

TOBACCO SETTLEMENT
FINANCING CORPORATION
STATE OF LOUISIANA



FINANCIAL STATEMENT AUDIT
ISSUED APRIL 9, 2008

**LEGISLATIVE AUDITOR
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Under the provisions of state law, this report is a public document. A copy of this report has been submitted to the Governor, to the Attorney General, and to other public officials as required by state law. A copy of this report has been made available for public inspection at the Baton Rouge office of the Legislative Auditor.

This document is produced by the Legislative Auditor, State of Louisiana, Post Office Box 94397, Baton Rouge, Louisiana 70804-9397 in accordance with Louisiana Revised Statute 24:513. Ten copies of this public document were produced at an approximate cost of \$48.20. This material was produced in accordance with the standards for state agencies established pursuant to R.S. 43:31. This report is available on the Legislative Auditor's Web site at www.la.state.la.us. When contacting the office, you may refer to Agency ID No. 7138 or Report ID No. 07302753 for additional information.

In compliance with the Americans With Disabilities Act, if you need special assistance relative to this document, or any documents of the Legislative Auditor, please contact Wayne "Skip" Irwin, Director of Administration, at 225-339-3800.

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to the Office of the Governor, Division of Administration,
Office of Statewide Reporting and Accounting Policy,
as of and for the Year Ended June 30, 2007

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Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	A
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LOUISIANA LEGISLATIVE AUDITOR
STEVE J. THERIOT, CPA

March 10, 2008

Independent Auditor's Report
on the Financial Statements

TOBACCO SETTLEMENT FINANCING CORPORATION
STATE OF LOUISIANA
Baton Rouge, Louisiana

We have audited the accompanying financial statements of the debt service fund and governmental activities of the Tobacco Settlement Financing Corporation (Corporation), a blended component unit of the State of Louisiana, as of and for the year ended June 30, 2007, which collectively comprise the Corporation's basic financial statements as listed in the table of contents. These financial statements are the responsibility of management of the Corporation. 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the debt service fund and governmental activities of the Corporation as of June 30, 2007, and the respective changes in financial position for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

During August and September of 2005, the State of Louisiana suffered considerable damage from two major hurricanes, Katrina and Rita, resulting in the President of the United States declaring Louisiana a major disaster area. Because of the severity of these two separate events and the resulting losses sustained, it is unknown exactly what economic impact recovery will have on state and local governmental operations in Louisiana. While the Corporation did not

directly suffer any major effects of these two hurricanes, the long-term effects of these events directly on the Corporation cannot be determined at this time.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 10, 2008, 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 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 read in conjunction with this report in considering the results of our audit.

Management's discussion and analysis on pages 5 through 8 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Corporation's basic financial statements. The accompanying supplementary information, Annual Fiscal Report to the Office of the Governor, Division of Administration, Office of Statewide Reporting and Accounting Policy, listed in the table of contents is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The accompanying supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Respectfully submitted,



Steve J. Theriot, CPA
Legislative Auditor

CLM:JMR:THC:sr

TSFC07

This section of the Tobacco Settlement Financing Corporation's (Corporation) annual financial report represents management's analysis of the Corporation's financial performance during the year ended June 30, 2007, in comparison to that of the previous fiscal year. Please read it in conjunction with the financial statements, which follows this section.

FINANCIAL HIGHLIGHTS

- The Corporation's net asset deficit decreased \$34,566,323 (or 3.98%) to \$834,361,667 as of June 30, 2007. This represents the net financial position of the Corporation on the full accrual basis of accounting. On the modified accrual basis, \$133,529,110 of fund balance is available for debt service and operations.
- The revenues of the Corporation increased \$17,435,126 (or 21.75%).
- The expenses of the Corporation decreased \$1,191,015 (or 1.85%).

The Corporation was formed to purchase Pledged Tobacco Settlement Revenues (TSRs) from the State of Louisiana. This purchase was financed by issuing bonds. The TSRs consist of amounts to be collected as part of a Master Settlement Agreement (MSA) between cigarette manufacturers (PMs) and 46 states and other U.S. jurisdictions (Settling States). Under the MSA, the PMs are required to pay the Settling States annual payments in perpetuity.

Much of the TSRs represent a portion of future sales of tobacco products, and under generally accepted accounting principles (GAAP), such contingent amounts can be recognized as a receivable and revenue when the domestic sale of tobacco products is known. Under the modified accrual basis of accounting, revenue should be recognized to the extent that the event occurs and resources become available.

OVERVIEW OF THE FINANCIAL STATEMENTS

These financial statements consist of two sections--Management's Discussion and Analysis (this section) and the basic financial statements (including the notes to the financial statements).

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The Statement of Net Assets and the Statement of Activities are two basic financial statements that report information about the Corporation as a whole. The data are reported using the accrual basis of accounting, which provides insight as to the Corporation's total financial position and whether or not the Corporation's total financial position has improved as a result of the current year's activities.

The Governmental Fund Balance Sheet and Statement of Net Assets (page 9) presents the current and long-term portions of assets and liabilities separately.

The Statement of Governmental Fund Revenues, Expenditures, and Changes in Fund Balance and Statement of Activities (page 11) present information on how the Corporation's assets changed as a result of current period operations.

Comparative condensed Statements of Net Assets and Activities for fiscal years 2007 and 2006 are as follows:

**Statement of Net Assets
June 30, 2007 and 2006**

	<u>June 30, 2007</u>	<u>June 30, 2006</u>
Current assets	\$276,909	\$259,581
Noncurrent assets	208,174,076	200,309,790
Total assets	<u>208,450,985</u>	<u>200,569,371</u>
Current liabilities	77,522,652	51,032,251
Noncurrent liabilities	965,290,000	1,018,465,000
Total liabilities	<u>1,042,812,652</u>	<u>1,069,497,251</u>
Net assets - restricted for debt service	182,188,908	173,549,725
Net assets (deficit) - unrestricted	<u>(1,016,550,575)</u>	<u>(1,042,477,605)</u>
Total net assets (deficit)	<u><u>(\$834,361,667)</u></u>	<u><u>(\$868,927,880)</u></u>

**Summary of Changes in Net Assets
For the Years Ended June 30, 2007 and 2006**

	<u>June 30, 2007</u>	<u>June 30, 2006</u>
Revenues	\$97,583,195	\$80,148,069
Expenses	<u>(63,016,981)</u>	<u>(64,207,996)</u>
Increase in net assets	<u><u>\$34,566,214</u></u>	<u><u>\$15,940,073</u></u>

The net asset deficit is a result of bonds payable and other liabilities exceeding recognized assets. The bonds are recognized as a liability, while the resources to repay the bonds, consisting of future TSRs, are not all recognized as assets until the underlying sales of tobacco products are known.

Revenues of the Corporation increased from prior year because of several reasons. First, the TSR collection depends upon sales of cigarettes which will vary from year to year. Second, the corporation collected TSRs related to prior years which had previously been withheld by one of the four original participating manufacturers because of an asserted loss of market share. Third, the MSA calls for a stream of payments to commence in 2008, identified in the settlement agreement as the "strategic contribution payments." The strategic contribution payment due in 2008 is based upon 2007 cigarette sales, and therefore a portion of the 2008 strategic

contribution payment is recorded as revenue for this fiscal year in accordance with the Governmental Accounting Standards Board Technical Bulletin 2004-1.

Expenses of the Corporation decreased because of decreased interest expense as the bonds are retired.

FUND FINANCIAL STATEMENTS

The fund financial statements provide detailed information about the Corporation as a debt service fund. A fund is a fiscal and accounting entity with a self-balancing set of accounts that the Corporation uses to keep track of specific sources of funding and spending for a particular purpose.

As a debt service fund, all of the Corporation's activity is reported in the governmental fund financial statements. 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 funds financial statements focus on near-term inflows and outflows of spendable resources. This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the Corporation's finances that assist in determining whether there will be adequate financial resources available to meet the current needs of the Corporation.

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 government's near-term financing decisions. Both the Governmental Funds Balance Sheet and the Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balance provide a reconciliation to facilitate this comparison between the governmental funds and the governmental activities. These reconciliations are presented in the adjustment column in each of the financial statements.

BUDGET ANALYSIS

The Corporation's original budget for the year ending June 30, 2007, was approved on October 18, 2006, by the Corporation's Board. Budget amendments for the fiscal year ending June 30, 2007, were not required. Differences between budgeted and actual amounts were not material.

LONG-TERM DEBT ACTIVITY

At June 30, 2007, the Corporation has \$1,035,220,000 in outstanding debt. The Corporation made bond payments totaling \$26,590,000 during the year ended June 30, 2007. A description of this bonded debt activity is located at note 4. The Corporation's bonds carry a BBB- rating from Standard & Poors as of June 30, 2007.

**CONTACTING THE TOBACCO SETTLEMENT
FINANCING CORPORATION'S MANAGEMENT**

This financial report is designed to provide a general overview of the Corporation's finances and to demonstrate the Corporation's accountability for the money it receives. If you have any questions about this report or need additional information, contact the Tobacco Settlement Financing Corporation, Post Office Box 44154, Baton Rouge, Louisiana 70804.

**TOBACCO SETTLEMENT FINANCING CORPORATION
STATE OF LOUISIANA**

**Governmental Fund Balance Sheet and
Statement of Net Assets, June 30, 2007**

	DEBT SERVICE FUND	ADJUSTMENTS*	STATEMENT OF NET ASSETS - GOVERNMENTAL ACTIVITIES
ASSETS			
Current Assets:			
Cash (note 2)	\$276,909		\$276,909
Investments (note 3)	133,171,542	(\$133,171,542) (1)	
Receivables (note 7)	212,553	(212,553) (1)	
Total current assets	<u>133,661,004</u>	<u>(133,384,095)</u>	<u>276,909</u>
Noncurrent Assets:			
Unamortized bond issue cost		25,985,168 (3)	25,985,168
Restricted assets:			
Investments (note 3)		133,171,542 (1)	133,171,542
Tobacco settlement receivable (note 7)		48,804,813 (2)	48,804,813
Interest receivable (note 7)		212,553 (1)	212,553
Total noncurrent assets	<u>NONE</u>	<u>208,174,076</u>	<u>208,174,076</u>
Total Assets	<u>\$133,661,004</u>	<u>74,789,981</u>	<u>208,450,985</u>
LIABILITIES			
Current Liabilities:			
Fees payable	\$131,894		131,894
Accrued interest payable		7,460,758 (3)	7,460,758
Bonds payable (note 4)		69,930,000 (3)	69,930,000
Total current liabilities	<u>131,894</u>	<u>77,390,758</u>	<u>77,522,652</u>
Noncurrent liabilities - bonds payable (note 4)	<u>NONE</u>	<u>965,290,000</u>	<u>965,290,000</u>
Total Liabilities	<u>131,894</u>	<u>1,042,680,758</u>	<u>1,042,812,652</u>
FUND BALANCE/NET ASSETS			
Fund balance - reserved for debt service	<u>133,529,110</u>	<u>(133,529,110)</u>	<u>NONE</u>
Total Liabilities and Fund Balance	<u>\$133,661,004</u>		
Net Assets (Deficit):			
Restricted for debt service (note 5)		182,188,908	182,188,908
Unrestricted (note 6)		<u>(1,016,550,575)</u>	<u>(1,016,550,575)</u>
Total Net Assets (Deficit)		<u>(\$834,361,667)</u>	<u>(\$834,361,667)</u>

*Explanations:

- (1) Investments and receivables restricted for debt service are reported as noncurrent restricted assets on the Statement of Net Assets.
(2) Full accrual receivables are recorded on the Statement of Net Assets but not within the fund statements of the Debt Service Fund.
(3) Bonds payable liabilities and unamortized bond issue costs are recorded on the Statement of Net Assets but not within the fund statements of the Debt Service Fund.

The accompanying notes are an integral part of this statement.

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**TOBACCO SETTLEMENT FINANCING CORPORATION
STATE OF LOUISIANA**

**Statement of Governmental Fund Revenues, Expenditures,
and Changes in Fund Balance and Statement of Activities
For the Year Ended June 30, 2007**

	DEBT SERVICE FUND	ADJUSTMENTS*	STATEMENT OF ACTIVITIES - GOVERNMENTAL ACTIVITIES
REVENUES			
Tobacco settlement revenues (note 7)	\$82,868,340	\$8,640,150 (1)	\$91,508,490
Investment income	6,074,705		6,074,705
Total revenues	<u>88,943,045</u>	<u>8,640,150</u>	<u>97,583,195</u>
EXPENDITURES/EXPENSES			
Bank fees	89,522		89,522
Professional services	154,908		154,908
Amortization of bond issue cost		555,843 (2)	555,843
Debt service:			
Principal retirement	26,590,000	(26,590,000) (3)	
Interest and fiscal charges	62,206,147	10,561 (2)	62,216,708
Total expenditures/expenses	<u>89,040,577</u>	<u>(26,023,596)</u>	<u>63,016,981</u>
EXCESS (Deficiency) OF REVENUES OVER (Under) EXPENDITURES/EXPENSES	(97,532)	34,663,746	34,566,214
FUND BALANCE/NET ASSETS (Deficit) AT BEGINNING OF YEAR	<u>133,626,642</u>	<u>(1,002,554,523)</u>	<u>(868,927,881)</u>
FUND BALANCE/NET ASSETS (Deficit) AT END OF YEAR	<u>\$133,529,110</u>	<u>(\$967,890,777)</u>	<u>(\$834,361,667)</u>

*Explanations:

- (1) Full accrual revenues are recorded on the Statement of Net Assets but not within the fund statements of the Debt Service Fund.
- (2) Debt service funds report the effects of issuance costs, discounts, and similar items when the debt is first issued, whereas these amounts are amortized in the Statement of Activities.
- (3) Principal retirement is an expenditure in the Debt Service Fund but not in the Statement of Activities.

