TOBACCO SETTLEMENT FINANCING CORPORATION

Financial Statements

June 30, 2015

(With Independent Auditors' Report Thereon)

TOBACCO SETTLEMENT FINANCING CORPORATION

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TOSKI & CO., P.C.
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Tobacco Settlement Financing Corporation:

Report on Financial Statements

We have audited the accompanying financial statements of the governmental activities and the governmental fund of Tobacco Settlement Financing Corporation (a component unit of the State of Rhode Island) (the "Corporation") as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the Corporation's basic financial statements as listed in the table of contents

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from 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.

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Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the governmental fund of Tobacco Settlement Financing Corporation as of June 30, 2015, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 13 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, 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 Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Tobacco Settlement Financing Corporation's basic financial statements. The supplemental information as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The supplemental information is the responsibility of management and were derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplemental information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with Government Auditing Standards, we have also issued our report dated December 3, 2015, on our consideration of the Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 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.

Toski & Co., CPAs, P.C.

Williamsville, New York
December 3, 2015

Management's Discussion and Analysis
Fiscal Year Ended June 30, 2015

Management's discussion and analysis (MD&A) provides a narrative overview and analysis of the financial activities of the Tobacco Settlement Financing Corporation (hereinafter referred to as "TSFC" or the "Corporation") for the fiscal year ended June 30, 2015. MD&A is intended to serve as an introduction to the Corporation's basic financial statements, which have the following components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. The MD&A is designed to (a) assist the reader in focusing on significant financial matters, (b) provide an overview of the Corporation's financial activities, and (c) highlight individual fund matters. The following presentation is by necessity highly summarized, and in order to gain a thorough understanding of the Corporation's financial condition, the following financial statements, notes and supplementary information should be reviewed in their entirety.

This section of the annual financial report represents our narrative overview and financial performance analysis for the fiscal year ended June 30, 2015. Please read it in conjunction with the financial statements, notes and supplementary information that follow this section.

It should also be noted that while attempts have been made to disclose all pertinent risk factors, it is difficult to capture all current litigation and other proceedings relating to the Master Settlement Agreement, and the reader should not rely upon management's discussion contained herein when making investment decisions.

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 and in the State's right to receive the moneys due under and pursuant to (i) the Master Settlement Agreement (MSA), 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 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 June 2007, the Corporation issued $197,005,742 of its Tobacco Settlement Asset-Backed Bonds, Series 2007A, B and C, which were structurally subordinate to the payment in full of the 2002 Series Bonds. The Trustee was entitled to receive the "Residual" tobacco settlement revenues pledged to pay the 2007 Series A, B and C Bonds upon full payment of the 2002 Series A Bonds.

On March 19, 2015 the Corporation issued $620,935,000 of Tobacco Settlement Asset-Backed Bonds that bear interest at annual rates ranging from 0.590% to 5.000% and mature in varying amounts through June 1, 2050. The proceeds of the new issuance, along with the release of debt service funds related to the bonds retired and the proceeds received for early termination of investment contracts, were used primarily to redeem all the remaining balance, $547,815,000, of the 2002 Series bonds and repurchase and retire the principal amount of $76,220,155 of the 2007 Series bonds as well as pay accreted interest of $13,600,495 on the retired 2007 Series bonds (The aggregate purchase price paid for the retired 2007 Series bonds was $89,820,650). In addition, the TSFC paid, pursuant to law, $31,342,128 to the State of Rhode Island and $5,000,000 to the RI Clean Water Finance Agency, a related organization of the State now known as the RI Infrastructure Bank, for the Municipal Road and Bridge Revolving Loan Fund program.

The transaction resulted in a cash flow savings of $1,283,693,000 and an economic gain of $369,828,000.

The remaining 2007 Series A and B bonds (all Series C bonds were repurchased and retired with proceeds from the 2015 issuance) are structurally subordinate to the payment in full of the 2015 Series bonds.

The 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 of Rhode Island or any political subdivision thereof is pledged to the payment of the principal of or the interest on the bonds. The bonds do not constitute an indebtedness of or a general, legal or "moral" obligation of the State or any political subdivision of the State.

In conjunction with refunding of the 2002 bonds the Corporation received $26,361,000 in proceeds for the early termination of investment contracts that were related to investments held in the Debt Service Fund and Debt Service Reserve Fund for the Series 2002 bonds that were redeemed.

Financial Highlights

Future revenues continue to be threatened by factors discussed under "Risk Factors and Future Revenue" and the "Economic Outlook" sections of this MD&A.

The following are the key highlights from the government-wide financial statements:

- Due to the balance of the revenue bonds outstanding exceeding the assets recognized, the liabilities of TSFC exceeded its assets at June 30, 2015 by $780,829,099. This occurred primarily because, with the exception of one-half of the estimated TSR revenue to be received for calendar 2015 in April 2016 being established as a receivable, no receivables for future revenues were recognized. Please see Note 1 for a description of the Corporation's revenue recognition policy. This deficiency increased by $44,648,945 from June 30, 2014. The increase in the net deficiency is primarily the result of transactions associated with the debt refunding that occurred in March 2015. See Note 4 of the Notes to Financial Statements for further details about this transaction.
- Revenues, consisting of TSRs and investment income amounted to $46,495,563 for fiscal year 2015. This compares to $56,047,371 for fiscal year 2014, a decrease of $9,551,808. This decline was mainly attributable to a reduction in the amount of TSR's received of $7,687,699 and a decline in investment income. The latter occurred because of the early termination of investment contracts as discussed above and in Note 3 of the Notes to Financial Statements.
- Expenses, primarily interest expense and bond issuance costs relating to the issuance of the Series 2015 asset-backed bonds, amounted to $54,802,380 for fiscal year 2015. This compares to $53,596,287 for fiscal year 2014.
- In addition, the Corporation in fiscal year 2015 had special items of $36,342,128 which represented a payment to the State of Rhode Island in connection with the issuance of Series 2015 asset-backed bonds discussed more fully above and a $5,000,000 payment to a related organization. Both of these payments were made pursuant to law.
- The Corporation had $25,520,000 in redemptions of outstanding bonds during the fiscal year, consisting of $20,520,000 of turbo redemptions and $5,000,000 of scheduled redemptions. However, the ending balance of bonds payable decreased by only $5,489,684 due to transactions related to the debt refunding that occurred in March 2015. See Note 4 of the Notes to Financial Statements for further details.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Corporation's basic financial statements. The basic financial statements include three components:

1. Government-wide financial statements
2. Fund financial statements
3. Notes to the financial statements

This report also contains other supplementary information in addition to the basic financial statements.

Government-wide Financial Statements

The government-wide financial statements provide a broad view of the Corporation's finances. The statements provide both short-term and long-term information about the Corporation's financial position, which assists in assessing the Corporation's financial condition at the end of the year. These financial statements are prepared using the accrual basis of accounting, which recognizes all revenues and grants when earned, and expenses at the time the related liabilities are incurred.

- The Statement of Net Position presents all of the Corporation's assets, deferred outflows of resources, liabilities, and deferred inflows of resources, with the difference being reported as "net position." Over time, increases and decreases in the Corporation's net position may serve as a useful indicator of whether the financial position of the Corporation is improving or deteriorating.
- The Statement of Activities presents information showing 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. Therefore, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Corporation uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The fund financial statements focus on the individual parts of the Corporation and report the Corporation's operations in more detail than the government-wide financial statements.

- Governmental funds: All of the Corporation's activities are financed through governmental funds. Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, the governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on spendable resources available at the end of the fiscal year. Such information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the Corporation's activities.

  Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Corporation's near-term financial decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and the governmental activities.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found immediately following the fund financial statements.

Supplementary information, which follows the notes to the financial statements, includes the calculation of debt service coverage ratios and information about the actual MSA receipts compared to base case projections at the time the revenue bonds were sold.

