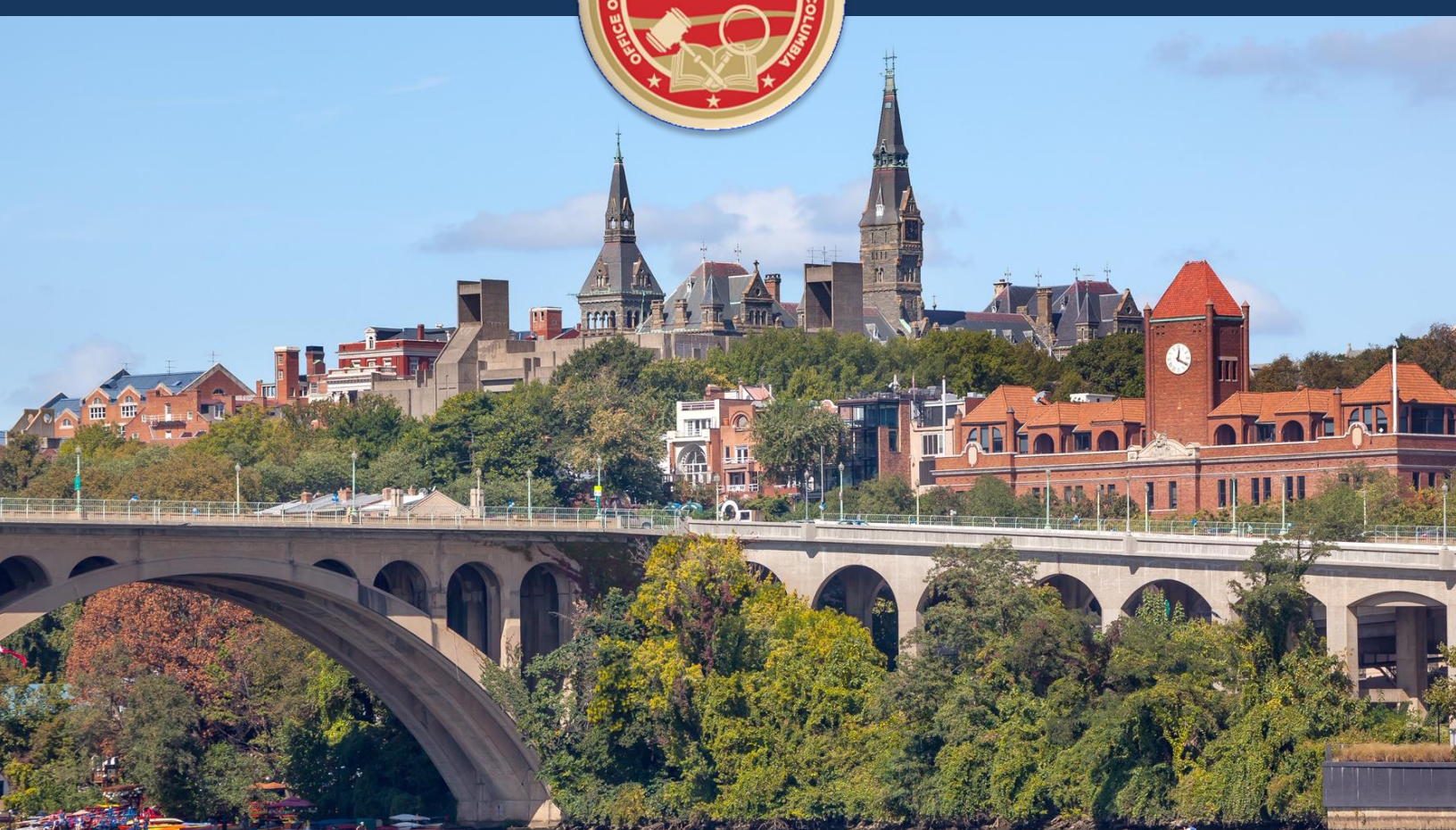


DISTRICT OF COLUMBIA OFFICE OF THE INSPECTOR GENERAL

OIG Project No. 20-1-13TT

January 2020



DISTRICT OF COLUMBIA TOBACCO SETTLEMENT FINANCING CORPORATION Financial Statements (Together With Independent Auditors' Report) For Fiscal Year Ended September 30, 2019

Guiding Principles

*Workforce Engagement * Stakeholders Engagement * Process-oriented * Innovation
* Accountability * Professionalism * Objectivity and Independence * Communication * Collaboration
* Diversity * Measurement * Continuous Improvement*

Mission

Our mission is to independently audit, inspect, and investigate matters pertaining to the District of Columbia government in order to:

- prevent and detect corruption, mismanagement, waste, fraud, and abuse;
- promote economy, efficiency, effectiveness, and accountability;
- inform stakeholders about issues relating to District programs and operations; and
- recommend and track the implementation of corrective actions.