The accompanying notes are an integral part of this statement.

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INTRODUCTION

The Tobacco Settlement Financing Corporation (Corporation) was created by Act 1145 of the 2001 Regular Session of the Louisiana State Legislature codified under the provisions of Louisiana Revised Statutes (R.S.) 39:99.1 through 39:99.20. The Corporation is a special purpose, public corporate entity, an instrumentality independent of the state.

On November 23, 1998, the State of Louisiana entered into a Master Settlement Agreement with the major United States tobacco product manufacturers that should result in Louisiana receiving substantial monies in perpetuity. The Corporation is authorized and empowered to, among other things, (1) purchase the state's allocation of monies to be received as a result of the Master Settlement Agreement and receive, or authorize the indenture trustee to receive, the tobacco settlement payments when they become due; (2) issue bonds; (3) determine the amounts of the residual interests and pay and transfer such residual interests to the state treasurer, semiannually, in accordance with the provisions of the Louisiana Revised Statutes noted above; and (4) do any and all other acts and things necessary, convenient, appropriate or incidental in carrying out the provisions of the Louisiana Revised Statutes noted above.

Income of the Corporation, and bond proceeds, if any, not previously paid to the state, that are in excess of the Corporation's requirements to pay its operating expenses, debt service, sinking fund requirements, reserve fund requirements, and any other contractual obligations to the holders or that may be incurred in connection with the issuance of the bonds, the amounts of which shall be determined by the board on or before January 1 and July 1 of each year for the next twelve months, and which, within 10 days after each such determination, shall be transferred and paid by the Corporation to the state treasurer for deposit in and credit to the Millennium Trust.

The Corporation shall have perpetual existence provided, however, the board shall dissolve and terminate the existence of the Corporation no later than two years after the date of final payment of all outstanding bonds and the payments or satisfaction of all other outstanding obligations and liabilities of the Corporation. Upon dissolution of the Corporation, title to all assets and properties of the Corporation shall vest in and become the property of the State of Louisiana and shall be deposited in and credited to the Millennium Trust.

The Corporation is governed by a board consisting of 13 members as follows: (i) the Governor or his designee; (ii) the State Treasurer or his designee; (iii) the Attorney General or his designee; (iv) the President of the Senate or his designee; (v) the Speaker of the House of Representatives or his designee; (vi) seven members appointed by the Governor from each of the seven congressional districts; and (vii) one additional member appointed from the state. The state treasurer serves as the secretary-treasurer of the Corporation and the board. The Corporation is a blended component unit of the state and is included in the state's financial statements.

Operations of the Corporation were funded initially with a portion of bond proceeds but are now funded with Corporation investment income. The Corporation has no employees. R.S. 39:99.8(A) states the staff of the Department of the Treasury, including that of the state Bond

Commission, may, pursuant to a cooperative endeavor agreement, serve as staff to the Corporation under the supervision of the state treasurer.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. REPORTING ENTITY

Using the criteria in Governmental Accounting Standards Board (GASB) Codification Section 2100, the Division of Administration, Office of Statewide Reporting and Accounting Policy, has defined the governmental reporting entity to be the State of Louisiana. The Office of Statewide Reporting and Accounting Policy considers the Corporation to be a blended component unit of the State of Louisiana because the state has financial accountability for fiscal matters as follows: (1) a majority of the members of the governing board are appointed by the governor; (2) the state has control and exercises authority over budget matters; (3) no later than two years after the full payment of tobacco settlement asset-backed bonds principal and interest, the board shall dissolve and terminate the existence of the Corporation; and (4) services are provided entirely to the primary government. Annually, the State of Louisiana issues financial statements, which include the activity contained in the accompanying financial statements. Those basic financial statements are audited by the Louisiana Legislative Auditor.

B. MEASUREMENT FOCUS AND BASIS OF ACCOUNTING

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the GASB. These principles are found in the *Codification of Governmental Accounting and Financial Reporting Standards*, published by the GASB. GASB is the accepted standard setting body for establishing governmental accounting principles and reporting standards.

The accompanying governmental fund financial statements (Balance Sheet and Statement of Revenues, Expenditures, and Changes in Fund Balance) are presented using the current financial resources measurement focus and the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when they become measurable and available to fund current operations. Expenditures are recognized when the related fund liability is incurred, except for principal and interest on long-term debt, which is recognized when due.

The accompanying government-wide statements (Statement of Net Assets and Statement of Activities) are presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when they are earned and expenses are recognized when the related liability is incurred, regardless of the timing of related cash flows.

The adjustments column on Statements A and B reflect the recording of bonds payable liabilities and unamortized bond issue cost on the Statement of Net Assets and the related effect of these transactions on the Statement of Activities. This column is also used to record full accrual revenues and receivables and to reclassify current assets as restricted assets.

The Corporation applies all GASB pronouncements as well as Financial Accounting Standards Board (FASB) statements and interpretations issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. In accordance with the State of Louisiana's Division of Administration, the board has elected to follow GASB statements issued after November 30, 1989, rather than the FASB statements and interpretations.

C. FUND ACCOUNTING

Fund level activities of the Corporation are accounted for in the Debt Service Fund. The Debt Service Fund accounts for the accumulation of resources for, and the payment of, long-term debt principal and interest. The Debt Service Fund consists of the current assets and liabilities of the Corporation with the difference being fund balance reserved for debt service.

D. BUDGET PRACTICES

Annually, the Corporation is required under R.S. 39:99.6 (C) to submit an operating budget for approval to the state Bond Commission and to the Joint Legislative Committee on the Budget. The Corporation's original budget for the year ending June 30, 2006, was approved on August 11, 2005, by the Corporation's board.

E. CASH AND INVESTMENTS

Cash consists of demand deposits. Investments consist of direct investments in commercial paper and money market funds. Under state law, the Corporation may deposit funds within a fiscal agent bank organized under the laws of the State of Louisiana, the laws of any other state in the Union, or the laws of the United States.

Under state law, any funds held by the Corporation or by the indenture trustee may be invested and reinvested in investments and securities that are legal investments under the laws of the State of Louisiana for the funds of the state, funds of political subdivisions of the state, or tax exempt bonds as defined in R.S. 49:342(C). Investments are stated at amortized cost, which approximates fair value, in accordance with GASB Statement No. 31.

F. RESTRICTED ASSETS

Restricted assets represent resources set aside for the purpose of funding debt service payments in accordance with bond resolutions.

G. CAPITAL ASSETS

The Corporation has no capital assets at June 30, 2007.

H. LONG-TERM OBLIGATIONS

Long-term obligations are reported at face value.

I. COMPENSATED ABSENCES, PENSION BENEFITS AND POSTEMPLOYMENT HEALTH CARE AND LIFE INSURANCE BENEFITS

The Corporation has no employees. Therefore, no compensated absences, pension benefits, or postretirement benefits are provided by the Corporation.

J. NET ASSETS

Net assets represent the difference between assets and liabilities and are classified in the following components:

Restricted net assets consist of net assets subject to external constraints placed on net asset use by creditors, grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

Unrestricted net assets consist of all other net assets that are not included in restricted net assets. All of the Corporation's net assets are restricted.

K. ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates. The most significant estimate contained within the financial statements is that determined for the Tobacco Settlement Revenue Receivable of \$48,804,813 (note 7).

2. CASH

At June 30, 2007, the Corporation has cash (book balances) totaling \$276,909, which is held in a demand deposit account, as presented on Statement A. Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Corporation will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The Corporation has \$100,000 in deposits (collected bank balances) that are secured from risk by federal deposit insurance. The remaining \$176,909 is uninsured and uncollateralized. The Corporation does not have a formal policy for custodial credit risk for cash.

3. INVESTMENTS

At June 30, 2007, investments of \$133,171,542, as presented on Statement A, consist of the following:

<u>Investment Type</u>	<u>Fair Value</u>	<u>*Credit Quality Rating</u>	<u>Percentage of Investments</u>	<u>Maturity - Less Than One Year</u>
JPMorgan Federal Money Market	\$28,736,002	AAAm	21.58%	\$28,736,002
Societe Generale - Commercial Paper	89,671,010	A-1+	67.33%	89,671,010
Briarwood Commercial Paper Trust - Commercial Paper	14,608,925	A-1+	10.97%	14,608,925
General Electric Capt. Corp. Commercial Paper	155,605	A-1+	0.12%	155,605
Total investments	<u>\$133,171,542</u>		<u>100.00%</u>	<u>\$133,171,542</u>

*Credit quality ratings obtained from Standard & Poor's Investor Services.

Custodial Credit Risk: For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Corporation will not be able to recover the value of its investment that is in the possession of an outside party. The Corporation does not have a formal investment policy for custodial credit risk. As of June 30, 2007, an amount of \$104,435,540 of the Corporation's total investments of \$133,171,542 was exposed to custodial credit risk since these investments were uninsured, unregistered, and held by the counterparty in the Corporation's name.

Credit Risk: This risk is defined as the risk that an issuer or other counterparty to an investment transaction will not fulfill its obligations. The Corporation's bond indenture restricts the Corporation to investments rated A-1 or higher by Standard & Poor's, P-1 by Moody's Investor's Service, and F-1 by Fitch.

Concentration of Credit Risk: The Corporation does not have a policy for this type of risk, which is defined as the risk of loss attributed to the magnitude of the Corporation's investment in a single issuer.

Interest Rate Risk: This risk is defined as the risk that changes in interest rates will adversely affect the fair value of an investment. To minimize this risk, the Corporation has entered into a reserve fund agreement with Lehman Brothers Special Financing Inc., that guarantees an annual investment rate of return of 4.36% on the 2001-A Liquidity Reserve Requirement balance and has entered into an agreement with Bayerische Hypo-Und Vereinsbank AG, New York Branch that guarantees an annual investment rate of return of 4.63% on the 2001-B Liquidity Reserve Requirement balance. These two investments account for 78.42% of total investments.

Reserve Requirements: Of the total investment balance of \$133,171,542, an amount of \$103,920,481 consists of the Liquidity Reserve Requirement provided for by the bond indenture. The 2001-A bond series reserve requirement is \$14,764,534 and for the 2001-B bond series, the reserve requirement is \$89,155,947. The Corporation met its reserve balance requirements at June 30, 2007.

4. BONDED DEBT

Bonded debt is composed of the following:

Series 2001A (Taxable) Term Bonds due May 15, 2025, with interest of 6.36% due semiannually on May 15 and November 15, commencing on May 15, 2002	\$115,425,000
Series 2001B (Tax Exempt) Term Bonds due May 15, 2030, with interest of 5.50% due semiannually on May 15 and November 15, commencing on May 15, 2002	230,390,000
Series 2001B (Tax Exempt) Term Bonds due May 15, 2039, with interest of 5.875% due semiannually on May 15 and November 15, commencing on May 15, 2002	<u>689,405,000</u>
Total bonded debt	<u><u>\$1,035,220,000</u></u>

The following is a summary of the debt obligation transactions for the year ended June 30, 2007:

	Bonded Debt Payable at June 30, 2006		Additions	Deductions	Bonded Debt Payable at June 30, 2007	
Tobacco Settlement Asset-Backed bonds:						
Series 2001A (Taxable) due May 15, 2025	\$142,015,000			\$26,590,000		\$115,425,000
Series 2001B (Tax Exempt) due May 15, 2030	230,390,000					230,390,000
Series 2001B (Tax Exempt) due May 15, 2039	689,405,000					689,405,000
Total	<u>\$1,061,810,000</u>		<u>NONE</u>	<u>\$26,590,000</u>		<u>\$1,035,220,000</u>

On November 7, 2001, the Corporation issued \$1,202,770,000 in Tobacco Settlement Asset-Backed Bonds. The bonds were issued to finance the Corporation's purchase of 60% of the state's future receipts from the MSA with participating cigarette manufacturers. The bonds are secured by the Corporation's claim to 60% of these future receipts. The claim is on parity with the claim of the state to the ownership of the remaining 40% of all amounts expected to be paid to the state under the MSA. In addition, the bonds are secured by all earnings on amounts on investments held in certain accounts pledged under the indenture and the amounts held in certain accounts established under the indenture.

The bond indenture states that the Series 2001 Bonds shall not be deemed to be nor constitute a debt or obligation of the state or a pledge of the full faith or credit of the state or any political subdivision thereof. The Corporation has no taxing power. No assets or revenues of the state or any political subdivision thereof is or shall be obligated or pledged to the payment of the principal of or interest on the bonds.

The proceeds of this issue were used for the following:

Payment to the state for 60% of expected MSA proceeds	\$1,069,510,895
Liquidity reserve accounts	103,920,481
Capitalized operating expenses	75,000
Costs of Issuance Account	2,274,000
Underwriters' discount	9,294,328
Original issue discount	17,695,296
Total bond proceeds	\$1,202,770,000

Debt service requirements, including interest to maturity, are as follows:

Fiscal Year	Term Bond Maturities		Sinking Fund Maturities		Turbo Maturities	
	Principal	Interest	Principal	Interest	Principal	Interest
2008		\$60,515,024		\$60,515,024	\$69,930,000	\$60,515,024
2009		60,515,024		60,515,024	58,125,000	56,067,476
2010		60,515,024		60,515,024	63,045,000	52,479,344
2011		60,515,024		60,515,024	68,170,000	49,011,869
2012		60,515,024		60,515,024	73,590,000	45,262,519
2013-2017		302,575,119		302,575,119	463,540,000	155,868,338
2018-2022		302,575,119	\$23,350,000	302,575,119	238,820,000	21,694,317
2023-2027	\$115,425,000	287,893,059		173,195,000		275,868,889
2028-2032	230,390,000	240,527,069		271,110,000		215,947,831
2033-3037		202,512,719		395,465,000		123,021,325
2038-2039	689,405,000	81,005,090	172,100,000	15,114,910		
Total	\$1,035,220,000	\$1,719,663,295	\$1,035,220,000	\$1,537,678,313	\$1,035,220,000	\$440,898,887

Term bond maturities represent the minimum amount of principal that the Corporation must pay as of specific distribution dates to avoid an event of default under the indenture.

