NEW YORK STATE OF OPPORTUNITY | Homes and Community Renewal

2014

Fiscal Year Financial Statements

Tobacco Settlement Financing Corporation

Tobacco Settlement Financing Corporation

Financial Statements

Fiscal Years Ended October 31, 2014 and 2013

Contents

RESPONSIBILITY FOR FINANCIAL REPORTING

The financial statements of the Tobacco Settlement Financing Corporation (the "Corporation"), for the fiscal years ended October 31, 2014 and 2013, are the responsibility of management. The financial statements were prepared in accordance with accounting principles generally accepted in the United States of America.

The Corporation maintains a system of internal control. The objectives of an internal control system are to provide reasonable assurance as to the protection of, and accountability for, assets; compliance with applicable laws and regulations; proper authorization and recording of transactions; and the reliability of financial records for preparing financial statements. The system of internal control is subject to periodic review by management and the internal audit staff.

The Corporation's annual financial statements have been audited by Ernst & Young LLP, independent auditors appointed by the Members of the Corporation. Management has made available to Ernst & Young LLP all the financial records and related data of the Corporation and has provided access to all the minutes of the meetings of the Members of the Corporation. The independent auditors periodically meet with the Members of the Corporation.

The independent auditors conducted their 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 of America. Those standards require that they plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. The audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, the independent auditors do not express an opinion on the effectiveness of the Corporation's internal control over financial reporting. The audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. The independent auditors' unmodified report expresses that the financial statements are presented, in all material respects, in accordance with accounting principles generally accepted in the United States of America.

Sheila Robinson

Darryl C. Towns
President/Chief Executive Officer

Sheila Robinson
Senior Vice President/Chief Financial Officer

January 29, 2015

Building a better working world

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Report of Independent Auditors

Management and the Members
Tobacco Settlement Financing Corporation
New York, New York

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and each major fund of the Tobacco Settlement Financing Corporation (the Corporation), a component unit of the State of New York, as of and for the years ended October 31, 2014 and 2013, 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 conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

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

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 each major fund of the Corporation as of October 31, 2014 and 2013, and the respective changes in financial position thereof for the years then ended in conformity with U.S. generally accepted accounting principles.

Required Supplementary Information

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

Other Information

The Introductory Section has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and, accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we also have issued our report dated January 29, 2015 on our consideration of the Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Corporation's internal control over financial reporting and compliance.

Ernst & Young LLP

January 29, 2015

TOBACCO SETTLEMENT FINANCING CORPORATION

A component unit of the State of New York

MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEARS ENDED OCTOBER 31, 2014 AND 2013

Overview of the Financial Statements - The following is a narrative overview of the financial performance of the Tobacco Settlement Financing Corporation (the "Corporation") for the fiscal years ended October 31, 2014 ("fiscal 2014") and 2013 ("fiscal 2013"), with selective comparative information for the fiscal year ended October 31, 2012 ("fiscal 2012"), and must be read in conjunction with the financial statements and the notes to the financial statements.

The annual financial statements consist of four parts: (1) management's discussion and analysis (this section); (2) the Corporation's entity-wide financial statements; (3) the governmental funds financial statements and (4) the notes to the financial statements.

Management's Discussion and Analysis

- This section of the Corporation's financial statements, Management's Discussion and Analysis ("MD&A"), presents an overview of the Corporation's financial performance during fiscal 2014, compared to the fiscal 2013 and fiscal 2012. The MD&A provides a discussion of financial highlights and an assessment of how the Corporation's position has changed from the past years. It also identifies the factors that, in management's view, significantly affected the Corporation's overall financial position. It may contain opinions, assumptions or conclusions made by the Corporation's management that should not be considered a replacement for, and must be read in conjunction with the financial statements described below.

The Entity-Wide Financial Statements

- The entity-wide financial statements of the Corporation, which include the statements of net position and the statements of activities, are presented to display information about the reporting entity as a whole, in accordance with Governmental Accounting Standards Board ("GASB") Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments* ("GASB No. 34"). The statements of net position and the statements of activities are prepared using the economic resources measurement focus and the accrual basis of accounting. This is to provide the reader with a broad overview of the Corporation's finances, similar to private-sector financial statements.

Governmental Funds Financial Statements

The focus of the Corporation's governmental funds financial statements is to provide information on short-term inflows, outflows, and balances of expendable resources. Such information is useful in assessing the Corporation's financial activity.

- The Corporation's governmental funds financial statements are presented using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized when it becomes susceptible to accrual, which is when it becomes both measurable and available to finance expenditures in the current period. The reconciliations of the entity-wide financial statements and the governmental funds financial statements are presented to assist the reader in understanding the differences between entity-wide and governmental funds financial statements.

The Notes to the Financial Statements

- The notes provide information that is essential to understanding the financial statements, such as the Corporation's accounting methods and policies providing information about the content of the financial statements.
- Details of contractual obligations, as well as future commitments and contingencies of the Corporation when applicable.
- Information regarding any other events or developing situations that could materially affect the Corporation's financial position.

Background

Pursuant to the Tobacco Settlement Financing Corporation Act (the "Act") of the State of New York (the "State"), the Corporation was created in 2003 as a subsidiary of the State of New York Municipal Bond Bank Agency (the "Agency"). By terms of its creation, the Corporation is treated and accounted for as a legal entity, separate from the State and the Agency, with separate corporate purposes. The Agency does not have financial accountability for the Corporation; accordingly, the Corporation is not a component unit of the Agency. Although legally separate from the State, the Corporation is a component unit of the State and, accordingly, is included in the State's financial statements.

In connection with the issuance of the 2003 Series A Bonds, the State sold TSFC fifty percent (50%) of the State's Share of (i) the Annual Payments and Strategic Contribution Fund Payments and of all adjustments to prior payments, payable to the State pursuant to the Master Settlement Agreement ("MSA"), and received on and after January 1, 2004 and (ii) all Lump Sum Payments payable to the State pursuant to the MSA and received at any time on or after June 19, 2003.

