

SCHEDULE OF INVESTMENTS

Tobacco Settlement Financing Corporation  
(A Component Unit of the State of New York)  
October 31, 2012 and 2011  
With Report of Independent Auditors

Ernst & Young LLP



Tobacco Settlement Financing Corporation  
(A Component Unit of the State of New York)

Schedule of Investments

Years Ended October 31, 2012 and 2011

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## Report of Independent Auditors

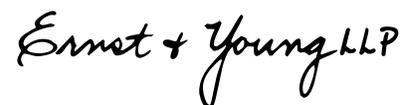
Tobacco Settlement Financing Corporation  
New York, New York

We have audited the financial statements of the governmental activities and each major fund of the Tobacco Settlement Financing Corporation (a component unit of the State of New York) (the “Corporation”) as of and for the years ended October 31, 2012 and 2011, which collectively comprise the Corporation’s basic financial statements, and have issued our report thereon dated January 29, 2013. We also have audited the accompanying Schedule of Investments of the Corporation as of October 31, 2012 and 2011. This schedule is the responsibility of the Corporation’s management. Our responsibility is to express an opinion on this schedule 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 audit to obtain reasonable assurance about whether the Schedule of Investments is free of material misstatement. We were not engaged to perform an audit of the Corporation’s internal control over financial reporting. Our audits included 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, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the schedule referred to above presents fairly, in all material respects, the investments of the Corporation at October 31, 2012 and 2011, in conformity with US generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 29, 2013 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* and should be considered in assessing the results of our audit.



January 29, 2013

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*

Tobacco Settlement Financing Corporation  
New York, New York

We have audited the financial statements of the governmental activities and each major fund of the Tobacco Settlement Financing Corporation (a component unit of the State of New York) (the “Corporation”), as of and for the year ended October 31, 2012, which collectively comprise the Corporation’s basic financial statements, and have issued our report thereon dated January 29, 2013. We have also audited the Schedule of Investments of the Corporation as of October 31, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

Management of the Corporation is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Corporation’s internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Corporation’s internal control over financial reporting.

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.

Our consideration of internal control over financial reporting 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 deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

## 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, grant agreements and investment policies established by the Corporation and the New York State Comptroller investment guideline requirements as presented in Section 201.3(c) of the *Accounting, Reporting and Supervision Requirements for Public Authorities*, 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*.

This report is intended solely for the information and use of management, the Board Members, others within the entity and the Office of the State Comptroller of the State of New York, and is not intended to be and should not be used by anyone other than these specified parties.

*Ernst + Young LLP*

January 29, 2013

Tobacco Settlement Financing Corporation  
(A Component Unit of the State of New York)

Schedule of Investments  
(In Thousands of Dollars)

	<b>October 31</b>	
	<b>2012</b>	<b>2011</b>
Cash equivalents	\$ 392,489	\$ 1,087
Restricted	<u>118,165</u>	<u>522,994</u>
Total investments	<u>\$ 510,654</u>	<u>\$ 524,081</u>

*The accompanying notes are an integral part of this schedule.*

Tobacco Settlement Financing Corporation  
(A Component Unit of the State of New York)

Notes to Schedule of Investments

October 31, 2012

**1. Background and Organization**

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 Agency does not have financial accountability for the Corporation; accordingly, it 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*. GASB Statement No. 61 is designed to improve financial reporting for governmental entities by amending the requirements of GASB Statement No. 14, *The Financial Reporting Entity*, and GASB Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis— for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively.

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, pursuant to the Master Settlement Agreement (“MSA”), less certain unsold payments which remain the property of the State.

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.

Tobacco Settlement Financing Corporation  
(A Component Unit of the State of New York)

Notes to Schedule of Investments (continued)

**1. Background and Organization (continued)**

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.

**2. Summary of Significant Accounting Policies**

**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.

**Investments**

Investments are recorded at fair value, in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools* ("GASB No. 31").

**3. 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, 2012 and 2011, all the Corporation funds were invested in accordance with the applicable policy (described below) or resolution. At October 31, 2012 and 2011, investments (exclusive of accrued interest receivable) held by the trustee in the Corporation's name amounted to approximately \$510,654,000 and \$524,081,000, respectively.

Tobacco Settlement Financing Corporation  
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Notes to Schedule of Investments (continued)

**3. Investments (continued)**

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.

Tobacco Settlement Financing Corporation  
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Notes to Schedule of Investments (continued)

**3. Investments (continued)**

**Debt Service Reserve Account Investment**

A portion of monies in the Debt Service Reserve Account are invested in a Reserve Fund Agreement.

The terms of the 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 11.1% of the Corporation's investments at October 31, 2012, respectively. Morgan Stanley & Co. Inc. was rated A and Baa1 by S&P and Moody's, respectively at October 31, 2012.

**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 Agreements category.

Under the terms of the Debt Service Reserve 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.

Tobacco Settlement Financing Corporation  
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Notes to Schedule of Investments (continued)

**3. Investments (continued)**

As of October 31, 2012, the Corporation had the following investments and maturities.

Values below are at fair value excluding accrued interest as of October 31, 2012.

	<b>Investment Maturities (In Years)</b>		
	<b>Fair Value</b>	<b>Less Than 1</b>	<b>More Than 10</b>
	<i>(In Thousands)</i>		
Restricted Funds:			
Investment type:			
Money Market	\$ 43	\$ 43	\$ –
Debt Service Reserve Fund Agreement	56,886	–	56,886
U.S Treasury Bills	392,444	392,444	–
U.S. Treasury Notes	61,281	61,281	–
	510,654	453,768	56,886
Less: amounts reported as cash equivalents	43	43	–
Total investments	\$ 510,611	\$ 453,725	\$ 56,886

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