

**GOVERNMENT OF THE DISTRICT OF COLUMBIA  
OFFICE OF THE INSPECTOR GENERAL**

**DISTRICT OF COLUMBIA**

**TOBACCO SETTLEMENT  
FINANCING CORPORATION**

**Financial Statements and Management's  
Discussion and Analysis, and  
Independent Auditors' Report  
Year Ended September 30, 2008**



**CHARLES J. WILLOUGHBY  
INSPECTOR GENERAL**

**GOVERNMENT OF THE DISTRICT OF COLUMBIA**  
**Office of the Inspector General**

Inspector General



March 16, 2009

The Honorable Adrian M. Fenty  
Mayor of the District of Columbia  
Mayor's Correspondence Unit, Suite 316  
John A. Wilson Building  
1350 Pennsylvania Avenue, N.W.  
Washington, D.C. 20004

The Honorable Vincent C. Gray  
Chairman  
Council of the District of Columbia  
John A. Wilson Building, Suite 504  
1350 Pennsylvania Avenue, N.W.  
Washington, D.C. 20004

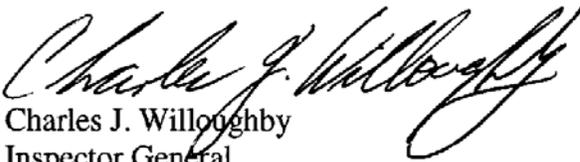
Dear Mayor Fenty and Chairman Gray:

As part of our contract for the audit of the District of Columbia's general purpose financial statements for fiscal year (FY) 2008, Bert Smith and Company (Bert Smith) submitted the enclosed final report on the Tobacco Settlement Financing Corporation (TSFC).

Bert Smith opined that the financial statements present fairly, in all material respects, the financial position of TSFC for the year ended September 30, 2008, in conformity with accounting principles generally accepted in the United States of America.

If you have questions or need additional information, please contact William J. DiVello, Assistant Inspector General for Audit, at (202) 727-2540.

Sincerely,

  
Charles J. Willoughby  
Inspector General

Enclosure

CJW/ws

cc: See Distribution List

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Mayor Fenty and Chairman Gray  
FY 2008 TSFC's Financial Statements, Management's  
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OIG No. 09-1-14TT – Final Report  
March 16, 2009  
Page 3 of 3

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**DISTRICT OF COLUMBIA  
TOBACCO SETTLEMENT FINANCING CORPORATION  
FINANCIAL STATEMENTS  
SEPTEMBER 30, 2008**  
*(Together with Independent Auditors' Report)*

**BERT SMITH  
& Co.**

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**Certified Public Accountants and Management Consultants**

**DISTRICT OF COLUMBIA  
TOBACCO SETTLEMENT FINANCING CORPORATION  
FINANCIAL STATEMENTS  
SEPTEMBER 30, 2008**

**TABLE OF CONTENTS**

Independent Auditors' Report.....	1
Management's Discussion and Analysis.....	2
<b>FINANCIAL STATEMENTS:</b>	
Balance Sheet.....	6
Statement of Revenues, Expenditures, and Change in Fund Balance.....	7
Notes to Financial Statements.....	8



**INDEPENDENT AUDITORS' REPORT**

To the Mayor and Members of  
The Council of the Government of the District of Columbia, and  
The Board of Directors of the District of Columbia Tobacco Settlement Financing Corporation

We have audited the accompanying balance sheet the District of Columbia Tobacco Settlement Financing Corporation (TSFC), a blended component unit of the District of Columbia, as of September 30, 2008, and the related statement of revenues, expenditures, and change in fund balance for the year then ended. These financial statements are the responsibility of the TSFC's management. Our responsibility is to express an opinion on the financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of TSFC were not audited in accordance with *Government Auditing Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the TSFC and do not purport to, and do not, present fairly the financial position of the Government of the District of Columbia as of September 30, 2008, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above presents fairly, in all material respects, the financial position of TSFC as of September 30, 2008 and the changes in financial position for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

A handwritten signature in black ink that reads "Bert Smith &amp; Co." with a period at the end.