In connection with the issuance of the 2003 Series B Bonds, the State sold TSFC fifty percent (50%) of the State's Share of (i) the Annual Payments and Strategic Contribution Fund Payments and of all adjustments to prior payments, payable to the State pursuant to the MSA and received on and after January 1, 2004 and (ii) all Lump Sum Payments payable to the State pursuant to the MSA and received at any time on or after December 2, 2003.

MSA payments are due annually to the Corporation. The MSA funds are used to pay debt service due on the Corporation's outstanding bonds, to pay administrative expenses and for certain arbitration expenses of the New York State Attorney General's Office.

Financial Highlights and Overall Analysis - Entity-Wide Financial Statements

Condensed Statements of Net Position
(in thousands)

	October 31,			% Change	
	2014	**2013**	**2012**	**2014-2013**	**2013- 2012**
Other assets	$ 554,293	$ 505,337	$ 511,696	9.7%	(1.2%)
Total Assets	554,293	505,337	511,696		
Deferred Outflows of Resources	1,734,906	2,030,031	2,293,438	(14.5%)	(11.5%)
Bonds payable, net	1,871,766	2,240,375	2,550,030	(16.5%)	(12.1%)
Other liabilities	36,249	46,619	51,525	(22.2%)	(9.5%)
Total Liabilities	1,908,015	2,286,994	2,601,555	(16.6%)	(12.1%)
Deferred Inflows of Resources	44,968	7,924	9,703	467.5%	(18.3%)
Total Net Position	$ 336,216	$ 240,450	$ 193,876		

Significant Changes in Assets and Liabilities:

Other Assets

Other assets which is primarily comprised of investments held increased from $505.3 million in fiscal 2013 to $554.3 million in fiscal 2014, an increase of approximately $49.0 million, or 9.7%. This increase was primarily a result of the receipt of certain settlement payments in fiscal 2014 in excess of the amount permitted to be used to call bonds in the current fiscal year. The funds will be used to call bonds in when allowed under the terms of the bond resolution. This compares with a decrease from $511.7 million in fiscal 2012 to $505.3 million in fiscal 2013, a decrease of approximately $6.4 million, or 1.2%.

Deferred Outflows of Resources

Funds made available from the sale of the Series 2003 A and Series 2003 B Bonds and paid to the State for the purchase of future Tobacco Settlement Revenues ("TSRs") are recorded as a deferred outflow of resources. At the time of the sale of such bonds, $2.2 billion and $2 billion, respectively, totaling $4.2 billion were transferred to the State. The Corporation has not paid funds to the State since 2003.

As a result of amortization, deferred outflows of resources have decreased by approximately $295.1 million, from $2.0 billion at October 31, 2013 to $1.7 billion at October 31, 2014, or 14.5%. This compares with a decrease from $2.3 billion at October 31, 2012 to $2.0 billion at October 31, 2013, a decrease of approximately $263.4 million, or 11.5%.

Bonds Payable, net

On December 20, 2013, the Corporation fully refunded Tobacco Settlement Financing Corporation Asset – Backed Revenue Bonds Series 2003A-1C Bonds, and Series 2003B-1C Bonds in the aggregate principal amount of $1.3 billion, through the issuance of Tobacco Settlement Financing Corporation Asset – Backed Revenue Bonds ("fiscal 2014 refunding bonds") Series 2013A and Series 2013B in the aggregate principal amount of $1.23 billion. The fiscal 2014 refunding bonds were sold at a premium in the amount of approximately $88 million. The refunding resulted in a gain recognized in the amount of $43.4 million and a calculated present value savings in the amount of $98.9 million.

As a result of the fiscal 2014 refunding and bond premium amortization, bonds payable net decreased from $2.2 billion as of October 31, 2013, to $1.9 billion at October 31, 2014, a decrease of approximately $368.6 million, or 16.5%, as compared with a decrease from $2.6 billion at October 31, 2012, to $2.2 billion at October 31, 2013, a decrease of approximately $309.7 million, or 12.1%.

On June 1, 2014, the aggregate amount of bonds retired was $308.5 million as follows:

- Scheduled redemptions were paid in the total amount of $136.6 million consisting of: $51.6 million of the Series 2011A Bonds, and $85 million of the Series 2011B Bonds.

- Series 2013A and Series 2013B Bonds subject to optional redemption were called at par value and without premium in the amount of $104 million, and $67.9 million respectively.

As of October 31, 2014 and 2013, principal amount of bonds outstanding was $1.7 billion and $2.1 billion, respectively. All of the Corporation's outstanding bond debt is in the form of fixed rate bonds.

Unamortized bond premium increased from $109.3 million at October 31, 2013, to $126.9 million at October 31, 2014, an increase of approximately $17.6 million, or 16.1%. The increase is attributable to bond premium relating to the sale of the fiscal 2014 refunding bonds in the amount of $88 million less amortization of $27.1 million, and a write-off of the fiscal 2013 balance in the amount of $43.3 million relating to the 2013 refunding. This compares with a decrease from $138.8 million at October 31, 2012, to $109.3 million at October 31, 2013, a decrease of approximately

$29.5 million, or 21.3%, which resulted from bond premium amortization.

Deferred Inflows of Resources

Deferred inflows of resources represent the deferred gain on refundings attributable to the fiscal 2011 and 2014 refundings.

As a result of the issuance of the fiscal 2014 refunding bonds, deferred inflows of resources have increased by approximately $37.1 million, from $7.9 million at October 31, 2013 to $45 million at October 31, 2014, or 467.5%, as compared with a decrease from $9.7 million at October 31, 2012 to $7.9 million at October 31, 2013, a decrease of approximately $1.8 million, or 18.3% which was a result of amortization.

