2015

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, 2015.

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

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

Management's Discussion and Analysis (continued)

Year Ended September 30, 2015

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, 2015, and 2014, 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, 2015 and 2014, the Corporation had outstanding bonds of approximately \$22.7 and \$23.3 million, 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 position, 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

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

Management's Discussion and Analysis (continued)

Year Ended September 30, 2015

statements have been presented together with an adjustments column reconciling the differences.

- *The Statement of Net Position and Debt Service Fund and Governmental Fund Balance Sheet* includes all of the Corporation's assets, deferred outflows of resources, and liabilities and provides information about the nature and amounts of investments in resources (assets), deferred charges on the purchase of tobacco settlement rights (deferred outflows of resources), 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 Position 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, deferred outflows of resources 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 Debt Service Fund and Governmental Fund Revenues, Expenditures, and Changes in 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 position changed during the fiscal year. All changes in net position 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 Position* 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.

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

Management's Discussion and Analysis (continued)

Year Ended September 30, 2015

Summary of Financial Results

Government-Wide Financial Statements

Statement of Net Position – Table 1 summarizes the Corporation's Statement of Net Position (Deficit) as of September 30, 2015 and 2014.

Table 1: Summary of Statement of Net Position (Deficit)

| | September 30 | | Change | % Change |
|------------------------------------|------------------------------|-----------------------|---------------|-----------------|
| | 2015 | 2014 | | |
| Current assets | | | | |
| Restricted | \$ 2,913,544 | \$ 2,828,331 | \$ 85,213 | 3% |
| Unrestricted | 1,617,433 | 1,561,013 | 56,420 | 4% |
| Total assets | <u>4,530,977</u> | <u>4,389,344</u> | 141,633 | 3% |
| Deferred outflows | 10,258,785 | 10,930,259 | (671,474) | (6%) |
| Total assets and deferred outflows | <u>14,789,762</u> | <u>15,319,603</u> | (529,841) | (3%) |
| Current liabilities | 369,297 | 286,216 | 83,081 | 29% |
| Bonds payable | 22,709,208 | 23,346,149 | (636,941) | (3%) |
| Total liabilities | <u>23,078,505</u> | <u>23,632,365</u> | (553,860) | (2%) |
| Total net position (deficit) | <u>\$ (8,288,743)</u> | <u>\$ (8,312,762)</u> | \$ 24,019 | (0.3%) |

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

Management's Discussion and Analysis (continued)

Year Ended September 30, 2015

For Fiscal Year 2015, the Corporation's assets amounted to \$4.5 million, of which \$2.9 million represented restricted investments and \$1.6 million represented accrued TSRs. Restricted investments increased by approximately \$85 thousand due to the net effect of \$2.1 million of TSR income recognized in the fiscal year, interest income of \$59 thousand, bond principal payments of \$1.5 million, interest expense of \$551 thousand, and general and administrative expense of \$88 thousand. Deferred outflows of resources representing deferred charges in connection with the purchase of TSR rights decreased by \$671 thousand due to the amortization of those charges. Total liabilities amounted to \$23.1 million and decreased by \$554 thousand. The decrease in total liabilities is mainly due to the net effect of principal payments of \$1.5 million, accretion expense of \$843 thousand and amortization of bond discounts of \$20 thousand.

Statement of Activities – Table 2 summarizes the Corporation's Statement of Activities for the fiscal years ended September 30, 2015 and 2014.

Table 2: Summary of Statement of Activities

| | September 30 | | Change | % Change |
|----------------------------------|-----------------------|----------------|---------------|-----------------|
| | 2015 | 2014 | | |
| General and program revenues | \$ 2,196,918 | \$ 2,233,429 | \$ (36,512) | (2%) |
| Expenses | 2,172,899 | 2,164,170 | 8,728 | (2%) |
| Change in net position | 24,019 | 69,259 | (45,240) | (65%) |
| Net position - beginning of year | (8,312,762) | (8,382,021) | 69,259 | (1%) |
| Net position - end of year | \$ (8,288,743) | \$ (8,312,762) | \$ 24,019 | (0.3%) |

For Fiscal Year 2015, general and program revenues of \$2.2 million reflect investment earnings of \$59 thousand and TSRs of \$2.1 million. The Corporation's expenses include interest expense of \$551 thousand, general and administrative expenses of \$88 thousand, accretion expense of \$843 thousand, and amortization expense of bond discounts of \$20 thousand and amortization of deferred charges on the purchase of tobacco settlement rights of \$671 thousand.