Vision

Our vision is to be a world-class Office of the Inspector General that is customer-focused, and sets the standard for oversight excellence!

Core Values

Excellence * Integrity * Respect * Creativity * Ownership
* Transparency * Empowerment * Courage * Passion
* Leadership



GOVERNMENT OF THE DISTRICT OF COLUMBIA

Office of the Inspector General

Inspector General



January 31, 2020

The Honorable Muriel Bowser
Mayor of the District of Columbia
Mayor's Correspondence Unit
1350 Pennsylvania Avenue, N.W., Suite 316
Washington, D.C. 20004

The Honorable Phil Mendelson
Chairman
Council of the District of Columbia
John A. Wilson Building
1350 Pennsylvania Avenue, N.W., Suite 504
Washington, D.C. 20004

Dear Mayor Bowser and Chairman Mendelson:

Enclosed is the final report entitled *District of Columbia Tobacco Settlement Financing Corporation Financial Statements for the Fiscal Year Ended September 30, 2019* (OIG No. 20-1-13TT). Bert Smith & Co. (BSC) conducted the audit and submitted this component report as part of our overall contract for the audit of the District of Columbia's general-purpose financial statements for fiscal year 2019.

On January 8, 2020, BSC issued its opinion and concluded that the financial statements are presented fairly in all material respects, in accordance with accounting principles generally accepted in the United States of America.

If you have questions about this report, please contact me or Benjamin Huddle, Assistant Inspector General for Audits, at (202) 727-2540.

Sincerely,


Daniel W. Lucas
Inspector General

DWL/ws

Enclosure

cc: See Distribution List

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Mr. Graylin (Gray) Smith, Partner, SB and Company, LLC (via email)

**DISTRICT OF COLUMBIA
TOBACCO SETTLEMENT FINANCING CORPORATION
FINANCIAL STATEMENTS
SEPTEMBER 30, 2019**
(Together with Independent Auditors' Report)

**DISTRICT OF COLUMBIA
TOBACCO SETTLEMENT FINANCING CORPORATION
FINANCIAL STATEMENTS
SEPTEMBER 30, 2019**

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INDEPENDENT AUDITOR'S REPORT

To the Mayor and Members of
The Council of the Government of the District of Columbia, and
The Board of Directors of the District of Columbia Tobacco Settlement Financing
Corporation

Report on the Financial Statements

We have audited the accompanying financial statements of the District of Columbia Tobacco Settlement Financing Corporation ("TSFC"), a blended component unit of the Government of the District of Columbia, as of and for the year ended September 30, 2019 and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of TSFC as of September 30, 2019, and the changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements present only TSFC and do not purport to, and do not, present fairly the financial position of the Government of the District of Columbia as of September 30, 2019 and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management discussion and analysis on pages 3 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Bert Smith & Co.

Washington, D.C.
January 8, 2020

**DISTRICT OF COLUMBIA
TOBACCO SETTLEMENT FINANCING CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
SEPTEMBER 30, 2019**

INTRODUCTION

We are pleased to provide this overview and analysis of the financial activities of the District of Columbia Tobacco Settlement Financing Corporation (TSFC) for the fiscal year ended September 30, 2019. Please read it in conjunction with the financial statements on pages 8 and 9.

This overview summarizes TSFC's financial position as of September 30, 2019, and the results of its operations during the fiscal year, as reflected in the Statement of Revenues, Expenditures, and Changes in Fund Balance.

OVERVIEW OF REQUIRED BASIC FINANCIAL STATEMENTS

The TSFC basic financial statements are presented on the modified accrual basis of accounting method.

Balance Sheet

This statement includes all of TSFC's assets and liabilities and provides information about its resources (assets) and obligations (liabilities). The assets and liabilities are presented in order of liquidity. The resulting fund balance presented in the statements is displayed as restricted and unassigned.

