VIRGINIA TOBACCO SETTLEMENT FINANCING CORPORATION

Financial Statements
(Unaudited)

For the Year Ended June 30, 2007

VIRGINIA TOBACCO SETTLEMENT FINANCING CORPORATION

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This section of the annual financial report of the Virginia Tobacco Settlement Financing Corporation ("the Corporation") presents an analysis of the Corporation's financial performance during the fiscal year that ended on June 30, 2007. This information should be considered in conjunction with the information contained in the financial statements, which follow this section.

Corporation Activities and Highlights

The Corporation is a public body corporate and an independent instrumentality of the state created by the Tobacco Settlement Financing Corporation Act, Chapters 482 and 488 of the 2002 Virginia Acts of the General Assembly (the "Act"). The Corporation is authorized under the Act to purchase up to fifty percent of the annual amount received by the Commonwealth of Virginia (the "Commonwealth") under the Master Settlement Agreement (MSA) between cigarette manufacturers and 46 states and other United States jurisdictions (the "Tobacco Assets").

On May 16, 2005, the Corporation issued $448,260,000 of its Tobacco Settlement Asset-Backed Bonds, Series 2005 (the "2005 Bonds") to finance the purchase of the Commonwealth's future right, title and interest to twenty-five percent of the Commonwealth's allocation under the MSA.

On May 3, 2007, the Corporation issued $1,149,273,283 in Tobacco Settlement Asset-Backed Bonds, Series 2007 A, B, C and D (the "2007 Bonds"). Under an amended and restated Purchase and Sale Agreement, the 2007 Bonds financed the purchase of the Commonwealth's future right, title and interest to fifty percent (an additional twenty-five percent) of the Commonwealth's allocation under the MSA. A portion of the proceeds of the 2007 Bonds was used to defease and refund all of the outstanding Series 2005 Bonds.

Overview of the Financial Statements

This discussion and analysis is an introduction to the Corporation's basic financial statements, which are comprised of two components: 1) government-wide and fund financial statements and 2) 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. These statements are prepared using the economic resources measurement focus and the accrual basis of accounting, similar to the accounting used by most private-sector companies. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. The Statement of Net Assets presents all of the Corporation's assets and liabilities, with the difference between the two reported as "net assets." Over time, increases and decreases in net assets measure whether the Corporation's financial position is improving or declining.

The Statement of Activities presents information showing how the Corporation's net assets changed during the most recent fiscal year. Changes in net assets are reported as soon as the underlying events giving rise to the change occur, regardless of the timing of related cash flows. Therefore, revenues and expenses are reported in these statements for some items that will only result in cash flows in future fiscal periods.

Fund Financial Statements

The fund financial statements provide detailed information about the Corporation using 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.

All of the Corporation's activity is reported using a governmental fund type. 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 assists in determining whether there will be adequate financial resources available to meet the current needs of the Corporation.

The focus of the governmental fund financial statements is narrower than that of the government-wide financial statements. Therefore, 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 fund balance sheet and the governmental fund statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and the governmental activities. These reconciliations are presented in the adjustment column in each of the financial statements.

Notes to the Financial Statements

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

Government-wide Financial Analysis of the Corporation

The Corporation was formed to purchase Tobacco Assets from the Commonwealth. The purchase was financed with the issuance of bonds. The Virginia Department of the Treasury provides staff support for the Corporation. Operating costs of the Corporation were initially funded with bond proceeds and will be funded in future years from corporation investment income. Current assets of the Corporation are bond proceeds held to pay costs of issuance on the Bonds and to pay operating costs of the Corporation over the next year. Noncurrent assets are primarily bond proceeds held in the capitalized interest and liquidity reserved accounts and restricted to the payment of debt service on the Bonds. The Corporation owns no capital assets.

Following is summarized financial data for the fiscal year ended June 30, 2007:

Condensed Statements of Net Assets
(in thousands)

	June 30, 2007	June 30, 2006
Current assets	$ 2,906	$ 963
Noncurrent assets	147,981	71,982
Total assets	150,887	72,945
Current liabilities	10,905	2,076
Noncurrent liabilities	1,107,091	442,195
Total liabilities	1,117,996	444,271
Net assets:		
Restricted	138,955	59,208
Unrestricted	(1,106,094)	(403,534)
Total net assets (deficit)	$ (967,139)	$ (371,326)

Condensed Statements of Activities
(in thousands)

	Years ended June 30, 2007	Years ended June 30, 2006
Revenues	$ 40,656	$ 45,450
Expenses	636,469	24,626
Change in net assets	(595,813)	20,824
Net assets (deficit) beginning of year	(371,326)	(392,150)
Net assets (deficit) end of year	$ (967,139)	$ (371,326)

Revenues for the year are comprised of tobacco settlement revenues, interest on investments and the net increase in the market value of investments. Expenses reflect bond interest expense and amortized issuance costs. The decrease in net assets resulted from the issuance of the 2007 Bonds.

