

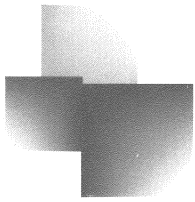
TOBACCO SETTLEMENT FINANCING CORPORATION

**FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2003**

TOBACCO SETTLEMENT FINANCING CORPORATION

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PRESCOTT CHATELLIER
FONTAINE & WILKINSON, LLP

CERTIFIED PUBLIC ACCOUNTANTS
BUSINESS CONSULTANTS

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Tobacco Settlement Financing Corporation

We have audited the accompanying basic financial statements of the TOBACCO SETTLEMENT FINANCING CORPORATION (a component unit of the State of Rhode Island) as of and for the year ended June 30, 2003, as listed in the foregoing table of contents. These financial statements are the responsibility of the Corporation's management. 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 of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and 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 5 to the financial statements, the Corporation has changed its method of accounting for its purchased interest in future Tobacco Settlement receipts to comply with proposed technical guidance issued by the Governmental Accounting Standards Board.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the TOBACCO SETTLEMENT FINANCING CORPORATION as of June 30, 2003 and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated April 2, 2004 on our consideration of the Corporation's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

TRUST ■ INTEGRITY ■ RESULTS

The Management's Discussion and Analysis on pages three through six is not a required part of the financial statements but is supplementary information required by 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 this information and express no opinion thereon.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information presented on pages 16 through 18 is presented for purposes of additional analysis and to provide information for presentation of the Corporation's financial statements in the State of Rhode Island's Comprehensive Annual Financial Report, and is not a required part of the Corporation's basic financial statements. Such information, has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly presented in all material respects in relation to the basic financial statements taken as a whole.

Russell Chatterlain Fountain & Wilkinson, LLP

April 2, 2004

Management's Discussion and Analysis

This section of the Tobacco Settlement Financing Corporation's (TSFC) annual financial report represents our narrative overview and financial performance analysis for the fiscal year ended June 30, 2003. Please read it in conjunction with the financial statements which follow this section.

The Tobacco Settlement Financing Corporation (TSFC) was created in 2002 as a public corporation, having a distinct legal existence from the State and not constituting a department of state government. The TSFC was created to finance the acquisition from the State of the State's right, title and interest in the State's rights to receive the moneys due under and pursuant to (i) the Master Settlement Agreement, dated November 23, 1998, among the attorneys general of 46 states, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa and the Territory of the Northern Marianas and Philip Morris Incorporated, R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation and Lorillard Tobacco Company and (ii) the Consent Decree and Final Judgment of the Rhode Island Superior Court for Providence County dated December 17, 1998, as the same has been and may be corrected, amended or modified, in the class action styled State of Rhode Island v. American Tobacco, Inc., et al. (Docket No. 97-3058), including without limitation, the rights of the State to receive the moneys due to it thereunder.

The Corporation issued \$685,390,000 of its Tobacco Settlement Asset-Backed Bonds, Series 2002A ("TSAC Bonds") in June 2002 to finance the costs of acquisition of the right, title and interest to one-hundred percent (100%) of the "state's tobacco receipts", as defined in the Act, after December 31, 2003.

In accordance with the Act, the TASC bonds are payable both as to principal and interest solely out of the assets of the Corporation pledged for such purpose; and neither the faith and credit nor the taxing power of the State or any political subdivision thereof is pledged to the payment of the principal of or the interest on the TASC bonds. The TASC bonds do not constitute an indebtedness of or a general, legal or "moral" obligation the State or any political subdivision of the State.