Statement of Revenues, Expenditures, and Changes in Fund Balance

The Statement of Revenues, Expenditures, and Changes in Fund Balance reports the revenues and expenditures of TSFC during the fiscal year and the change in TSFC's fund balance. This statement measures the activities of TSFC's operations and is used to identify TSFC's debt service and operational costs.

FINANCIAL HIGHLIGHTS

Balance Sheet

The Balance Sheet reports the financial position of TSFC as of September 30, 2019. In accordance with the modified accrual basis of accounting for governmental funds, the Tobacco Settlement Revenues (TSRs) and Tobacco Settlement Asset-Backed Bond debt service payments are recorded only to the extent that they are receivable or payable in the current period.

Assets

As of September 30, 2019, TSFC's assets totaled \$79,801,847, consisting of \$51,817,754 in cash, cash equivalents, and investments, \$27,948,950 in accrued tobacco settlement revenue receivable, \$17,900 in prepaid expenses, and \$17,443 in accrued interest receivables.

DISTRICT OF COLUMBIA
TOBACCO SETTLEMENT FINANCING CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
SEPTEMBER 30, 2019

Restricted cash and cash equivalents as of September 30, 2019 consist of \$9,918,942 in the following three accounts: the debt service account, from which debt service payments on the Tobacco Bonds are paid; the Trapping Account, in which, under certain circumstances, TSRs in excess of amounts required for annual debt service payments are held (see Note 5); and the 2006 Revenue Account, in which excess amounts are held related to the 2006 bond issuance costs (see Note 5). The Collection Account, in which TSRs are initially deposited before allocation to another account and the Operating Account, which is used for ongoing operating expenses of TSFC, are considered unrestricted cash.

As of September 30, 2019, unrestricted cash totaled \$693,693. Restricted investments of \$41,205,119 in the debt service reserve fund as of September 30, 2019 represent funds required to be held to cover any shortfalls in the availability of funds to pay debt service payments of the Tobacco Bonds in the future.

Liabilities

TSFC liabilities as of September 30, 2019 consisted of accrued operating expenses of \$5,143.

Fund Balance

TSFC's fund balance as of September 30, 2019 was \$79,796,704. Of this amount, the vast majority, \$79,108,154 as of September 30, 2019 were in TSFC accounts held by the Trustee and represent balances reserved for debt service and related purposes of the Tobacco Bonds. There was a surplus of 688,550 in unassigned fund balance as of September 30, 2019. Unassigned fund balance represents funds in the TSFC operating and collection accounts that were not earmarked for payment of the year-end accrued expenses and were not mandated to be reserved for a specific purpose.

Statement of Revenues, Expenditures, and Changes in Fund Balance

Revenues

Revenues consisted primarily of TSRs, which are payments to the TSFC resulting from a purchase and sale agreement between the District and TSFC, through which the TSFC purchased from the District the right to receive such payments, and the Master Settlement Agreement ("MSA") entered into by certain cigarette manufactures, the District, 46 states, and five other U.S. jurisdictions in November 1998 in settlement of certain smoking-related litigation. The amount of TSRs received each year pursuant to the MSA is calculated based on a formula in which a key variable is cigarette consumption in the United States of America. The TSRs for fiscal year 2019 totaled \$37,668,899. The other source of revenue is interest income and unrealized gain on investments totaling \$2,457,919.

DISTRICT OF COLUMBIA
TOBACCO SETTLEMENT FINANCING CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
SEPTEMBER 30, 2019

Expenditures

Expenditures consisted primarily of debt service, i.e., principal and interest payments on TSFC's outstanding bonds. TSFC issued \$521,105,000 and \$248,264,046 of Tobacco Settlement Asset- Backed Bonds (the "Tobacco Bonds") in March 2001 and August 2006, respectively. The purpose of the issuance of the 2001 Tobacco Bonds was to obtain funds to defease certain debt obligations of the District, in exchange for TSFC obtaining the right to receive the annual TSRs, allowing the District to receive the benefit of future TSRs upfront. The purpose of the issuance of the 2006 Tobacco Bonds was to further leverage future TSRs to receive an upfront benefit to be transferred to the District, primarily for use on health-care related initiatives. Total debt service expenditures in fiscal year 2019 were \$43,279,425, which consisted of \$20,804,425 in interest expense and \$22,475,000 in principal repayment of the Tobacco Bonds.

The general and administrative expenses included payment of legal fees, trustee fees, rating agency fees, and other administrative expenses totaling \$211,945 for the year ended September 30, 2019.