Financial Analysis of the Corporation's Funds

All balances of the corporation relate to the issuance of the Series 2007 Bonds.

Debt Administration

As a financing entity, the business of the Corporation is debt administration. The Corporation issued Bonds to purchase Tobacco Assets from the Commonwealth and to refinance bonds previously issued to purchase Tobacco Assets from the Commonwealth. The outstanding Bonds are secured solely by fifty percent of future tobacco settlement revenues allocated to the Commonwealth and investment earnings. As of June 30, 2007, there were no plans for the Corporation to issue additional debt. The table below summarizes bond issuance activity during the year.

Summary of Bond Obligations
(in millions)

	Tobacco Settlement Asset-Backed Bonds
Outstanding, 7/1/06	$ 442
Issued during year	2,042
Defeased during year	(442)
Unamortized discount and other deferrals	(934)
Outstanding, 6/30/07	$ 1,108

VIRGINIA TOBACCO SETTLEMENT FINANCING CORPORATION

Statement of Net Assets and Debt Service Fund Balance Sheet (Unaudited)
As of June 30, 2007

	DEBT SERVICE FUND	ADJUSTMENTS (NOTE 1-C)	STATEMENT OF NET ASSETS
ASSETS			
Current Assets:			
Cash equivalents (note 2)	$ 2,906,207	$ -	$ 2,906,207
Investments (note 3)	117,433,091	(117,433,091)	-
Receivable	252,052	(252,052)	-
Prepaid expenses	25,487	(25,487)	-
Total current assets	120,616,837	(117,710,630)	2,906,207
Noncurrent Assets:			
Unamortized bond issue costs	-	8,970,640	8,970,640
Restricted assets:			
Investments (note 3)	-	117,433,091	117,433,091
Tobacco settlement receivable (note 7)	-	21,269,518	21,269,518
Interest receivable	-	252,052	252,052
Prepaid expenses	-	25,487	25,487
Total noncurrent assets	-	147,950,788	147,950,788
Total Assets	$ 120,616,837	30,240,158	150,856,995
LIABILITIES			
Current Liabilities:			
Bonds payable (note 4)	$ -	800,000	800,000
Accrued expenses payable	26,500	-	26,500
Accrued interest payable	-	10,079,072	10,079,072
Total current liabilities	26,500	10,879,072	10,905,572
Noncurrent liabilities - bonds payable (note 4)	-	1,107,090,888	1,107,090,888
Total Liabilities	26,500	1,117,969,960	1,117,996,460
FUND BALANCE/NET ASSETS			
Fund Balance - reserved for debt service	120,590,337	(120,590,337)	-
Total Liabilities and Fund Balance	$ 120,616,837		
Net Assets (Deficit)			
Restricted for debt service (note 5)		138,954,661	138,954,661
Unrestricted (note 6)		(1,106,094,126)	(1,106,094,126)
Total Net Assets (Deficit)		$ (967,139,465)	$ (967,139,465)

The accompanying notes are an integral part of this statement.

VIRGINIA TOBACCO SETTLEMENT FINANCING CORPORATION

Statement of Activities and Debt Service Fund Revenues, Expenditures, and Changes in Fund Balance (Unaudited)
For the Year Ended June 30, 2007