Washington, D.C.  
January 30, 2009

**DISTRICT OF COLUMBIA  
TOBACCO SETTLEMENT FINANCING CORPORATION  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
SEPTEMBER 30, 2008**

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## **INTRODUCTION**

We are pleased to provide this overview and analysis of the financial activities of the District of Columbia Tobacco Settlement Financing Corporation (TSFC) for the fiscal year ended September 30, 2008. Please read it in conjunction with the financial statements on pages 6 and 7.

This overview summarizes TSFC's financial position as of September 30, 2008, which incorporates the results of its operations over the course of the fiscal year, as reflected in the Statement of Revenues, Expenditures, and Change in Fund Balance.

## **OVERVIEW REQUIRED BASIC FINANCIAL STATEMENTS**

The basic financial statements of TSFC report information about TSFC's based upon the modified accrual basis of accounting methods. These statements offer information about the TSFC's activities.

### **Balance Sheet**

This statement includes all of TSFC's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to TSFC creditors (liabilities). The assets and liabilities are presented in order of liquidity. The resulting fund balance presented in these statements is displayed as reserved or unreserved.

### **Statement of Revenues, Expenditures, and Change in Fund Balance**

The Statement of Revenues, Expenditures, and Change in Fund Balance reports the revenues and expenditures of TSFC during the fiscal year and the change in TSFC's fund balance. All of the current year's revenue and expenses are accounted for in the Statement of Revenues, Expenses and Changes in Fund Balance. This statement measures the activities of TSFC's operations over the past year and is used to identify TSFC's debt service and operational costs.

## **FINANCIAL HIGHLIGHTS**

### **Balance Sheet**

The Balance Sheet reports the financial position of TSFC as of September 30, 2008. In accordance with the modified accrual basis of accounting for governmental funds, the Tobacco Settlement Revenues (TSRs) receivable in the future and the Tobacco Settlement Asset-Backed Bonds (Tobacco Bonds) are recorded only to the extent that they are receivable or payable in the current period.

#### *Assets*

As of September 30, 2008, TSFC's assets totaled \$106,451,384, consisting of \$73,770,192 in cash/cash equivalents and investments, \$32,468,702 in accrued tobacco settlement revenue receivable, \$171,400 in accrued interest and \$41,090 in prepaid expenses. Restricted cash and cash equivalents consist of \$27,710,339 in the following two accounts: the debt service account, from which debt service payments on the Tobacco Bonds are made, and the Trapping Account, in which TSRs in excess of amounts needed for annual debt service payments are to be held (see Note 4 to the financial statements). The cash in the

**DISTRICT OF COLUMBIA  
TOBACCO SETTLEMENT FINANCING CORPORATION  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
SEPTEMBER 30, 2008**

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Collection Account, into which TSRs are initially deposited before allocation to another account, along with the cash in the Operating Account, which is used for ongoing operating expenses of the Corporation, is considered unrestricted. As of September 30, 2008, unrestricted cash totaled \$3,913,489. Restricted investments of \$42,146,364 in the debt service reserve fund represents funds required to be held to cover any shortfalls in the availability of funds to pay debt service on the Tobacco Bonds in the future.

***Liabilities***

TSFC liabilities as of September 30, 2008 consisted of accrued operating expenses of \$80,000.

***Fund Balance***

TSFC's fund balance as of September 30, 2008 was \$106,371,384. Of this amount, the vast majority, \$106,295,828, was in TSFC accounts held by the Trustee and represents balances reserved for debt service and related purposes of the Tobacco Bonds. A relatively small amount of the year-end fund balance, \$75,556, was considered unreserved fund balance, as it represents funds in the TSFC operating account at year-end that were not earmarked for payment of the year-end accrued expenses and were not mandated to be reserved for a specific purpose (but are to be used for FY 2009 TSFC operating expenses).