Condensed Statements of Activities
(in thousands)

	Fiscal Year Ended October 31, 2014	2013	2012	% Change 2014-2013	2013-2012
Program Revenues:					
Tobacco Settlement Revenues	$ 441,425	$ 394,908	$ 395,100	11.8%	(0.05%)
Claim Settlement and Other Revenues	21,505	2,896	2,463	642.6%	17.6%
Total Revenues	462,930	397,804	397,563		
Program Expenses:					
Amortization of Deferred Outflows of Resources	295,126	263,406	261,985	12.0%	0.5%
Interest Expense	64,202	86,241	100,132	(25.6%)	(13.9%)
Bond Discount and Cost of Issuance Expenses	6,608	-	-	N/A	-
General and Administrative Expenses	1,228	1,583	1,150	(22.4%)	37.7%
Total Expenses	367,164	351,230	363,267		
Total Change in Net Position	$ 95,766	$ 46,574	$ 34,296		

Significant Changes in Revenues and Expenses:

Tobacco Settlement Revenues

Tobacco settlement revenues ("TSRs") consist primarily of the Pledged Settlement Payments sold by the State to the Corporation pursuant to the Purchase and Sale Agreement between the State and the Corporation. Pledged TSRs are contingent on tobacco sales and other factors, which cannot be predicted and therefore are only recognized when the payment is received by the Corporation.

During fiscal 2014, the Corporation received $50 million as a result of the settlement of a lawsuit where the Participating Manufacturers (tobacco companies) disputed MSA payments in sales years 2003 through 2012 on the basis that certain Settling States, including New York, did not diligently enforce their respective Qualifying Statutes in each of those years. After some Settling States settled their disputes with the Participating Manufacturers in March 2013, the State of New York, represented by the Attorney General of the State, was one of 15 contested states that continued in arbitration proceedings with the Participating Manufacturers regarding the 2003 Non-Participating Manufacturers Adjustment ("NPM Adjustment"). The Arbitration Panel released its decision on September 11, 2013. The Arbitration Panel unanimously determined that the State diligently enforced its Qualifying Statute during sales year 2003 and therefore is not subject to the NPM Adjustment for 2003 pursuant to the MSA. The decision that the State diligently enforced its Qualifying Statute during sales year 2003 may not necessarily indicate that the State will be determined in future arbitrations to have diligently enforced its Qualifying Statute in additional sales years. A future determination that the State failed to diligently enforce its Qualifying Statute could result in a complete loss or substantial reduction in the amount of future Pledged Settlement Payments up to the amount of the State's Pledged Settlement Payments for such future sales year or years, plus interest due on all or a portion of such amount, if any.

TSRs increased from $394.9 million in fiscal 2013 to $441.4 million in fiscal 2014, an increase of approximately $46.5 million, or 11.8% primarily as a result of the aforementioned settlement receipt of $50 million. This compares with the decrease from $395.1 million in fiscal 2012 to $394.9 million in 2013, a decrease of approximately $192 thousand, or 0.05%. To the extent allowed under the provisions of the bond resolution, any MSA funds received in excess of the minimum amount required to pay the scheduled annual debt service and administrative expenses have been used to redeem additional bonds ("Turbo calls").

Claim Settlement and Other Revenues

Claim settlement and other revenues increased from $2.9 million in fiscal 2013 to $21.5 million in fiscal 2014, an increase of approximately $18.6 million, or 642.6%, as compared with an increase from $2.5 million in fiscal 2012 to $2.9 million in 2013, an increase of approximately $433 thousand, or 17.6%. The increase from fiscal 2013 to fiscal 2014 was primarily attributable to the funds received in connection with the jointly administered Chapter 11 Plan of Lehman Brothers Holdings Inc. and its Affiliated Debtors as confirmed by the Bankruptcy Court on December 6, 2011 in the amount of 19.2 million (see note 7).

Amortization of Deferred Outflows of Resources

Amortization of deferred outflows of resources increased from $263.4 million in fiscal 2013 to $295.1 million in fiscal 2014, an increase of approximately $31.7 million, or 12%, as compared with an increase from $262 million in fiscal 2012 to $263.4 million in fiscal 2013, an increase of approximately $1.4 million, or 0.5%.

The Corporation amortizes deferred outflows of resources in proportion to bonds redeemed during the fiscal year (the bond outstanding method), which totaled approximately $308.5 million in fiscal 2014 as compared to $280.2 million in fiscal 2013.

Interest Expense

As a result of bond amortization and the issuance of the fiscal 2014 refunding bonds, which led to lower interest costs on the outstanding bonds, interest expense declined by approximately $22.0 million, from $86.2 million in fiscal 2013 to $64.2 million in fiscal 2014, or 25.6%, as compared with a decrease from $100.1 million in fiscal 2012 to $86.2 million in fiscal 2013, a decrease of approximately $13.9 million, or 13.9%.

Bond Discount and Cost of Issuance Expenses

The bond discount and cost of issuance expenses of approximately $6.6 million in fiscal 2014 represented expenses incurred in connection with the issuance of the 2014 refunding bonds.

General and Administrative Expenses

General and Administrative expenses decreased from $1.6 million in fiscal 2013 to $1.2 million in fiscal 2014, a decrease of approximately $355 thousand, of 22.4%. This decrease was primarily a result of the decrease in the amount paid to the New York State Attorney General from $432 thousand in fiscal to 2013 to $18 thousand in fiscal year 2014. This compares with an increase from $1.1 million in fiscal 2012 to $1.6 million in fiscal 2013, an increase of approximately $433 thousand or 37.7%. In fiscal 2013 the increase is primarily attributable to the portion of bond insurance expense due to AMBAC Assurance Corporation relating to fiscal 2013. There were no payments due under the policy in years prior to fiscal 2013. The bonds covered under the bond insurance policy were called in December 2013; therefore the Corporation will not be required to remit payments subsequent to the fiscal 2014 payment of $893 thousand.