Sinking fund maturities represent the amount of principal that the Corporation will pay according to the terms of the indenture. The Corporation is required to make these payments to the extent that funds are available for payment. Failure by the Corporation to make a sinking fund installment according to the terms of the indenture will not constitute an event of default under

the terms of the indenture. The amount of any sinking fund installments made will be credited against term maturities in ascending chronological order.

Turbo maturities represent the requirement contained in the indenture to apply 100% of all collections that are in excess of the funding requirements of the indenture to redemption of the Series 2001 Term Bonds. The amount of any turbo redemption made will be credited against both sinking fund installments and term bond maturities in ascending chronological order.

5. RESTRICTED NET ASSETS

Restricted net assets represent the assets restricted for debt service. The composition of restricted net assets is as follows:

Investments	\$133,171,542
Tobacco settlement receivable	48,804,813
Interest receivable	<u>212,553</u>
Net assets restricted for debt service	<u><u>\$182,188,908</u></u>

6. UNRESTRICTED NET ASSETS (DEFICIT)

On November 7, 2001, the Corporation issued \$1,202,770,000 in Tobacco Settlement Asset-Backed Bonds. During the fiscal year ended June 30, 2002, a total of \$1,069,510,895 was transferred to other funds of the State of Louisiana in accordance with state law. Of the remaining assets related to the bond issuance and other operations of the Corporation at June 30, 2007, a total of \$182,188,908 is restricted for debt service, resulting in a deficit for unrestricted net assets of \$1,016,550,575, as presented on Statement A.

7. TOBACCO SETTLEMENT REVENUES AND RECEIVABLE

Tobacco Settlement Revenues (TSRs) consist of the amounts to be received under the terms of an MSA among participating cigarette manufacturers and 46 states and six other U.S. jurisdictions (Settling States). The MSA is an industry wide settlement of litigation between the Settling States and the Original Participating Manufacturers (OPMs) and was entered into between the attorneys general of the Settling States and the OPMs on November 23, 1998. The MSA provides for other tobacco companies, referred to as Subsequent Participating Manufacturers (SPMs), to become parties to the MSA. The four OPMs together with the 30+ SPMs are referred to as the Participating Manufacturers (PMs). The settlement represents the resolution of a large potential financial liability of the PMs for smoking-related injuries, the cost of which has been borne and will likely to continue to be borne by cigarette consumers. Pursuant to the MSA, the Settling States agreed to settle all their past and future smoking-related claims against the PMs in exchange for agreements and undertakings by the PMs concerning a number of issues. These issues include, among other things, making payments to the Settling States, abiding by more stringent advertising restrictions and funding educational programs, all in

accordance with the terms and conditions set forth in the MSA. Distributors of the PMs are also covered by the settlement of such claims to the same extent as the PMs.

Under the MSA, the PMs are required to pay to the Settling States (i) five initial payments, the first of which was due on November 12, 1999, with the remaining four due on January 10, 2000 through 2003 (Initial Payments); (ii) annual payments required to be made on April 15, commencing April 15, 2000, and continuing in perpetuity (Annual Payments) and (iii) 10 annual payments required to be made on each April 15, commencing April 15, 2008, and continuing through April 15, 2017 (Strategic Contribution Payments). Before forming the Corporation, the PMs made the first of the three required Initial Payments and the Annual Payments due April 15, 2000 and 2001, none of which the Corporation had any right to receive.

The TSRs due under the MSA are subject to numerous adjustments, some of which are material. Such adjustments include, among others, reductions for decreased domestic cigarette shipments, reductions for amounts paid by PMs to four states that had previously settled their claims independently of the MSA, and in the case of Annual Payments and Strategic Contribution Payments, increases related to inflation of not less than 3% per annum. Furthermore, TSRs are subject to a Nonparticipating Manufacturer (NPM) adjustment which may be triggered by, among other occurrences, the determination that the MSA has contributed to market share loss. One of the four OPMs reduced its annual payment due March 31, 2007, in applying this adjustment. The Settling States have not agreed to this adjustment and are engaged in discussions with the OPMs regarding this matter.

Much of the TSRs represent a portion of future sales of tobacco products. Technical Bulletin 2004-1 clarified guidance relating to the recognition of revenues and receivables. Specifically, the bulletin allows for the recognition of revenue to be received based on the shipment of domestic cigarettes. The amount recognized is estimated to be 50% of the next projected payment due from the MSA. Accordingly, the Statement of Net Assets includes an estimated receivable of \$49,017,366.

The composition of accounts receivable is as follows:

Estimated tobacco settlement receivable	\$48,804,813
Interest receivable	<u>212,553</u>
Total accounts receivable	<u><u>\$49,017,366</u></u>

8. ADMINISTRATIVE EXPENSES

The State of Louisiana performs certain accounting, legal, and administrative services for the Corporation for which it receives no compensation. The value of such services was immaterial to the Corporation's financial statements.

9. CONTINGENCIES

Certain smokers, consumer groups, cigarette manufacturers, cigarette importers, cigarette distributors, native American tribes, taxpayers, taxpayers' groups, and other parties have

instituted litigation against various tobacco manufacturers, including the PMs, as well as certain Settling States, including Louisiana, and other public entities. The lawsuits allege, among other things, that the MSA violates certain provisions of the United States Constitution, state constitutions, the federal antitrust laws, federal civil rights laws, state consumer protection laws and unfair competition laws, while other suits allege breach of MSA. These actions, if ultimately successful, could result in a determination that the MSA is void or unenforceable. The lawsuits seek, among other things, an injunction against one or more of the Settling States from collecting any monies under the MSA and barring the PMs from collecting cigarette price increases related to the MSA and/or a determination that the MSA is void or unenforceable. In addition, class action lawsuits have been filed in several federal and state courts alleging that under the federal Medicaid law, any amount of tobacco settlement funds that the Settling States receive in excess of what they paid through the Medicaid program to treat tobacco-related diseases should be paid directly to Medicaid recipients. To date, no such lawsuits have been successful. The enforcement of the terms of the MSA may, however, continue to be challenged in the future. In the event of an adverse court ruling, the Corporation may not have adequate financial resources to make payment on the Series 2001 Term Bonds.

A case challenging the MSA was filed in federal court in Shreveport, Louisiana, on August 2, 2005. This case (*A.B. Coker, et al. v. Charles C. Foti, Jr.*, CV-05-1372 S) raises a multitude of constitutional challenges in an attempt to overturn the MSA. On October 31, 2005, the State of Louisiana filed a motion to dismiss this case. In November 2006, the district judge granted Louisiana's motion to dismiss as a tenth amendment claim but denied the motion as to the other claims. The remaining claims in *Coker* are based on Federal Cigarette Labeling and Advertising Act (FCLAA) preemption and alleged violations of the Commerce, Due Process, and Compact clauses of the federal constitution. The case is in preliminary discovery stages and trial will likely begin in 2008.

This is just the most recent in a string of constitutional challenges to the MSA and related statutes, every one of which has been rejected. See *Star Scientific, Inc v. Beales*, 278 F.3d 339 (4th Cir.), *cert. denied sub nom.* *Star Scientific, Inc. v. Kilgore*, 537 U.S. 818 (2002) (due process, equal protection, Commerce Clause, Compact Clause); *Mariana v. Fisher*, 226 F.Supp.2d 575 (M.D. Pa. 2002), *aff'd on other grounds*, 338 F.3d 189 (3d Cir. 2003), *cert. denied sub nom.* *Mariana v. Pappert*, 540 U.S. 1179 (2004) (Commerce Clause, Compact Clause); *Grand River Enter. Six Nations Ltd. v. Pryor*, 2003 WL 22232974 (S.D.N.Y. Sep. 29, 2003) (Commerce Clause, due process, equal protection, preemption, First Amendment), *vacated in part on other grounds*, 2004 WL 1594869 (S.D.N.Y. Jul. 15, 2004), *appeal pending* (2d Cir. No. 03-9179cv); *Freedom Holdings, Inc. v. Spitzer*, 357 F.3d 205 (2d Cir. 2004) (Commerce Clause); *Forces Action Project, LLC v. State of California*, No. C99-0607MJJ (N.D. Cal. Jan. 15, 2002), *aff'd*, 2003 WL 1900848 (9th Cir. Apr. 17, 2003) (No. 02-15336) (motion to amend complaint to add Commerce Clause claim denied on ground of futility); *Xcaliber Int'l Ltd. v. Ieyoub*, 377 F.Supp.2d 567 (E.D.La. 2005), *appeal pending* (5th Cir. No. 05-30323) (First Amendment, due process, equal protection, Commerce Clause); *Xcaliber Int'l Ltd, LLC v. Edmondson*, No. 04-CV-0922-CVE-PJC (N.D. Okla Apr. 5, 2005), *reconsideration denied* (Aug. 31, 2005) (First Amendment, due process, equal protection,

Commerce Clause); North American Trading Co. v. National Ass'n of Attys Gen'l, Civ. Action No. 01-01600 (D.D.C. Sep. 18, 2001), *aff'd on other grounds*, No. 01-7173 (D.C. Cir. Nov. 25, 2002) (Commerce Clause); Star Scientific, Inc. v. Carter, 2001 WL 1112673 (S.D. Ind. Aug. 20, 2001) (Commerce Clause); PTI, Inc. v. Philip Morris Inc., 100 F. Supp.2d 1179 (C.D. Cal. 2000) (Compact Clause, Commerce Clause, equal protection); Hise v. Philip Morris, Inc., 46 F. Supp.2d 1201 (N.D. Okla. 1999), *aff'd mem.*, 208 F.3d 226 (10th Cir.), *cert. denied*, 531 U.S. 959 (2000) (Compact Clause).

Also, Xcaliber International Limited, LLC vs. Foti (Civil Action No. 04-0069 Section "S" (4) was filed on January 12, 2004, in the United States District Court for the Eastern District of Louisiana whereby plaintiffs are seeking declaratory and injunctive relief regarding the constitutionality of La. 13:5061-5063 (the "Escrow Statutes"), particularly 13:5063 (c)(2)(b) - the allocable share amendment. The plaintiffs allege they are harmed by the MSA and seek to have the MSA declared unconstitutional and an injunction issued against the enforcement of the MSA and related Louisiana statutes. The case is still ongoing and in the discovery phase of the lawsuit. Trial will likely begin in 2008.

The Corporation is also exposed to various risks of loss related to torts, theft of assets, and errors and omissions that could occur in the normal course of business. The Corporation retains the risk of loss in the event of any judgments against it. As of June 30, 2007, no known asserted or unasserted claims or judgments were 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, shall not be subject to any personal liability resulting from carrying out the powers and duties conferred on them pursuant to R.S. 39:99.5 and shall have the indemnification rights provided in R.S. 13:5108.1 with respect to such actions.

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**ANNUAL FISCAL REPORT TO THE OFFICE OF THE GOVERNOR,
DIVISION OF ADMINISTRATION,
OFFICE OF STATEWIDE REPORTING AND ACCOUNTING POLICY**

The following supplementary information presents the financial position of the Tobacco Settlement Financing Corporation as of June 30, 2007, and the results of its operations for the year then ended. The information is presented in the format requested by the Office of Statewide Reporting and Accounting Policy for consolidation into the Louisiana Comprehensive Annual Financial Report.

TOBACCO SETTLEMENT FINANCING CORPORATION
STATE OF LOUISIANA

ANNUAL FISCAL REPORT

JUNE 30, 2007



Tobacco Settlement Financing Corporation
STATE OF LOUISIANA
Annual Financial Statements
June 30, 2007

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MD&A

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- B. Adjustments
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STATE OF LOUISIANA
Annual Financial Statements
Fiscal Year Ending June 30, 2007

Tobacco Settlement Financing Corporation

Division of Administration
Office of Statewide Reporting
and Accounting Policy
P. O. Box 94095
Baton Rouge, Louisiana 70804-9095


Legislative Auditor
P. O. Box 94397
Baton Rouge, Louisiana 70804-9397

Physical Address:
1201 N. Third Street
Claiborne Building, 6th Floor, Suite 130
Baton Rouge, Louisiana 70802

Physical Address:
1600 N. Third Street
Baton Rouge, Louisiana 70802

AFFIDAVIT

Personally came and appeared before the undersigned authority, Jenny Luke LeBlanc (Name)
(Title) of MISSIONER OF ADMINISTRATION (Agency) who duly sworn, deposes and says, that the
financial statements herewith given present fairly the financial position of
(agency) at June 30, 2007 and the results of operations for the year then ended in accordance with policies
and practices established by the Division of Administration or in accordance with Generally Accepted
Accounting Principles as prescribed by the Governmental Accounting Standards Board. Sworn and
subscribed before me, this 7th day of September, 2007.