	DEBT SERVICE FUND	ADJUSTMENTS (NOTE 1-C)	STATEMENT OF ACTIVITIES
REVENUES			
Tobacco settlement revenues	$ 31,546,009	$ 6,139,749	$ 37,685,758
Investment interest	2,078,577	-	2,078,577
Net increase in fair value of investments	891,755	-	891,755
Total revenues	34,516,341	6,139,749	40,656,090
EXPENDITURES/EXPENSES			
General & administrative	56,269	-	56,269
Bond issue cost	8,921,664	(8,921,664)	-
Amortization of bond issue cost	-	1,371,917	1,371,917
Purchase of additional 25% of future tobacco settlement revenues from the Commonwealth of Virginia	613,994,236	-	613,994,236
Debt service:			
Principal retirement	-	-	-
Interest	11,996,759	9,050,299	21,047,058
Total expenditures/expenses	634,968,928	1,500,552	636,469,480
Excess (Deficiency) of revenues over (under) expenditures/expenses	(600,452,587)	-	-
OTHER FINANCING SOURCES (USES)			
Principal amount of bonds issued	2,041,825,000	(2,041,825,000)	-
Bond discount	(899,463,376)	899,463,376	-
Payment to refunded bond escrow agent	(466,308,100)	466,308,100	-
Total other financing sources (uses)	676,053,524	(676,053,524)	-
Excess (deficiency) of revenues and other financing sources over (under) expenditures/expenses and other financing uses	75,600,937	(75,600,937)	-
Net change in net assets		(595,813,390)	(595,813,390)
Fund balance/net assets (deficit) at beginning of year	44,989,400	(416,315,475)	(371,326,075)
Fund balnnce/net assets (deficit) at end of year	$ 120,590,337	$ (1,087,729,802)	$ (967,139,465)

The accompanying notes are an integral part of this statement.

INTRODUCTION

The Tobacco Settlement Financing Corporation (Corporation) was created by the Tobacco Settlement Financing Corporation Act, Chapters 482 and 488 of the Acts of the General Assembly of the Commonwealth of Virginia (Commonwealth) during the 2002 General Session. The Corporation is a public corporate entity and an independent instrumentality of the state, managed by a six-member board, including the State Treasurer.

The purpose of the Corporation is to purchase from the Commonwealth portions of its future right, title and interest in the Tobacco Settlement Revenues (TSRs) under the Master Settlement Agreement and the Consent Decree and Final Judgment (MSA). The MSA resolved tobacco-related litigation between the settling states and the Participating Manufacturers (PMs), released the PMs from past and present tobacco-related claims of the settling states, and provides for a continuing release of future tobacco-related claims, in exchange for certain payments to be made to the settling states, as well as certain tobacco advertising and marketing restrictions, among other things.

In May 2005, pursuant to a Purchase and Sale Agreement with the Commonwealth, the Commonwealth sold to the Corporation 25% of its future right, title and interest in the TSRs. Specifically, these rights include a 25% share of TSRs received by the Commonwealth starting May 15, 2005, and in perpetuity under the MSA. Consideration paid by the Corporation to the Commonwealth for TSRs consisted of a cash amount deposited into an endowment to fund the long-term spending plan approved by the Tobacco Indemnification and Community Revitalization Commission.

On May 3, 2007, the Corporation issued $1,149,273,282 of its Tobacco Settlement Asset-Backed Bonds, Series 2007 A, B-1, B-2, C and D. Proceeds of the sale were used to fully defease the Corporation's outstanding Tobacco Settlement Asset-Backed Bonds Series 2005. Pursuant to an Amended and Restated Sale Agreement dated as of May 1, 2007, net proceeds from the sale in the amount of $613,994,236 will be transferred to the Tobacco Indemnification and Community Revitalization Endowment Fund as consideration for the purchase of an additional 25% share of TSRs received by the Commonwealth starting April 27, 2007, and in perpetuity under the MSA.

The bonds of the Corporation are asset-backed instruments secured solely by the TSRs, and the Corporation's right to receive TSRs is expected to produce funding for its obligations. The TSR payments are dependent on a variety of factors, some of which are:

- the financial capability of the participating cigarette manufacturers to pay TSRs,
- future cigarette consumption which impacts the TSR payment, and
- future legal and legislative challenges against the tobacco manufacturers and the master settlement agreement providing for the TSRs.

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

Operations of the Corporation were funded initially with a portion of bond proceeds and in subsequent years will be funded with Corporation investment income.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. 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 Governmental Accounting Standards Board (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.

B. 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.

C. ADJUSTMENTS

The adjustments column represents 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. Governmental fund statements do not reflect bonds payable. This column is also used to record full accrual revenues and receivables and to reclassify current assets as restricted assets on the Statement of Net Assets.

D. CASH EQUIVALENTS AND INVESTMENTS

Cash equivalents consist of money market funds. Investments consist of direct investments in interest bearing and discounted commercial paper. Investments are stated at fair value, as determined by quoted market values, in accordance with GASB Statement No. 31.

E. RESTRICTED ASSETS

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

F. CAPITAL ASSETS

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

G. LONG-TERM OBLIGATIONS

Long-term obligations are reported at face value.

H. DEFERRED BOND ISSUANCE COSTS

Bond issuance costs of $8,980,194 relating to the issued bonds are being amortized using the effective interest method over the life of the bonds.