Financial Highlights

Management believes the TSFC financial condition is stable. The TSFC's financial position at the end of the first full year of operation reflects a change in the accounting methodology based upon a proposed standard relating to recognition of future Tobacco Master Settlement revenues. The change in the asset "Rights to future Tobacco Settlement revenue" and the related revenue occurred because at the time the June 30, 2002 financial statements were issued there was no guidance from the Governmental Accounting Standards Board (GASB) on this specific situation; however, management thought that this situation was addressed by the Financial Accounting Standards Board (FASB). Therefore, management recognized the asset and related revenue. On December 31, 2003, GASB issued Proposed Technical Bulletin, Tobacco Settlement Recognition and Financial Reporting Entity Issues. Among other things, the exposure draft states, "The event that results in the recognition of an asset and revenue by a settling government is the domestic shipment of cigarettes (sales). Therefore, the settling governments should not recognize a receivable and revenue for TSRs until that event occurs. Management opted to early implement the exposure draft.

The following are the key financial highlights:

- Due to the amount bonds outstanding exceeding the assets recognized (no future revenues were recognized) the liabilities of TSFC exceeded its assets at the close of the most recent fiscal year by \$579,956,412 (net assets).
- Revenues, consisting of investment income, amounted to \$3,026,264.
- Expenses, primarily interest, amounted to \$40,055,689.
- Net assets of the Corporation decreased by \$37,029,425 during the fiscal year.

Overview of Comprehensive Annual Financial Report

The TSFC's basic financial statements consists of two components: the Financial Statements and the Notes to the Financial Statements. In addition to the basic financial statements, the report contains other supplemental information and Management's Discussion and Analysis (MD&A).

The MD&A serves as an introduction to the basic financial statements and supplementary

The Statement of Net Assets presents the financial position of the TSFC on the accrual basis of accounting. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the TSFC is improving or deteriorating.

All of the current year's revenues and expenses are accounted for in the Statement of Activities. This statement measures the success of the TSFC's financial operations over the past year and can be used to determine whether the TSFC will successfully garner sufficient revenues from the Master Settlement Agreement to pay debt service obligations.

	Condensed Statements of Net Assets	
	<u>June 30, 2003</u>	<u>June 30, 2002</u>
Current assets	\$72,205,935	\$108,070,204
Other assets	1,521,611	1,285,627
Total assets	73,727,546	109,355,831
Current liabilities	600,672	
Long-term debt	653,082,957	652,282,489
Total liabilities	653,683,629	652,282,489
Net Assets (as restated)	\$(579,956,083)	\$(542,926,658)

	Condensed Statements of Activities	
	<u>June 30, 2003</u>	<u>June 30, 2002</u>
Revenues	\$3,026,264	\$1,311,752
Expenses	40,055,689	544,238,410
Change in Net Assets (as restated)	\$(37,029,425)	\$(542,926,658)

The corporation purchased the State's rights to the TSRs beginning with TSRs received after December 31, 2003. Therefore, the corporation issued bonds in an amount sufficient to cover the purchase price; a required debt service reserve; and scheduled interest payments until such date as the corporation obtained the rights to the TSRs. During the fiscal year ended June 30, 2003 the corporation utilized \$37,029,425 of designated cash reserves to fund a portion of the \$39,184,181 in aggregate interest payments made on its outstanding bonds.

other tobacco securitization debts, were placed on rating watch by all three major credit rating agencies. The TSFC debt is rated "Baa2" by Moody's Investors Service, reflecting a downgrade from "A3" announced on June 2, 2003. The bonds were previously downgraded by Moody's from A1 to A3 on March 31, 2003. The bonds are rated "BBB" by Fitch Ratings, reflecting a downgrade from "A-" announced on May 6, 2003. The bonds were previously downgraded by Fitch from "A+" to "A-" on April 3, 2003. Standard & Poor's Rating Services rates the TSFC debt "BBB", reflecting a downgrade from "A-" on August 28, 2003. The bonds had been downgraded from "A" to "A-" on April 18, 2003 by Standard & Poor's. In general, the rating changes reflect the increased vulnerability of tobacco companies to adverse litigation in some jurisdictions. Ratings are subject to change at any time.

For additional information relating to capital assets or long-term debt, see the notes to the financial statements of this report.