CONDENSED FINANCIAL INFORMATION

The following table represents the condensed balance sheets as of September 30, 2019 and 2018.

	<u>2019</u>	<u>2018</u>	<u>Variance</u>
Assets			
Total Assets	<u>\$79,801,847</u>	<u>\$83,033,749</u>	<u>\$ (3,231,902)</u>
Total Assets	<u>\$79,801,847</u>	<u>\$83,033,749</u>	<u>\$ (3,231,902)</u>
Liabilities			
Total Liabilities	<u>5,143</u>	<u>2,000</u>	<u>3,143</u>
Total Liabilities	<u>5,143</u>	<u>2,000</u>	<u>3,143</u>
Fund Balance			
Restricted for Debt Service	79,108,154	82,472,582	(3,364,428)
Unassigned	688,550	559,167	129,383
Total Fund Balance	<u>79,796,704</u>	<u>83,031,749</u>	<u>(3,235,045)</u>
Total Liabilities and Fund Balance			
Balance	<u>\$79,801,847</u>	<u>\$83,033,749</u>	<u>\$(3,231,902)</u>

For fiscal year 2019, assets decreased by \$3,231,902 or 3.9% from the prior fiscal year. The change was primarily due to expenditures exceeding revenues for fiscal year 2019 compared to an excess of revenues over expenditures for fiscal year 2018, as shown below.

DISTRICT OF COLUMBIA
TOBACCO SETTLEMENT FINANCING CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
SEPTEMBER 30, 2019

The following table presents the condensed statements of revenues, expenditures, and changes in fund balance for the years ended September 30, 2019 and 2018.

	<u>2019</u>	<u>2018</u>	<u>Variance</u>
Revenues			
Tobacco Settlement Revenue	\$37,668,899	\$46,851,792	\$(9,182,893)
Investment Income	2,457,919	2,371,610	86,309
Total Revenues	<u>40,126,818</u>	<u>49,223,402</u>	<u>(9,096,584)</u>
Expenditures			
Interest Expense	20,804,425	22,254,900	(1,450,475)
Bond Principal Payment	22,475,000	22,315,000	160,000
General Administrative Expenses	211,945	225,037	(13,092)
Total Expenditures	<u>43,491,370</u>	<u>44,794,937</u>	<u>(1,303,567)</u>
Excess (Deficiency) of Revenues Over Expenditures	(3,364,552)	4,428,465	(7,793,017)
Other Financing Sources			
Transfer in	<u>\$ 129,507</u>	<u>\$ -</u>	<u>\$ 129,507</u>

(a) Revenues Comparison

Total revenues in fiscal year 2019 decreased by \$9,182,893 or 18.5% as compared to fiscal year 2018. The decrease resulted from (1) a reduction in cigarette sales volume and (2) a lower adjusted Non-Participating Tobacco Product Manufacturer ("NPM") payment than was received in fiscal year 2018. Consequently, the annual MSA payments from Participating Tobacco Product Manufacturers ("PM") were lower in 2019 as compared to 2018 TSRs under the MSA and the cigarette consumption formula.

(b) Expenditures Comparison

Total expenditures in fiscal year 2019 decreased by \$1,303,567 or 2.9% as compared to fiscal year 2018. The overall decrease in 2019 was primarily due to lower interest expense.

(c) Excess (Deficiency) of Revenues over Expenditures

Due to the fact that the debt service payments on the Tobacco Bonds are covered by a given year TSRs that cross fiscal years and the variability in the amount of TSRs and investment earnings from year to year, there are likely to be relatively small operating surpluses or deficits from year to year, neither of which would indicate a fiscal problem or irregularity.

In fiscal year 2019, TSFC's operating results produced a deficiency of revenues over expenditures of \$7,793,017 compared to an excess of revenues over expenditures of \$4,428,465 in fiscal year 2018. This is primarily due to lower revenue receipts as a result of reduced tobacco sales, partially offset by reduced NPM withholdings.