Signature of Agency Official



NOTARY PUBLIC

Carlos A. Romanach, LA Bar #21051
Notary Public
State of Louisiana

Prepared by: _____

Title: _____

Telephone No.: _____

Date: _____

STATE OF LOUISIANA
Annual Financial Statements
Fiscal Year Ending June 30, 2007

Tobacco Settlement Financing Corporation

Division of Administration
Office of Statewide Reporting
and Accounting Policy
P. O. Box 94095
Baton Rouge, Louisiana 70804-9095

Legislative Auditor
P. O. Box 94397
Baton Rouge, Louisiana 70804-9397

Physical Address:
1201 N. Third Street
Claiborne Building, 6th Floor, Suite 130
Baton Rouge, Louisiana 70802

Physical Address:
1600 N. Third Street
Baton Rouge, Louisiana 70802

AFFIDAVIT

Personally came and appeared before the undersigned authority, _____(Name)
(Title) of _____(Agency) who duly sworn, deposes and says, that the
financial statements herewith given present fairly the financial position of
(agency) at June 30, ___ and the results of operations for the year then ended in accordance with policies
and practices established by the Division of Administration or in accordance with Generally Accepted
Accounting Principles as prescribed by the Governmental Accounting Standards Board. Sworn and
subscribed before me, this _____ day of _____, 20 ____.

Signature of Agency Official

NOTARY PUBLIC

Prepared by: _____

Title: _____

Telephone No.: _____

Date: _____



Postlethwaite & Netterville

A Professional Accounting Corporation
Associated Offices in Principal Cities of the United States
www.pncpa.com

Accountants' Compilation Report

Tobacco Settlement Financing Corporation
State of Louisiana
Baton Rouge, Louisiana

We have compiled the accompanying Annual Fiscal Report containing the financial statements of the governmental activities and the major fund of the Tobacco Settlement Financing Corporation, as of and for the year ended June 30, 2007, which collectively comprise the Corporation's basic financial statements as listed in the table of contents, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management. We have not audited or reviewed the accompanying Annual Fiscal Report containing the financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

The management's discussion and analysis contained in the four pages preceding the basic financial statements (statements A through C) is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have compiled the supplementary information from information that is the representation of management, without audit or review. Accordingly, we do not express an opinion or any other form of assurance on the supplementary information.

Postlethwaite & Netterville

August 27, 2007
Baton Rouge, Louisiana

**TOBACCO SETTLEMENT FINANCING CORPORATION
MANAGEMENT'S DISCUSSION & ANALYSIS
JUNE 30, 2007**

This section of the Tobacco Settlement Financing Corporation's (TSFC) annual financial report represents management's analysis of the TSFC's financial performance during the fiscal year ended June 30, 2007 in comparison to that of the previous fiscal year. Please read it in conjunction with the financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

- The TSFC's net asset deficit decreased \$34,680,108, or 3.99% to 834,247,773 as of June 30, 2007. This represents the net financial position of the corporation on the full accrual basis of accounting. On the modified accrual basis, \$133,643,004 of fund balance is available for debt service and operations.
- The revenues of the TSFC increased \$17,435,126, or 21.75%.
- The expenses of the TSFC decreased \$1,304,909, or 2.03%.

The TSFC was formed in 2006 by an act of the Louisiana Legislature for the purpose of purchasing Tobacco Settlement Revenues (TSRs) from the State of Louisiana. This purchase was financed by the issuance of bonds. The TSRs consist of amounts to be collected as part of a Master Settlement Agreement (MSA) between cigarette manufacturers (PMs) and 46 states and other U.S. jurisdictions (Settling States). Under the MSA, the PMs are required to pay the Settling States annual payments in perpetuity.

Much of the TSRs represent a portion of future sales of tobacco products, and under generally accepted accounting principles (GAAP), such contingent amounts can be recognized as a receivable and revenue when the domestic sale of tobacco products is known. Under the modified accrual basis of accounting, revenue should be recognized to the extent that the event occurs and resources become available.

OVERVIEW OF THE FINANCIAL STATEMENTS

These financial statements consist of two sections – Management's Discussion and Analysis (this section) and the basic financial statements (including the notes to the financial statements).

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The Statement of Net Assets and the Statement of Activities are two basic financial statements that report information about the TSFC as a whole using a long-term economic resources focus. The data is reported using the accrual basis of accounting, and provides insight as to the TSFC's total financial position and whether or not the TSFC's total financial position has improved as a result of the current year's activities.

TOBACCO SETTLEMENT FINANCING CORPORATION
MANAGEMENT'S DISCUSSION & ANALYSIS
JUNE 30, 2007

GOVERNMENT-WIDE FINANCIAL STATEMENTS (continued)

Comparative condensed Statements of Net Assets and Activities for 2007 and 2006 are as follows:

**Statement of Net Assets
June 30, 2007 and 2006**

	June 30, 2007	June 30, 2006
Current assets	\$ 276,909	\$ 259,581
Noncurrent assets	208,174,076	200,309,790
Total assets	208,450,985	200,569,371
Current liabilities	77,408,758	51,032,251
Noncurrent liabilities	965,290,000	1,018,465,000
Total liabilities	1,042,698,758	1,069,497,251
Net assets - restricted for debt service	182,188,908	173,549,725
Net assets (deficit) - unrestricted	(1,016,436,681)	(1,042,477,605)
Total net assets (deficit)	\$ (834,247,773)	\$ (868,927,880)

**Statement of Activities
For the Years Ended June 30, 2007 and 2006**

	June 30, 2007	June 30, 2006
Revenues	\$ 97,583,195	\$ 80,148,069
Expenses	(62,903,087)	(64,207,996)
Change in net assets (deficit)	\$ 34,680,108	\$ 15,940,073

The net asset deficit is a result of bonds payable and other liabilities exceeding recognized assets. The bonds are recognized as a liability, while the resources to repay the bonds - the future TSR's, - are not recognized as assets until the underlying sales of tobacco products are known.

TOBACCO SETTLEMENT FINANCING CORPORATION
MANAGEMENT'S DISCUSSION & ANALYSIS
JUNE 30, 2007

GOVERNMENT-WIDE FINANCIAL STATEMENTS (continued)

Revenues of the Corporation increased from prior year due to several reasons. Firstly, the TSR collection depend upon sales of cigarettes which will vary from year to year. Secondly, the corporation collected TSR's related to prior years which had previously been withheld by one of the four original participating manufacturers because of an asserted loss of market share. Thirdly, the master settlement agreement calls for a stream of payments to commence in 2008, identified in the settlement agreement as the "strategic contribution payments". The strategic contribution payment due in 2008 is based upon 2007 cigarette sales, and therefore a portion of the 2008 strategic contribution payment is recorded as revenue for this fiscal year in accordance with GASB technical bulletin 2004-1.

Expenses of the Corporation decreased due to decreased interest expense as the bonds are retired.

FUND FINANCIAL STATEMENTS

The fund financial statements provide detailed information about the TSFC as a debt service fund. A fund is a fiscal and accounting entity with a self-balancing set of accounts that the TSFC uses to keep track of specific sources of funding and spending for a particular purpose.

As a debt service fund, all of the TSFC's transactions are reported in the Governmental Fund Financial Statements. 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. This approach applies a flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the TSFC's finances that assist in determining whether there will be adequate financial resources available to meet the current needs of the TSFC.

Because the focus of governmental funds is narrower than that of the governmental-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the governmental-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the Governmental Funds Balance Sheet and the Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balance provide a reconciliation to facilitate this comparison between the governmental funds and the governmental activities. These reconciliations are presented in the adjustment column in each of the financial statements.

LONG-TERM DEBT ACTIVITY

At June 30, 2007, the TSFC has \$1,035,220,000 in outstanding debt. The TSFC made bond payments totaling \$26,590,000 during the year ended June 30, 2007. A description of this long-term debt activity is located at note 4. The Corporation's bonds carried a BBB negative rating from Standard and Poors as of June 30, 2007.

**TOBACCO SETTLEMENT FINANCING CORPORATION
MANAGEMENT'S DISCUSSION & ANALYSIS
JUNE 30, 2007**

**CONTACTING THE TOBACCO SETTLEMENT
FINANCING CORPORATION'S MANAGEMENT**

This financial report is designed to provide a general overview of the TSFC finances and to demonstrate the TSFC's accountability for the money it receives. If you have any questions about this report or need additional information, contact the Tobacco Settlement Financing Corporation, P.O. Box 44154, Baton Rouge LA 70804.

STATE OF LOUISIANA
 TOBACCO SETTLEMENT FINANCING CORPORATION
 STATEMENT OF NET ASSETS AND GOVERNMENTAL FUNDS BALANCE SHEET
 AS OF JUNE 30, 2007

	<u>Debt Service Fund</u> (modified accrual)	<u>Adjustments</u> (Note B)	<u>Statement of Net Assets</u> (full accrual)
ASSETS:			
Current Assets:			
Cash and cash equivalents (Note C1)	\$ 276,909	\$ -	\$ 276,909
Investments (Note C2)	133,171,542	(133,171,542)	-
Receivables (net) (Note M)	212,553	(212,553)	-
Due from other funds (Note P)	-	-	-
Other current assets	-	-	-
Total current assets	133,661,004	(133,384,095)	276,909
Non-current Assets:			
Restricted assets:			
Cash and cash equivalents (Note C1)	-	-	-
Investments (Note C2)	-	133,171,542	133,171,542
Receivables (net) (Note M)	-	49,017,366	49,017,366
Other non-current assets	-	25,985,168	25,985,168
Total non-current assets	-	208,174,076	208,174,076
TOTAL ASSETS	\$ 133,661,004	\$ 74,789,981	\$ 208,450,985
LIABILITIES:			
Current liabilities:			
Accounts payable and accruals (Note N)	\$ 18,000	\$ -	\$ 18,000
Contracts and retainage payable	-	-	-
Due to other funds (Note P)	-	-	-
Bonds payable	-	69,930,000	69,930,000
Claims and litigation	-	-	-
Other current liabilities	-	7,460,758	\$ 7,460,758
Total current liabilities	18,000	77,390,758	77,408,758
Non-current liabilities: (Note F)			
Contracts payable	-	-	-
Bonds payable	-	965,290,000	965,290,000
Claims and litigation	-	-	-
Other non-current liabilities	-	-	-
Total non-current liabilities	-	-	-
TOTAL LIABILITIES	18,000	1,042,680,758	1,042,698,758
FUND BALANCE/NET ASSETS:			
Fund Balance:			
Reserved	133,643,004	(133,643,004)	-
Designated	-	-	-
Unreserved, undesignated	-	-	-
TOTAL FUND BALANCE	133,643,004	(133,643,004)	-
TOTAL LIABILITIES AND FUND BALANCE	\$ 133,661,004		
Net Assets:			
Restricted for:			
Debt service		182,188,908	182,188,908
Other specific purposes		-	-
Unrestricted		(1,016,436,681)	(1,016,436,681)
Total net assets		\$ (834,247,773)	\$ (834,247,773)

The accompanying notes are an integral part of this statement

STATE OF LOUISIANA
 TOBACCO SETTLEMENT FINANCING CORPORATION
 STATEMENT OF REVENUES EXPENDITURES, AND CHANGES IN FUND BALANCES
 FOR THE YEAR ENDED JUNE 30, 2007

	<u>Debt Service</u> <u>Fund</u> (modified accrual)
REVENUES:	
Intergovernmental revenues	\$ -
Taxes	-
Tobacco settlement	82,868,340
Use of money and property	-
Licenses, permits, and fees	-
Sales of commodities and services	-
Other	6,074,705
Total revenues	88,943,045
EXPENDITURES:	
Intergovernmental	-
Capital outlay	-
Debt service:	-
Principal retirement	26,590,000
Interest and fiscal charges	62,206,147
Amortization	-
Other	130,536
Total expenditures	88,926,683
Excess (deficiency) of revenues over expenditures	16,362
Other financing sources(uses):	
Payments to refunded bond escrow agent	-
Proceeds from issuance of long-term debt	-
Other	-
Transfers from other funds	-
Transfers to other funds	-
Total other financing sources(uses)	-
Net change in fund balances	16,362
Fund Balance at beginning of year	133,626,642
Fund Balance at end of year	\$ 133,643,004

The accompanying notes are an integral part of this statement

INSTRUCTIONS FOR THE SIMPLIFIED STATEMENT OF ACTIVITIES

These instructions are designed to report the operations/activities of your agency using the full accrual basis of accounting.

Expenses – include all expenses, both operating and non-operating.

Program Revenues – include revenues derived from the program itself. These revenues reduce the net cost of activities that must be financed from general revenues. Program revenues should be reported in the following three categories:

Charges for services - include revenues based on exchange or exchange-like transactions. (An exchange transaction is one in which each party receives and gives up essentially equal values.) These revenues arise from charges to customers or applicants who purchase, use, or directly benefit from the goods, services, or privileges provided. Revenues in this category include fees charged for specific services.

Operating grants and contributions - revenue arising from mandatory and voluntary nonexchange transactions with other governments, organizations, or individuals that are restricted for use in a particular program and that may be used **either for operating or capital expenses** at the discretion of the grantee. (A non-exchange transaction is one in which an entity gives or receives value without directly receiving or giving equal value in return.)

Capital grants and contributions – revenue arising from mandatory and voluntary nonexchange transactions with other governments, organizations, or individuals that are restricted for use in a particular program and that are **restricted for capital purposes only** - to purchase, construct, or renovate capital assets associated with a specific program.

Net (Expense) Revenue - Program revenues minus expenses.

General Revenues – all revenues are general revenues unless they are specifically required to be reported as program revenues.

Taxes – include all taxes received here, as all are considered general revenues, even those levied for a specific purpose.

State appropriations - include warrants drawn during the fiscal year and the 13th period, plus 14th period if applicable.