Government-wide Financial Statement Analysis

The Corporation's net deficiency totaled $780,829,099 at the end of fiscal year 2015, as compared with a net deficiency of $736,180,154 at June 30, 2014. The increase in the net deficiency is primarily the result of transactions associated with the debt refunding that occurred in March 2015. See Note 4 of the Notes to Financial Statements for further details about this transaction.

As discussed previously, the overall deficiency in net position is primarily attributable to long term receivables for future TSR revenues not being recognized while the full amount of bonds payable is reflected on the Statement of Net Position.

The Corporation received a one-time payment of $26,361,000 in connection with the early termination of investment contracts related to funds invested for the Series 2002 bonds that were redeemed in March 2015. This payment was factored into the gain on refunding of debt which has been established as a deferred inflow of resources on the Statement of Net Position.

A condensed statement of activities for fiscal years ended 2015 and 2014 follows:

	2015	2014	Change
Revenues	$ 46,495,563	$ 56,047,371	$ (9,551,808)
Expenses	(54,802,380)	(53,596,287)	1,206,093
Special Items	(36,342,128)	-	36,342,128
	$ (44,648,945)	$ 2,451,084	$ (47,100,029)

During fiscal year 2015, the Corporation recognized $45,060,062 of revenues from TSRs and investment income of $1,435,501, a decrease of $9,551,808 from fiscal year 2014. This decline was attributable to a reduction in the amount of TSR's received of $7,687,699 and a decline in investment income. The decline in investment income occurred because of the early termination of the investment contracts as discussed above and in Note 3 of the Notes to Financial Statements.

Interest and other charges amounted to $55,666,516 for fiscal year 2015 as compared to $52,325,018 in the prior fiscal year. Included in this category for fiscal year 2015 is $46,209,675 in interest expense on bonds. In addition, the Corporation incurred $9,456,840 of costs in connection with the issuance of the previously discussed Series 2015 debt. These costs included issuance costs related to the new debt and attorney's fees related to litigation that was initiated in connection with the debt issuance.

Also, the Corporation made a $5,000,000 payment to the RI Clean Water Finance Agency (now known as the RI Infrastructure Bank) and a $31,342,128 payment to the State of Rhode Island in connection with the issuance of Series 2015 asset-backed bonds and associated transactions as discussed more fully above. These payments which were both made pursuant to law, are recorded as special items in the accompanying financial statements.

Analysis of Fund Financial Statements

The governmental fund had a combined fund balance of $77,395,901 at June 30, 2015. This represents a decrease of $17,133,668 from June 30, 2014. This decrease is primarily attributable to declining tobacco settlement revenues and higher expenditures associated with the debt refunding and the special items discussed above.

Long-Term Debt

In June 2007, the TSFC issued $197,005,742 of asset-backed bonds, which included $176,974,412 of Series 2007 A Bonds, $17,336,218 of Series 2007 B Bonds and $2,695,112 of Series 2007 C Bonds.

As of August 26, 2015 Standard & Poor's Rating Services rates the TSFC 2007 Series A debt "CCC+" and the Series B debt "CCC".

In March 2015, the TSFC issued $620,935,000 of asset-backed bonds, which included $332,300,000 of Series 2015 A Bonds and $288,635,000 of Series B Bonds. In connection with this issuance, all of the outstanding 2002 Series asset-backed bonds were redeemed. In addition, principal of $68,324,411 of 2007 Series A, principal of $5,200,633 of 2007 Series B, and all of 2007 Series C were repurchased and retired.

On March 19, 2015, Standard & Poor's rated the 2015 Series A asset-backed bonds maturing from 2016 to 2025 "A," those bonds maturing from 2026 to 2030 and in 2035 were rated "A-," and the June 1, 2040 maturity was rated "BBB+."

On August 20, 2015, Standard & Poor's announced that the ratings for certain of the 2015 asset-backed bonds were being changed as follows: the rating on the 2015 Series A asset-backed bonds maturing from 2019 to 2025 was changed to "BBB+," the rating on the bonds maturing from 2026 to 2030 and in 2035 was changed to "BBB," and the rating on the June 1, 2040 maturity bonds was also changed to "BBB."

Fitch Ratings rated both the 2015 Series A and Series B bonds "BBB+sf."

Ratings on all the bonds are subject to change at any time and readers should refer to information available from the rating services for the most current ratings.

During fiscal year 2015, the Corporation paid $25,520,000 in principal on long-term debt pursuant to the turbo redemption provisions of the Trust Indenture relating to its outstanding bonds. The amount of principal determined by the Trustee to be subject to the turbo redemption was based upon actual cash available in June 2015.

For additional information relating to long-term debt, see the notes to the financial statements.

Risk Factors and Future Revenue

The Corporation has little or no control over the level of revenues that are collected. Risk factors possibly impacting the level of revenues to be received by the TSFC are beyond the control of the Corporation and include, but are not limited to, cigarette consumption, financial viability of the Participating Manufacturers, and the liability of the tobacco industry. In the event of non-payment of the amounts due and payable under the Master Settlement Agreement that have been assigned to the Corporation, the State of Rhode Island has pledged to pursue legal remedies to the extent possible to obtain amounts due pursuant to the Master Settlement Agreement and payable to the Corporation.

Many adjustments are included in the calculation of an MSA Payment, such as a volume adjustment, cost of living adjustment and Non-Participating Manufacturer (NPM) adjustment. An NPM adjustment would permit the Participating Manufacturers (PM) to reduce their MSA payments provided that the PMs' market share loss exceeds 2% of the original participating manufacturers' 1997 market share, that the MSA was a significant factor for the PMs' market share loss, and that the states did not enact a Model Escrow Statute included in the MSA and diligently enforce it and the MSA. If the NPM adjustment is applied, the payment reduction is based on the percentage of market share lost to NPMs multiplied by three and allocated to states that did not diligently enforce the MSA and the escrow statute, up to the amount of the allocable share. The offset is not carried forward to other MSA payments.

States have collected less TSRs than originally expected due to a decline in cigarette volume attributable to many factors, including, but not limited to, the Master Settlement Agreement and higher excise taxes, both state and federal. The adjustment for inflation has offset the volume adjustment, but it has not outweighed it to date.

In April 2005, the total revenues received by the Corporation as a result of the Tobacco Master Settlement Agreement (MSA) were $45,315,618. Eleven of the forty-three Subsequent Participating Manufacturers (SPMs) to the MSA paid their MSA payment due April 15, 2005 into an escrow disputed account, and nine SPMs withheld all or part of their MSA payment due April 1, 2005. On or about October 4, 2005, Rhode Island received a distribution in the amount of $514,707, as a result of some SPMs releasing funds deposited in the escrow dispute account and the first payment in the General Tobacco settlement.

The SPMs asserted that the Independent Auditor's calculation for the MSA payment due April 15, 2005 was incorrect, primarily because it did not contain a Non-Participating Manufacturers (NPM) adjustment. The value of the April 15, 2005 Rhode Island MSA payment in dispute is $1,366,519.

In April 2005, the Independent Auditor determined that the PMs experienced a 2003 market share loss exceeding 2% of the Original Participating Manufacturers' (OPMs') 1997 market share. Rhode Island, along with the other Settling States and the PMs, initiated a Significant Factors Determination (SFD) proceeding to determine whether or not the MSA was a significant factor in the PMs' market share loss of greater than 2%. The Settling States and the PMs selected an economic firm, The Brattle Group, to conduct the analysis and determine whether or not the MSA was a significant factor in the PMs' loss of market share. Rhode Island, along with the other Settling States and the PMs, engaged experts, presented data, and briefed legal issues to the selected economic firm, The Brattle Group.