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Tobacco Settlement Financing Corporation

(A Component Unit of the State of New York)

STATEMENTS OF NET POSITION

(Amounts in Thousands)

	October 31, 2014	October 31, 2013
Assets		
Restricted cash equivalents	$ 25	$ 61
Restricted investments	549,823	500,702
Accrued interest receivable	4,445	4,574
Total assets	**554,293**	**505,337**
Deferred Outflows of Resources		
Deferral of Cost from Purchase of Future TSRs	**1,734,906**	**2,030,031**
Liabilities		
Accrued interest payable	36,003	45,790
Payable to the State of New York Municipal Bond Bank Agency	238	452
Accounts Payable	8	377
Bonds payable, (net)		
Portion payable within one year	143,000	136,600
Portion payable after one year	1,728,766	2,103,775
Total liabilities	**1,908,015**	**2,286,994**
Deferred Inflows of Resources		
Deferred Gain on defeasance	**44,968**	**7,924**
Net Position Restricted for Debt Service	**$ 336,216**	**$ 240,450**

See notes to financial statements.

Tobacco Settlement Financing Corporation

(A Component Unit of the State of New York)

STATEMENTS OF ACTIVITIES
FOR FISCAL YEARS ENDED

(Amounts in Thousands)

	Fiscal Year Ended October 31, 2014	2013
Program Expenses		
Amortization of deferred charges	$ 295,126	$ 263,406
Interest expense	64,202	86,241
Bond discount and cost of issuance expenses	6,608	-
General and administrative expenses	1,228	1,583
Total expenses	**367,164**	**351,230**
Program Revenues		
Tobacco settlement revenue	441,425	394,908
Settlement Revenue resulting from Investment Agreement Termination	19,157	217
Earnings on investments	2,348	2,679
Total revenues	**462,930**	**397,804**
Change in net position	**95,766**	**46,574**
Net Position, beginning of fiscal year	**240,450**	**193,876**
Net Position, end of fiscal year	**$ 336,216**	**$ 240,450**

See notes to financial statements.

Tobacco Settlement Financing Corporation

(A Component Unit of the State of New York)

GOVERNMENTAL FUNDS BALANCE SHEET

(Amounts in Thousands)

	October 31, 2014		
	General Fund	**Debt Service**	**Total Governmental Funds**
Assets			
Cash and cash equivalents	$ -	25	$ 25
Restricted investments	-	549,823	549,823
Accrued interest receivable	-	4,445	4,445
Total assets	**-**	**554,293**	**554,293**
Liabilities			
Payable to the State of New York Municipal Bond Bank Agency	238	-	238
Accounts Payable	8	-	8
Total liabilities	**246**	**-**	**246**
Fund (Deficit) Balances			
Unassigned	(246)	-	(246)
Restricted for debt service	-	554,293	554,293
Total fund balances	**(246)**	**554,293**	**554,047**
Total Liabilities and Fund Balances	**$ -**	**$ 554,293**	**$ 554,293**

See notes to financial statements.

Tobacco Settlement Financing Corporation

(A Component Unit of the State of New York)

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

(Amounts in Thousands)

	Fiscal Year Ended October 31, 2014		
	General Fund	Debt Service	Total Governmental Funds
Revenues			
Earnings on investments	$ -	$ 2,348	$ 2,348
Tobacco settlement revenues	-	441,425	441,425
Other Income	-	19,157	19,157
Total revenues	**-**	**462,930**	**462,930**
Expenditures			
General and administrative expenses	1,228	-	1,228
Bond discount and cost of issuance	-	6,608	6,608
Principal amount of bonds retired	-	308,450	308,450
Interest expense	-	107,405	107,405
Total expenditures	**1,228**	**422,463**	**423,691**
Deficiency of Revenues Over Expenditures	**(1,228)**	**40,467**	**39,239**
Other Financing Sources (Uses)			
Proceeds from refunding bonds	-	1,225,745	1,225,745
Payment to refunding bond escrow agent		(1,303,485)	(1,303,485)
Premium on bonds issued	-	88,040	88,040
Total other financing sources	**-**	**10,300**	**10,300**
Transfers	**1,811**	**(1,811)**	**-**
Net Change in Fund Balances	**583**	**48,956**	**49,539**
Fund (Deficit) Balances, Beginning of fiscal year	**(829)**	**505,337**	**504,508**
Fund (Deficit) Balances, End of fiscal year	**$ (246)**	**$ 554,293**	**$ 554,047**

See notes to financial statements.

Tobacco Settlement Financing Corporation

(A Component Unit of the State of New York)

GOVERNMENTAL FUNDS BALANCE SHEET

(Amounts in Thousands)

	October 31, 2013		
	General Fund	**Debt Service**	**Total Governmental Funds**
Assets			
Cash and cash equivalents	$ -	61	$ 61
Restricted investments	-	500,702	500,702
Accrued interest receivable	-	4,574	4,574
Total assets	**-**	**505,337**	**505,337**
Liabilities			
Payable to the State of New York Municipal Bond Bank Agency	452	-	452
Accounts Payable	377	-	377
Total liabilities	**829**	**-**	**829**
Fund (Deficit) Balances			
Unassigned	(829)	-	(829)
Restricted for debt service	-	505,337	505,337
Total fund balances	**(829)**	**505,337**	**504,508**
Total Liabilities and Fund Balances	**$ -**	**$ 505,337**	**$ 505,337**

See notes to financial statements.

Tobacco Settlement Financing Corporation

(A Component Unit of the State of New York)

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

(Amounts in Thousands)

	Fiscal Year Ended October 31, 2013		
	General Fund	**Debt Service**	**Total Governmental Funds**
Revenues			
Earnings on investments	$ -	$ 2,679	$ 2,679
Tobacco settlement revenues	-	394,908	394,908
Other Income	-	217	217
Total revenues	**-**	**397,804**	**397,804**
Expenditures			
General and administrative expenses	1,583	-	1,583
Cost of issuance	-	-	-
Principal amount of bonds retired	-	280,120	280,120
Interest expense	-	123,024	123,024
Total expenditures	**1,583**	**403,144**	**404,727**
Deficiency of Revenues Over Expenditures	**(1,583)**	**(5,340)**	**(6,923)**
Transfers	**1,019**	**(1,019)**	**0**
Net Change in Fund Balances	(564)	(6,359)	(6,923)
Fund (Deficit) Balances, Beginning of fiscal year	**(265)**	**511,696**	**511,431**
Fund (Deficit) Balances, End of fiscal year	**(829)**	**505,337**	**504,508**

See notes to financial statements.