Risk Factors and Next Year's Revenues

TSFC is governed by a five-member Board. The Board has little or no control over the level of revenues which are collected by the Corporation. Risk factors impacting the level of revenues to be received by the TSFC include any factors affecting cigarette consumption and the financial liability of the tobacco industry, including litigation risk facing the industry. As described above, the risk of default is monitored by the credit rating agencies. In the event of non-payment of the amounts due and payable under the master settlement which have been assigned to the Corporation, the Attorney General of the State of Rhode Island has pledged to pursue legal remedies to the extent possible to garner amounts due to the Corporation.

Requests for Information

This financial report is designed to provide a general overview of the TSFC finances for all those with an interest in this organization. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Chairperson, Tobacco Settlement Financial Corporation, c/o State Budget Office, One Capitol Hill, Providence, Rhode Island 02908.

Tobacco Settlement Financing Corporation

Statement of Net Assets
as of June 30, 2003

Assets:

Investments - unrestricted...	\$ 601,027
Investments - restricted...	71,004,236
Accrued Settlement Agreement receipts...	600,672
Bond issue costs, net...	1,521,611

Total Assets	<u>73,727,546</u>
--------------	-------------------

Liabilities:

Due to State...	600,672
Bonds payable, net of unamortized discount...	653,082,957
Total Liabilities...	<u>653,683,629</u>

Net Assets:

Unrestricted...	(579,956,083)
Total Net Assets...	<u>\$ (579,956,083)</u>

See Notes to Financial Statements.

Tobacco Settlement Financing Corporation

Statement of Activities
for the year ended June 30, 2003

Revenues:

Investment income...	<u>\$ 3,026,264</u>
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Expenses:

General and administrative...	32,024
Amortization of bond issue costs...	39,016
Interest expense...	<u>39,984,649</u>
Total expenses...	<u>40,055,689</u>

Net increase/(decrease) in Net Assets	(37,029,425)
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Net Assets:

Beginning of the period, as restated...	(542,926,658)
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End of the period...	<u><u>\$ (579,956,083)</u></u>
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See Notes to Financial Statements.

Tobacco Settlement Financing Corporation

Statement of Cash Flows
for the year ended June 30, 2003

Cash flows from operating activities:	
Cash received from Settlement Agreement...	\$ 52,147,879
Payments to vendors...	(32,024)
Payments of Settlement Agreement receipts to State...	(52,147,879)
	<hr/>
Net cash used for operating activities...	(32,024)
Cash flows from non-capital financing activities:	
Interest paid on long-term debt...	<hr/> (39,184,181)
Cash flows from investing activities:	
Bond issuance costs...	(275,000)
Change in investments - unrestricted...	306,846
Change in investments - restricted...	36,158,095
Investment earnings...	3,026,264
	<hr/>
Net cash provided by investing activities...	39,216,205
Net increase/(decrease) in cash...	-
Cash, beginning of period...	<hr/> -
Cash, end of period...	<hr/> <hr/> \$ -
Reconciliation of increase in net assets to net cash provided by/ (used for) operating activities:	
Decrease in net assets...	\$ (37,029,425)
Amortization of bond issue costs...	39,016
Amortization of bond discount...	800,468
Interest expense...	39,184,181
Investment earnings...	<hr/> (3,026,264)
	<hr/>
Net cash provided by/(used for) operating activities...	\$ (32,024)

See Notes to Financial Statements.

TOBACCO SETTLEMENT FINANCING CORPORATION

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Tobacco Settlement Financing Corporation (the Corporation) was organized on June 13, 2002 as a public corporation by the State of Rhode Island, pursuant to Title 42 of the General Laws, Chapter 133. The Corporation is legally independent and separate from the State and there is no financial accountability between the two entities. The purpose of the Corporation is to purchase Tobacco Settlement Revenues from the State. The Corporation is authorized to issue bonds necessary to provide sufficient funds for carrying out its purpose.