Grants and contributions not restricted to specific programs – revenue arising from mandatory and voluntary nonexchange transactions with other governments, organizations or individuals that are not restricted to a specific program.

Interest – any interest earned that is not required to be reported as program revenue (earnings on investments legally restricted to use by a specific program should be reported as program revenue).

Miscellaneous - any general revenues that do not specifically fall under one of the categories listed.

STATE OF LOUISIANA
 TOBACCO SETTLEMENT FINANCING CORPORATION
 SIMPLIFIED STATEMENT OF ACTIVITIES
 FOR THE YEAR ENDED JUNE 30, 2007

(full accrual)

	Program Revenues				Net (Expense) Revenue and Changes in Net Assets
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	
Entity	\$ 62,903,087	\$ _____	\$ _____	\$ _____	62,903,087
General revenues:					
Taxes					
State appropriations					
Grants and contributions not restricted to specific programs					
Interest					6,074,705
Tobacco Settlement Revenue					91,508,490
Other					
Special items					
Transfers					
Total general revenues, special items, and transfers					97,583,195
Change in net assets					34,680,108
Net assets – beginning as restated (Note R2)					(868,927,881)
Net assets – ending					\$ (834,247,773)

The accompanying notes are an integral part of this statement

STATE OF LOUISIANA
TOBACCO SETTLEMENT FINANCING CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2007

INTRODUCTION

The Tobacco Settlement Financing Corporation was created by the Louisiana State Legislature under the provisions of Louisiana Revised Statutes 39:99.1 through 39:99.20. The following is a brief description of the operations of Tobacco Settlement Financing Corporation:

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Basis of Accounting

In April of 1984, the Financial Accounting Foundation established the Governmental Accounting Standards Board (GASB) to promulgate generally accepted accounting principles and reporting standards with respect to activities and transactions of state and local governmental entities. The GASB has issued a Codification of Governmental Accounting and Financial Reporting Standards (GASB Codification). This codification and subsequent GASB pronouncements are recognized as generally accepted accounting principles for state and local governments. The accompanying financial statements have been prepared in accordance with such principles.

The accompanying financial statements of net assets and activities present information only as to the transactions of the programs of the TSFC as authorized by Louisiana statutes and administrative regulations. The accounts of the corporation are maintained in accordance with applicable statutory provisions and the regulations of the Division of Administration – Office of Statewide Reporting and Accounting Policy.

Basis of accounting refers to when revenues and expenses are recognized and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied. The accompanying government-wide financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. The accompanying governmental funds financial statements are presented using the current financial resources measurement focus and the modified accrual basis of accounting.

B. ADJUSTMENTS

The adjustments column represents the changes necessary to convert a Governmental Fund's Balance Sheet, reported on the modified accrual basis of accounting, to its Government-Wide Statement of Net Assets required by GASB Statement 34 and reported on the full accrual basis of accounting. The Statement of Revenue, Expenditures, and Changes in Fund Balances (modified accrual) does not contain an adjustments column showing the conversion of the fund level to the government-wide level because of the differences between it and the Simplified Statement of Activities (full accrual).

Schedule 5, "SCHEDULE OF ADJUSTING ENTRIES, Modified Accrual to Full Accrual Basis Reporting" provides a complete list of adjustments necessary to convert to the full accrual basis of accounting from the modified accrual basis of accounting.

C. DEPOSITS WITH FINANCIAL INSTITUTIONS AND INVESTMENTS (If all entity cash and investments are deposited in the State Treasury, disregard Note C.)

1. Deposits with Financial Institutions

For reporting purposes, deposits with financial institutions include savings, demand deposits, time deposits, and certificates of deposit. Further, the TSFC may invest in time certificates of deposit in any bank domiciled or having a branch office in the state of Louisiana; savings accounts or shares of savings and loan associations and savings banks; and in share accounts and share certificate accounts of federally or state chartered credit unions.

As reflected on the Statement of Net Assets, the entity had deposits in bank accounts per bank totaling \$276,909 at June 30, 2007. Deposits in bank accounts are stated at cost, which approximates market. Under state law these deposits must be secured by federal deposit insurance or the pledge of securities owned by the fiscal agent bank. The market value of the pledged securities plus the federal deposit insurance must at all times equal the amount on deposit with the fiscal agent. These pledged securities are held in the name of the pledging fiscal agent bank in a holding or custodial bank in the form of safekeeping receipts held by the state treasurer.

STATE OF LOUISIANA
 TOBACCO SETTLEMENT FINANCING CORPORATION
 NOTES TO THE FINANCIAL STATEMENTS
 FOR THE YEAR ENDED JUNE 30, 2007

GASB Statement 40, which amended GASB Statement 3, to eliminate the requirement to disclose all deposits by the three categories of risk. GASB Statement 40 requires only the disclosure of deposits that are considered to be exposed to custodial credit risk. An entity's deposits are exposed to custodial credit risk if the deposit balances are either 1) uninsured and uncollateralized, 2) uninsured and collateralized with securities held by the pledging financial institution, or 3) uninsured and collateralized with securities held by the pledging financial institution's trust department or agent, but not in the entity's name.

The deposits at June 30, 2007, consisted of the following:

	<u>Cash</u>	<u>Certificates of Deposit</u>	<u>Other (Describe)</u>	<u>Total</u>
Deposits per Statement of Net Assets (SNA)	\$ 276,909	\$ _____	\$ _____	\$ 276,909.00
Deposits in Bank Accounts Per Bank	\$ 276,909	\$ _____	\$ _____	\$ 276,909.00
Deposits in Bank Accounts Per Bank Exposed to Custodial Credit Risk:				
a. Uninsured and uncollateralized	176,909	_____	_____	176,909.00
b. Uninsured and collateralized with securities held by the pledging institution	_____	_____	_____	-
c. Uninsured and collateralized with securities held by the pledging institution's trust department or agent, but not in the entity's name	_____	_____	_____	-
Total Bank Balances of All Deposits Regardless of Custodial Credit Risk	\$ 276,909.00	\$ _____	\$ _____	\$ 276,909.00

Note: The "Deposits in Bank Accounts Per Bank" will not necessarily equal the "Cash and Cash Equivalents per Statement of Net Assets (SNA)".

Cash in State Treasury and petty cash must not be reported in the note disclosure. However, to aid in reconciling amounts reported on the Statement of Net Assets to amounts reported in this note, list below any cash in treasury and petty cash that are included in the Statement of Net Assets.

Cash in State Treasury	\$ <u>N/A</u>
Petty cash	\$ <u>N/A</u>

The following is a breakdown by banking institution, program, *account number, and amount of the "Deposits in Bank Accounts per Bank" balances shown above:

<u>Banking institution</u>	<u>Program</u>	<u>Amount</u>
1. Chase Bank	none	\$ 276,909
2. _____	_____	_____
3. _____	_____	_____
4. _____	_____	_____
Total		\$ 276,909

*(Account numbers are not required. However, if you have more than one account at a single institution, you should identify each account separately, such as "Account A", "Account B", or some similar designation that does not involve the actual account number.)

STATE OF LOUISIANA
 TOBACCO SETTLEMENT FINANCING CORPORATION
 NOTES TO THE FINANCIAL STATEMENTS
 FOR THE YEAR ENDED JUNE 30, 2007

2. Investments

The Tobacco Settlement Financing Company does maintain investment accounts as authorized by R.S. 39:99.6(E).

Custodial Credit Risk

Investments can be exposed to custodial credit risk if the securities underlying the investment are uninsured, not registered in the name of the entity, and are held by either the counterparty or the counterparty's trust department or agent but not in the entity's name. Repurchase agreements are not subject to credit risk if the securities underlying the repurchase agreement are exempt from credit risk disclosure. Using the table below, list each type of investment disclosing the carrying amount, market value, and applicable category of risk.

GASB Statement 40, which amended GASB Statement 3, eliminated the requirement to disclose all investments by the three categories of risk. GASB Statement 40 requires only the separate disclosure of investments that are considered to be exposed to custodial credit risk. Those investments exposed to custodial credit risk are reported by type in one of two separate columns depending upon whether they are held by a counterparty, or held by a counterparty's trust department or agent not in the entity's name. In addition, the total reported amount and fair value columns must be reported for total investments regardless of exposure to custodial credit risk. Using the table below, list each type of investment disclosing the carrying amount, market value, and applicable category of risk.

Type of Investment	Investments Exposed to Custodial Credit Risk		All Investments Regardless of Custodial Credit Risk Exposure	
	Uninsured, *Unregistered, and Held by Counterparty	Uninsured, *Unregistered, and Held by Counterparty's Trust Dept. or Agent not in Entity's Name	Reported Amount Per Balance Sheet	Fair Value
Repurchase agreements	\$ _____	\$ _____	\$ _____	\$ _____
U.S. Government Securities	_____	_____	_____	_____
U.S. Agency Obligations	_____	_____	_____	_____
Common & preferred stock	_____	_____	_____	_____
Commercial paper	_____	_____	104,435,540	104,435,540
Corporate bonds	_____	_____	_____	_____
Other: Money Markets	_____	_____	28,736,002	28,736,002
	_____	_____	_____	_____
	_____	_____	_____	_____
	_____	_____	_____	_____
	_____	_____	_____	_____
Total investments	\$ _____ -	\$ _____ -	\$ 133,171,542	\$ 133,171,542

*unregistered – not registered in the name of the government or entity

3. Derivatives

The institution does not invest in derivatives as part of its investment policy. Accordingly, the exposure to risks from these investments is as follows:

credit risk	N/A	_____
market risk	N/A	_____
legal risk	N/A	_____

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 TOBACCO SETTLEMENT FINANCING CORPORATION
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 FOR THE YEAR ENDED JUNE 30, 2007

Technical Bulletin 2003-1 requires certain note disclosures for derivatives that are not reported at fair value on the Statement of Net Assets. See Appendix for more details and disclose any of these required note disclosures below, if applicable.

4. Credit Risk, Concentration of Credit Risk, Interest Rate Risk, and Foreign Currency Risk Disclosures

A. Credit Risk of Debt Investments

Disclose the credit risk of debt investments by credit quality ratings as described by rating agencies as of the fiscal year end, including the rating agency used (Moody's, S&P, etc.). All debt investments regardless of type can be aggregated by credit quality rating (if any are un-rated, disclose that amount)

Rating Agency	Rating	Fair Value
Standard & Poor's	AAAm	\$ 28,736,002
Standard & Poor's	A-1+	104,435,540
	Total	\$ 133,171,542

B. Interest rate Risk

1. Disclose the interest rate risk of debt investments by listing the investment type, total fair value, and breakdown of maturity in years for each debt investment type. (Note – This is the prescribed method, segmented time distribution, for the CAFR. Also, total debt investments reported in this table should equal total debt investments reported in Section A – Credit Risk of Debt Investments.)

Type of Debt Investment	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 - 5	6 - 10	Greater Than 10
U.S. Government obligations	\$	\$	\$	\$	\$
U.S. Agency obligations					
U.S. Treasury obligations					
Mortgage backed securities					
Collateralized mortgage obligations					
Corporate bonds					
Other bonds					
Commercial Paper	104,435,540	104,435,540			
Other: Money Markets	28,736,002	28,736,002			
Total debt investments	\$ 133,171,542	\$ 133,171,542	\$ -	\$ -	\$ -

2. List the fair value and terms of any debt investments that are highly sensitive to changes in interest rates due to the terms of the investment (eg. coupon multipliers, reset dates, etc.). See Appendix for examples of debt investments that are highly sensitive to changes in interest rates.

STATE OF LOUISIANA
 TOBACCO SETTLEMENT FINANCING CORPORATION
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<u>Debt Investment</u>	<u>Fair Value</u>	<u>Terms</u>
N/A	N/A	
Total	\$ -	

C. Concentration of Credit Risk

List, by issuer and amount, investments in any one issuer that represents 5% or more of total investments (not including U.S. government securities, mutual funds, and external investment pools).

<u>Issuer</u>	<u>Amount</u>	<u>% of Total Investments</u>
JPM US Government MMKT Fund	\$ 28,736,002	21.60%
Societe Generale	89,671,010	67.30%
Briarwood CP Trust	14,608,925	11.00%
Total	\$ 133,015,937	

D. Foreign Currency Risk

Disclose the U.S. dollar balances of any deposits or investments that are exposed to foreign currency risk (deposits or investments denominated in foreign currencies). List by currency denomination and investment type, if applicable.

<u>Foreign Currency</u>	<u>Fair Value in U.S. Dollars</u>	
	<u>Bonds</u>	<u>Stocks</u>
N/A	\$ -	\$ -
Total	\$ -	\$ -

5. Policies

Briefly describe the deposit and/or investment policies related to the custodial credit risk, credit risk of debt investments, concentration of credit risk, interest rate risk, and foreign currency risk disclosed in this note. If no policy exists concerning the risks disclosed, please state that fact.

No formal policy is maintained.