Tobacco Settlement Financing Corporation

(A Component Unit of the State of New York)

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEETS TO THE STATEMENTS OF NET ASSETS

(Amounts in Thousands)

	October 31, 2014	October 31, 2013
Total fund balance - governmental funds	$ 554,047	$ 504,508
Amounts reported for governmental activities in the statement of net assets are different because:		
Deferred outflows of resources, which represent the amortized balance relating to funds transferred to the State that are not available to pay for current-period expenditures and therefore are deferred and not reported in the funds	1,734,906	2,030,031
Some liabilities are not due and payable in the current period from currently available financial resources and are therefore not reported in the governmental funds financial statements. Those liabilities consist of:		
Bonds payable (net)	(1,916,734)	(2,248,299)
Accrued interest on bonds	(36,003)	(45,790)
Net position of governmental activities	**$ 336,216**	**$ 240,450**

See notes to financial statements.

Tobacco Settlement Financing Corporation

(A Component Unit of the State of New York)

RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENTS OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES TO THE STATEMENTS OF ACTIVITIES

(Amounts in Thousands)

	Fiscal Year Ended October 31,	
	2014	**2013**
Net change in fund balances - total government funds	**$ 49,539**	**$ (6,923)**
Amounts reported for governmental activities in the statement of activities are different because:		
Bonds proceeds provide current financial resources to governmental funds, but debt issued increases long term liabilities in the statement of net position.	(1,225,745)	-
Bond premium, underwriters discount, and cost of issuance for debt issued during the fiscal year.	(81,432)	-
Governmental funds report bond premium/ discounts as other financing sources (uses). However, in the statement of activities, bond premiums/discounts are amortized over the lives of the debt as interest income (expenses	20,476	29,535
Governmental funds report the effect of deferred outflows of resources when debt is first issued but these amounts are deferred and amortized in the statement of activities.	(295,126)	(263,406)
Interest expense is reported in the statement of activities on the accrual basis, but interest is reported as an expenditure in governmental funds when the outlay of financing resources is required.	16,119	7,248
Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net position.	1,611,935	280,120
Change in Net Position	**$ 95,766**	**$ 46,574**

See notes to financial statements.

NOTE 1. Tobacco Settlement Financing Corporation

The Tobacco Settlement Financing Corporation (the "Corporation") is a public benefit corporation of the State of New York (the "State") created as a subsidiary of the State of New York Municipal Bond Bank Agency (the "Agency") and created pursuant to the Tobacco Settlement Financing Corporation Act (the "Act"), Part D3 of Chapter 62 of the Laws of the State of New York of 2003. By the terms of the Act, the Corporation shall be treated and accounted for as a legal entity separate from the State and the Agency with its separate corporate purposes set forth in the Act. The directors of the Agency are the members of the Corporation. The Corporation is governed by a seven-member board: the Chairman of the Agency, the Secretary of State, the Director of the Budget of the State, three directors appointed by the Governor of the State and the State Comptroller or his appointee. Although legally separate from the State, the Corporation is a component unit of the State and, accordingly, is included in the State's financial statements.

The Corporation does not have financial accountability to the Agency; accordingly, the Corporation is not a component unit of the Agency in accordance with the requirements of Governmental Accounting Standards Board ("GASB") Statement No. 61, *The Financial Reporting Entity: Omnibus.* Therefore, the financial activities of the Corporation are not included in the Agency's financial statements.

NOTE 2. Summary of Significant Accounting Policies

A. Basis of Accounting

The entity-wide financial statements of the Corporation, which include the statements of net position and the statements of activities, are presented to display information about the reporting entity as a whole. The statements of net position and the statements of activities are prepared using the economic resources measurement focus and the accrual basis of accounting.

The Corporation's governmental fund financial statements are presented using the current financial resources measurement focus and the modified accrual basis of accounting. They recognize revenue when it becomes susceptible to accrual, which is when it becomes both measurable and available to finance expenditures in the current fiscal period. Expenditures are recognized when the related liability is incurred, except for unmatured interest and principal which is recognized when due.

The Corporation presents their financial statements in accordance with generally accepted accounting principles as promulgated by the Governmental Accounting Standards Board ("GASB").

B. The governmental funds consist of the General Fund and the Debt Service Fund. The General Fund accounts for all financial resources associated with the Corporation except for those required to be accounted for in the Debt Service Fund. The Debt Service Fund accounts for the accumulation of resources for payment of principal and interest on long-term debt and the Debt Service Reserve Account.

C. The Debt Service Fund contains three accounts: the Debt Service Account, the Supplemental Fund Account and the Debt Service Reserve Account. The cash and investments in the Debt Service Account are available to pay current debt service on bonds. At October 31, 2014 and 2013, $43.2 million and $54.9 million (including accrued interest receivable), respectively, were on deposit in this account.

The purpose of the Debt Service Reserve Account is to pay principal of and interest on the outstanding bonds, if there is a shortfall in available funds. Cash and investments, including accrued interest, in the Debt Service Reserve Account, as valued in accordance with the respective bond resolutions at October 31, 2014 and 2013, were as follows:

	2014	2013
	(in Millions)	
On Deposit	$ 452.8	$ 450.3
Reserve Requirement	449.1	449.1
Excess	$ 3.7	$ 1.2

The Funds on deposit in the Supplemental Fund Account in the amounts of $58.3 million and $6 thousand as of October 31, 2014 and 2013 respectively represent funds on deposit in excess of the amount currently allowed to be used for optional bond calls, in accordance with the provisions of the Corporation's bond resolutions.

D. Cash and Cash Equivalents

All highly liquid investments with a maturity when purchased of 90 days or less are considered to be cash equivalents. Cash equivalents are stated at cost, which approximates fair value.