In June 2002, the Corporation issued revenue bonds that are the sole obligation of the Corporation. Accordingly, the State is not liable for any debts issued by the Corporation. Also in June 2002, pursuant to a Purchase and Sale Agreement with the State, the State sold to the Corporation its future rights in the Tobacco Settlement Revenues (TSR's) under the Master Settlement Agreement and the Consent Decree and Final Judgment (the "MSA"). When the Corporation's obligations with the bonds have been fulfilled, the TSR's will revert back to the state.

The Corporation's rights to receive TSR's are expected to produce funding for its obligations.

The TSR payments are dependent on a variety of factors, which include:

- the financial capability of the participating cigarette manufacturers to pay TSR's;
- future cigarette consumption which impacts the TSR payment; and
- future legal and legislative challenges against the tobacco manufacturers and the master settlement agreement that provides for the TSR payments.

The bonds of the Corporation are asset-backed instruments that are secured solely by the tobacco settlement revenues.

The Corporation is a component unit of the State of Rhode Island for financial reporting purposes. Accordingly, the Corporation's financial statements are included in the State of Rhode Island's Annual Financial Report.

In accordance with State reporting requirements, the Corporation has elected not to apply Financial Accounting Standards Board statements and interpretations, Accounting Principles Board opinions, and accounting research bulletins of the Committee on Accounting Procedures issued after November 30, 1989.

Recently Issued Accounting Standards

On December 31, 2003 the Governmental Accounting Standards Board issued a Proposed Technical Bulletin titled: *Tobacco Settlement Recognition and Financial Reporting Entity Issues*. This Proposed Technical Bulletin was issued to provide guidance on recording and presenting Tobacco Settlement transactions and determining if separate entities created to purchase a settling government's interest in future settlement revenues should be considered component units of that government. The Corporation has elected to adopt the applicable provisions of this Proposed Technical Bulletin in these 2003 financial statements.

(CONTINUED)

TOBACCO SETTLEMENT FINANCING CORPORATION

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Basis of Presentation – Entity-wide Financial Statements

The Statement of Net Assets displays information on the financial position of the Corporation. The Statement of Activities presents the revenues and expenses of the Corporation for the fiscal period.

The Corporation is treated as a special-purpose government. The entity-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recognized when earned and expenses are recognized when incurred, regardless of the related cash flows.

Net assets comprise the various net earnings from operating and non-operating revenues, and expenses. Net assets are classified in the following two components: restricted for debt service and unrestricted net assets. Restricted for debt service consists of all net assets subject to external restrictions which limit their use to the payment of debt service. Unrestricted consists of all other net assets not included in the above categories.

Basis of Presentation – Supplemental Information (Fund Financial Statements)

The fund financial statements provide detailed information for the Corporation's individual funds.

In order to ensure observances of limitations and restrictions placed on the use of resources available to the Corporation, the accounts of the Corporation are maintained in accordance with the principles of "Fund Accounting". This is a procedure by which resources for various purposes are classified for accounting and reporting purposes into funds that are in accordance with activities or objectives specified. Separate accounts are maintained for each fund. Account groups are reporting devices used to account for certain assets and liabilities not recorded directly in the funds.

The Corporation uses the following fund types:

Governmental funds are used to account for the Corporation's general activities, and utilize the flow of current financial resources measurement focus and the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (i.e., when "measurable and available"). "Measurable" means that the amount of the transaction can be determined and "available" means collected within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures are recorded when the related fund liability is incurred, except for unmatured interest on long-term debt which is recognized when due.

Governmental funds include the following fund types:

- General Fund. The Corporation's primary operating fund is the General Fund. It accounts for all financial resources of the Corporation, except those required to be accounted for in another fund.
- Debt Service Fund. The Corporation's accumulation of resources for, and payment of, principal and interest on long-term debt is accounted for in the Debt Service Fund.

Reservations of fund balances represent amounts that are not appropriable or are legally segregated for a specific purpose. Designations of fund balance represent management plans that are subject to change. The financial activities of the Corporation are limited by its enabling legislation and by its revenue bond resolution.