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 comprise the various net earnings from revenues and expenses. Net assets generally are classified in the following components:

> Restricted net assets consist of 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.

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 revenue and expenditures during the reporting period. Actual results could differ from those estimates.

2. CASH EQUIVALENTS

At June 30, 2007, the Corporation has cash equivalents (book balances) totaling $2,906,207, which is held in JPMorgan US Government money market funds, as presented on the Statement of Net Assets and Debt Service Fund Balance Sheet.

3. INVESTMENTS

At June 30, 2007, investments of $117,433,091, as presented on the Statement of Net Assets and Debt Service Fund Balance Sheet, consist of the following:

Investment Type	Fair Value	Percentage of Investments	Maturity - Less Than 1 Year	Standard & Poor's Ratings
United States Treasury - Interest Bearing Note	$32,392,815	27.58%	$32,392,815	AAA
SBLI - Interest Bearing Commercial Paper	32,636,077	27.79%	32,636,077	A+
General Electric Capital Corp. - Discounted Commercial Paper	52,404,199	44.63%	52,404,199	AAA
Total investments	$117,433,091	100.00%	$117,433,091	

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 are in the possession of an outside party. The Corporation does not have a formal investment policy for custodial credit risk.

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 Standards & Poor's, P-1 by Moody's Investors 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. Investments that represent more than 5 percent of the Corporation's net investments are noted above.

Interest Rate Risk: This risk is defined as the risk that changes in interest rates will adversely affect the fair value of an investment. The Corporation mitigates interest rate risk by structuring investment maturities to meet cash requirements as outlined in the indenture.

Reserve Requirements: Of the total investment balance of $117,433,091, an amount of $85,392,039 consists of the Liquidity Reserve Requirement provided for by the bond indenture. The Corporation met its reserve balance requirements at June 30, 2007.

VIRGINIA TOBACCO SETTLEMENT FINANCING CORPORATION
Notes to the Financial Statements (Unaudited)

4. LONG-TERM DEBT

Activity in the bonds payable and related accounts for fiscal year 2007 was as follows:

Description	Balance at June 30, 2006	Increases	Decreases	Balance at June 30, 2007	Amount due Within One Year
Total bonds outstanding	$ 442,195,000	$ 2,041,825,000	$ (442,195,000)	$ 2,041,825,000	$ 800,000
Less:					
Unamortized discount - capital appreciation bonds	-	(892,551,718)	1,168,433	(891,383,285)	-
Unamortized issuance discounts	-	(6,911,659)	8,485	(6,903,174)	-
Derferral on debt defeasance	-	(36,618,340)	970,687	(35,647,653)	-
	$ 442,195,000	$ 1,105,743,283	$ (440,047,395)	$ 1,107,890,888	$ 800,000

Long-term debt is comprised of the following:

Series 2007A Turbo Term Bonds due June 1, 2046, with interest of 6.706% due semiannually June 1 and December 1, commencing on December 1, 2007	$682,650,000
Series 2007B-1 Turbo Term Bonds due June 1, 2047, with interest of 5% due semiannually June 1 and December 1, commencing on December 1, 2007	335,625,000
Series 2007B-2 Senior Convertible Bonds due June 1, 2046, convertible to interest bearing bonds on December 1, 2011 with interest of 5.2% due semiannually June 1 and December 1, commencing on June 1, 2012	27,031,178
Series 2007C First Subordinate Capital Appreciation Bonds due June 1, 2047, with approximate yield of 5.67%, maturity value $724,870,000	77,800,705
Series 2007D Second Subordinate Capital Appreciation Bonds due June 1, 2047, with approximate yield of 5.77%, maturity value $264,770,000	27,334,832
Total long-term debt	1,150,441,715
Unaccreted Capital Appreciation Bonds	891,383,285
Total Outstanding Maturities	$2,041,825,000

On May 3, 2007, the Corporation issued $1,149,273,282 of its Tobacco Settlement Asset-Backed Bonds, Series 2007 A, B-1, B-2, C and D. Proceeds of the sale of $466,308,100 were used to fully defease the Corporation's outstanding Tobacco Settlement Asset-Backed Bonds Series 2005. The debt defeasance resulted in an accounting loss of $36,618,340 that is deferred and amortized over the remaining life of the old debt. It will, however, reduce total debt service payments over the next 30 years by $61,998,747 resulting in an economic gain of $43,296,642 discounted at a rate of 3 percent.