**DISTRICT OF COLUMBIA
TOBACCO SETTLEMENT FINANCING CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS *(Continued)*
SEPTEMBER 30, 2019**

Contacting the District TSFC

This report is intended to provide TSFC stakeholders with a general overview of the financial activities and position of TSFC. TSFC is functioning as it was designed to function, fulfilling its mission of being a vehicle for leveraging the TSRs through the issuance of the Tobacco Bonds; providing the District with upfront compensation representing the value of TSRs that it was to receive in future years; affording the District the ability to shift (to Tobacco bondholders) most of the risk associated with the prospect of future non-payment of TSRs by tobacco manufacturers; servicing the Tobacco Bonds in accordance with the structure and requirements associated with the transaction; and providing the District with ongoing revenue from any annual residual TSRs from the tobacco manufacturers (see Note 3). Any questions or requests regarding this report should be directed to: District of Columbia Tobacco Settlement Financing Corporation, 1350 Pennsylvania Ave., N.W., Suite 200, Washington, D.C. 20004, or (202) 727-6055.

**DISTRICT OF COLUMBIA
TOBACCO SETTLEMENT FINANCING CORPORATION
BALANCE SHEET
SEPTEMBER 30, 2019
(With Comparative Totals for 2018)**

	2019	2018
ASSETS		
Unrestricted Cash and Cash Equivalents	\$ 693,693	\$ 561,167
Restricted Cash Equivalents:		
Debt Service	9,786,790	10,496,828
Trapping Account	70	68
Revenue Account	132,082	-
Restricted Investment		
Debt Service Reserve	41,205,119	41,018,736
Accrued Interest Receivable	17,443	17,105
Accrued Tobacco Settlement Revenue Receivable	27,948,750	30,923,745
Prepaid Expense	17,900	16,100
	\$ 79,801,847	\$ 83,033,749
LIABILITIES AND FUND BALANCE		
Liabilities:		
Accrued Expenses	5,143	2,000
Total Liabilities	5,143	2,000
Fund Balance:		
Restricted for Debt Service	79,108,154	82,472,582
Unassigned	688,550	559,167
Total Fund Balance	79,796,704	83,031,749
Total Liabilities and Fund Balance	\$ 79,801,847	\$ 83,033,749

The accompanying notes are an integral part of these financial statements.

DISTRICT OF COLUMBIA
TOBACCO SETTLEMENT FINANCING CORPORATION
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
FOR THE YEAR ENDED SEPTEMBER 30, 2019
(With Comparative Totals for 2018)

	<u>2019</u>	<u>2018</u>
Revenues		
Tobacco Settlement Revenue	\$ 37,668,899	\$ 46,851,792
Investment Income	2,457,919	2,371,610
Total Revenues	<u>40,126,818</u>	<u>49,223,402</u>
Expenditures		
Interest Expense	20,804,425	22,254,900
Bond Principal Payment	22,475,000	22,315,000
General and Administrative Expenses	211,945	225,037
Total Expenditures	<u>43,491,370</u>	<u>44,794,937</u>
Excess (Deficiency) of Revenues Over Expenditures	(3,364,552)	4,428,465
Other Financing Sources		
Transfers in	129,507	-
Fund Balance Beginning of Year	<u>83,031,749</u>	<u>78,603,284</u>
Fund Balance End of Year	<u>\$ 79,796,704</u>	<u>\$ 83,031,749</u>

The accompanying notes are an integral part of these financial statements.

**DISTRICT OF COLUMBIA
TOBACCO SETTLEMENT FINANCING CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2019**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- ***Organization***

The District of Columbia Tobacco Settlement Financing Corporation (“TSFC”) is a special purpose, independent instrumentality of the Government of the District of Columbia (the “District”) created by the Tobacco Settlement Financing Act of 2000 (the “Act”). TSFC is governed by a five-person board of directors consisting of the Mayor of the District or designee, the Chairman of the Council of the District or designee, the Chief Financial Officer of the District and two private citizens, one of whom is appointed by the Mayor and the other is appointed by the Council. Although legally separate from the District, TSFC is a blended component unit of the District and, accordingly, is included in the District’s financial statements.

Pursuant to the Act, and a purchase and sale agreement, dated as of February 1, 2001, between the District and TSFC, the District sold to TSFC on March 13, 2001, substantially all of its rights, title and interest in certain amounts paid or payable to the District under the Master Settlement Agreement (the “MSA”) entered into by participating cigarette manufacturers (“PCMs”), the District, forty-six (46) states and five (5) other U.S. jurisdictions in November 1998 in the settlement of certain smoking-related litigation. The sale included certain initial and annual payments already received by the District and the District’s right to receive future initial, annual and strategic contribution fund payments (the “tobacco settlement revenues” or “TSRs”) to be made to the PCMs under the MSA.