(CONTINUED)

TOBACCO SETTLEMENT FINANCING CORPORATION

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments

Investments in debt and equity securities are stated at fair value.

Income Taxes

The Corporation is exempt from federal and state income taxes.

Use of Estimates

Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and reported revenues and expenses. Actual results could differ from those estimates.

Amortization of Bond Discount and Issuance Costs

Bond discounts and issue costs are deferred and amortized over the term of the bonds, using the interest method for discounts and the straight-line method for issue costs. Bond discounts are presented as an adjustment to the face amount of the bonds payable.

Cash and Cash Equivalents

Cash represents amounts in demand deposit accounts with financial institutions. Cash equivalents are defined as highly liquid investments with a maturity of three months or less at the time of purchase.

2. INVESTMENTS

The table below categorizes the Corporation's investments so as to provide an indication of the level of market risk and credit risk assumed by the Corporation at year end. Market risk is the risk that the market value of an investment, collateral securing the investment or securities underlying a repurchase agreement will decline. Credit risk can be associated with the issuer of a security, with a financial institution holding deposits, or with the custodian of securities or collateral. Category 1 includes insured, registered or securities held by the Corporation or its agent in the Corporation's name. Category 2 includes uninsured and unregistered, with securities held by the counterparty's trust department or agent in the Corporation's name. Category 3 includes uninsured and unregistered with securities held by the counterparty or by its trust department or agent, but not in the Corporation's name.

(CONTINUED)

TOBACCO SETTLEMENT FINANCING CORPORATION

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003**

2. INVESTMENTS (Continued)

At June 30, 2003, the investments held by the Corporation were as follows:

Description	Category			Fair Value
	1	2	3	
Commercial paper.....	\$71,004,236			\$71,004,236
Investments not subject to categorization:				
Money Market Mutual Funds.....				601,027
Total	\$71,004,236	\$0	\$0	\$71,605,263

3. LONG-TERM DEBT

On June 27, 2002 the Corporation issued \$685,390,000 of Tobacco Settlement Asset-Backed Bonds. The bond proceeds were used to purchase the State's future rights in the Tobacco Settlement Revenues (TSR's) under the Master Settlement Agreement and the Consent Decree and Final Judgment (the "MSA"). The bonds bear interest ranging from 5.920% to 6.250% and mature in varying amounts through June 1, 2042. The bonds are subject to early redemption provisions, in whole or in part, at the redemption price of 100% of the principal amount plus accrued interest, without premium. Term Maturities represent the minimum amount of principal that the Corporation must pay as of specific dates. Turbo Maturities represent the requirement contained in the bond indenture to apply 100% of all collections that are in excess of the funding requirements of the indenture to the early redemption of the bonds. The amount of any turbo redemptions made will be credited against the term maturities in ascending chronological order.

Principal and interest payments assuming the Term Maturities schedule are as follows:

Year ending June 30	Principal	Interest	Total
2004		\$ 42,234,447	\$ 42,234,447
2005		42,234,447	42,234,447
2006		42,234,447	42,234,447
2007		42,234,447	42,234,447
2008		42,234,447	42,234,447
2009 – 2013	\$ 35,660,000	209,061,163	244,721,163
2014 – 2018		200,616,875	200,616,875
2019 – 2023	109,770,000	200,616,875	310,386,875
2024 – 2028		167,685,875	167,685,875
2029 – 2033	168,260,000	157,379,950	325,639,950
2034 – 2038		116,156,250	116,156,250
2039 – 2042	371,700,000	92,925,000	464,625,000
Totals	\$ 685,390,000	\$ 1,355,614,223	\$ 2,041,004,223

(CONTINUED)

TOBACCO SETTLEMENT FINANCING CORPORATION

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003**

3. LONG-TERM DEBT (Continued)

Principal and interest payments assuming the expected Turbo Maturities schedule are as follows:

<i>Year ending June 30</i>	<i>Principal</i>	<i>Interest</i>	<i>Total</i>
2004	\$ 7,425,000	\$ 42,234,448	\$ 49,659,448
2005	8,720,000	41,794,888	50,514,888
2006	9,885,000	41,278,664	51,163,664
2007	11,125,000	40,693,472	51,818,472
2008 – 2012	139,545,000	184,925,080	324,470,080
2013 – 2017	213,350,000	134,058,662	347,408,662
2018 – 2022	294,680,000	58,281,252	352,961,252
2023 – 2027	660,000	41,250	701,250
2028 – 2032			
2033 – 2037			
2038 – 2042			
Totals	\$ 685,390,000	\$ 543,307,716	\$ 1,228,697,716

The balance due on the Corporation's bonds payable articulates to the reported amount included in the statement of net assets through the following reconciliation:

Outstanding balance on bonds payable...	\$685,390,000
Less: unamortized bond discount...	<u>(32,307,043)</u>
Bonds payable, per statement of net assets...	<u>\$653,082,957</u>

4. COMMITMENTS AND CONTINGENCIES

Litigation has been filed against various tobacco manufacturers as well as certain states and public entities. The lawsuits allege, among other claims, that the Master Settlement Agreement (MSA) violates provisions of the U.S. Constitution, state constitutions, federal antitrust and civil rights laws, state consumer protection laws; these actions, if ultimately successful, could result in a determination that the MSA is void or unenforceable. The lawsuits seek to prevent the states from collecting any monies under the MSA, and/or a determination that prevents the tobacco manufacturers from collecting MSA payments through price increases to cigarette consumers. In addition, class action lawsuits have been filed in jurisdictions alleging violations of state Medicaid agreements. To date, no such lawsuits have been successful. The enforcement of the terms of the MSA may continue to be challenged in the future. In the event of an adverse court ruling, the corporation may not have adequate financial resources to service its debt obligations.

5. ACCOUNTING FOR PURCHASED INTEREST IN TOBACCO SETTLEMENT REVENUE

In accordance with the guidance provided in the Governmental Accounting Standards Board Proposed Technical Bulletin dated December 31, 2003, the corporation has changed its method of accounting for its purchased interest in future Settlement Agreement receipts. The guidance concludes that neither asset or revenue from the Settlement Agreement should be recorded until the domestic sale of cigarettes occurs. Accordingly, the Corporation de-recognized the investment in its future Settlement Agreement rights, which were being carried at their cost of \$544,238,410. The result of this change is the restatement of the Corporation's Net Assets as of July 1, 2002 to \$(542,926,658), a reduction of \$544,238,410.

In the future, transactions related to the Settlement Agreement will be recognized on the accrual basis, consistent with the timing of the domestic sale of cigarettes and the resulting Settlement Agreement payments required to be made by the participating cigarette manufacturers.

(CONTINUED)

TOBACCO SETTLEMENT FINANCING CORPORATION

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003**

6. SUBSEQUENT EVENTS

In July 2003 the Corporation received \$600,672 in Settlement Agreement receipts, attributable to transactions occurring prior to the effective date of its right to receive such payments. Accordingly, this amount has been recognized in the Statement of Net Assets as both an asset and liability (Due to State), as this amount was subsequently transferred to the State.

(CONCLUDED)

SUPPLEMENTARY INFORMATION

Tobacco Settlement Financing Corporation

Balance Sheet, Governmental Funds
as of June 30, 2003

	<u>General Fund</u>	<u>Debt Service Fund</u>	<u>Total Governmental Funds</u>
Assets:			
Investments...	\$ 601,027	\$ 71,004,236	\$ 71,605,263
Accrued TSA receipts...	600,672		600,672
Total Assets	<u>\$ 1,201,699</u>	<u>\$ 71,004,236</u>	<u>\$ 72,205,935</u>
Liabilities and Fund Balances:			
Liabilities:			
Due to State...	\$ 600,672	\$ -	\$ 600,672
Total Liabilities	<u>600,672</u>	<u>-</u>	<u>600,672</u>
Fund Balances:			
Reserved for debt service...	-	51,309,844	51,309,844
Designated for future expenditure...	601,027	19,694,392	20,295,419
Total Fund Balances	<u>601,027</u>	<u>71,004,236</u>	<u>71,605,263</u>
Total Liabilities and Fund Balances	<u>\$ 1,201,699</u>	<u>\$ 71,004,236</u>	<u>\$ 72,205,935</u>