E. Investments

Investments are recorded at fair value.

F. Unamortized Bond Premiums

Bond premiums are capitalized and amortized over the lives of the related debt in the entity-wide financial statements. Bond premiums are amortized using the effective interest method. The governmental funds financial statements recognize bond premiums during the current period.

The face amount of debt issued and any premium thereon is reported as other financing sources in the fund financial statements.

G. Deferred Gains and Losses on Refunding

Gains or losses in connection with advanced refundings are recorded as either a deferred outflows (loss) or deferred inflows (gain) of resources and amortized as an adjustment to interest expense over the original life of the refunded bonds or the life of the refunding bonds, whichever is shorter.

H. Use of Net Position

When both restricted and unrestricted assets are available for a particular restricted use, it is the Corporation's policy to use restricted assets first, and then unrestricted as needed.

I Deferral of Cost from Purchase of Future TSRs

In accordance with the GASB Statement No. 65, the Corporation recorded the transfer of funds made to the State for the purchase of future TSRs as a deferred outflow of resources.

Funds made available resulting from the sale of Series 2003 A and Series 2003 B Bonds allowed for transfers to the State in the amounts of $2.2 billion and $2.0 billion respectively. Each transfer was made at the time of the respective bond sale.

The Corporation amortizes their deferred outflows of resources in proportion to bonds redeemed during the fiscal year (the bond outstanding method). For the fiscal years ended October 31, 2014 and 2013, the Corporation amortized $295.1 million and $263.4 million, respectively, in deferred outflows of resources. The unamortized balance of the deferred outflow of resources at October 31, 2014 and 2013 totaled $1.7 billion and $2.0 billion, respectively.

J. Contingencies

The amount of revenue recognized by the Corporation could be adversely impacted by certain third party litigation involving tobacco companies and others. Therefore, the Corporation cannot predict the actual amount of pledged settlement payments that it ultimately will receive. Therefore, since the receivable is not reasonably estimable, the Corporation recognizes tobacco settlement revenue when the cash is received.

K. Net Position

The Corporation's "Net Position" represents the excess of assets and deferred outflows over liabilities and deferred inflows on the government-wide, proprietary, and fiduciary fund statements. Net position is reported in two categories:

- Restricted net position is restricted due to legal restrictions from creditors, grantors, or laws and regulations of other governments.
- Unrestricted net position consists of net position which do not meet the definition of the preceding category.

L. Fund Balances

The Corporation's "Fund Balance" on the Governmental Financial Statements represents the difference between assets and liabilities. Fund balances are reported in the following categories:

- Restricted fund balances are restricted due to legal restriction from creditors, grantors, or laws and regulations of other governments.
- Unassigned fund balance is the residual classification for the general fund. This classification represents fund balance that has not been assigned to other funds and that has not been restricted, committed, or assigned to specific purposes within the general fund. Any negative fund balances are unassigned.

M. Recently Adopted Accounting Pronouncements

In March 2012, GASB issued Statement No. 66, Technical Corrections–2012. The objective of this Statement is to improve accounting and financial reporting by state and local governmental entities by resolving conflicting guidance that resulted from the issuance of two pronouncements–Statements No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, and No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. The implementation of this standard did not have an impact on the Corporation's financial statements.

In February 2013, GASB issued Statement No. 70, Accounting and Financial Reporting for Nonexchange Financial Guarantees ("GASB 70"). The objective of this Statement is to improve the comparability of financial statements among governments by requiring consistent reporting by those governments that extend and/or receive nonexchange financial guarantees. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2013. The implementation of this standard did not have an impact on the Corporation's financial statements.

N. Accounting Pronouncements Issued But Not Yet Adopted

In June 2012, GASB issued Statement No. 68, Accounting and Financial Reporting for Pensions ("GASB 68"). The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. The provisions of this Statement are effective for government combinations and disposals of government operations occurring in fiscal reporting periods beginning after June 15, 2014. Since the Corporation does not have any employees, this standard will not have an impact on its financial statements.

In January 2013, GASB issued Statement No. 69, Government Combinations and Disposals of Government Operations ("GASB 69"). The objective of this Statement is to improve the accounting for mergers and acquisitions among state and local governments by providing guidance specific to the situations and circumstances encountered within the governmental environment. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2013. The Corporation does not anticipate that the implementation of this standard will have an impact on its financial statements.

In November 2013, GASB issued Statement No. 71, Pension Transition for Contributions Made Subsequent to the Measurement Date ("GASB 71"). The objective of this Statement is to address an issue regarding application of the transition provisions of GASB 68. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. Since the Corporation does not have any employees, this standard will not have an impact on its financial statements.

NOTE 3. Tobacco Settlement Revenues

Pursuant to the Act and the Purchase and Sale Agreement, the State has sold to the Corporation 100% of the annual payments, strategic contribution payments and lump sum payments payable to the State (the "State's Share"), pursuant to the Master Settlement Agreement ("MSA"), less certain unsold payments which remain the property of the State. In connection with the issuance of the 2003A Bonds, the State sold TSFC fifty percent (50%) of the State's Share of (i) the annual payments and strategic contribution fund payments and of all adjustments to prior payments, payable to the State pursuant to the MSA and received on and after January 1, 2004 and (ii) all lump sum payments payable to the State pursuant to the MSA and received at any time on or after June 19, 2003.

In connection with the issuance of the 2003B Bonds, the State sold TSFC fifty percent (50%) of the State's Share of (i) the annual payments and strategic contribution fund payments and of all adjustments to prior payments, payable to the State pursuant to the MSA and received on and after January 1, 2004 and (ii) all lump sum payments payable to the State pursuant to the MSA and received at any time on or after December 2, 2003.

The MSA (a) resolved cigarette smoking related litigation between the settling states and certain other jurisdictions and the Participating Manufacturers ("PMS"), (b) released the PMS from past and present smoking-related claims, and (c) provides for a continuing release of future smoking-related claims in exchange for certain payments to be made to the settling states and certain other jurisdictions and certain tobacco advertising and marketing restrictions, among other things. A decree was entered by the Supreme Court of the State allocating to the State a share of the Tobacco Settlement Revenue ("TSRs") under the MSA.