The purchase price of the District’s rights, title and interest in the TSRs has been financed by the issuance by TSFC of the Tobacco Settlement Asset-Backed Bonds (the “Tobacco Bonds”).

TSFC issued its first series of Tobacco Bonds in the amount of \$521,105,000 on March 13, 2001. In accordance with the aforesaid purchase and sale agreement, TSFC deposited the net proceeds of the Tobacco Bonds into irrevocable escrow accounts held by a trustee in TSFC’s name to defease certain obligations of the District.

- ***Basis of Presentation***

TSFC’s financial transactions are accounted for as a special revenue fund in the District’s financial statements. The accompanying financial statements present the financial results of only TSFC and do not purport to, and do not, present fairly the financial position of the District as of September 30, 2019 and the changes in its financial position for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

- ***Basis of Accounting***

The accompanying financial statements are prepared on the modified accrual basis of accounting. Under this method, TSFC recognizes revenue when it becomes susceptible to accrual, which is when it becomes both measurable and available to finance expenditures in the current fiscal year. Expenditures are recognized when the related liability is incurred or, in the case of debt service, when payments are due.

Future Tobacco settlement collections are contingent upon future tobacco product sales subject to various adjustments as outlined in the MSA. The TSFC recognizes revenue from tobacco settlement collections as the collections are received. In addition, an accrued receivable (Master Settlement Agreement receivable) is recorded at year-end for estimated product sales occurring from January 1 to September 30 of each year.

- ***Use of Estimates***
The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires TSFC's 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 determining the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.
- ***Cash Equivalents***
Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash with an original maturity of three (3) months or less.
- ***Investments***
TSFC follows the District's investment policy. Investments are limited to obligations of the United States and agencies, money market funds, municipal obligations, collateralized or insured certificates of deposit, prime commercial paper, bankers' acceptances and repurchase agreements fully collateralized in obligations of the United States government and agency securities.

Money market funds such as short-term, highly liquid debt instrument and participating interest earning investments, such as repurchase agreements that at the time of purchase of one year or less, are carried at amortized cost which approximates fair value. Other investments are stated at fair value.

- ***Fund Balance***
Governmental accounting standards establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed on the use of the resources reported in governmental funds.
 - ... **Nonspendable:** Amounts that are not in spendable form or are legally or contractually required to be maintained intact.
 - ... **Restricted:** Amounts that are legally restricted by outside parties, constitutional provisions, or enabling legislation for use for a specific purpose. Restricted fund balance is to be used for the purpose of paying future debt service and related expenses associated with the Tobacco Bonds.
 - ... **Committed:** Amounts that have been formally set aside by the City Council or the Board of Directors for use for specific purposes. Commitments are made and can be rescinded only via resolution of the City Council or the Board of Directors.
 - ... **Assigned:** Amounts that are intended to be spent on specific purposes expressed by the governing body.
 - ... **Unassigned:** Amounts that are available for any purpose. TSFC intends the amounts to be used for the subsequent fiscal years' operating expenses.

At September 30, 2019, the TSFC had two fund balance classifications: unassigned and restricted.

NOTE 2 CASH AND CASH EQUIVALENTS

TSFC's cash and cash equivalents consist of bank deposits and money market funds. As of September 30, 2019, total cash and cash equivalents are summarized as follows:

Unrestricted	
Cash	\$ 692,156
Money Market	1,537
Total Unrestricted	<u>693,693</u>
Restricted	
Money Market	<u>9,918,942</u>
Total Restricted	<u>9,918,942</u>
Total Cash and Cash Equivalents	<u>\$ 10,612,635</u>

TSFC's cash and cash equivalents consist of cash and money market funds which are in accordance with the permitted investments under the bond indenture. The cash and cash equivalents are collateralized by securities held by TSFC's agent in TSFC's name. As of September 30, 2019, cash and cash equivalents consisted of \$692,156 in the operating account and \$9,920,479 invested in money market funds in the collection, trapping, revenue account, and debt service account.

The unrestricted cash and cash equivalents as of September 30, 2019 was available to fund operating costs of the TSFC. The remaining funds were restricted for distribution in accordance with the Tobacco Bonds indenture.