**Revenues**

Revenues consisted primarily of Tobacco Settlement Revenues (TSRs), which are payments to the TSFC resulting from a purchase and sale agreement between the District and TSFC, through which the TSFC purchased from the District the right to receive such payments, and the Master Settlement Agreement (MSA) entered into by certain cigarette manufactures, the District, 46 states and five other U.S. jurisdictions in November 1998 in settlement of certain smoking related litigation. The amount of TSRs received each year pursuant to the MSA is calculated based on a formula in which a key variable is cigarette consumption in the United States of America. TSRs received by TSFC in FY 2008 totaled \$42,334,946, taking into account the calculation of accrued TSRs in accordance with GASB 48. The other sources of revenue were interest income totaling \$3,116,750 on various funds held by TSFC during the course of the year.

**Expenditures**

Expenditures consisted primarily of debt service, i.e., principal and interest payments on TSFC's outstanding bonds. TSFC issued \$521,105,000 and \$248,264,046 of Tobacco Settlement Asset-Backed Bonds (the "Tobacco Bonds") in March 2001 and August 2006, respectively. The purpose of the issuance of 2001 Bonds was to obtain funds to defease certain debt obligations of the District, in exchange for TSFC obtaining the right to receive the annual TSRs, allowing the District to receive the benefit of future TSRs up front. The purpose of the issuance of the 2006 Bonds was to further leverage future TSRs to receive an upfront benefit to be transferred to the District, primarily for use on health-care related initiatives. Total debt service expenditures in FY 2008 were \$44,187,555, comprised of \$31,602,555 in interest expense and \$12,585,000 in principal repayment of the Tobacco Bonds. General and administrative expenses totaled \$169,957.

**DISTRICT OF COLUMBIA  
TOBACCO SETTLEMENT FINANCING CORPORATION  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
SEPTEMBER 30, 2008**

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The general and administrative expenses included the payment legal fees, trustee fees, rating agency fees, liability insurance premium, and other administrative expenses. The total TSFC FY 2008 expenditures were within budget, as the debt service payment were made as budgeted, and the general and administrative expenses were below the budgeted amount.

**CONDENSED FINANCIAL INFORMATION**

	<u>2008</u>	<u>2007</u>	<u>Variance</u>
<b>Assets</b>			
Current Assets	\$106,451,384	\$105,345,201	\$1,106,183
<b>Total Assets</b>	<u>\$106,451,384</u>	<u>\$105,345,201</u>	<u>\$1,106,183</u>
<b>Liabilities</b>			
Current Liabilities	\$ 80,000	\$ 68,000	\$ 12,000
<b>Total Liabilities</b>	<u>\$ 80,000</u>	<u>\$ 68,000</u>	<u>\$ 12,000</u>
<b>Fund Balance</b>			
Unreserved	\$ 75,556	\$ 272,353	\$ (196,797)
Reserved	106,295,828	105,004,848	1,290,980
<b>Total Net Assets</b>	<u>\$106,371,384</u>	<u>\$105,277,201</u>	<u>\$1,094,183</u>

Assets increased by \$1,106,183 or 1% from September 30, 2007 to September 30, 2008 primarily due to the increase in the cash and cash equivalents

The following table presents the statement of revenues, expenditures and changes:

	<u>2008</u>	<u>2007</u>
<b>Revenues</b>		
Tobacco Settlement Revenue	\$ 42,334,946	\$ 43,778,869
Investment Earnings	3,116,750	3,452,200
<b>Total Revenues</b>	<u>\$ 45,451,696</u>	<u>\$ 47,231,068</u>
<b>Expenditures</b>		
Interest Expense	\$ 31,602,555	\$ 31,928,493
Bond Principal Payment	12,585,000	5,215,000
General and Administrative Expenses	169,957	159,347
<b>Total Expenditures</b>	<u>\$ 44,357,512</u>	<u>\$ 37,302,840</u>

**(a) Revenues Compared to Prior Year**

Total revenues in FY 2008 decreased by \$1,779,373 as compared to fiscal year 2007. This was primarily due to the change in the amount of TSRs received based on the MSA and the cigarette consumption formula referenced above.