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

Management's Discussion and Analysis (continued)

Year Ended September 30, 2015

Governmental Fund Financial Statements

Governmental Fund Balance Sheet - Table 3 summarizes the Corporation's Balance Sheet as of September 30, 2015 and 2014.

Table 3: Summary of Governmental Fund Balance Sheet

| | <u>September 30</u> | | Change | % Change |
|------------------------------------|---------------------|--------------|---------------|-----------------|
| | <u>2015</u> | <u>2014</u> | | |
| Restricted assets | \$ 2,913,544 | \$ 2,828,331 | \$ 85,213 | 3% |
| Total assets | 2,913,544 | 2,828,331 | 85,213 | |
| Total liabilities | 158,464 | 75,000 | 83,464 | 11% |
| Total liabilities and fund balance | \$ 2,755,080 | \$ 2,753,331 | \$ 1,749 | 0.1% |

For Fiscal Year 2015, the Corporation's restricted assets, as reported on the Governmental Fund Balance Sheet, amounted to approximately \$2.9 million, consisting of restricted investments. The increase in restricted assets is mainly due to the net effect of \$2.1 million collected in TSR's in April 2015, interest income of \$59 thousand, and bond principal payments of \$1.5 million, interest expense of \$551 thousand, and general and administrative expense of \$88 thousand. Liabilities represent management fees of \$150 thousand accrued and unpaid as of the end of the fiscal year and \$8 thousand due to the Government of the U.S. Virgin Islands restricted to purpose.

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

Management's Discussion and Analysis (continued)

Year Ended September 30, 2015

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, 2015 and 2014.

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

| | September 30 | | Change | % Change |
|---------------------------------------|---------------------|--------------|--------------|----------|
| | 2015 | 2014 | | |
| General and program revenues | \$ 2,140,499 | \$ 2,352,010 | \$ (211,511) | (9%) |
| Expenses | 2,138,750 | 2,343,948 | (205,198) | (9%) |
| Excess of revenues (expenses) | \$ 1,749 | \$ 8,062 | \$ (6,313) | |
| Restricted fund balance/net position: | | | | |
| Beginning of year | \$ 2,753,331 | \$ 2,745,269 | \$ 8,062 | 0.3% |
| End of year | \$ 2,755,080 | \$ 2,753,331 | \$ 1,749 | 0.1% |

General and program revenues, for the year ending September 30, 2015, of \$2.1 million reflect the receipt of \$2.1 million in TSRs, and investment earnings of \$59 thousand. The Corporation's expenses include interest paid of \$551 thousand, bond principal expense of \$1.5 million, and \$88 thousand of general and administrative expenses. The decrease in general and program revenue is due to a decrease in TSR collections in fiscal year 2015 amounting to \$158 thousand and a decrease in investment income of \$54 thousand.

Statement of Fiduciary Net Position - Table 5 summarizes the Corporation's Statement of Fiduciary Net Position as of September 30, 2015 and 2014.