The bonds were also issued to finance the Corporation's purchase of an additional 25% of the state's future receipts from the MSA with participating cigarette manufacturers. The bonds are secured by the Corporation's claim to 50% of these future receipts. The claim is on parity with the claim of the Commonwealth to the ownership of the remaining 50% of all amounts expected to be paid to the Commonwealth under the MSA. In addition, the bonds are secured by all earnings on amounts on deposit in certain accounts pledged under the indenture and the amounts held in certain accounts established under the indenture. The capital appreciation bonds were issued at an aggregate discount from par of $892,551,718. The discount is being amortized using the effective interest method over the life of the bonds.

The bond indenture states that the Series 2007 Bonds shall not be deemed to be nor constitute a debt or obligation of the Commonwealth or a pledge of the full faith or credit of the Commonwealth or any political subdivision thereof. The Corporation has no taxing power. No assets or revenues of the Commonwealth 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 2007B-2, 2007C, and 2007D Bonds have Capital Appreciation Bonds with unaccreted values of $6,878,822, $647,069,295, and $237,435,168, respectively, as of June 30, 2007.

The proceeds of this issue were used for the following:

Payment to the Commonwealth for an additional 25% of the expected MSA proceeds	$613,994,236
Deposit to escrow fund for Series 2005 bonds	466,308,100
Liquidity reserve accounts	85,392,039
Capitalized interest	32,946,278
Capitalized operating expenses	173,108
Costs of Issuance	7,084,851
Series 2005 Bonds investment agreement termination	2,010,000
Total Bond Proceeds including amounts held under the Series 2005 Indenture	$1,207,908,612

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

Fiscal Year	Sinking Fund Installments and Turbo Term Bond Maturities	Interest	Term Bond Maturities	Interest
2008	$ 800,000	$ 62,532,935	$ -	$ 72,638,831
2009	1,500,000	62,455,816	-	62,559,759
2010	2,400,000	62,325,049	-	62,559,759
2011	2,940,000	62,145,999	-	62,559,759
2012	2,640,000	63,722,221	-	63,588,362
2013-2017	20,900,000	315,167,575	-	321,615,395
2018-2022	61,100,000	301,460,511	-	321,615,395
2023-2027	87,200,000	276,879,668	-	321,615,395
2028-2032	125,490,000	241,704,352	-	321,615,395
2033-2037	180,980,000	190,643,527	-	321,615,395
2038-2042	248,075,000	118,730,845	-	321,615,395
2043-2047	1,307,800,000	41,909,750	2,041,825,000	268,713,309
	$ 2,041,825,000	$ 1,799,678,248	$ 2,041,825,000	$ 2,522,312,150

Term bond maturities represent the minimum amount of principal that the Corporation must pay as of specific distribution dates in order 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 2007 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 by the indenture for debt service. The composition of restricted net assets is as follows:

Investments	$117,433,091
Tobacco settlement receivable	21,269,518
Interest receivable	252,052
Net assets restricted for debt service	$138,954,661

6. UNRESTRICTED NET ASSETS (DEFICIT)

On May 3, 2007, the Corporation issued $1,149,273,282 of its Tobacco Settlement Asset-Backed Bonds. During the fiscal year ended June 30, 2007, a total of $613,994,236 was deposited into an endowment to fund the long-term spending plan approved by the Tobacco Indemnification and Community Revitalization Commision. Of the remaining assets related to the bond issuance and other operations of the Corporation at

June 30, 2007, a total of $138,954,661 is restricted for debt service, resulting in a deficit for unrestricted net assets of $1,106,094,126, as presented on the Statement of Net Assets and Debt Service Fund Balance Sheet.

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 attorney 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 potential financial liability of the PMs for smoking-related injuries, the cost of which have 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) ten annual payments required to be made on each April 15, commencing on April 15, 2008, and continuing through April 15, 2017 (Strategic Contribution Payments). Before forming the Corporation, the PMs made all five required Initial Payments and the Annual Payments due April 15, 2000 through 2005, 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.

Much of the TSRs represent a portion of future sales of tobacco products. Technical Bulletin No. 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 $21,269,518.

The composition of accounts receivable is as follows:

Estimated tobacco settlement receivable	$21,269,518
Interest receivable	252,052
Total accounts receivable	$21,521,570

8. ADMINISTRATIVE EXPENSES

Administration expenses for the year ending June 30, 2007 were $56,269, for trustee, accounting and rating agency fees.

9. CONTINGENCIES

Tobacco Litigation Risk

The amount of revenue recognized by the Corporation could be adversely impacted by certain third party litigation involving tobacco companies and others.