**DISTRICT OF COLUMBIA  
TOBACCO SETTLEMENT FINANCING CORPORATION  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
SEPTEMBER 30, 2008**

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***(b) Expenditures Compared to Prior Year***

Total expenditures in FY 2008 increased \$7,054,672 as compared to fiscal year 2007. This was primarily due to the bond principal payment, which increased by \$7,370,000 in FY 2008.

***(c) Excess of Expenditures Over Revenues***

Due to the fact that the debt service payments on the Tobacco Bonds that are covered by a given year's TSRs cross fiscal years, and due to the variability in the amount of TSRs and investment earnings from year to year, there are likely to be relatively small operating surpluses or deficits from year to year, neither of which would indicate a fiscal problem or irregularity.

For fiscal year 2008, TSFC's operating results produced an excess of revenues over expenditures of \$1,094,184.

**GASB Statement No. 48**

In September 2006, GASB issued Statement No. 48, Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues. Governments sometimes exchange an interest in their expected cash flows from specific receivables or specific revenues, for immediate cash payments - generally, a single lump sum. This Statement establishes criteria that governments will use to ascertain whether the proceeds should be reported as revenue or as a liability. This Statement also includes guidance to be used for recognizing other assets and liabilities arising from a sale of specific receivables or future revenue, including residual interests and recourse provisions. The requirements in this Statement improve financial reporting by establishing measurement, recognition, and disclosure requirements that apply to both governmental and business-type activities.

The District implemented this Statement in FY 2008, as required.

**Conclusion**

This report is intended to provide TSFC stakeholders with a general overview of the financial activities and position of TSFC. TSFC is functioning as it was designed to function, fulfilling its mission of being a vehicle for leveraging the TSRs through the issuance of the Tobacco Bonds; providing the District with upfront compensation representing the value of TSRs that it was to receive in future years; affording the District the ability to shift (to Tobacco bondholders) most of the risk associated with the prospect of future non-payment of TSRs by tobacco manufacturers; servicing the Tobacco Bonds in accordance with the structure and requirements associated with the transaction; and providing the District with ongoing revenue from any annual residual TSRs from the tobacco manufacturers (see Note 3 to the financial statements). Any questions or requests regarding this report should be directed to: District of Columbia Tobacco Settlement Financing Corporation, 1350 Pennsylvania Ave., N.W., Suite 200, Washington, DC 20004, or (202) 727-6055.

**DISTRICT OF COLUMBIA  
TOBACCO SETTLEMENT FINANCING CORPORATION  
BALANCE SHEET  
SEPTEMBER 30, 2008**

	<b>2008</b>
<b>ASSETS</b>	
<b>Current Assets:</b>	
Cash and Cash Equivalent	
Unrestricted	\$ 3,913,489
Restricted	
Debt Service	15,972,849
Trapping Account	11,737,490
Debt Service Reserve - Investments	42,146,364
Interest Receivable	171,400
Tobacco Settlement Receivable	32,468,702
Prepaid Expense	41,090
Total Current Assets	\$ 106,451,384
<b>LIABILITIES AND FUND BALANCE</b>	
<b>Current Liabilities:</b>	
Accrued Expenses	\$ 80,000
Total Current Liabilities	80,000
<b>Fund Balance</b>	
Unreserved	75,556
Reserved - Debt Service	106,295,828
Total Fund Balance	106,371,384
Total Liabilities and Fund Balance	\$ 106,451,384

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

**DISTRICT OF COLUMBIA**  
**TOBACCO SETTLEMENT FINANCING CORPORATION**  
**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGE IN FUND BALANCE**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2008**

	<b>2008</b>
<b>Revenues</b>	
Tobacco Settlement Revenue	\$ 42,334,946
Interest Income	3,116,750
Total Revenues	45,451,696
 <b>Expenditures</b>	
Interest Expense	31,602,555
Bond Principal Payment	12,585,000
General and Administrative Expenses	169,957
Total Expenditures	44,357,512
Excess of Revenues Over Expenditures	1,094,184
Fund Balance Beginning of Year	105,277,200
Fund Balance End of Year	\$ 106,371,384