On March 27, 2006, The Brattle Group made its final determination that the MSA was a significant factor contributing to the market share loss for calendar year 2003. In a statement dated March 28, 2006, the co-chairs of the National Association of Attorneys General (NAAG) Tobacco Committee stated, among other things, that the Settling States believe it would not be appropriate for a PM to withhold any portion of the April 2006 Annual Payment. According to the statement, the Settling States believed that the PMs must still prove to a court that the Settling States have not enacted the Model Statute and diligently enforced it, and they also believed that every Settling State will be found to have diligently enforced its Model Statute in 2003. It has been reported, however, that the general counsel of Reynolds Tobacco has stated that he believes that not all states were diligently enforcing their Model Statutes.

It has been reported that on March 31, 2006, Philip Morris made its full $3.4 billion payment, even though it believes that sum should eventually be reduced to reflect its market share loss due to the MSA, and it intends to continue to negotiate with the Settling States' Attorneys General for a reduction of its payment. It has been further reported that Lorillard paid approximately $558 million of its 2006 Annual MSA Payment on March 31, 2006 to the Settling States and deposited the balance of the 2006 MSA Annual Payment, $108 million, into the Disputed Payments Account pending final non-appealable resolution of the 2003 NPM Adjustment. Additionally, it has been reported that Reynolds American paid approximately $1.3 billion of its Annual MSA Payment for 2006 to Settling States and deposited $647 million in the Disputed Payment Account pending resolution of the 2003 NPM Adjustment. According to the co-chairs of the NAAG Tobacco Committee in a statement released on April 18, 2006, the Annual Payments paid by Lorillard and Reynolds American to the Settling States constitute about 82% of the amount that was due. The three SPMs from whom the largest payments were due made substantial payments. One of the three SPMs paid a portion of its payment to the Disputed Payments Account and the other two SPMs each withheld a portion of the payment due.

In April 2006, the Independent Auditor calculated that the PMs' payment for the MSA payment due April 15, 2006 should be $6,568,524,930. The PMs paid the Settling States $5,754,873,468 for the Annual MSA payment due April 15, 2006. The total revenues received by the Corporation as a result of the MSA were $41,545,702. The value to Rhode Island of the April 15, 2006 MSA payment in dispute is approximately $5,858,290, which includes PMs that either withheld or deposited into Disputed Escrow Accounts $39,579,991 related to the 2003 NPM Adjustment.

To obtain the full MSA payment due April 15, 2006, Rhode Island issued a 30-day notice of intent to initiate proceedings to the PMs, pursuant to the MSA. On April 18, 2006, the co-chairs of the NAAG Tobacco Committee restated that the Settling States believed that no NPM Adjustment would be found to apply and, thus, the Settling States are entitled to receive the full payment due under the MSA. They stated that each Settling State has enacted a Model Statute, that all states believe they have diligently enforced their Model Statute, and that they will ultimately receive the money in dispute. Since that date, more than 30 Settling States have filed suit in their respective state courts against one or more of the PMs to obtain the entire 2006 MSA Payment and/or the PMs sued the state to compel arbitration.

In October 2006, the OPMs and some SPMs moved to compel Rhode Island to arbitrate the 2003 NPM Adjustment. Rhode Island argued that the issue of whether or not a state diligently enforced the Qualifying Statute should be determined by the state MSA court rather than nationwide arbitration. In 2007, the Rhode Island Superior Court held that the issue of diligent enforcement is integral to the 2003 NPM Adjustment and the 2003 NPM Adjustment should be decided in arbitration for consistency.

Rhode Island moved for reconsideration, which the Rhode Island Superior Court denied. Rhode Island appealed the Rhode Island Superior Court decision and sought a stay of it. The Supreme Court of Rhode Island remanded the case to Rhode Island Superior Court to determine if a stay should be granted. The Rhode Island Superior Court denied the motion for a stay. While the appeal was pending before the Supreme Court of Rhode Island, the PMs and 46 states entered into an Agreement Regarding Arbitration whereby the states agreed to arbitration and the PMs agreed to release some money from the 2003 NPM Adjustment disputed account, cap damages by a 20% reduction on an award of damages from the states, and other benefits for the states.

By June 30, 2010, the three-member arbitration panel was seated. On November 3, 2011, after both the PMs and the Settling States engaged in an arduous discovery and briefing process, the PMs issued a notice of contest as to each Settling State's diligent enforcement. In that same notice, the PMs notified certain Settling States, including Rhode Island, that they would not contest those States' diligence for the purpose of the 2003 NPM Adjustment. Thus, Rhode Island was not subject to the NPM Adjustment because its diligence was ultimately not contested, rendering Rhode Island diligent for the purposes of the 2003 NPM Adjustment. The arbitration proceeded against the contested Settling States, concluding in 2013.

On June 1, 2015, seventeen (17) States, including Rhode Island, and Philip Morris entered into a Panel Formation Agreement to commence the 2004 NPM Adjustment Arbitration. Each side named its arbitrator on July 31, 2015. On September 1, 2015, R.J. Reynolds filed a motion in Rhode Island "to enforce the arbitration provisions of the Master Settlement Agreement and Compel Arbitration." As of September 11, 2015, R.J. Reynolds filed the same motion in the sixteen (16) other States that are also signatories to the Panel Formation Agreement. A briefing schedule has been set, and oral argument on R.J. Reynolds' motion and any cross-motion Rhode Island plans to file is scheduled for Tuesday, December 15, 2015.

The State of Rhode Island has adopted the Model Statute (which is a Qualifying Statute under the MSA). "Diligent Enforcement" is not defined in the MSA. Furthermore, no provision of the MSA attempts to define what activities, if undertaken by a Settling State, would constitute diligent enforcement. As noted above, the Rhode Island Attorney General's Office has stated that the State has been and is diligently enforcing its Model Statute.

Future NPM Adjustment claims for Settling States remain possible for calendar years 2004, 2005, and all future years. The Brattle Group has been engaged as the firm to determine whether or not the MSA was a significant factor for the PMs' loss of market share in 2004. Rhode Island prepared for a

Significant Factors Determination Proceeding concerning market share loss. The economic firm determined that the MSA was a significant factor for the PMs' market share loss of greater than 2% in 2004 and 2005. For a significant factor determination for year 2006, the PMs and the Settling States selected a different economic firm; however, the significant factor determination was the same, that the MSA was a significant factor in the market share loss of the PMs of greater than 2% of the PMs' market share from 1997. For the significant factor determination for years 2007 through 2009, the PMs and the Settling States agreed to instruct the Independent Auditor that the MSA was a significant factor for the PMs' loss of market share of greater than 2% of the PMs' 1997 market share. The Settling States agreed to provide the PMs with data for years 2007 through 2009. The OPMs agreed to pay $15 million over three years to the "Antitrust/Consumer Protection Tobacco Enforcement Fund" established pursuant to MSA § VIII. A similar agreement was entered into for years 2010, 2011, and 2012, whereby the States agreed not to contest the PMs' claim that the MSA was a significant factor contributing to Market Share Loss in exchange for the PMs paying $15 million over three years into "The States' Antitrust/Consumer Protection Tobacco Enforcement Fund." For Years 2013 and 2014, the States that did not sign the Term Sheet, as described in the Commitments and Contingencies note to the Financial Statements, entered into agreement with the PMs whereby the States agreed not to contest the PMs' claim that the MSA was a significant factor contributing to Market Share Loss in exchange for the PMs paying $3.5 million to the States for each year.

In 2007, PMs withheld or deposited in the Disputed Payments Account $759,901,725, of which approximately $5.4 million would be allocated to Rhode Island.

In April 2008, PMs paid the Settling States $7,022,663,940 and withheld or deposited in the Disputed Payments Account $536,189,064. Rhode Island received an MSA payment in the amount of $53,246,221.