6. Other Disclosures Required for Investments N/A

- a. Investments in pools managed by other governments or mutual funds _____
- b. Securities underlying reverse repurchase agreements _____

STATE OF LOUISIANA
TOBACCO SETTLEMENT FINANCING CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2007

- c. Unrealized investment losses _____
- d. Commitments as of June 30, 2007, to resell securities under yield maintenance repurchase agreements:
 - 1. Carrying amount and market value at June 30 of securities to be resold _____
 - 2. Description of the terms of the agreement _____
- e. Losses during the year due to default by counterparties to deposit or investment transactions _____
- f. Amounts recovered from prior-period losses that are not shown separately on the SNA _____

Legal or Contractual Provisions for Reverse Repurchase Agreements N/A

- g. Source of legal or contractual authorization for use of reverse repurchase agreements _____
- h. Significant violations of legal or contractual provisions for reverse repurchase agreements that occurred during the year _____

Reverse Repurchase Agreements as of the SNA Date N/A

- i. Credit risk related to the reverse repurchase agreements (other than yield maintenance agreements) outstanding at the SNA date, that is, the aggregate amount of reverse repurchase agreement obligations including accrued interest compared to aggregate market value of the securities underlying those agreements including interest _____
- j. Commitments on June 30, 20____, to repurchase securities under yield maintenance agreements _____
- k. Market value on June 30, 20____, of the securities to be repurchased _____
- l. Description of the terms of the agreements to repurchase _____
- m. Losses recognized during the year due to default by counter parties to reverse repurchase agreements _____
- n. Amounts recovered from prior-period losses that are not separately shown on the operating statement _____

Fair Value Disclosures N/A

- o. Methods and significant assumptions used to estimate fair value of investments, if fair value is not based on quoted market prices _____
- p. Basis for determining which investments, if any, are reported at amortized cost _____
- q. For investments in external investment pools that are not SEC-registered, a brief description of any regulatory oversight for the pool _____
- r. Whether the fair value of your investment in the external investment pool is the same as the value of the pool shares _____

STATE OF LOUISIANA
 TOBACCO SETTLEMENT FINANCING CORPORATION
 NOTES TO THE FINANCIAL STATEMENTS
 FOR THE YEAR ENDED JUNE 30, 2007

- s. Any involuntary participation in an external investment pool _____
- t. If you are unable to obtain information from a pool sponsor to determine the fair value of your investment in the pool, methods used and significant assumptions made in determining that fair value and the reasons for having had to make such an estimate _____
- u. Any income from investments associated with one fund that is assigned to another fund _____

D. CAPITAL ASSETS – INCLUDING ASSETS ACQUIRED BY CAPITAL LEASE

N/A

The fixed assets used in the Special Purpose Government are included on the balance sheet and are capitalized at cost. Depreciation of all exhaustible fixed assets used by the entity is charged as an expense against operations. Accumulated depreciation is reported on the balance sheet. Depreciation for financial reporting purposes is computed by the straight-line method over the useful lives of the assets.

	For the year ended June 30, 2007						Balance 6/30/2007
	Balance 6/30//2006	Prior Period Adjustment	Adjusted Balance 6/30/2006	Additions	Transfers* Retirements	Retirements	
Capital assets not being depreciated:							
Land	\$	\$	\$	\$	\$	\$	\$
Non-depreciable land improvements							
Capitalized collections							
Construction in progress							
Total capital assets not being depreciated	\$	\$	\$	\$	\$	\$	\$
Other capital assets							
Furniture, fixtures, and equipment	\$	\$	\$	\$	\$	\$	\$
Less accumulated depreciation							
Total furniture, fixtures, and equipment							
Buildings and improvements							
Less accumulated depreciation							
Total buildings and improvements							
Depreciable land improvements							
Less accumulated depreciation							
Total depreciable land improvements							
Infrastructure							
Less accumulated depreciation							
Total infrastructure							
Total other capital assets	\$	\$	\$	\$	\$	\$	\$
Capital asset summary:							
Capital assets not being depreciated	\$	\$	\$	\$	\$	\$	\$
Other capital assets, at cost							
Total cost of capital assets							
Less accumulated depreciation							
Capital assets, net	\$	\$	\$	\$	\$	\$	\$

*Should be used only for those completed projects coming out of construction-in-progress into fixed assets; not associated with transfers reported elsewhere in the packet.

STATE OF LOUISIANA
 TOBACCO SETTLEMENT FINANCING CORPORATION
 NOTES TO THE FINANCIAL STATEMENTS
 FOR THE YEAR ENDED JUNE 30, 2007

E. RESTRICTED ASSETS

Restricted assets at June 30, 2007, reflects \$182,188,908 in the non-current assets section on Statement A, and consists of \$133,171,542 in investments in money markets and commercial paper, \$212,553 in accrued interest receivable, and \$48,804,813 in tobacco settlement receivable. The restricted net assets represent the assets restricted for debt service.

F. LONG-TERM LIABILITIES

The following is a summary of long-term debt transactions for the year ended June 30, 2007:

	Balance June 30, 2006	Year ended June 30, 2007		Balance at June 30, 2007	Amounts due within one year
		Additions	Reductions		
Bonds:					
Bonds payable	\$ 1,061,810,000	\$ -	\$ 26,590,000	\$ 1,035,220,000	\$ 69,930,000
Total bonds	<u>1,061,810,000</u>	<u>-</u>	<u>26,590,000</u>	<u>1,035,220,000</u>	<u>69,930,000</u>
Other liabilities:					
Contracts payable					
Claims and litigation					
Other long-term liabilities					
Total other liabilities	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total long-term liabilities	<u>\$ 1,061,810,000</u>	<u>\$ -</u>	<u>\$ 26,590,000</u>	<u>\$ 1,035,220,000</u>	<u>\$ 69,930,000</u>

A detailed summary, by issue, of all debt outstanding at June 30, 2007, including outstanding interest of \$7,460,756 is shown on Schedule 3-B. Schedule 4-D is an amortization schedule of the out-standing debt. (Send OSRAP a copy of the amortization schedule for any new debt issued.)

G. LITIGATION

1. The _____ is a defendant in litigation seeking damages as follows:

Date of Action	Description of Litigation and Probable outcome Reasonably possible or Probable	Primary Attorney	Estimated Settlement Amt. for Claims & Litigation (opinion of legal counsel)	Insurance Coverage
08/02/05	A.B. Coker vs Charles Foti undeterminable	Attorney General	\$ N/A	\$ N/A
09/22/99	US vs Tobacco Companies	US Attorneys	N/A	N/A
08/12/04	Xcaliber Intl. Limited LLC vs. Foti undeterminable	Attorney General	N/A	
Totals			\$ -	\$ -

Our legal advisor estimates that potential claims not covered by insurance would affect the financial statement as follows (would not materially affect the financial statements or is unable to estimate the effect on the financial statement): N/A

2. Claims and litigation costs of \$ N/A were incurred in the current year and are reflected in the accompanying financial statement.

H. RELATED PARTY TRANSACTIONS **N/A**

FASB 57 requires disclosure of the description of the relationship, the transaction(s), the dollar amount of the transaction(s) and any amounts due to or from which result from related party transactions. List all related party transactions.

I. ACCOUNTING CHANGES **N/A**

Accounting changes made during the year involved a change in accounting _____ (principle, estimate, error or entity). The effect of the change is being shown in _____.

J. IN-KIND CONTRIBUTIONS **N/A**

(List all in-kind contributions that are not included in the accompanying financial statements.)

<u>In-Kind Contributions</u>	<u>Cost/Estimated Cost/Fair Market Value/As Determined by the Grantor</u>
_____	\$ _____
_____	_____
_____	_____
_____	_____
_____	_____
Total	\$ _____

K. DEFEASED ISSUES **N/A**

In _____, 20____, the _____, issued \$_____ of taxable/nontaxable bonds. The purpose of the issue was to provide monies to advance refund portions of _____ bonds. In order to refund the bonds, portions of the proceeds of the new issue \$_____, plus an additional \$_____ of sinking fund monies together with certain other funds and/or securities, were deposited and held in an escrow fund created pursuant to an escrow deposit agreement dated _____ between the _____ and the escrow trustee. The amount in the escrow, together with interest earnings, will be used to pay the principal, redemption premium, and interest when due. The refunding resulted in reducing the total debt service payments by almost \$_____ and an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$_____.

L. VIOLATIONS OF FINANCE-RELATED LEGAL OR CONTRACTUAL PROVISIONS **N/A**

At _____ (fiscal year end) _____ was not in compliance with the provisions of _____ Bond Reserve Covenant that requires _____. The _____ did _____ to correct this deficiency.

STATE OF LOUISIANA
 TOBACCO SETTLEMENT FINANCING CORPORATION
 NOTES TO THE FINANCIAL STATEMENTS
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M. DISAGGREGATION OF RECEIVABLE BALANCES

Receivables at June 30, 2007, were as follows:

Activity	Customer Receivables	Taxes	Receivables from other Governments	Other Receivables	Total Receivables
Tobacco Settlement Receivable	\$ _____	\$ _____	\$ _____	\$ 48,804,813	\$ 48,804,813
Interest Receivable	_____	_____	_____	212,553	212,553
Gross receivables	\$ _____	\$ _____	\$ _____	\$ 49,017,366	\$ 49,017,366
Less allowance for uncollectible accounts	_____	_____	_____	_____	_____
Receivables, net	\$ _____	\$ _____	\$ _____	\$ 49,017,366	\$ 49,017,366

Amounts not scheduled
for collection during the
subsequent year

\$ _____	\$ _____	\$ _____	\$ _____	\$ _____	\$ _____
----------	----------	----------	----------	----------	----------

N. DISAGGREGATION OF PAYABLE BALANCES

Payables at June 30, 2007, were as follows:

Activity	Vendors	Salaries and Benefits	Accrued Interest	Other Payables	Total Payables
Operating	\$ Various	\$ _____	\$ _____	\$ 8,000	\$ 8,000
Operating	State of Louisiana	_____	_____	10,000	10,000
Total	\$ _____	\$ _____	\$ _____	\$ 18,000	\$ 18,000

O. SUBSEQUENT EVENTS

N/A

[Disclose any material event(s) affecting financial operations occurring between the close of the fiscal period and issuance of the financial statement.]

P. DUE TO/DUE FROM AND TRANSFERS

N/A

1. List by fund type the amounts due from other funds detailed by individual fund at your fiscal year end:

Type of Fund	Name of Fund	Amount
_____	_____	\$ _____
_____	_____	_____
Total due from other funds	_____	\$ _____

STATE OF LOUISIANA
 TOBACCO SETTLEMENT FINANCING CORPORATION
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2. List by fund type the amounts due to other funds detailed by individual fund at fiscal year end:

Type of Fund	Name of Fund	Amount
_____	_____	\$ _____
_____	_____	_____
_____	_____	_____
Total due to other funds		\$ _____

3. List by fund type all transfers from other funds for the fiscal year:

Type of Fund	Name of Fund	Amount
_____	_____	\$ _____
_____	_____	_____
_____	_____	_____
Total transfers from other funds		\$ _____

4. List by fund type all transfers to other funds for the fiscal year:

Type of Fund	Name of Fund	Amount
_____	_____	\$ _____
_____	_____	_____
_____	_____	_____
Total transfers to other funds		\$ _____

Q. LIABILITIES PAYABLE FROM RESTRICTED ASSETS

Liabilities payable from restricted assets at June 30, 2007, are \$77,408,758 in the current liabilities section on Statement A, and consist of \$18,000 in accounts payable, \$69,930,000 in the current portion of bonds payable, and \$7,460,758 in accrued interest payable.

Liabilities payable from restricted assets at June 30, 2007, are \$965,290,000 in the non-current liabilities section on Statement A, and consist of \$0 in accounts payable, and \$965,290,000 in the long term portion of bonds payable.

R. PRIOR-YEAR RESTATEMENT OF FUND BALANCE/NET ASSETS N/A

The following adjustments were made to restate beginning fund balance/net assets for June 30, 20__.

1. Modified Accrual:

Ending fund balance 6/30/06 as reported to OSRAP on PY AFR	Adjustments to ending fund balance 6/30/06 (after AFR was submitted to OSRAP) + or (-)	Restatements (Adjustments to beg. balance 7/1/06) + or (-)	Beg fund balance @ 7/1/06 as restated
\$ _____	\$ _____	\$ _____	\$ _____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

Each adjustment must be explained below in detail.

STATE OF LOUISIANA
 TOBACCO SETTLEMENT FINANCING CORPORATION
 NOTES TO THE FINANCIAL STATEMENTS
 FOR THE YEAR ENDED JUNE 30, 2007

2. Full Accrual:

Ending Net Assets 6/30/06 as reported to OSRAP on PY AFR	Adjustments to ending net assets 6/30/06 (after AFR was submitted to OSRAP) + or (-)	Restatements (Adjustments to beg. balance 7/1/06) + or (-)	Beg net assets @ 7/1/06 as restated
\$ _____	\$ _____	\$ _____	\$ -
_____	_____	_____	-
_____	_____	_____	-
_____	_____	_____	-
_____	_____	_____	-

Each adjustment must be explained below in detail.