Table 5: Statement of Fiduciary Net Position

| | September 30 | | Change | % Change |
|--|---------------------|--------------|------------|----------|
| | 2015 | 2014 | | |
| Assets | | | | |
| Restricted investments | \$ 2,161,301 | \$ 2,281,791 | \$ 120,490 | (5%) |
| Total assets | \$ 2,161,301 | \$ 2,281,791 | \$ 120,490 | |
| Liabilities | | | | |
| Due to Government of the U.S. Virgin Islands | \$ 2,161,301 | \$ 2,281,791 | \$ 120,490 | (5%) |
| Total liabilities | \$ 2,161,301 | \$ 2,281,791 | \$ 120,490 | |

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

Management's Discussion and Analysis (continued)

Year Ended September 30, 2015

Restricted Assets Held on Behalf of the Government of the Virgin Islands

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 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, 2015 through 2006, resulted in Turbo Redemptions of \$1.5 million on May 15, 2015, \$220 thousand on May 15, 2014, \$200 thousand on May 15, 2013, \$100 thousand on May 15, 2012, \$135 thousand on May 16, 2011, \$315 thousand on May 17, 2010, \$645 thousand on May 15, 2009, \$5 thousand on November 11, 2008, \$495 thousand on May 15, 2008, \$20 thousand on November 15, 2007, \$295 thousand on May 15, 2007, and \$5 thousand 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, 2015 and 2014.

TSFC bond ratings, as assigned by Moody, for 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.

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

Management's Discussion and Analysis (continued)

Year Ended September 30, 2015

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
PO 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 Position (Deficit) and Governmental Fund Balance Sheet

September 30, 2015

| | Debt Service Fund and Total Government Fund | | Reconciliation | Statement of Net Position (Deficit) |
|--|--|-----------|-----------------------|--|
| Assets | | | | |
| Restricted investments | \$ 2,909,072 | \$ | – | \$ 2,909,072 |
| Interest receivable | 4,472 | | – | 4,472 |
| Accrued tobacco settlement revenues | – | | 1,617,433 | 1,617,433 |
| Total assets | <u>2,913,544</u> | | <u>1,617,433</u> | <u>4,530,977</u> |
| Deferred outflows | | | | |
| Purchase of settlement rights, net | – | | 10,258,785 | 10,258,785 |
| Total deferred outflows of resources | <u>\$ –</u> | <u>\$</u> | <u>10,258,785</u> | <u>\$ 10,258,785</u> |
| Liabilities | | | | |
| Accrued expenses payable | \$ 150,000 | \$ | – | \$ 150,000 |
| Accrued interest payable | – | | 210,833 | 210,833 |
| Due to Government of the U.S. Virgin Islands | 8,464 | | – | 8,464 |
| Total current liabilities | <u>158,464</u> | | <u>210,833</u> | <u>369,297</u> |
| Bonds payable (net of bond discounts) due in more than one year | – | | 22,709,208 | 22,709,208 |
| Total liabilities | <u>158,464</u> | | <u>22,920,041</u> | <u>23,078,505</u> |
| Fund balance/net position | | | | |
| Restricted fund balance/net deficit: | | | | |
| Reserved for debt service | 2,913,544 | | – | 2,913,544 |
| Unassigned fund balance (deficit) | (158,464) | | (11,043,823) | (11,202,287) |
| Total fund balance/net position (deficit) | <u>\$ 2,755,080</u> | <u>\$</u> | <u>(11,043,823)</u> | <u>\$ (8,288,743)</u> |

See accompanying notes.

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

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

Year Ended September 30, 2015

| | Debt Service Fund and Total Government Fund | Reconciliation | Statement of Activities |
|--|--|-----------------------|------------------------------------|
| General and program revenues: | | | |
| Tobacco settlement revenues | \$ 2,081,352 | \$ 56,419 | \$ 2,137,771 |
| Interest income: | | | |
| Cash and investments | 59,147 | – | 59,147 |
| Total general and program revenues | 2,140,499 | 56,419 | 2,196,918 |
| General and program expenses: | | | |
| General and administrative expenses | 87,750 | – | 87,750 |
| Bond principal expense | 1,500,000 | (1,500,000) | – |
| Bond interest expense | 551,000 | (385) | 550,615 |
| Accretion expense | – | 842,817 | 842,817 |
| Amortization expense | – | 691,717 | 691,717 |
| Total general and program expenses | 2,138,750 | 34,149 | 2,172,899 |
| Net change in fund balance/net position | 1,749 | 22,270 | 24,019 |
| Restricted fund balance/net position (deficit): | | | |
| Beginning of year | 2,753,331 | (11,066,093) | (8,312,762) |
| End of year | \$ 2,755,080 | \$ (11,043,823) | \$ (8,288,743) |

See accompanying notes.