The Independent Auditor calculated that the MSA payment due April 15, 2009 to the Settling States was $7,577,256,366. On April 15 and 17, 2009, the participating manufacturers paid the Settling States $7,050,630,533 for 2008 and $56,037,366 for earlier years. The participating manufacturers paid $110,179,682 into the Disputed Payments Account on account of the NPM Adjustment. The participating manufacturers withheld $412,698,683 on account of the NPM Adjustment, $3,333,328 on account of the "Net vs. Gross" dispute, and $418,888 was defaulted on by Daughters and Ryan (the only PM to default this year). Rhode Island received an MSA payment in the amount of $58,018,809, including $3,866,745 for joining the Agreement Regarding Arbitration.

The Independent Auditor calculated that the MSA payment due April 15, 2010 to the Settling States was $7,068,272,985. On April 15 and 17, 2010, the participating manufacturers paid the Settling States $6,381,050,380 for 2009 and $12,309,983 for earlier years. The participating manufacturers paid $576,112,050 into the Disputed Payments Account on account of the NPM Adjustment. The participating manufacturers withheld $21,083,728 on account of the NPM Adjustment, $3,116,080 on account of other basis, and $86,943,059 was defaulted on by General Tobacco (the only PM to default this year). Rhode Island received an MSA payment in the amount of $48,620,448.

The Independent Auditor calculated that the MSA payment due April 15, 2011 to the Settling States was $6,957,627,854. On April 15 and 19, 2011, the participating manufacturers paid the Settling States $6,029,481,330 for 2010 and $5,978,580 for earlier years. The participating manufacturers paid $881,449,597 into the Disputed Payments Account on account of the NPM Adjustment. The participating manufacturers withheld $20,686,101 on account of the NPM Adjustment, $3,288,831 on account of the Liggett Group LLC "Liggett" "Net vs. Gross" dispute (this issue is currently being arbitrated), and $22,723,650 was defaulted upon (mainly by Farmers and General Tobacco). Rhode Island received an MSA payment in the amount of $45,812,109.

The Independent Auditor calculated that the MSA payment due April 16, 2012 to the Settling States was $6,924,308,841.56. On April 16 and 18, 2012, the participating manufacturers paid the Settling States $6,140,121,872.39 for 2011. The participating manufacturers paid $776,000,700.86 into the Disputed Payments Account on account of the NPM Adjustment, and $3,853,374.45 was paid into the DPA on other grounds. The participating manufacturers withheld $3,032,745.06 on account of the Liggett Group LLC "Liggett" "Net vs. Gross" dispute, and $1,300,148.80 was defaulted upon ($1,223,043.46 of the amount defaulted upon was paid late and will be distributed at a later date). Rhode Island received an MSA payment in the amount of $46,710,284.97 in 2012.

The Independent Auditor calculated that the MSA payment due April 15, 2013 to the Settling States was $6,105,975,023.36. On April 15, 17, and 24, 2013, the participating manufacturers paid the Settling States $5,265,513,662.23 for 2012. The participating manufacturers paid $830,807,622.95 into the Disputed Payments Account on account of the NPM Adjustment and on other grounds, $6,992,964.31 was withheld by Farmers and Liggett, and $319,445.38 was defaulted upon by Virginia Carolina Corporation, Inc. Rhode Island received an MSA payment in the amount of $46,692,088.33.

On April 16 and 17, 2014, the PMs paid the Settling States $5,958,971,723.12.[1] The PMs deposited over $600,000,000 into the Disputed Payments Account, Farmers and Liggett withheld funds, and Virginia Carolina defaulted.[2] Rhode Island received an actual MSA payment of $51,756,760.89.

For Payment Year 2015, Rhode Island received an actual MSA payment of $45,295,061.83. This year, Payment Year 2015, money was disbursed on April 15th and April 17th. Originally, Rhode Island received $39,961,538.36. The Tobacco Enforcement Unit of the Attorney General's office reviewed the relevant notices and spreadsheets provided to the States by the Independent Auditor and the National Association of Attorneys General (NAAG) and discovered a substantial discrepancy between the original amount received and the amount the Independent Auditor calculated Rhode Island should have received. Rhode Island received substantially lower disbursements than the amount projected, causing over a $5 million dollar gap. The Attorney General's office immediately notified NAAG, which discovered that the Independent Auditor made certain gross miscalculations that resulted in overpayments to half of the States by approximately $350 million, and underpayments to the other half of the States by the same. NAAG spearheaded a collaborative effort with the States to successfully remit payment from the overpaid States to the underpaid States. RI has received practically 100% of the amount the Independent Auditor calculated. Any *de minimis* balance (for Rhode Island, $100 or less) will be remitted through the 2016 payment cycle.

Rhode Island will continue to vigorously enforce the MSA and related statutes. Although a Settling State that diligently enforces its Qualifying Statute is not subject to the NPM Adjustment, many procedural uncertainties, as described above, still remain regarding the resolution of a dispute regarding NPM Adjustment. In addition, the resolution of the substance of such disputes could take years. A decision by the PMs to pay the amount of a claimed NPM Adjustment into the Disputed Payments Account or to withhold payment of such an amount pending the resolution of the dispute would have a material adverse effect on the amounts of TSRs available to the Corporation to make turbo redemptions and other payments on the bonds during such period. Should a PM be determined with finality to be entitled to an NPM Adjustment in a future year, the operation of the NPM Adjustment would also have a material adverse effect on the amounts of TSRs available to the Corporation to make turbo redemptions and other payments on the bonds.

There continues to be concern that litigation could threaten the ability of the tobacco companies to pay the amounts owed under the MSA, including, but not limited to, bankruptcy. Antitrust and constitutional challenges to the MSA are pending in several Settling States, which potentially could affect the legality of the MSA and the MSA payments for Rhode Island. Rhode Island continues to work with the other Settling States to defend these challenges. In addition, the issue of whether or not the PMs would seek bankruptcy protection continues to be a concern. A number of PMs have filed for bankruptcy; however, Rhode Island and the other Settling States are pursuing claims in the bankruptcy courts.

In addition, please see Note 5 of the notes to financial statements for additional information about Commitments and Contingencies.

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[1] As of April 25, 2014, pursuant to an agreement known as the Agreement to Arbitrate concerning the 2003 NPM Adjustment, six states (not Rhode Island) received additional payments, totaling $125,737,633.81.

[2] The exact amounts have not yet been determined.

Economic Outlook

Future payments of all types on the Bonds are contingent on Actual MSA Receipts. These Receipts are dependent on a number of factors, including, but not limited to, the rates of consumption of tobacco products.

In structuring the financial transactions for the issuance of the bonds, the Corporation engaged the services of independent consultants to develop forecasts of these Receipts.

It should be noted that shipments of cigarettes have decreased at a rate greater than was projected when the Corporation issued the Series 2007 bonds. Over the past few years there have been significant increases in tobacco excise taxes in various jurisdictions and at the Federal level, and varying restrictions on public smoking have been enacted, further contributing to a decline in tobacco consumption.

Please see the "Supplemental Schedule of Actual MSA Receipts Compared to Base Case Projections at Time of Sale" in the Supplementary Information section of this report for more information about this.

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 Financing Corporation, c/o State Budget Office, One Capitol Hill, Providence, Rhode Island 02908.

Tobacco Settlement Financing Corporation

Statement of Net Position
June 30, 2015

Assets:	
Current assets:	
Cash and cash equivalents	$ 1,063,848
Cash equivalents-restricted	52,374,053
Receivables	23,958,000
Total current assets	77,395,901
Liabilities:	
Current liabilities:	
Accrued interest	2,250,000
Bonds payable	11,150,000
Total current liabilities	13,400,000
Noncurrent liabilities:	
Bonds payable, net of unamortized premium/discount	811,236,000
Total liabilities	824,636,000
Deferred inflows of resources:	
Deferred gain on refunding of debt	33,589,000
Net position (deficiency):	
Restricted for debt service	52,374,053
Unrestricted/(deficiency)	(833,203,152)
	$ (780,829,099)

The notes to the financial statements are an integral part of this statement.