The purchase price of the State's future right, title and interest to the payments sold to the Corporation has been financed by the issuance of certain series of bonds of the Corporation and by the issuance of certain residual certificates in connection therewith. The residual certificates represent the entitlement to deliver to the holder of the residual certificates any amounts remaining in any of the accounts established under the trust indenture to which the residual certificate applies, after making all deposits and payments set forth in the Indenture, and provided that there are no outstanding bonds and no obligations to make payments to any beneficiaries which are secured by the pledge of the indenture to which the residual certificate applies.

During fiscal 2014, the Corporation received $50 million as a result of the settlement of a lawsuit where the Participating Manufacturers (tobacco companies) disputed MSA payments in sales years 2003 through 2012 on the basis that certain Settling States, including New York, did not diligently enforce their respective Qualifying Statutes in each of those years. After some Settling States settled their disputes with the Participating Manufacturers in March 2013, the State of New York, represented by the Attorney General of the State, was one of 15 contested states that continued in arbitration proceedings with the Participating Manufacturers regarding the 2003 Non-Participating Manufacturers Adjustment ("NPM Adjustment"). The Arbitration Panel released its decision on September 11, 2013. The Arbitration Panel unanimously determined that the State diligently enforced its Qualifying Statute during sales year 2003 and therefore is not subject to the NPM Adjustment for 2003 pursuant to the MSA. The decision that the State diligently enforced its Qualifying Statute during sales year 2003 may not necessarily indicate that the State will be determined in future arbitrations to have diligently enforced its Qualifying Statute in additional sales years. A future determination that the State failed to diligently enforce its Qualifying Statute could result in a complete loss or substantial reduction in the amount of future Pledged Settlement Payments up to the amount of the State's Pledged Settlement Payments for such future sales year or years, plus interest due on all or a portion of such amount, if any.

NOTE 4. Service Agreement

The Corporation has an agreement with the Agency whereby the Agency provides managerial, administrative and financial services to the Corporation. Pursuant to this agreement, the Corporation was charged approximately $538,000 and $455,000 for various expenses, including salaries, in fiscal years 2014 and 2013, respectively. As of October 31, 2014 and 2013 the Corporation owed the Agency the amounts of $238,000 and $452,000, respectively in accordance with the TSFC Service Agreement.

NOTE 5. Deposits and Investments

All the Corporation funds are held in trustee accounts and are governed by the applicable bond resolution. All of the Corporation's investments that are securities are in registered form, and are held by agents of the Corporation or by the trustee under the applicable bond resolution, in the Corporation's name. The agents or their custodians take possession of the securities. For the fiscal years ended October 31, 2014 and 2013, all the Corporation funds were invested in accordance with the applicable policy (described below) or resolution. At October 31, 2014 and 2013, investments (exclusive of accrued interest receivable) held by the trustee in the Corporation's name amounted to $549.8 million and $500.8 million respectively. There were no uncollateralized cash on deposit for the fiscal year ended October 31, 2014 and 2013.

Credit Risk

The Corporation has a formal investment policy which is approved annually by the Corporation's board. The investment policy is in compliance with the New York State Comptroller's Investment Guidelines and governs the investment of all the Corporation's monies. These guidelines and policies are designed to protect principal by limiting credit risk. A summary of permitted investment policies and procedures is as follows:

- General obligations of, or obligations guaranteed by any state of the United States of America or political subdivision thereof, or the District of Columbia or any agency or instrumentality of any of them (excluding FNMA and FHLMC obligations as defeasance collateral);

- Certificates of deposit, savings accounts, demand and time deposits or other obligations or accounts of banks or trust companies in the State, secured as required by the Corporation;

- Obligations in which the State Comptroller is authorized to invest pursuant to Section 98 or 98-a of the State Finance Law;

- Commercial or finance company paper payable not more than 190 days after the date of issuance;

- Units of taxable money market funds which funds are regulated investment companies and seek to maintain a constant net asset value per share;

- Repurchase obligations, investment agreements or guaranteed investment contracts;

- Non-AMT Tax-Exempt obligation (Supplemental Account only).

There are minimum ratings requirements associated with the authorized investments described above. Additionally, there are restrictions on the call features of investments used as defeasance collateral.

Custodial Credit Risk

The Corporation manages custodial credit risk by limiting its investments to highly rated institutions and/ or requiring high quality collateral be held by the counterparty in the name of the Corporation.

Debt Service Reserve Account Investment

A portion of monies in the Debt Service Reserve Account are invested in a Debt Service Reserve Fund Agreement.
The terms of the Debt Service Reserve Fund Agreement requires the Corporation to make funds available in the Debt Service Reserve Account at the time of delivery by the Counterparty of qualified securities for purchase by the Corporation and deposit into the Debt Service Reserve Account. On deposit dates, the Counterparty sells the Corporation qualified securities that will mature on or prior to the related bond payment dates in amounts equal to the amounts deposited plus the guaranteed rate for the period. This Debt Service Reserve Fund Agreement with Morgan Stanley & Co. Inc. amounted to $56.9 million or 10.3% of the Corporation's investments at October 31, 2014. Morgan Stanley & Co. Inc. was rated A- and Baa2 by S&P and Moody's, respectively at October 31, 2014.

Interest Rate Risk

Securities purchased with tobacco settlement revenues are invested in U.S. Treasury Obligations with maturities as close as practical to the next debt service payment date or date of usage, typically less than one year. Interest rate risk is therefore minimal due to the short term duration of the Corporation's investments in the other than Debt Service Reserve Fund Agreements category.

Under the terms of the Debt Service Reserve Fund Agreement, the Corporation is guaranteed a certain rate of return by the Counterparty. If, however, the Counterparty is not in compliance with the terms of the agreement, the Corporation could sustain interest rate risk if the Corporation is unable to invest liquidated funds at comparable rates.