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

Statement of Fiduciary Net Position

Year Ended September 30, 2015

| | <u>Agency Fund</u> |
|--|---------------------|
| Assets | |
| Restricted investments | \$ 2,161,301 |
| Total assets | <u>\$ 2,161,301</u> |
| Liabilities | |
| Due to Government of the U.S. Virgin Islands | \$ 2,161,301 |
| Total liabilities | <u>\$ 2,161,301</u> |

See accompanying notes.

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

Financial Statements

September 30, 2015

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, i.e., the statement of net position and the statement of activities, are prepared using the accrual basis of accounting and the economic resources measurement focus. The government-wide focus is on the sustainability of the Corporation as an entity and the change in the Corporation’s net position resulting from current year activities.

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.

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

Financial Statements (continued)

September 30, 2015

2. Summary of Significant Accounting Policies (continued)

Fund Financial Statements

In addition to the government-wide financial statements, the Corporation has prepared fund financial statements for the Corporation's debt service fund which is also 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 are separately presented on the accrual basis of accounting and only present a statement of fiduciary net position.

New and Adopted Accounting Standards

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 adoption of this Statement has no effect for financial reporting as the Corporation does not have any employees.

Effective for 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*, provides transition provisions in connection with the implementation of GASBS Statement No. 68. The adoption of this Statement has no effect for financial reporting as the Corporation does not have any employees.

Effective for periods beginning after June 15, 2015, GASB Statement No. 72, *Fair Value Measurement and Application*, addresses accounting and financial reporting issues related to fair value measurements. 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, 2015

2. Summary of Significant Accounting Policies (continued)

New and Adopted Accounting Standards (continued)

Effective for 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*, improves 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 as it has no employees.

Effective for periods beginning after June 15, 2016, GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other than Pension Plans*, improves 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 government 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 as it has no employees.

Effective for periods beginning after June 15, 2017, GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, improves accounting and financial reporting for postemployment benefits other than pensions (OPEB). The impact of the adoption of this Statement has not been determined by management, although it is not expected to impact the Corporation as it has no employees.

Effective for periods beginning after June 15, 2015, GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* identifies the hierarchy of generally accepted accounting principles for governmental entities. The impact of the adoption of this Statement has not been determined by management.

Effective for periods beginning after December 15, 2015, GASB Statement No. 77, *Tax Abatement Disclosures* provides guidance on disclosures regarding tax abatement information about: (1) a reporting entity's own tax abatement agreements, and (2) those that are entered into by other governments and that reduce a government's tax revenues. 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, 2015

2. Summary of Significant Accounting Policies (continued)

New and Adopted Accounting Standards (continued)

Effective for periods beginning after December 15, 2015, GASB Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, amends the scope and applicability of GASB Statement No. 68 to exclude pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension plan that is (1) not a state or local governmental pension plan, (2) is used to provide defined benefit pensions both to employees of state or local governmental employers and to employees of employers that are not state or local governmental employers, and (3) has no predominant state or local governmental employer. The impact of the adoption of this Statement has not been determined by management, although it is not expected to impact the Corporation as it has no employees.

Effective for periods beginning after June 15, 2015, GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*, provides guidance for certain external investment pools to qualify for making the election to measure all of its investments at amortized cost for financial reporting purposes. The impact of the adoption of this Statement has not been determined by management.

Effective for periods beginning after June 15, 2016, GASB Statement No. 80, *Blending Requirements for Certain Component Units-an Amendment of GASB Statement No. 14* provides guidance on the financial statement presentation for the blending of not-for-profit corporations in which the primary Government is the sole corporate member. The impact of this Statement has not been determined by management.