Tobacco Settlement Financing Corporation

Statement of Activities
For the Fiscal Year Ended June 30, 2015

Revenue:	
Tobacco settlement revenue	$ 45,060,062
Investment income	1,435,501
Total revenue	46,495,563
Expenses:	
General and administrative	125,520
Amortization of premium/(discount) and deferred gain on refunding of debt	(989,656)
Interest	46,209,676
Costs of issuance	9,456,840
Total expenses	54,802,380
Special Items:	
Transfers to State and related organization	(36,342,128)
Decrease in net position	(44,648,945)
Net position/(deficiency)	
Beginning of the year	(736,180,154)
End of year	$ (780,829,099)

The notes to the financial statements are an integral part of this statement.

Tobacco Settlement Financing Corporation

Statement of Cash Flows
For the Fiscal Year Ended June 30, 2015

Cash flows from operating activities:	
Cash received from tobacco settlement revenue	$ 45,295,062
Payments to vendors	(125,520)
Net cash provided by operating activities	45,169,542
Cash flows from non-capital financing activities:	
Principal paid on long-term debt	(25,520,000)
Interest paid on long-term debt	(49,228,211)
Proceeds from sale of bonds	654,717,623
Payments to 2002 and 2007 bond holders	(624,035,155)
Special items	(36,342,128)
Proceeds from early termination of investment contracts	26,361,000
Costs of issuance	(9,456,840)
Net cash used for non-capital financing activities	(63,503,711)
Cash flows from investing activities:	
Change in investments-restricted	70,127,651
Investment earnings	1,435,501
Net cash provided by investing activities	71,563,152
Net increase in cash	53,228,983
Cash and cash equivalents, July 1, 2014	208,918
Cash and cash equivalents, June 30, 2015	$ 53,437,901
Reconciliation of increase in net position to net cash provided by operating activities:	
Decrease in net position	$ (44,648,945)
Amortization of bond premiums/discounts	(989,656)
Change in accrued interest	584,040
Decrease in tobacco revenue receivable	235,000
Accretion of interest on capital appreciation bonds	11,166,000
Special items	36,342,128
Not classified as operating:	
Interest	43,916,476
Increase in investment earnings	(1,435,501)
	$ 45,169,542

The notes to the financial statements are an integral part of this statement.

Tobacco Settlement Financing Corporation

Balance Sheet - Governmental Fund
June 30, 2015

Assets:		
Current assets:		
Cash and cash equivalents		$ 1,063,848
Cash and equivalents - restricted		52,374,053
Receivables		23,958,000
Total assets		$ 77,395,901
Fund balance:		
Restricted for debt service		52,374,053
Assigned for future expenditures		25,021,848
Total fund balance		$ 77,395,901
Amounts reported in the Statement of Net Position differ because:		
Total fund balances, governmental fund		$ 77,395,901
Bonds, accrued interest and other liabilities are not due and payable in the current period and therefore are not reported in the funds.		
Bonds payable	$ (716,200,587)	
Deferred discounts	473,587	
Deferred premiums	(33,280,000)	
Accreted interest	(73,379,000)	
Accrued interest	(2,250,000)	
		(824,636,000)
Deferred inflows of resources - deferred gain on refunding bonds		(33,589,000)
Net Position in Statement of Net Position		$ (780,829,099)

The notes to the financial statements are an integral part of this statement.

Tobacco Settlement Financing Corporation

Statement of Revenue and Expenditures, and Changes in Fund Balance
Governmental Fund
For the Fiscal Year Ended June 30, 2015

Revenue:	
Tobacco settlement revenue	$ 45,060,062
Investment income	1,435,501
Total revenue	46,495,563
Expenditures:	
Current - general and administrative	125,520
Debt service:	
Principal	25,520,000
Interest	49,228,211
Costs of issuance	9,456,840
Total expenditures	84,330,571
Excess of revenue over/(under) expenditures	(37,835,008)
Other financing sources/(uses):	
Proceeds from the sale of bonds	620,935,000
Proceeds from bond premiums	33,782,623
Payments to escrow agent	(624,035,155)
Proceeds from early termination of investment contracts	26,361,000
Total other financing sources/(uses)	57,043,468
Special items - transfers to State and related organization	(36,342,128)
Excess of revenue and other financing sources over/(under) expenditures, other financing uses, and special items	(17,133,668)
Fund balance - beginning	94,529,569
Fund balance - ending	$ 77,395,901
Net change in fund balance - governmental fund	$ (17,133,668)
Amounts reported in the Statement of Activities differ because:	
Bond proceeds provide current financial resources to governmental funds by issuing debt which increases long-term debt in the Statement of Net Position. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Position. Interest expense, and bond premiums/(discounts) are recognized when the transaction occurs in the governmental funds.	
Principal paid on debt	25,520,000
Accrued interest	584,040
Proceeds from the sale of bonds	(620,935,000)
Premium	(33,782,623)
Payments to escrow agent	624,035,155
Accreted interest	(11,166,000)
Proceeds from early termination of investment contracts	(26,361,000)
Accreted interest paid	13,600,495
Amortization of gain on refunding	806,115
Amortization of discount 2007 bonds	(319,082)
Amortization of premium 2015 bonds	502,623
Change in Net Position in the Statement of Activities	$ (44,648,945)

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 (the State), pursuant to Title 42 of the General Laws, Chapter 133. 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, and again in June 2007, the Corporation issued asset-backed 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 and 2007, pursuant to Purchase and Sale Agreements with the State, the State sold to the Corporation its future rights in the Tobacco Settlement Revenues (TSRs) 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 TSRs will revert back to the State. In March 2015 the Corporation issued asset-backed bonds that were used to fully retire the June 2002 bonds and repurchase and retire a portion of the 2007 bonds.

The future receipts of TSR payments are dependent on a variety of significant factors, which include but are not limited to:

- the financial capability of the participating cigarette manufacturers to pay TSRs;
- future cigarette consumption which impacts the TSR payments; and
- future legal and legislative challenges against the tobacco manufacturers and the MSA that provides for the TSR payments.

Changes in any of these factors could affect the amount of funds available to pay scheduled debt service requirements.

All of 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.

These financial statements were prepared in accordance with accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board.

Recently Issued Accounting Standards

During the fiscal year ended June 30, 2015, the Corporation adopted the following new accounting standards issued by GASB:

- GASB Statement No. 68 - Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27
- GASB Statement No. 69 - Government Combinations and Disposals of Government Operations
- GASB Statement No. 71 - Pension Transition for Contributions Made Subsequent to the Measurement Date - an Amendment of GASB Statement No. 68

Implementation of these standards did not impact the Corporation's financial statements.

The Corporation will adopt the following new accounting pronouncements in future years:

- GASB Statement No. 72 - Fair Value Measurement and Application
- GASB Statement No. 73 - Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement No. 68, and Amendments to Certain Provisions of GASB Statements 67 and 68
- GASB Statement No. 74 - Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans
- GASB Statement No. 75 - Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions
- GASB Statement No. 76 - The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments
- GASB Statement No. 77 - Tax Abatement Disclosures

The impact, if any, of these pronouncements on the Corporation's financial statements has not been determined.

Basis of Presentation - Government-wide Financial Statements

The Statement of Net Position 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 government-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.

Basis of Presentation - 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 specified activities or objectives. 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 a single fund for financial reporting purposes, which is an amalgamation of multiple funds established by the trustee under the bond indentures.