NOTE 3 RESTRICTED INVESTMENTS

TSFC categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles (GAAP). GAAP established a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of the asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 -Observable market inputs that are unadjusted quoted prices for identical assets or liabilities in active markets that a government can access at the measurement date.
- Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly (for example, quoted prices for similar assets or liabilities in active markets).
- Level 3 - Unobservable inputs

TSFC's investments are considered a Level 2.

TSFC' investments measured at fair value as of September 30, 2019 are summarized as follows:

Commercial Paper	\$ 40,246,255
Money Market Fund	<u>958,864</u>
Total Restricted	<u>\$ 41,205,119</u>

Pursuant to the Tobacco Bonds offering, TSFC was required to establish a Debt Service Reserve Account to be held by the indenture trustee. The balance of the account must be maintained, to the extent available, at the lesser of (i) the initial deposit of \$40,111,100 or (ii) the principal amount of the Senior Bonds outstanding. The balance in this account as of September 30, 2019 was \$41,205,119 which included investment earnings on the required balance.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to magnitude of a government's investment in a single issuer. TSFC's commercial paper was with one single issuer. However, TSFC purchases and sales the commercial paper with different issuers twice a month.

Interest Rate Risk

An investment with a longer maturity will generally have greater sensitivity to fair value changes that are related to market interest rates. As a means to limiting its exposure to fair value losses resulting from rising interest rates the TSFC investment policy limits the portfolio to maturities of less than one year.

Credit Risk

TSFC policy requires that for investments in (a) commercial paper, the issuing corporation, or its guarantor have a short term rating of not less than A-1 (or its equivalent) by at least two credit rating agencies; and (b) repurchase agreements, the counterparty has a long-term credit of an AA or the equivalent, and does not have a negative outlook associated with such rating, has been in operation for at least five years, and is reputable among market participants.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event a counterparty fails to uphold their agreement to a transaction, the TSFC would not be able to recover the value of its investment or collateral securities in the possession of an outside party. All of TSFC's investments are collateralized by securities held in TSFC's name by a custodial bank.

NOTE 4 ACCRUED TOBACCO SETTLEMENT RECEIVABLE

Tobacco Settlement Revenues represent a portion of future sales of tobacco products expected to be received in a calendar year. GASB Technical Bulletin 2004-1 allows for the recognition of revenue to be based on the shipment of domestic cigarettes. TSFC has recognized an accrued receivable and revenue in the financial statements that is estimated to be 75% of the next projected payment due from the MSA. Accordingly, the balance sheet includes an estimated receivable of \$27,948,750 for fiscal year 2019.

NOTE 5 TOBACCO SETTLEMENT ASSET-BACKED BONDS

In November 1998, the District (along with a number of other States and various jurisdictions) signed a Master Settlement Agreement with the major U.S. tobacco companies that ended litigation over health care treatment costs incurred for smoking-related illnesses. Under the settlement, the District is scheduled to receive total annual payments aggregating an estimated \$1.2 billion by 2025. There are several potential adjustments to this schedule, including an inflation adjustment and cigarette volume adjustment

At September 30, 2019 the following Bond Principals were outstanding.

	Outstanding Principal Balance at September 30, 2018	Issued	Principal Retired or Decreased	Outstanding Principal Balance at September 30, 2019
Series 2001	\$ 312,855,000	\$ -	\$ 22,475,000	\$ 290,380,000
Series 2006	248,264,046	-	-	248,264,046
	<u>\$ 561,119,046</u>	<u>\$ -</u>	<u>\$ 22,475,000</u>	<u>\$ 538,644,046</u>

In 2001, TSFC issued \$521,105,000 principal amount of its Tobacco Settlement Asset-Backed Bonds, Series 2001, of which \$290,380,000 was outstanding as of September 30, 2019.

In 2006, TSFC issued \$248,264,046 principal amount of its Tobacco Settlement Asset-Backed Bonds, Series 2006. There were no payments made on these bonds during fiscal year 2019 and the amount of principal outstanding as of September 30, 2019 was \$248,264,046. The payment of these bonds is secured by the distributions under the Master Settlement Agreement. Payments received by the TSFC under the Master Settlement Agreement in excess of the annual debt service requirements for the Tobacco Bonds may revert to the District’s General Fund. There was no transfer of funds from Tobacco proceeds to the General Fund in fiscal year 2019. The Tobacco Bonds are neither general nor moral obligations of the District and are not secured by a pledge of the full faith and credit of the District.