Tobacco Settlement Financing Corporation

Statement of Revenues, Expenditures and Changes in Fund Balances,
Governmental Funds
For the year ended June 30, 2003

	General Fund	Debt Service Fund	Total Governmental Funds
Revenues:			
Investment income...	\$ 6,105	\$ 3,020,159	\$ 3,026,264
Settlement Agreement receipts...	52,748,551	-	52,748,551
Total Revenues	<u>52,754,656</u>	<u>3,020,159</u>	<u>55,774,815</u>
Expenditures:			
Current:			
Costs of bond issuance...	275,000	-	275,000
General and administrative...	32,024	-	32,024
Debt Service: Interest...	-	39,184,181	39,184,181
Total Expenditures	<u>307,024</u>	<u>39,184,181</u>	<u>39,491,205</u>
Excess of Revenues over/(under) Expenditures	<u>52,447,632</u>	<u>(36,164,022)</u>	<u>16,283,610</u>
Other Financing Source/(Uses):			
Operating transfers...	(5,927)	5,927	-
Transfer of Settlement Agreement receipts to State...	(52,748,551)	-	(52,748,551)
Net Other Financing Uses	<u>(52,754,478)</u>	<u>5,927</u>	<u>(52,748,551)</u>
Excess of Revenues and Other Financing Sources Over Expenditures and Other Financing Uses	(306,846)	(36,158,095)	(36,464,941)
Fund Balances:			
Beginning of the period...	907,873	107,162,331	108,070,204
End of the period...	<u>\$ 601,027</u>	<u>\$ 71,004,236</u>	<u>71,605,263</u>

Amount reported in the Statement of Net Assets differs because:

Long-term liabilities are not due and payable in the current period and therefore are not reported in the funds... (653,082,957)

Long-term assets do not represent currently expendable resources and therefore are not reported in the funds... 1,521,611

Net Assets in Statement of Net Assets... \$ (579,956,083)

Tobacco Settlement Financing Corporation

Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances
to the Statement of Activities
for the year ended June 30, 2003

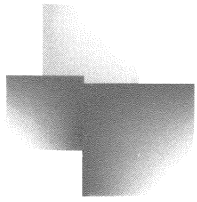
Net change in fund balances for governmental funds \$ (36,464,941)

Bond discounts are not recorded in governmental funds as the net proceeds of bond issues are recorded as current revenue. In the Statement of Activities these amounts are recorded and amortized as a component of interest expense over the life of the bond. (800,468)

Governmental funds report outlays for long-term assets as current expenditures. However, in the statement of activities such costs are not reported and are instead capitalized in the Statement of Net Assets. 275,000

Amortization of bond issue costs is not recorded in governmental funds, as such outlays are recorded as current expenditures. In the Statement of Net Assets these costs are recorded and amortized over the term of the bond. (39,016)

Change in Net Assets in Statement of Activities \$ (37,029,425)



PRESCOTT CHATELLIER
FONTAINE & WILKINSON, LLP

CERTIFIED PUBLIC ACCOUNTANTS
BUSINESS CONSULTANTS

**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL
REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Board of Directors
Tobacco Settlement Financing Corporation

We have audited the financial statements of the Tobacco Settlement Financing Corporation, as of and for the year ended June 30, 2003, and have issued our report thereon dated April 2, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Tobacco Settlement Financing Corporation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Board of Directors, management, the Rhode Island Department of Administration, Rhode Island Auditor General and others within the Organization and is not intended to be and should not be used by anyone other than these specified parties.

Russell Chatellin Fountain & Willinson, LLP

April 2, 2004