The flow of current financial resources measurement focus and the modified accrual basis of accounting are utilized in the preparation of the fund financial statements. 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.

Cash Equivalents

Cash equivalents are defined as highly liquid investments with a maturity of three months or less at the time of purchase and at June 30, 2015 consisted of a money market fund that invests only in U.S. Treasury securities.

Cash Equivalents - Restricted

Cash equivalents-restricted are defined as highly liquid investments with a maturity of three months or less at the time of purchase and at June 30, 2015 consisted of a money market fund that invests only in U.S. Treasury securities. These funds are held by the trustee and restricted for use only for debt service or debt service reserve fund purposes.

Equity Classifications

Government-wide Financial Statements

Equity is classified as net position and displayed in two components:

- Restricted net position - Consists of net position with constraints placed on the use thereof either by 1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments, or 2) law through constitutional provisions or enabling legislation.

- Unrestricted net position - that portion of net position that does not meet the definition of "restricted."

Fund Financial Statements

Governmental fund equity is classified as fund balance in accordance with GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions. Fund balance is classified as non-spendable, restricted, committed, assigned or unassigned as described below:

- Non-Spendable - the amount of fund balance that cannot be spent because it is either not in spendable form or there is a legal or contractual requirement for the funds to remain intact.

- Restricted - the amount of fund balance that can only be spent on specific expenses due to constraints on the spending because of legal restrictions, outside party creditors, and grantor/donor requirements. The Corporation's restricted fund balance amounts can only be spent for future bond payments due to constraints on the spending because of legal obligations. The financial activities of the Corporation are limited by its enabling legislation and by its revenue bond resolution.

- Committed - the Corporation's Board of Directors, as the Corporation's highest level of decision-making authority, may commit fund balance for specific purposes pursuant to constraints imposed by formal actions taken, such as an ordinance or resolution. These committed amounts cannot be used for any other purpose unless the Corporation's Board of Directors removes or changes the specific use through the same type of formal action taken to establish the commitment. This constraint must be imposed prior to the fiscal year end, but the specific amount may be determined at a later date.

- Assigned - the amount of fund balance that includes the portion of the spendable fund balance that reflects funds intended to be used by the government for specific purposes assigned by management. The assigned fund balance, designated by the Corporation's Board of Directors, represents a "plan" for spending the amount, but it is not restricted or committed.

- Unassigned - the amount of fund balance that remains from residual positive net resources of the General Fund and Debt Service Fund in excess of what can properly be classified in one of the other four categories, not subject to any constraints or intended use, no external or self-imposed limitations, no set spending plan and are available for any purposes. Unassigned fund balance is commonly used for emergency expenditures not previously considered. In addition, the resources classified as unassigned can be used to cover expenditures for revenues not yet received.

Fund balance classifications are presented consistent with the bond indentures (restricted amounts) or as assigned by the Corporation's Board of Directors. The Corporation does not maintain a formal spending policy in accordance with GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions.

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 Premiums and Discounts

Bond premiums and discounts are deferred and amortized over the term of the bonds, using the outstanding principal method. Bond premiums and discounts are presented as an adjustment to the face amount of the bonds payable.

Deferred Inflows of Resources

Deferred inflows of resources reflected on the Statement of Net Position relate to gains on the refunding of debt. They are being amortized using the outstanding principal method for the gain related to the Series 2002 bonds and the straight line method for the gain related to the Series 2007 capital appreciation bonds.

Accreted Interest

The Corporation records the accumulation of accreted interest by accruing interest that is not due until the bond maturity date. The cumulative accreted interest is included as part of bonds payable and relates to the Tobacco Settlement Asset-Backed Bonds (2007 Series). The accreted interest decreased by $39,440,602 due to the repurchase and retirement on March 19, 2015 of certain of the 2007 Series bonds as discussed further in Note 4 below. The current year addition to accreted interest was $11,166,000 for a cumulative balance of $73,379,000.

Revenue Recognition

The Corporation recognizes receivables and revenue with respect to TSRs based on the domestic shipment of cigarettes. The Corporation accrues at June 30th for TSRs that are derived from estimated sales of cigarettes from January 1 to June 30. This accrual is estimated based upon the historical TSR payments for the prior three fiscal years.

The GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues (the Statement),* effective for financial statement periods beginning on or after December 15, 2006. The Statement required restatement of prior period financial statements, except for the deferral requirements relative to sales of future revenues which were permitted to be applied prospectively.

As allowed under GASB Statement No. 48, the Corporation and State elected to not retroactively apply the deferral requirements to its 2002 and 2007 TSR sales completed prior to the effective date. In accordance with accounting standards in effect at the time of the 2002 and 2007 TSR sales, the State fully recognized the amount received for its sale of future TSRs to the Tobacco Settlement Financing Corporation as revenue in those years.

In addition, GASB Statement No. 48 and other applicable pronouncements provide that the event that results in the recognition of an account receivable and revenue with respect to TSRs is the domestic shipment of cigarettes. The Corporation accrues at June 30th for TSRs that are derived from estimated sales of cigarettes from January 1 to June 30. This accrual is estimated based upon the historical TSR payments for the prior three fiscal years.

2. CASH EQUIVALENTS

At year end, the carrying amount of deposits considered cash equivalents was $53,437,901.

Information about the money market fund held at June 30, 2015 is presented in the table below.

Description	Fair Value	Average Days to Maturity	Moody's Rating	Standard & Poors Rating
Goldman Sachs Financial Square Treasury Instruments Fund #506	$ 53,437,901	58	Aaa-mf	AAAm

Of the amount reflected above, $52,374,053 is held by the trustee and restricted for use only for debt service or debt service reserve fund purposes.

3. DERIVATIVES

In connection with the issuance of bonds in June 2002, the Corporation entered into two interest earning investment contracts, considered hedging derivatives. The contracts are a type of investment in which the investor, in this case the Corporation, purchases eligible securities selected by the agreement provider on a periodic basis from the agreement provider at a fixed rate of return that is specified in the contract.

One contract, having a notional amount of $51,351,531, with Morgan Stanley & Co. Inc. as provider, generated a fixed annual rate of return of 5.48% through June 1, 2042. In March 2015, in connection with issuance of the 2015 series asset-backed bonds and retirement of the 2002 bonds, as more fully discussed in Note 4, the investment contract was terminated. In connection with this early termination the Corporation received a payment of $24,736,000 from the provider.

The other contract, the notional amount of which varied based on the Corporation's debt service payment requirements, was with JP Morgan Chase Bank, N.A. as provider and generated a fixed annual rate of return of 4.013% through June 1, 2022 or the date on which the trustee and the Corporation had satisfied all of their obligations under the agreement. In March 2015, in connection with issuance of the 2015 series asset-backed bonds and retirement of the 2002 bonds, as more fully discussed in Note 4, the investment contract was terminated. In connection with this early termination the Corporation received a payment of $1,625,000 from the provider.

The total early termination payments received of $26,361,000 were deferred and factored into the calculation of the gain on the refunding of the Series 2002 bonds as more fully discussed in Note 4 below.

4. LONG-TERM DEBT

On June 27, 2002 the Corporation issued $685,390,000 of Tobacco Settlement Asset-Backed Bonds (2002 Series). The bond proceeds were used to purchase the State's future rights in the Tobacco Settlement Revenues (TSRs) under the Master Settlement Agreement and the Consent Decree and Final Judgment (the MSA). The bonds accrued interest at rates ranging from 5.920% to 6.250% and matured in varying amounts through June 1, 2042. The bonds were 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 represented the minimum amount of principal that the Corporation had to pay as of specific dates. The bond indenture contained "Turbo Maturity" provisions, whereby the Corporation was required to apply 100% of all collections in excess of the then current funding requirements of the indenture to the early redemption of the bonds. The amount of any turbo redemptions made was credited against the term maturities in ascending chronological order. The 2002 Series bonds were fully redeemed on March 19, 2015.