Effective for periods beginning after December 15, 2016, GASB Statement No. 81, *Irrevocable Split-Interest Agreements* provides recognition and measurement guidance for situations in which a government is a beneficiary of an irrevocable split-interest agreement. This Statement requires a government receiving an irrevocable split-interest agreement to recognize assets, liabilities and deferred inflows associated with the agreement, and to recognize revenue when the resources become applicable. The impact 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, 2015

2. Summary of Significant Accounting Policies (continued)

New and Adopted Accounting Standards (continued)

Effective for periods beginning after June 15, 2016, GASB Statement No. 82, *Pension Issues—an amendment of GASB Statements No. 67, No. 68, and No. 73* amends Statement 67 and 68 to require the presentation of covered payroll, defined as the payroll on which contributions to a pension plan are based, and ratios that use that measure. Employers are also required to recognize expenses in the period for which the contributions are assessed. The impact of the adoption of this Statement has not been determined by management, although it is not expected to impact the Corporation as it has no employees.

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 position. 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, 2015

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.

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 in its government-wide statement of net position for TSR revenue received after the close of the fiscal year.

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 position.

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

Financial Statements (continued)

September 30, 2015

2. Summary of Significant Accounting Policies (continued)

Deferred Charge

Under GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, the Corporation recognizes the purchase price of tobacco settlement rights from the Government of the Virgin Islands as a deferred outflow of resources that is amortized over the life of the sale agreement.

Bond Discounts and Accretion

Bond discounts are amortized over the life of the bonds they relate to 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 & Capital Improvement Fund for the Government of the Virgin Islands in an agency capacity.

Restricted investments at September 30, 2015, were as follows:

| Debt Service Fund: | Par Value | Fair value | Maturity |
|---------------------------|---------------------|---------------------|-----------------|
| Investment Type | | | |
| Money Market Fund | \$ 232,946 | \$ 232,946 | |
| NORDEA Discounted Note | 2,402,000 | 2,401,626 | 11/09/2015 |
| Repurchase Agreement | 274,500 | 274,500 | 05/15/2031 |
| Debt service reserve | <u>\$ 2,909,446</u> | <u>\$ 2,909,072</u> | |

Restricted investments in the agency fund as of September 30, 2015, were as follows:

| | |
|-------------------|---------------------|
| Money Market Fund | <u>\$ 2,161,301</u> |
| Agency Fund | <u>\$ 2,161,301</u> |

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

Financial Statements (continued)

September 30, 2015

3. Restricted Investments (continued)

Activity in the agency fund for 2015, consisted of the following:

| | |
|--------------------------------------|---------------------|
| Investments: Beginning of period | \$ 2,281,791 |
| Disbursements for capital projects | (112,300) |
| Accounts closed to debt service fund | (8,464) |
| Earnings | 274 |
| Investments: End of period | <u>\$ 2,161,301</u> |

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. Issuer credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Investments issued or explicitly guaranteed by the United States government are excluded. 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, 2015, 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 NORDEA discounted note was rated Aaa by Moody's.

Concentration of Credit Risk. Concentration of credit risk is the risk of loss attributable to the magnitude of investment in a single issuer. Information regarding investment in any one issuer that represents five percent or more of the System's total investments must be disclosed under GASB No. 40, excluding investments issued or explicitly guaranteed by the United States government. The Corporation places no limit on the amount that may be invested in one issuer.

Governmental Fund: At September 30, 2015, more than 5% of the Corporation's Governmental Fund investments were invested in a NORDEA discounted Note (82.55%), a PSA Master Repurchase Agreement with Bayerische Bank (9.44%) and Invesco Treasury Cash Management (8.01%).

Agency Fund: At September 30, 2015, agency fund investments were invested in Invesco Treasury Cash Management (55.12%) and Goldman Financial Square Money Market Fund (42.88%).

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

Financial Statements (continued)

September 30, 2015

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, 2015, 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 Outflow of Resources 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.

| | <u>September 30, 2015</u> |
|--|---------------------------|
| Deferred outflow of resources on purchase of tobacco settlement rights (TSR) | \$ 18,453,870 |
| Amortization | <u>(8,195,085)</u> |
| Net deferred outflow of resources on purchase of tobacco settlement rights | <u>\$ 10,258,785</u> |

Amortization of the deferred charge amounted to \$671,474 for the fiscal year ended September 30, 2015.