STATE OF LOUISIANA
Tobacco Settlement Financing Corporation
SCHEDULE OF BONDS PAYABLE
June 30, 2007
(Fiscal close)

Issue	Date of Issue	Original Issue	Principal Outstanding 6/30/PY	Redeemed (Issued)	Principal Outstanding 6/30/CY	Interest Rates	Interest Outstanding 6/30/CY
Series 2001A (Taxable) Due 5/15/2025	11/7/02	\$282,975,000	\$142,015,000	\$26,590,000	\$115,425,000	6.36%	\$905,058
Series 2001B (TaxExempt) Due 5/15/2030	11/7/02	230,390,000	230,390,000	_____	230,390,000	5.50%	1,562,236
Series 2001B (TaxExempt) Due 5/15/2039	11/7/02	689,405,000	689,405,000	_____	689,405,000	5.875%	4,993,464
_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____
Total		<u>\$1,202,770,000</u>	<u>\$1,061,810,000</u>	<u>\$26,590,000</u>	<u>\$1,035,220,000</u>		<u>\$7,460,758</u>

*Send copies of new amortization schedules

STATE OF LOUISIANA
SCHEDULE OF CAPITAL LEASE AMORTIZATION
For The Year Ended June 30, 20__

Fiscal Year Ending:	<u>Payment</u>	<u>Interest</u>	<u>Principal</u>	<u>Balance</u>
2008	\$ _____	\$ _____	\$ _____	\$ _____ --
2009	_____	_____	_____	_____ --
2010	_____	_____	_____	_____ --
2011	_____	_____	_____	_____ --
2012	_____	_____	_____	_____ --
2013-2017	_____	_____	_____	_____ --
2018-2022	_____	_____	_____	_____ --
2023-2027	_____	_____	_____	_____ --
2028-2032	_____	_____	_____	_____ --
Total	\$ _____ --	\$ _____ --	\$ _____ --	\$ _____ --

SCHEDULE 4-A

STATE OF LOUISIANA
SCHEDULE OF NOTES PAYABLE AMORTIZATION

Fiscal Year Ending:	<u>Principal</u>	<u>Interest</u>
2008	\$ _____	\$ _____
2009	_____	_____
2010	_____	_____
2011	_____	_____
2012	_____	_____
2013-2017	_____	_____
2018-2022	_____	_____
2023-2027	_____	_____
2028-2032	_____	_____
Total	\$ <u>_____</u>	\$ <u>_____</u>

SCHEDULE 4-B

**STATE OF LOUISIANA
TOBACCO SETTLEMENT FINANCING CORPORATION
SCHEDULE OF BONDS PAYABLE AMORTIZATION
Term Maturities
For the Year Ended June 30, 2007**

Fiscal Year				
Ending:		Principal		Interest
2008	\$	—	\$	60,515,024
2009		—		60,515,024
2010		—		60,515,024
2011		—		60,515,024
2012		—		60,515,024
2013		—		60,515,024
2014		—		60,515,024
2015		—		60,515,024
2016		—		60,515,024
2017		—		60,515,024
2018		—		60,515,024
2019		—		60,515,024
2020		—		60,515,024
2021		—		60,515,024
2022		—		60,515,024
2023		—		60,515,024
2024		—		60,515,024
2025		115,425,000		60,515,024
2026		—		53,173,994
2027		—		53,173,994
2028		—		53,173,994
2029		—		53,173,994
2030		230,390,000		53,173,994
2031		—		40,502,544
2032		—		40,502,544
2033		—		40,502,544
2034		—		40,502,544
2035		—		40,502,544
2036		—		40,502,544
2037		—		40,502,543
2038		—		40,502,543
2039		689,405,000		40,502,543
2040		—		—
2041		—		—
Total	\$	1,035,220,000	\$	1,719,663,295

SCHEDULE 4-C-1

**STATE OF LOUISIANA
TOBACCO SETTLEMENT FINANCING CORPORATION
SCHEDULE OF BONDS PAYABLE AMORTIZATION
Sinking Fund Maturities
For the Year Ended June 30, 2007**

Fiscal Year Ending:	<u>Principal</u>	<u>Interest</u>
2008	\$ --	\$ 60,515,024
2009	--	60,515,024
2010	--	60,515,024
2011	--	60,515,024
2012	--	60,515,024
2013	--	60,515,024
2014	--	60,515,024
2015	--	60,515,024
2016	--	60,515,024
2017	--	60,515,024
2018	--	60,515,024
2019	--	60,515,024
2020	--	60,515,024
2021	--	60,515,024
2022	23,350,000	60,515,024
2023	27,470,000	59,029,964
2024	30,585,000	57,282,872
2025	34,020,000	55,337,666
2026	38,720,000	53,173,994
2027	42,400,000	51,044,393
2028	45,710,000	48,712,394
2029	49,680,000	46,198,343
2030	53,880,000	43,465,944
2031	58,450,000	40,502,544
2032	63,390,000	37,068,606
2033	68,670,000	33,344,444
2034	74,285,000	29,310,081
2035	80,050,000	24,945,837
2036	86,210,000	20,242,900
2037	86,250,000	15,178,062
2038	86,925,000	10,110,875
2039	85,175,000	5,004,034
2040	--	--
2041	--	--
Total	\$ 1,035,220,000	\$ 1,537,678,313

SCHEDULE 4-C-2

**STATE OF LOUISIANA
TOBACCO SETTLEMENT FINANCING CORPORATION
SCHEDULE OF BONDS PAYABLE AMORTIZATION
Turbo Maturities
For The Year Ended June 30, 2007**

Fiscal Year Ending:	Principal	Interest
2008	\$ 69,930,000	\$ 60,515,024
2009	58,125,000	56,037,476
2010	63,045,000	52,479,344
2011	68,170,000	49,011,868
2012	73,590,000	45,232,519
2013	79,360,000	41,215,069
2014	85,575,000	36,631,250
2015	92,170,000	31,573,719
2016	99,390,000	26,158,731
2017	107,045,000	20,319,569
2018	112,930,000	14,030,675
2019	121,335,000	7,336,037
2020	2,555,000	237,606
2021	--	--
2022	--	--
2023	--	--
2024	--	--
2025	--	--
2026	--	--
2027	--	--
2028	--	--
2029	--	--
2030	--	--
2031	--	--
2032	--	--
2033	--	--
2034	--	--
2035	--	--
2036	--	--
2037	--	--
2038	--	--
2039	--	--
2040	--	--
2041	--	--
Total	\$ 1,035,220,000	\$ 440,838,887

SCHEDULE 4-C-3

STATE OF LOUISIANA
TOBACCO SETTLEMENT FINANCING CORPORATION
SCHEDULE OF ADJUSTING ENTRIES
Full Accrual to Modified Accrual Basis Reporting
For the Year Ended June 30, 2007

Ref #	Accounts	Debit	Credit
1	Fund Balance	\$	\$ 40,164,663.50
	Settlement Revenue		8,640,479.50
	TS Receivable	48,804,813.00	
	To record the TS receivable and beginning net assets		
2	Accrued Interest Payable		7,460,756.35
	Interest Expense		208,494.74
	Fund Balance	7,669,251.09	
	To record accrued interest payable and Record prior period adjustment for interest		
3	Acc. Accreted Discount		1,167,754.87
	Acc. Amort Underwriter Fee		1,643,644.93
	Acc. Amort Bond Issue Costs		387,988.63
	Fund Balance		26,760,064.75
	Discount	17,695,295.38	
	Underwriter's Fees	9,294,328.36	
	Bond Issuance Costs	2,194,931.94	
	Discount Accretion	216,054.00	
	Underwriter Fee Amortization	449,645.00	
	Bond Issue Costs Amortization	106,198.00	
	To record bond issue costs to balance Sheet and related amortization expense		
4	Bonds Payable – Current		69,930,000.00
	Bonds Payable		965,290,000.00
	Principle Payments and Long Term Debt		26,590,000.00
	Fund Balance	1,061,810,000.00	
	To record long term debt		
5	Inventory – Restricted	131,171,542.00	
	Receivables – Restricted	212,553.00	
	Investments – current		131,171,542.00
	Receivables – current		212,553.00
	To reclassify the investments and accrued interest receivable for the government-wide statements.		

STATE OF LOUISIANA
TOBACCO SETTLEMENT FINANCING CORPORATION
SCHEDULE OF ADJUSTING ENTRIES
Full Accrual to Modified Accrual Basis Reporting
For the Year Ended June 30, 2007

SCHEDULE 5

Appendix

Information for Note C "Deposits with Financial Institutions and Investments"
(GASB Statement 3 Amended by GASB Statement 40 and Technical Bulletin 2003-1)

I. Purpose:

Note C provides the required disclosures about the governmental entities' deposits with financial institutions and investments. The disclosures required for deposits and investments as of the fiscal year ended date provides information about the credit risk and market risk of the deposits and investments and are designed to provide users of the financial statements information about the potential for losses associated with the deposits and investments. GASB Statement 40 has modified or eliminated portions of GASB Statement 3 including:

- modified the custodial credit risk disclosures of Statement 3 for deposits and investments to limit the required disclosure to only those exposed to custodial credit risk (similar to GASB 3's category 3).
- established or modified disclosure requirements related to concentrations of credit risk of investments, credit risk of debt investments, and interest rate risks of debt investments (including sensitivity to changes in interest rates), and
- established disclosure requirements for foreign currency risks for both deposits and investments.

Although GASB Statement 40 eliminated some of the disclosures required for custodial credit risk (the 3 categories for example), the total reported amounts of all deposits and investments must still be reported.

II. Comparison of amounts disclosed per requirements in Note C to amounts shown on the Balance Sheet (if Balance Sheet is required as part of AFR packet):

- Generally, the amounts of cash and investments on the balance sheet will not be classified exactly the way they would be classified in Note C.
- "Deposits with Financial Institutions" and "Investments" in Note C may be reported on the balance sheet using titles or line items that are different than those in Note C, or they may be combinations of titles or line items. For instance, "Deposits" in Note C may come from several line items on the balance sheet such as "Cash in Bank" and "CD's", or even "Investments" (See section III below that gives further guidance on what should be considered "Deposits" in note C).
- Line items on the balance sheet may include amounts that would be deposits in Note C, and may also include amounts that would be investments in Note C. Also, cash and cash equivalents line items on the balance sheet may include amounts that are not deposited in bank accounts of the entity and therefore would not be reported in Note C as deposits but as separate line items such as petty cash, cash on hand, and treasury cash. These amounts must be reported separately from the deposits in Note C.
- Each line item on the balance sheet that involves cash or investments, including any restricted cash and/or investments, needs to be analyzed to determine what is included in the item and how it should be disclosed in Note C.

III. "Deposits with Financial Institutions" section of Note C:

- Generally, this section of the Note C disclosure refers to the various examples of "Deposits with Financial Institutions" (See "A" below for examples). The term "cash and cash equivalents" is used in reference to GASB Statement 9 that affects presentation for the balance sheet and statement of cash flows, not the note disclosures required by GASB Statement 3 & 40. "Deposits with Financial Institutions" include deposit accounts in banks, savings and loan associations, and credit unions. They can be demand, savings, or time accounts, including negotiable order of withdrawal (NOW) accounts and non-negotiable CD's. As stated previously, deposits for Note C may be a combination of balance sheet line items or titles.
- Do not include treasury cash, petty cash not in a bank account, or cash on hand in Note C as part of the deposits in bank accounts. As mentioned previously, these amounts would be reported separately.

A. Examples and/or definitions:

Nonnegotiable Certificates of Deposit – Nonnegotiable CDs are time deposits that are placed by depositors directly with financial institutions and generally are subject to a penalty if redeemed before maturity. These are treated as deposits for GASB 3 Note C disclosures. (Negotiable CDs are securities that are normally sold in \$1 million units that are traded in a secondary market. These are treated as investments for Note C disclosures.)

Money Market Accounts – financial institution "money market" accounts are simply deposits that pay interest at a rate set to make the accounts competitive with money market mutual funds. They should be treated like any other deposit account for Note C disclosures.

Bank Investment Contracts (BICs) – A BIC is a general obligation instrument issued by a bank, typically to a pension plan, that provides for a guaranteed return on principal over a specified period. Since these are issued by a bank, they are treated as deposits for Note C disclosures.

B. Other definitions as applied to deposits:

Insured (Insurance) – deposits are insured by federal deposit insurance (FDIC), state deposit insurance, multiple financial institution collateral pools that insure public deposits, and even commercial insurance (if scope of coverage would be substantially the same as FDIC).

Collateral – Security pledged by a financial institution to a government entity for its deposits.

IV. "Investments" section of Note C:

- Types of investments for listing investments by type definitions/examples:
 1. Repurchase Agreements – An agreement in which a governmental entity (buyer-lender) transfers cash to a broker-dealer or financial institution (seller-borrower); the broker-dealer or financial institution transfers securities to the entity and promises to repay the cash plus interest in exchange for a) the same securities, or for b) different securities.
 2. U.S. Government Obligations – examples include treasury bills, treasury notes and treasury strips; obligations of certain U.S. Government Agencies such as FNMA, FHLM, or SLMA.
 3. Common & Preferred Stock – a security that represents an ownership interest in an entity.
 4. Commercial Paper (mortgages, notes, etc.) – An unsecured promissory note issued primarily by corporations for a specific amount and maturing on a specific day. Almost all commercial paper is rated as to credit risk by rating services.
 5. Corporate Bonds
 6. Other (identify) – It is not appropriate to present material amounts of investments as "Other", unless the note disclosure describes the composition of the "Other" category. The following are examples of other investments:
 - a. Closed-end Mutual Fund – The investment company sells shares of its stock to investors and it invests on the shareholders' behalf in a diversified portfolio of securities. A closed-end mutual fund has a constant number of shares, the value depends on the market supply and demand for the shares rather than directly on the value of the portfolio, the fund does issue certificates, and the securities are traded on a stock exchange.
 - b. Open-end Mutual Funds – The investment company sells shares of its stock to investors and it invests on the shareholders' behalf in a diversified portfolio of securities. In contrast to a closed-end mutual fund, the open-end mutual fund creates new shares to meet investor demand, the value depends directly on the value of the portfolio, and the fund does not issue

certificates but sends out periodic statements showing account activity. These investments are not evidenced by securities that exist in physical or book entry form.

c. Reverse Repurchase Agreements - An agreement in which a broker-dealer or financial institution (buyer-lender) transfers cash to a governmental entity (seller-borrower); the entity transfers securities to the broker-dealer or financial institution and promises to repay the cash plus interest in exchange for a) the same securities, or for b) different securities.

d. Investments in pools managed by another government - Generally, these investments would not be exposed to custodial credit risk because the investments themselves are not evidenced by securities that exist in physical or book entry form.

e. Private placements, such as venture capital and limited partnerships

f. Investments in real estate, annuity contracts, and direct investments in mortgages

V. Risk Disclosures for Deposits and Investments:

Deposits and investments are subject to several types of risks, mainly credit risk, market risk, interest rate risk, and foreign currency risk.