On June 27, 2007 the Corporation issued $197,005,742 of additional Tobacco Settlement Asset-Backed Bonds (2007 Series). The bond proceeds were used to purchase the State's future rights to residual Tobacco Settlement Revenues which were not purchased under the 2002 purchase agreement. The bonds are Capital Appreciation Bonds, on which no periodic interest payments are made, but which are issued at a deep discount from par and accreting to full value at maturity in the year 2052. At maturity, the bond redemption values represent accreted yields ranging from 6.000% to 6.750%. The bonds are subject to early redemption provisions, in whole or in part, at the redemption price of 100% of the issue amount plus accreted interest, without premium. A portion of the 2007 Series Bonds were redeemed in March 2015.

On March 19, 2015 the Corporation issued $620,935,000 of Tobacco Settlement Asset-Backed Bonds (Series A and B) that bear interest at annual rates ranging from 0.590% to 5.000% and mature in varying amounts through June 1, 2050. The bonds are subject to a number of 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 has to pay as of specific dates.

The Series 2015 bond indenture contains "Turbo Maturity" provisions, whereby the Corporation is required to apply the funds collected that are in excess of the then current funding requirements of the indenture to the early redemption of certain of the Series 2015 B bonds (based upon a minimum turbo redemption schedule established for the bonds) and then to the Series 2007 bonds. The amount available for turbo redemptions on the Series 2015 B bonds are credited against the term maturities in ascending chronological order based on a schedule contained in the indenture. Excess turbo funds available, if any, will be used to retire Series 2007 bonds.

The proceeds of the new issuance of the Series 2015 bonds, along with the release of debt service funds related to the bonds retired, and the proceeds from the early termination of investment contracts (as discussed in Note 3), were used primarily to redeem all the remaining balance, $547,815,000, of the 2002 Series bonds and repurchase and retire the principal amount of $76,220,155 of the 2007 Series bonds as well as pay accreted interest of $13,600,495 on the retired 2007 Series bonds (the aggregate purchase price paid for the retired 2007 Series bonds was $89,820,650). In addition, the TSFC paid, pursuant to law, $31,342,128 to the State of Rhode Island and $5,000,000 to the RI Clean Water Finance Agency, a related organization of the State now known as the RI Infrastructure Bank, for the Municipal Road and Bridge Revolving Loan Fund Program.

The transaction resulted in a cash flow savings of $1,283,693,000 and an economic gain of $369,828,000.

A deferred gain on refunding of debt in the amount of $8,555,008 on the Series 2002 bonds and $25,840,107 on the Series 2007 bonds, net of $806,115 amortization, is reflected as a deferred inflow of resources in the accompanying Statement of Net Position.

A reserve account in the amount of $26,700,250 was established for the Series 2015A bonds. The Corporation is required to maintain this reserve account to the extent of available funds. Amounts on deposit with the trustee in the reserve account are available to pay (i) the principal of sinking fund installments of, and interest on, the Series 2015A bonds to the extent revenues are insufficient for such purpose and (ii) upon the occurrence of an event of default, extraordinary prepayments. Unless an event of default has occurred, amounts withdrawn from the reserve account will be replenished from revenues.

In addition, a reserve account in the amount of $12,175,975 was established for the Series 2015B bonds. The Corporation is required to maintain this reserve account to the extent of available funds. Amounts on deposit with the trustee in the reserve account are available to pay (i) the principal of sinking fund installments of, and interest on, the Series 2015B bonds to the extent revenues are insufficient for such purpose and (ii) upon the occurrence of an event of default, extraordinary prepayments. Unless an event of default has occurred, amounts withdrawn from the reserve account will be replenished from revenues.

With respect to the 2015 Series bonds, the table below reflects scheduled principal payments due as stated in the maturity schedule included in the indenture. As stated above the bonds are subject to a number of early redemption provisions, in whole or in part, at the redemption price of 100% of the principal amount plus accrued interest, without premium.

Principal and interest payments that are due according to the maturity schedule are as follows:

Fiscal Year Ending June 20	Principal	Accreted Interest	Interest	Total
2016	$ 11,150,000	$ -	$ 26,995,453	$ 38,145,453
2017	11,335,000	-	26,886,563	38,221,563
2018	10,220,000	-	26,433,163	36,653,163
2019	10,580,000	-	26,024,363	36,604,363
2020	11,020,000	-	25,495,363	36,515,363
2021 - 2025	63,490,000	-	118,686,813	182,176,813
2026 - 2030	73,780,000	-	101,372,063	175,152,063
2031 - 3035	68,110,000	-	83,523,563	151,633,563
2036 - 2040	67,615,000	-	66,665,313	134,280,313
2041 - 2045	146,985,000	-	50,968,213	197,953,213
2046 - 2050	121,130,000	-	30,282,500	151,412,500
2052	120,785,587	1,608,984,412	-	1,729,769,999
	$ 716,200,587	$ 1,608,984,412	$ 583,333,370	$ 2,908,518,369

The changes in bonds payable for the year ended June 30, 2015 are as follows:

Beginning balance	$ 827,875,684
Amortization of bond discount	13,000
Bond discount on Series 2002 bonds redeemed	17,805,991
Bond discount on Series 2007 bonds	306,082
Accretion of interest on capital appreciation bonds	11,166,000
Accretion of interest related to refunded bonds	(39,440,602)
Unamortized bond premium	33,280,000
Bonds issued	620,935,000
Bonds refunded	(624,035,155)
Bond principal matured	(5,000,000)
Turbo Payments	(20,520,000)
Ending balance	$ 822,386,000

The balance due on the Corporation's bonds payable reconciles to the reported amount included in the statement of net position as follows:

Original bond principal	$ 882,395,742
Turbo redemptions	(158,095,000)
Bonds issued	620,935,000
Bonds refunded	(624,035,155)
Bond principal redeemed	(5,000,000)
Accretion of interest on capital appreciation bonds	73,379,000
	789,579,587
Unamortized bond premium	33,280,000
Unamortized bond discount	(473,587)
Bonds payable, per statement of net position	$ 822,386,000

General long-term debt consists of the long-term liabilities that are not recorded as fund liabilities (e.g. debt of general fund). Amounts are as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year	Amounts Due Thereafter
Bonds payable	$ 744,820,742	$ 620,935,000	$(649,555,155)	$ 716,200,587	$ 11,150,000	$ 705,050,587
Accreted interest	101,653,602	11,166,000	(39,440,602)	73,379,000	-	73,379,000
Net unamortized premium	-	33,782,623	(502,623)	33,280,000	-	33,280,000
Net unamortized discount	(18,598,660)	-	18,125,073	(473,587)	-	(473,587)
	$ 827,875,684	$ 665,883,623	$ (671,373,307)	$ 822,386,000	$ 11,150,000	$ 811,236,000

During the years ended June 30, 2015, 2014 and 2013 the Corporation utilized $20,520,000, $20,340,000, and $14,265,000 of excess collections to early redeem an equal amount of outstanding bonds.

The remaining 2007 Series A and B bonds (all Series C bonds were repurchased with proceeds from the 2015 issuance) are structurally subordinate to the payment in full of the 2015 Series bonds.

The Corporation was in compliance with its Debt Service Reserve requirements as of June 30, 2015.