The Corporation had the following investments and maturities:

Values below are at fair value excluding accrued interest
as of October 31, 2014:

		Investment Maturities (In Years)	
	Fair Value	Less than 1	More than 10
Restricted Funds:	($ in Thousands)		
Investment Type			
Money Market	$ 25	$ 25	$ -
Debt Service Reserve Fund Agreement	56,886	-	56,886
U.S. Treasury Bills	1,882	1,882	
U.S. Treasury Notes	491,055	491,055	-
	549,848	492,962	56,886
Less: Amounts reported as cash equivalents	25	25	-
Total Investments	$ 549,823	$ 492,937	$ 56,886

NOTE 6. Bonds Payable

Outstanding bonds are secured by the pledged settlement payments. In addition, they are further secured by a pledge of all of the Corporation's interest under a contingency contract entered into between the Corporation and the State which provides for payment to the Corporation of such amounts, if any, as shall be necessary to provide for the payment of principal of and interest on the bonds coming due on the next payment date if all other funds pledged and available, including pledged settlement payments and moneys in the debt service reserve account, are inadequate. The State's obligation to make such payments under the contingency contract exists only to the extent moneys are available to the State and the State incurs no liability beyond the moneys available to it and appropriated for such purpose.

A summary of changes in outstanding bonds during the fiscal year ended October 31, 2014 is as follows:

Schedule of Bonds Outstanding
October 31, 2014

	Original Face Amount	Balance October 31, 2013	Bonds Issued	Retired/ Principal Payments	Balance October 31, 2014	
	(in Thousands)					
Series 2003 A:						
Sub-Series 2003 A1C - 4.0% to 5.5%	$1,796,940	$ 700,220	$ -	$ 700,220	$ -	
Series 2003 B:						
Sub-Series 2003 B1C - 4.0% to 5.5%	1,713,235	603,265	-	603,265	-	
Series 2011:						
Sub-Series 2011A (Refunding Bonds) 2% - 5%	415,600	365,600	-	51,600	314,000	
Sub-Series 2011B (Refunding Bonds) 4% - 5%	543,595	462,000	-	85,000	377,000	
Sub-Series 2013A (Refunding Bonds) 3% - 5%	660,090	-	660,090	103,950	556,140	*
Sub-Series 2013B (Refunding Bonds) 5%	565,655	-	565,655	67,900	497,755	*
Total Bond Indebtedness	5,695,115	2,131,085	1,225,745	1,611,935	1,744,895	
Bond Premium	-	109,290	88,040	70,458	$ 126,872	
Total Net Bond Indebtedness	**$5,695,115**	**$2,240,375**	**$1,313,785**	**$1,682,393**	**$1,871,767**	

***On December 21, 2013, the Corporation refunded Series 2003A and 2003B Bonds in the aggregate principal amount of $1,303,485,000, through the issuance of Series 2013A and 2013B in the aggregate principal amount of $1,225,745,000, resulting in a reduction of total debt service payments by $106,765,000 and to obtain an economic gain of $98,986,000.**

Future debt service requirements are as follows:

Fiscal year ending October 31,	Principal	Interest	Total
	($ in Thousands)		
2015	$ 143,000	$ 86,407	$ 229,407
2016	172,000	79,557	251,557
2017	179,000	71,348	250,348
2018	197,000	62,454	259,454
2019	60,085	52,695	112,780
2020 - 2023	993,810	95,774	1,089,584
Total	$ 1,744,895	$ 448,235	$ 2,193,130

NOTE 7. Settlement Revenue from Investment Agreement Termination

In fiscal 2014, the amount of $19.2 million was received in connection with the jointly administered Chapter 11 Plan of Lehman Brothers Holdings Inc. and its Affiliated Debtors as confirmed by the Bankruptcy Court on December 6, 2011. The amount received was in connection with (i) a Reserve Fund Agreement dated as of June 19, 2003 (the "June 2003 RFA") and (ii) a Reserve Fund Agreement dated as of December 2, 2003 (the "December 2003 RFA" and, together with the June 2003 RFA, collectively, the "RFAs"), each entered into among, inter alia, the Tobacco Settlement Financing Corporation ("TSFC") and Lehman Brothers Special Financing Inc. ("LBSF"). The obligations of LBSF under each RFA were guaranteed by Lehman Brothers Holdings Inc. ("LBHI" and, together with LBSF, collectively, "Lehman").

The RFAs served as investment vehicles through which TSFC invested certain reserve funds that served as a source of backup payment for debt service owed on its Bonds. The RFAs enabled TSFC to invest the reserve funds by purchasing qualifying securities from LBSF at purchase prices that were set to ensure that TSFC received certain guaranteed rates of investment. Under the RFAs, LBSF would cause qualified dealers to deliver qualifying securities to Bank of New York, as trustee for the Corporation on specified deposit dates which occurred every 6 months. Following such delivery, the Trustee would immediately purchase such securities by paying the qualified dealer an aggregate purchase price as close as possible to, but not exceeding, certain scheduled reserve amount

LBHI and LBSF filed for bankruptcy on September 15, 2008 and October 3, 2008, respectively. LBSF failed to deliver qualifying securities to the Trustee on both November 28, 2008 and May 29, 2009. Litigation ensued and the amount received in fiscal 2014 represents a portion of the settlement for the lost interest earnings. The bankruptcy filings of LBHI and LBSF had no impact on the principal amounts of the RFAs, which amounts remained unchanged from inception.

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

Management and the Members
Tobacco Settlement Financing Corporation
New York, New York

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities and each major fund of the Tobacco Settlement Financing Corporation (the Corporation), a component unit of the State of New York, as of and for the year ended October 31, 2014 and the related notes to the financial statements, which collectively comprise the Corporation's basic financial statements, and have issued our report thereon dated January 29, 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 opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

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Compliance and Other Matters

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

Purpose of this Report

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

Ernst & Young LLP

January 29, 2015