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

**DISTRICT OF COLUMBIA  
TOBACCO SETTLEMENT FINANCING CORPORATION  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED SEPTEMBER 30, 2008**

**NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

■ ***Organization***

The District of Columbia Tobacco Settlement Financing Corporation (TSFC or the Corporation) is a special purpose, independent instrumentality of the District of Columbia (the District) created by the Tobacco Settlement Financing Act of 2000 (the Act). TSFC is governed by a five-person board of directors consisting of the Mayor of the District or his designee, the Chairman of the Council of the District or her designee, the Chief Financial Officer of the District and two private citizens, one of whom is appointed by the Mayor and the other is appointed by the Council. Although legally separate from the District and, accordingly, is included in the District of Columbia's financial statements.

Pursuant to the Act, and a purchase and sale agreement, dated as of February 1, 2001, between the District and TSFC, the District sold to TSFC on March 13, 2001, substantially all of its right, title and interest in certain amounts paid or payable to the District under the Master Settlement Agreement (the MSA) entered into by participating cigarette manufacturers (PCMs), the District, 46 states and five other U.S. jurisdictions in November 1998 in the settlement of certain smoking-related litigation. The sale included certain initial and annual payments already received by the District and the District's right to receive future initial, annual and strategic contribution fund payments (the tobacco settlement revenues or TSRs) to be made the PCMs under the MSA.

The purchase price of the District's right, title and interest in the TSRs has been financed by the issuance by TSFC of the Tobacco Settlement Asset-Backed Bonds (the Tobacco Bonds).

TSFC issued its first series of Tobacco Bonds in the amount of \$521,105,000 on March 13, 2001. In accordance with the aforesaid purchase and sale agreement, TSFC deposited the net proceeds of the Tobacco Bonds into irrevocable escrow accounts held by a trustee in TSFC's name to defease certain obligations of the District.

■ ***Basis of Presentation***

TSFC's financial transactions are accounted for as a special revenue fund in the District's financial statements. The accompanying financial statements present only TSFC and do not purport to, and do not present fairly the financial position of the Government of the District of Columbia as of September 30, 2008 and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America. The District provides certain legal, central accounting and other services to TSFC.

■ ***Basis of Accounting***

The accompanying financial statements are prepared on the modified accrual basis of accounting. Under this method, TSFC recognizes revenue when it becomes susceptible to accrual, which is when it becomes both measurable and available to finance expenditures in the current fiscal year. Expenditures are recognized when the related liability is incurred or, in the case of debt service, when payments are due.

**■ Use Estimates**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires TSFC's management to make estimates and assumptions in determining the reported amounts and disclosures. Actual results could differ from those estimates.

**■ Cash Equivalents**

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and mature in such a short period of time that their values are effectively immune from changes in interest rates. Cash equivalents include short-term investments with an original maturity of three months or less.

**NOTE 2: CASH/CASH EQUIVALENTS AND INVESTMENTS****Cash and Cash Equivalents**

TSFC's cash/cash equivalents and investments consist of bank deposits and short-term, fixed-income investment instruments consistent with the permitted investments of the TSFC pursuant to the bond indenture held by TSFC's agent in TSFC's name. As of September 30, 2008, cash and cash equivalents consisted of investments in repurchase agreements totaling \$3,913,489 and investments in money market mutual funds totaling \$27,710,339. \$3,913,489 was available to fund operating costs of TSFC and other TSFC accounts as needed; the remainder is restricted for distribution in accordance with the Tobacco Bonds indenture.

**Investments - Debt Service Reserve Account**

Pursuant to the Tobacco Bonds offering, TSFC was required to establish a Debt Service Reserve Account to be held by the indenture trustee. The balance of the account must be maintained, to the extent available, at the lesser of (i) the initial deposit of \$40,111,100 or (ii) the principal amount of the Senior Bonds outstanding. The balance in this account as September 30, 2008 was \$42,146,364, which included investment earnings on the required balance. As of September 30, 2008 TSFC had investments in commercial paper totaling \$42,146,364 with maturities of less than one year.