5. COMMITMENTS AND CONTINGENCIES

According to the Master Settlement Agreement ("MSA"), for any year in which the Participating Manufacturers (PMs) suffer a loss of market share of more than two percent as compared to their collective market share in 1997, there is the potential of a Non-Participating Manufacturer Adjustment ("NPM Adjustment"), which would permit the tobacco manufacturers to reduce their MSA payments for that year. Whether such an adjustment is applicable depends on whether (1) an economic firm jointly selected by the Settling States and the PMs determines that the disadvantages experienced by the PMs as a result of the provisions of the MSA were a "significant factor" contributing to the market share loss ("Significant Factor Proceeding"); and (2) the State is found to not have diligently enforced its escrow statute. For calendar years 2003, 2004, 2005 and 2006, there have been four Significant Factor Proceedings in which the firm found in favor of the PMs. There will not be Significant Factor Proceedings for calendar years 2007, 2008, 2009, 2010, 2011, 2012, 2013 and 2014.

From April 2005 through April 2015, many of the tobacco manufacturers participating in the MSA either withheld all or portions of their payments due or remitted their payments to an escrow account, disputing the calculations of amounts due under the agreement. These manufacturers assert that the calculations of the amounts due failed to apply the NPM Adjustment. The total share of these disputed payments applicable to Rhode Island at June 30, 2015 (as calculated by the Independent Auditor) is $44,378,945.77.

In conjunction with the March 2015 bond issuance discussed in Note 4 above, the Corporation agreed with the Series 2007 Majority Interest Holder, on behalf of the Series 2007 bondholders, that to the extent that any funds on deposit in the disputed payments account on March 19, 2015 are received subsequently, the funds will be shared by the Corporation and the State in the following percentages: 70% to the Corporation and 30% to the State. It was further agreed that any such funds received by the Corporation will be used to retire Series 2007 bonds.

There has been a long-standing dispute between the PMs and the MSA Settling States relating to NPM Adjustment Disputes, and up until December 2012, all MSA Settling States and the PMs were engaged in an arbitration proceeding regarding the issue of Diligent Enforcement for calendar year 2003 ("2003 Dispute"). Rhode Island's Diligent Enforcement is no longer being challenged for 2003. In December 2012, the PMs reached a settlement agreement with certain MSA States & Territories ("Term Sheet States") in connection with certain claims relating to NPM Adjustment Disputes, including the 2003 Dispute. The general terms thereof were memorialized in a Term Sheet ("Term Sheet") with the PMs. In March of 2013, the Panel, which was convened for the 2003 Dispute, issued a Stipulated Partial Settlement and Award ("Award") that incorporated certain provisions of the Term Sheet. Also, the

Award included specific instructions to the Independent Auditor directing it to implement the provisions provided therein, which it did in preparing final calculations for the 2013 MSA payments.

Twenty-eight (28) MSA States and Territories ("States and Territories") have not accepted the terms of the Term Sheet, so the NPM Adjustment disputes between these States and Territories and PMs remain unresolved. Future NPM Adjustments could be as large as or exceed the reported potential $1.2 billion calendar year 2003 NPM adjustment. The resolution of the substance of such disputes could take years. Moreover, there is no assurance that these funds will be collected by the Corporation in the future. Due to these uncertainties regarding the ultimate realization of the remaining amount of these disputed payments, they have not been recognized as revenue in the accompanying financial statements. The Corporation and the other affected parties are taking actions prescribed in the MSA to arrive at a resolution of these matters.

In addition to NPM Adjustment arbitration, litigation has been filed alleging, among other claims, that the MSA violates provisions of the U.S. Constitution, state constitutions, federal antitrust and civil rights laws, and 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.

Investment income earned by the Corporation is limited by U.S. Treasury regulations. Income earned in excess of allowable amounts will be remitted to the federal government as required by the applicable laws and regulations. The Corporation is required to submit payment of its rebateable arbitrage earnings on the five-year anniversary of the bond issue, and on each succeeding five-year anniversary. No accrual for rebateable arbitrage is necessary as of June 30, 2015.

6. ADMINISTRATIVE EXPENSES

The State of Rhode Island performs certain accounting, legal, and administrative services on behalf of the Corporation for which it receives no compensation. The values of such services are not material to the Corporation's financial statements, and have not been reflected herein.

7. RISK MANAGEMENT

The Corporation is exposed to various risks of loss related to torts, asset misappropriation, and errors and omissions that could occur in the normal course of operations. The Corporation retains the risk of loss in the event of any judgments against it. As of June 30, 2015, there are no known asserted or unasserted claims or judgments pending against the Corporation.

Members of the Board and persons acting on the Corporation's behalf, while acting within the scope of their duties or employment, are indemnified against damages pursuant to the Corporation's enabling legislation, state law and a memorandum of understanding between the Corporation and the State.

8. SUBSEQUENT EVENTS

The Corporation has evaluated subsequent events through December 3, 2015, the date the financial statements were available to be issued.

Tobacco Settlement Financing Corporation

Supplemental Calculation of Debt Service Coverage Ratios
for the Fiscal Years Ended June 30, 2015 and 2014

	2015	2014
Revenue:		
Tobacco settlement revenue, cash basis	$ 45,295,062	51,756,761
Investment income	1,435,501	3,299,610
Total revenue	46,730,563	55,056,371
Expense reserve	125,520	61,737
Net reserve available for debt service	$ 46,605,043	54,994,634
Annual debt service:		
Required interest payments	$ 35,632,618	35,228,875
Total required interest payments	35,632,618	35,228,875
Covered ratio before turbo principal payments	131%	156%
Turbo principal payments	25,520,000	20,340,000
Total annual debt service	$ 61,152,618	55,568,875
Coverage ratio after turbo principal payments	76%	99%

Tobacco Settlement Financing Corporation

Supplemental Schedule of Actual MSA Receipts Compared to
Base Case Projections at Time of Sale

Fiscal Year Ended June 30	A 2002 Series A & B DRI-WEFA Base Case Expected MSA Revenue	B 2007 Series A, B. & C Global Insight Base Case Expected MSA Revenue	C 2015 Series A & B Global Insight Base Case Expected MSA Revenue	D Actual MSA Revenue Received	D-A Variance of DRI-WEFA Compared to Actual	D-B Variance of Global Insight Compared to Actual	D-C Variance of Global Insight Compared to Actual
2004	$ 47,047,106	$ -	$ -	$ 45,190,449	$ (1,856,657)	$ -	$ -
2005	47,570,858	-	-	45,315,617	(2,255,241)	-	-
2006	48,196,297	-	-	42,060,409	(6,135,888)	-	-
2007	48,825,273	-	-	44,024,516	(4,800,757)	-	-
2008	50,476,947	57,443,691	-	53,246,221	2,769,274	(4,197,470)	-
2009	51,191,991	58,186,214	-	58,038,800	6,846,809	(147,414)	-
2010	51,870,793	58,863,587	-	48,620,449	(3,250,344)	(10,243,138)	-
2011	52,612,259	59,577,361	-	45,812,110	(6,800,149)	(13,765,251)	-
2012	53,353,020	60,279,274	-	46,710,285	(6,642,735)	(13,568,989)	-
2013	54,057,103	60,971,444	-	46,692,088	(7,365,015)	(14,279,356)	-
2014	54,744,345	61,641,825	-	51,756,761	(2,987,584)	(9,885,064)	-
2015	55,417,655	62,295,687	51,722,705	45,295,062	-	(17,000,625)	(6,427,643)

TOSKI & CO., P.C.
CERTIFIED PUBLIC ACCOUNTANTS

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

The Board of Directors
Tobacco Settlement Financing Corporation:

We have audited, in accordance with the 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, the financial statements of the governmental activities and the governmental fund of Tobacco Settlement Financing Corporation (a component unit of the State of Rhode Island) (the "Corporation"), as of and for the year ended June 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 December 3, 2015.

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 opinions 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 a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. 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.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Corporation's financial statements are free from 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 results of that testing, and not to provide an opinion on the effectiveness of the Corporation'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 Corporation's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Toski & Co., CPAs, P.C.

Williamsville, New York
December 3, 2015