The 2006 Tobacco Bonds are subordinate to the 2001 Tobacco Bonds, and are payable from the portion of the payments to be received under the MSA in excess of the amounts required to pay the debt service and other obligations associated with the 2001 Tobacco Bonds. The portion of the MSA payments due to the District is known as “Residual Interest”. Rights to such residual interest were sold by the District to TSFC in exchange for the proceeds of the 2006 Tobacco Bonds with certain conditions.

The proceeds of the 2006 Tobacco Bonds were transferred to the District by TSFC upon receipt, and the balance of such funds is an asset of the District and not TSFC. Because TSFC is an instrumentality of the District and is accounted for as a blended component unit, its debt is considered to be a component of the long-term debt of the District. However, since the Tobacco Bonds are revenue bonds payable solely from Tobacco Settlement Revenues and do not constitute a direct debt of the District, they are not a part of the District’s debt burden.

The District retains the rights to the residual interest in excess of the amounts needed to retire the 2006 Tobacco Bonds. The proceeds of the 2006 Tobacco Bonds have been fully allocated and expended. A nominal balance allocated for the cost of issuance is being held in the 2006 Revenue account pursuant to the 2006 Tobacco Bond Indenture.

As of September 30, 2019, the total outstanding balance for all Tobacco Bonds was \$538,644,046.

Debt service requirements for planned principal and interest payments, at September 30, 2019, are as follows:

<u>Series</u>	<u>Year Ending September 30</u>	<u>Maturities</u>	<u>Interest Due</u>	<u>Total Debt Service</u>
Series 2001	2020	50,155,000	19,343,550	69,498,550
Series 2001	2021	30,530,000	16,083,475	46,613,475
Series 2001	2022 – 2026	209,695,000	48,914,850	258,609,850
Series 2006	2046	159,732,846	1,697,592,154	1,857,325,000
Series 2006	2055	88,531,200	2,478,468,800	2,567,000,000
	Total	\$ 538,644,046	\$ 4,260,402,829	\$ 4,799,046,875

The principal payments shown above represent the amount of the principal that TSFC has covenanted to pay to the extent that there are sufficient available TSRs collected. At September 30, 2019, TSFC maintained its required debt service reserve account.

NOTE 6 CONCENTRATION IN CREDIT RISK

TSFC’s projected revenue is derived from a Master Settlement Agreement entered into by certain cigarette manufacturers. Projected revenue to be recognized in future years may be subject to variability due to cigarette consumption levels, financial stability of some of the tobacco companies, along with disputed claims filed by other tobacco manufacturers.

NOTE 7 GENERAL AND ADMINISTRATIVE EXPENSES

The general and administrative expenses include legal, trustee and rating agency fees, shared service and other ancillary costs, which totaled \$211,945 for fiscal year 2019. Shared service cost was \$143,306 for fiscal year 2019. It covers allocable tax compliance personnel services performed by District employees on TSFC’s behalf of \$142,806 and space rental of \$500.

NOTE 8 NPM ADJUSTMENT DISPUTE SETTLEMENTS

During recent years, the District’s MSA payments have been reduced by amounts that the Participating Tobacco Product Manufacturers (“PMs”) have withheld for expected NPM Adjustments. An NPM Adjustment is a potential percentage reduction applied against each year’s MSA payment based on the combined national market share of Non-Participating Tobacco Product Manufacturers (“NPMs”). In December 2012, the District, Puerto Rico and seventeen (17) other signatory States to the Master Settlement Agreement (“MSA”) entered a settlement term sheet with the PMs to resolve any and all NPM adjustment claims for MSA payment years 2004 through 2015. Subsequently, seventeen (17) more states became signatories to the term sheet. In 2017, the term sheet was reduced to a formal written settlement agreement and NPM adjustment claims for 2016 and 2017 were settled. Going forward, the settlement agreement contemplates NPM Adjustment claims being resolved through a streamlined process involving a newly created entity called the Data Clearinghouse.

NOTE 9 CONTINGENCIES

TSFC's legal counsel asserts that there have been no material claims, suits, or complaints filed nor are any pending against the corporation. In the opinion of management, all other matters which are asserted or unasserted are without merit and would not have a significant effect on the financial position or changes in net assets if disposed of unfavorably.

NOTE 10 SUBSEQUENT EVENTS

In preparing these financial statements, TSFC evaluated events and transactions for potential recognition through January 8, 2020, the date the financial statements were available to be issued. There were no additional events or transactions that were discovered during the evaluation that required further disclosure.