**Interest Rate Risk**

TSFC's investments are all short-term (less than one year) based on the need to have the funds available for the purposes of the Corporation. Repurchase agreements, money market mutual funds, and corporate commercial paper are the investment instruments in which TSFC's funds are invested. Because these investments are either able to be liquidated at cost value plus accrued interest or are invested to the maturity of the security, there is no risk of loss of any of the principal of TSFC's investments due to interest rate fluctuations.

**Credit Risk**

TSFC's repurchase agreements and money market funds are backed by U.S. Government and/or U.S. Government agency securities, and are thus virtually free of credit risk. Its commercial paper investments are required to be in securities rated in the highest commercial paper rating category by Mood's and Standard & Poor's rating agencies. There is obviously some credit risk associated with commercial paper investments, given the risk of failure of the issuer; however, this risk is minimized due the requirement that TSFC's commercial paper investments be rated in the highest category.

**Custodial Credit Risk**

All of TSFC's investments are represented by securities held in TSFC's name by a custodial bank, and in its fiduciary duty and under its contractual relationship with TSFC, the custodian is required by law to either transfer possession of the securities or liquidate the securities and transfer the liquidated value of the securities of the TSFC in the event of circumstances that call for TSFC to obtain possession of its investments. As such, TSFC's custodial credit risk is minimal.

**NOTE 3: TOBACCO SETTLEMENT ASSET-BACKED BONDS**

In November 1998, the District (along with a number of other States and various jurisdictions) signed a Master Settlement Agreement with the major U.S. tobacco companies that ended litigation over health care treatment costs incurred for smoking-related illnesses. Under the settlement, the District is scheduled to receive total annual payments aggregating an estimated \$1.2 billion by 2025. There are a number of potential adjustments to this schedule, including an inflation adjustment and cigarette volume adjustment. In addition, there are numerous risks regarding whether the District will receive the full amount to which it is entitled under the terms of the Master Settlement Agreement, including various lawsuits outside the District alleging that the Master Settlement Agreement is void or voidable.

In 2001, the Tobacco Corporation issued \$521,105,000 principal amount of its Tobacco Settlement Asset-Backed Bonds, Series 2001, of which \$476,220,000 was outstanding as of September 30, 2008.

In 2006, the Tobacco Corporation issued \$248,264,000 principal amount of its Tobacco Settlement Asset-Backed Bonds, Series 2007. Since no payment was made in 2008, the amount outstanding as of September 30, 2008 was \$248,264,000. The payment of these bonds is secured by the distribution under the Master Settlement Agreement. Payments received by the Tobacco Corporation under the Master Settlement Agreement in excess of the annual debt service requirements for the Tobacco Bonds may revert to the General Fund. There was no transfer of funds from Tobacco proceeds to the General Fund in fiscal year 2008. The Tobacco Bonds are neither general nor moral obligations of the District and are not secured by a pledge of the full faith and credit of the District.

The 2006 Tobacco Bonds are subordinate to the 2001 Tobacco Bonds, and are payable from the portion of the payments to be received under the MSA in excess of the amounts required to pay the debt service and other obligations associated with the 2001 Tobacco Bonds. This portion of the MSA payments due to the District is known as "Residual Interest". Rights to such residual interest were sold by the District to the Tobacco Corporation in exchange for the proceeds of the 2006 Tobacco Bonds.

The proceeds of the 2006 Tobacco Bonds were transferred to the District by the Tobacco Corporation upon receipt, and the balance of such funds is an asset of the District and not the Tobacco Corporation. Because the Tobacco Corporation is an instrumentality of the District and is accounted for as a blended component unit, its debt is considered to be a component of the long-term debt of the District. However, since the Tobacco Bonds are revenue bonds payable solely from Tobacco Settlement Revenues and do not constitute a direct debt of the District, they are not considered tax-supported debt of the District's debt burden.