Credit risk - defined as the risk that a counterparty to an investment transaction will not fulfill its obligations and can be associated with the issuer of securities, with a financial institution holding deposits, or with a party holding investment or collateral securities.

Concentration of credit risk - defined as the risk of loss attributed to the magnitude of a government's investment in a single issuer.

Market risk - defined as the risk that the market value of investment securities, collateral securities protecting a deposit, or securities of a repurchase agreement will decline.

Interest rate risk - defined as the risk that changes in interest rates will adversely affect the fair value of an investment.

Foreign currency risk - defined as the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit.

A. Custodial Credit Risk Disclosures for Deposits:

Following GASB Statement 3, deposits were classified into three categories of custodial credit risk depending on whether they were insured or collateralized, and who holds the collateral and how the collateral is held.

Collateral - Securities pledged by the financial institution for the purpose of securing the governmental entity's deposits.

Collateralized - When the entity's deposits are secured with securities pledged by the financial institution holding the deposits.

GASB Statement 40 amended GASB Statement 3 to eliminate the requirement to disclose all deposits by the 3 categories of risk. GASB Statement 40 requires only the disclosure of deposits that are considered to be exposed to custodial credit risk. An entity's deposits are exposed to custodial credit risk if the deposit balances are 1) uninsured and uncollateralized, 2) uninsured and collateralized with securities held by the pledging financial institution, or 3) uninsured and collateralized with securities held by the pledging financial institution's trust department or agent, but not in the entity's name.

B. Custodial Credit Risk Disclosures for Investments:

Following GASB Statement 3, investments (listed by type) were either classified into three categories (depending on whether they are insured or registered and who holds the securities and how they are held), or listed as non-classified investments.

GASB Statement 40 amended GASB Statement 3 to eliminate the requirement to disclose all investments by the 3 categories of risk. GASB Statement 40 requires only the separate disclosure of investments that are considered to be exposed to custodial credit risk. However, the total reported amount and fair value columns still must be reported for total investments regardless of exposure to custodial credit risk. Those investments exposed to custodial credit

risk are reported by type in one of two separate columns depending upon whether they are held by a counterparty, or held by a counterparty's trust department or agent not in the entity's name.

C. Additional Risk Disclosures Required by GASB Statement 40:

Credit Risk - Disclose the credit risk of debt investments by credit quality ratings as described by rating agencies as of the fiscal year end, including the rating agency used. All debt investments regardless of type can be aggregated by credit quality rating (if any are un-rated, disclose that amount). Examples of un-rated debt investments include U.S. Treasury Notes, external investment pools, or investments held by foundations. The preparer may need to contact their investment advisor for complete information relating to debt investments and their credit quality ratings.

Debt securities issued by a federal government-sponsored enterprise (GSE) and held by a state or local government as an investment are subject to credit risk. GSEs are independent organizations sponsored by the federal government. Examples include the Federal Farm Credit Banks, the Federal Home Loan Bank System, Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA) and Student Loan Marketing Association (SLMA). The liabilities of the GSE are not backed by the full faith and credit of the federal government.

Interest Rate Risk - Disclose the interest rate risk of debt investments by listing the investment type, total fair value, and breakdown of maturity in years of those investments. The preparer may need to contact their investment advisor for complete information relating to the related maturities of these investments.

Highly Sensitive Investments - Disclose the fair value and terms of any debt investments that are highly sensitive to changes in interest rates due to the terms (e.g. coupon multipliers, reset dates, embedded options, etc.) of the investment. Examples of debt investments that are highly sensitive to changes in interest rates include asset-backed securities such as mortgage pass-through securities issued by FNMA, Government National Mortgage Association (GNMA), and FHLMC.

Concentration of Credit Risk - List, by amount and issuer (not including U.S. government securities, mutual funds, and investment pools), investments in any one issuer that represents 5% or more of total investments.

Foreign Currency Risk - Disclose the U.S. dollar balances of any deposits or investments that are exposed to foreign currency risk (deposits or investments denominated in foreign currencies). List these by currency denomination and investment type, if applicable.

Deposits and Investments Policies Relating to Risk - Briefly describe the deposit and/or investment policies related to the custodial credit risk, credit risk of debt investments, concentration of credit risk, interest rate risk, and foreign currency risk disclosed in this note. If no policy exists concerning the risks disclosed, that fact should be stated.

VI. Securities as Applied to Credit Risk of Deposits and Investments:

Securities defined - a transferable financial instrument that evidences ownership or creditorship. Securities can be in either paper or book-entry form.

1. Examples of securities that are often held by or pledged to (as collateral) governmental entities include:

- a. treasury bills, treasury notes, treasury bonds
- b. federal agency obligations
- c. corporate debt instruments (including commercial paper)
- d. corporate equity instruments
- e. negotiable CD's (keyword here is negotiable)
- f. bankers' acceptances
- g. shares of closed-end mutual funds (keyword here is closed-end)
- h. shares of unit investment trusts

2. Instruments or investments that are not securities include:

- a. investments made directly with another party (such as limited partnerships)

- b. real estate
- c. direct investments in mortgages and other loans
- d. investments in open-ended mutual funds (keyword here is open-ended)
- e. pools managed by other governments
- f. annuity contracts

Technical Bulletin 2003-1 -- Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets (Below is an excerpt from this technical bulletin)

2. What is a derivative?

3. A derivative instrument is a financial instrument or other contract with all three of the following characteristics:

- a. It has (1) one or more underlyings and (2) one or more notional amounts or payment provisions or both. Those terms determine the amount of the settlement or settlements, and, in some cases, whether or not a settlement is required.
- b. It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.
- c. Its terms require or permit net settlement, it can readily be settled net by a means outside the contract, or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

Notwithstanding the above characteristics, loan commitments that relate to the origination of mortgage loans that will be held for sale, as discussed in paragraph 21 of FASB Statement No. 65, Accounting for Mortgage Banking Activities (as amended), shall be accounted for as derivative instruments by the issuer of the loan commitment (that is, the potential lender). Paragraph 10(i) provides a scope exception for the accounting for loan commitments by issuers of certain commitments to originate loans and all holders of commitments to originate loans (that is, the potential borrowers).

4. What financial statement note disclosures should be presented for derivatives that are not reported at fair value on the statement of net assets? 1

5. Governments that, as of the date of the financial statements, are party to a derivative that was not reported at fair value on the statement of net assets should disclose the information described in paragraphs 6 through 10. Disclosure information for similar derivative types may be aggregated.

6. Objective of the derivative—The government should disclose its objective for entering into the derivative, the context needed to understand that objective, and its strategies for achieving the objective, indicating the types of derivatives used including options purchased or sold.

7. Significant terms—The government should disclose the significant terms of the transaction, including:

- a. Notional, face, or contract amount
- b. Underlying indexes or interest rates, including terms such as caps, floors, or collars
- c. Options embedded in the derivatives
- d. The date when the derivative became effective and when it is scheduled to terminate or mature
- e. The amount of cash paid or received when the derivative was initiated.

8. Fair value—The government should disclose the fair value of the derivative at the reporting date and, if that fair value is based on other than quoted market prices, the method and significant assumptions used to estimate the fair value of the derivative. Acceptable methods are discussed in Question 3.

9. Associated debt—Some derivatives may be entered into with the intention of effectively making a government's debt obligation carry a synthetic interest rate. For example, a government may issue variable-rate debt and issue a pay-fixed, receive-variable interest rate swap with the objective of achieving a synthetic fixed rate for the combined instruments. If this is the case, the derivative's net cash

flow should be disclosed in addition to the debt service requirements of the associated debt. Debt service requirements to maturity are required disclosures established by Statement 38, paragraphs 10 and 11.

10. Risks—The government should disclose, when applicable, its exposure to the following risks that could give rise to financial loss. Risk disclosures are limited to derivatives that are extant as of the date of the statement of net assets. Disclosures required by this paragraph may contain information that is also required by other paragraphs. However, these disclosures should be presented in the context of a derivative's risk.

a. Credit risk is the risk that a counterparty will not fulfill its obligations. If a derivative exposes a government to credit risk, the government should disclose that exposure as credit risk and also disclose the following information:

(1) The credit quality ratings of counterparties as described by nationally recognized statistical rating organizations—rating agencies—as of the date of the statement of net assets. If a credit risk disclosure is required and the counterparty is not rated, the disclosure should indicate that fact.

(2) The maximum amount of loss due to credit risk, based on the fair value of the derivative as of the date of the statement of net assets, that the government would incur if the parties to the derivative failed to perform according to the terms of the contract, without respect to any collateral or other security.

(3) A brief description of the collateral or other security that supports derivatives subject to credit risk and information about the government's access to that collateral or other security.

(4) Information about any master netting arrangements to mitigate credit risk. The disclosure should include a brief description of the terms of those arrangements.

(5) The extent of diversification among counterparties.

b. Interest rate risk is the risk that changes in interest rates will adversely affect the fair values of a government's financial instruments or a government's cash flows. If a derivative increases a government's exposure to interest rate risk, the government should disclose that increased exposure as interest rate risk and also the derivative's terms that increase such a risk. The determination of whether a derivative increases interest rate risk should be made after considering, for example, the effects of the derivative and any associated debt.

c. Basis risk is the risk that arises when variable interest rates on a derivative and an associated bond or other interest-paying financial instrument are based on different indexes. When relationships between different indexes vary and that variance adversely affects the government's calculated payments, cost savings or synthetic interest rates may not be realized. If a derivative exposes a government to basis risk, the government should disclose that exposure as basis risk and should also disclose the derivative's payment terms and any payment terms of the government's associated debt.

d. Termination risk is the risk that a derivative's unscheduled end will affect a government's asset/liability strategy or will present the government with potentially significant unscheduled termination payments to the counterparty. For example, a government may be relying on an interest rate swap to insulate it from the possibility of increasing interest rate payments. If the swap has an unscheduled termination, that benefit would not be available. If a derivative exposes a government to termination risk, the government should disclose that exposure as termination risk and also the following information, as applicable:

(1) Any termination events that have occurred.

(2) Dates that a derivative may be terminated.

(3) Out-of-the-ordinary termination events contained in contractual documents, such as "additional termination events" contained in the Schedule to the International Swap Dealers Association Master Agreement.

e. Rollover risk is the risk that a derivative associated with a government's debt does not extend to the maturity of that debt. When the derivative terminates, the associated debt will no longer have the benefit of the derivative. An example is an interest rate swap that pays the government a variable-rate payment that is designed to match the term of the variable-rate interest payments on the government's bonds. If the derivative's term is ten years and the associated debt's term is thirty years, after ten years the government will lose the benefit of the swap payments. If a derivative exposes a government to rollover risk, the government should disclose that exposure as rollover risk and should also disclose the maturity of the derivative and the maturity of the associated debt.

f. Market-access risk is the risk that a government will not be able to enter credit markets or that credit will become more costly. For example, to complete a derivative's objective, an issuance of refunding bonds may be planned in the future. If at that time the government is unable to enter credit markets, expected cost savings may not be realized. If the derivative creates market-access risk, the government should disclose that exposure as market-access risk.

11. What methods are acceptable for determining a derivative's fair value?

12. GASB Statement 25, paragraph 24, provides:

Fair value should be measured by the market price if there is an active market for the investment. If a market price is not available, a forecast of expected cash flows may aid in estimating fair value, provided that the expected cash flows are discounted at a rate commensurate with the risk involved.

Within the context of discounted cash flows, formula-based methods such as zero-coupon and par-value methods are acceptable. The zero-coupon method calculates the future net settlement payments required—for example, by an interest rate swap—assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap. The par-value method compares, for example, the fixed rate on an interest rate swap with the current fixed rates that could be achieved in the marketplace should the swap be unwound. An option contained in a derivative may also be priced using an option pricing model, such as the Black-Scholes model, that considers probabilities, volatilities, time, underlying prices, and other variables.

OTHER REPORT REQUIRED BY
GOVERNMENT AUDITING STANDARDS

The following pages contain a report on internal control over financial reporting and on compliance with laws and regulations and on other matters as required by *Government Auditing Standards*, issued by the Comptroller General of the United States. This report is based solely on the audit of the financial statements and includes, where appropriate, any significant deficiencies and/or material weaknesses in internal control, compliance, or other matters that would be material to the presented financial statements.



LOUISIANA LEGISLATIVE AUDITOR
STEVE J. THERIOT, CPA

March 10, 2008

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
STATE OF LOUISIANA**

Baton Rouge, Louisiana

We have audited the financial statements of the debt service fund and the governmental activities of the Tobacco Settlement Financing Corporation (Corporation), a blended component unit of the State of Louisiana, as of and for the year ended June 30, 2007, which collectively comprise the Corporation's basic financial statements and have issued our report thereon dated March 10, 2008. Our report was modified to include an emphasis of a matter regarding the impact of hurricanes Katrina and Rita. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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 control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Corporation's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Corporation's financial statements that is more than inconsequential will not be prevented or detected by the Corporation's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Corporation's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be 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, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Corporation, its board of directors, its management, and the Louisiana Legislature and is not intended to be, and should not be, used by anyone other than these specified parties. Under Louisiana Revised Statute 24:513, this report is distributed by the Legislative Auditor as a public document.

Respectfully submitted,



Steve J. Theriot, CPA
Legislative Auditor

CLM:JMR:THC:sr

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