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

Financial Statements (continued)

September 30, 2015

5. Bonds Payable

Bonds payable consisted of the following as of September 30, 2015:

| Series | Date of Issue | September 30, 2015 | | |
|---|-------------------|----------------------|---------------|-------------------------|
| | | Original Issuance | Interest Rate | Ultimate Maturity Value |
| Series 2001, Capital Appreciation Bonds | 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 | | | | (34,701,415) |
| Bond discounts | | | | (254,377) |
| Bond principal payments | | | | (9,730,000) |
| Turbo redemptions | | | | (4,435,000) |
| Total bonds payable outstanding | | | | <u>\$ 22,709,208</u> |
| as of September 30, 2015 | | | | |

On March 15, 2006, the Corporation issued the 2006 Tobacco Settlement Financing Corporation Asset-Backed Bonds (Series A), Subordinated Series 2006 (Turbo (Series B) and Capital Appreciation Bonds (Series C and D) 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, 2015

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 expense during the year ended September 30, 2015 was \$551 thousand.

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

Financial Statements (continued)

September 30, 2015

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:

| | Principal | Interest | Total |
|------------------------|------------------|-----------------|---------------|
| 2016 | \$ — | \$ 550,000 | \$ 550,000 |
| 2017 | — | 550,000 | 550,000 |
| 2018 | — | 550,000 | 550,000 |
| 2019 | — | 550,000 | 550,000 |
| 2020 | | 550,000 | 550,000 |
| 2021-2025 | 1,475,000 | 2,159,000 | 3,634,000 |
| 2026-2030 | — | 2,011,250 | 2,011,250 |
| 2031-2035 | 8,045,000 | 804,500 | 8,849,500 |
| 2036 | 48,145,000 | — | 48,145,000 |
| Less: future accretion | (34,701,415) | — | (34,701,415) |
| | \$ 22,963,585 | \$ 7,724,750 | \$ 30,688,335 |

Change in Outstanding Debt

| | Total Series | Series 2001 | Series 2006 |
|-------------------------------|---------------------|--------------------|--------------------|
| Balance at September 30, 2014 | \$ 23,620,768 | \$ 11,020,000 | \$ 12,600,768 |
| Principal payments | (1,500,000) | (1,500,000) | — |
| Accretion | 842,817 | — | 842,817 |
| Balance at September 31, 2015 | \$ 22,963,585 | \$ 9,520,000 | \$ 13,443,585 |

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

Financial Statements (continued)

September 30, 2015

5. Bonds Payable (continued)

Other Bond 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.

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

Financial Statements (continued)

September 30, 2015

5. Bonds Payable (continued)

Other Bond Information (continued)

During the fiscal years ended September 30, 2006 through 2015, the Tobacco Settlement Financing Corporation exercised its optional redemption on Term Bonds in the amounts of \$1.5 million in May 2015, \$220 thousand in May 2014, \$200 thousand in May 2013, \$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.

6. Contingencies in Connection with 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.

7. 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.

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

Financial Statements (continued)

September 30, 2015

7. Contingencies (continued)

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 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.

8. Related Party Transactions

The Corporation incurred administrative fees to another blended component unit of the USVI Government amounting to \$75,000 in fiscal year 2015. As of September 30, 2015, the Corporation owed \$150,000 in management fees to a related party.

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

Financial Statements (continued)

September 30, 2015

9. Subsequent Events

The Corporation has performed a review of subsequent events from October, 2015 through July 27, 2016, and concluded there were no events or transactions that occurred during this period that required recognition or disclosure in the financial statements.

Report of Independent Auditors 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, 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, the financial statements of the 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 then ended September 30, 2015, and the related notes to the financial statements, which collectively comprise the Corporation’s basic financial statements and have issued our report thereon dated July 27, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Corporation’s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the Corporation’s internal control.

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 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. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst & Young LLP

July 27, 2016

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