The District retains the rights to the residual interest in excess of the amounts needed to retire the 2006 Tobacco Bonds. The full uses of the proceeds of the 2006 Tobacco Bonds has not been finally determined; however, it is expected that all of such funds will be used to fund healthcare facility(ies) and other healthcare related needs of the District.

As of September 30, 2008, the total outstanding balance for all Tobacco Bonds was \$724,484,000.

Debt service requirements for planned principal and interest payments, at September 30, 2008, are as follows:

<u>Year Ending September 30</u>	<u>Maturities</u>	<u>Interest Due</u>	<u>Total Debt Service</u>
2009	\$ 13,245,000	\$ 30,876,892	\$ 44,121,892
2010	14,305,000	30,111,930	44,416,930
2011	15,450,000	29,277,718	44,727,718
2012	16,515,000	28,329,942	44,844,942
2013	17,510,000	27,337,052	44,847,052
2013 - 2017	105,145,000	119,040,686	224,185,686
2018 - 2023	147,805,000	79,719,352	227,524,352
2024 - 2028	146,245,000	22,769,100	169,014,100
2044 - 2048	159,733,000	1,697,592,000	1,857,325,000
2054 - 2058	88,531,000	2,478,469,000	2,567,000,000
<b>Total</b>	<b>\$ 724,484,000</b>	<b>\$ 4,543,523,672</b>	<b>\$ 5,268,007,672</b>

The principal payments shown above represent the amount of the principal that TSFC has covenanted to pay to the extent that there are sufficient available TSRs collected. At September 30, 2008, TSFC maintained its required debt service reserve account.

**NOTE 4: RESIDUAL INTEREST**

As part of the purchase and sale agreement between the District and TSFC, the District obtained the “Residual Interest,” which is the right to receive from TSFC the portion of the payments received under the Master Settlement Agreement not required in each year to pay expenses, debt service, or reserves for the Tobacco Bonds. The Residual Interest is required to be transferred to the District and deposited in the District’s Tobacco Trust Fund (the “Trust Fund”). During fiscal year 2008, there was no Residual Interest transferred to the District.

The indenture pursuant to which the Tobacco Bonds were issued provides that in the event one of the four original participating tobacco manufacturers that is a party to the Master Settlement Agreement is rated below investment grade (defined as a “Trapping Event”), the Residual Interest shall be used to fund a special reserve account (the “Trapping Account”). As a result of downgrades of R.J. Reynolds Tobacco Holdings, Inc.’s senior unsecured debt to below investment grade in June and July of 2003, the Residual Interest for fiscal year 2004 and subsequent fiscal years will accordingly be retained by the Corporation until the balance is retained is equal to 25% of the principal amount of the Tobacco Bonds or until least one year after R.J. Reynolds Tobacco Holdings, Inc.’s ratings are restored to investment grade.

**NOTE 5: CONTINGENCIES**

TSFC’s legal counsel asserts that there have been no material claims, suits, or complaints filed nor are any pending against the corporation. In the opinion of management, all other matters which are asserted or unasserted are without merit and would not have a significant effect on the financial position or changes in net assets if disposed of unfavorably.

**NOTE 6: REVENUE CONCENTRATION IN CREDIT RISK**

TSFC's Projected Revenue is derived from a Master Settlement Agreement entered into by certain cigarette manufacturers. Projected revenue to be recognized in future years may be subject to variability due to cigarette consumption levels, financial stability of some of the tobacco companies along with disputed claims filed by other tobacco manufacturers.

**NOTE 7: GENERAL AND ADMINISTRATIVE EXPENSES**

The general and administrative expenses include the payment of legal fees, trustee fees, rating agency fees, liability insurance premiums and other administrative cost. The other administrative cost is comprised of the central services costs totaling \$80,000, recorded in the current liabilities section of the financial statements and covers allocable personnel and other services performed by District employees on TSFC's behalf.