TOBACCO SETTLEMENT AUTHORITY

(A Component Unit of the State of Washington)

Independent Auditor's Report and Financial Statements with Supplemental Information

June 30, 2008 and 2007

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Tobacco Settlement Authority

We have audited the accompanying statements of net deficit of the Tobacco Settlement Authority (the TSA), at June 30, 2008 and 2007 and the related statements of revenues, expenses, and changes in net deficit and cash flows for the years then ended. These financial statements are the responsibility of the TSA's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the TSA as of June 30, 2008 and 2007, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying Management's Discussion and Analysis on pages 2 through 8 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the TSA's management. We have applied certain limited procedures, which consisted principally 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 audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental information on pages 20 through 22 is presented for purposes of additional analysis and is not a required part of the financial statements. The supplemental information, which is the responsibility of the TSA's management, has been subjected to the procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

Moss Adams LLP

Seattle, Washington
November 14, 2008

As management of the Tobacco Settlement Authority (the "Authority"), we offer readers of the Authority's financial statements this narrative overview and analysis of the financial activities of the Authority for the years ended June 30, 2008 and 2007. This overview and analysis is required by accounting principles generally accepted in the United States of America ("GAAP") in Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments* ("GASB 34").

FINANCIAL HIGHLIGHTS

Tobacco Settlement Revenues ("TSRs") of $54.5 million and $38.7 million were recognized as revenue in the fiscal years ended June 30, 2008 and 2007, respectively. In accordance with the GASB 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues,* $24 million TSRs applicable to cigarette sales between January 1, 2008 and June 30, 2008 were recorded as accrued TSR Receivable as of June 30, 2008 while $20.1 million TSRs applicable to cigarette sales between January 1, 2007 and June 30, 2007 were recorded as accrued TSR Receivable as of June 30, 2007. No additional bonds were issued during 2008.

During the fiscal year ended June 30, 2008:

- Total assets increased by $2.8 million to $87.1 million due to the increase in the TSR receivable over the prior year of $3.9 million, net of a decrease in cash and cash equivalents of $1.1 million. The increase in the receivable is primarily attributable to the strategic payments while the decrease in cash and cash equivalents is due to the use of available liquid assets for bond payments.

- At year-end, the Authority had total bonds payable of $457.9 million, net of discounts. This represents a net decrease of $21.6 million, or 4.5%, resulting from principal payments on bonds.

- At June 30, 2008, the Authority had a reduction of $24.5 million (6.2%) in the Net Deficit over that of the previous fiscal year end.

- TSRs increased by $15.8 million due in part to the receipt of the first annual strategic contribution payment.

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial statements consist of three parts: Management's Discussion and Analysis, the basic financial statements and the notes to the financial statements. The financial statements are presented in a manner similar to that of a private business, using the economic resources measurement focus and the accrual basis of accounting. The financial statements report information for all Authority operations. The Statement of Net Deficit includes all of the Authority's assets and liabilities. All of the revenues and expenses of the Authority are accounted for in the Statements of Revenues, Expenses and Changes in Net Deficits.

In addition, program financial statements are presented as supplemental schedules. These statements separate the financial statements into the Restricted Bond Fund and General Operating Fund.

The financial statements of the Authority have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to governmental units. The Governmental Accounting Standards Board ("GASB") is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The Authority has applied all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989 (unless they conflict with or contradict GASB pronouncements): Statements and Interpretations of the Financial Accounting Standards Board, Accounting Principles Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures. All program and general operating funds of the Authority are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of these funds are included on the balance sheet. The operating statements for all funds present increases (e.g., revenues) and decreases (e.g., expenses) in net fund equity. These funds utilize the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Management believes that the present value amount of TSRs that will be collected over time is $373,276,487, an amount equal to the net deficit. However, prior to the issuance of GASB No. 48 which is effective for years beginning on or after December 15, 2006, accounting principles generally accepted in the United States of America did not allow these future revenues to be recorded in the financial statements. As such, the only TSRs receivable recorded in the accompanying financial statements are those estimated to accrue due to cigarette shipments from January 1 to June 30, 2008.

According to the summary data provided by the Bureau of the Census September 2007 update reports; the industry trends indicate a continued drop in cigarette consumption. Because Tobacco Settlement Revenues are based on a formula that includes the domestic shipment of cigarettes, a continued decrease in sales is likely to extend the average life of the bond issue past that projected at the time of issuance in 2002.

The financial markets have deteriorated in September and October, 2008 and tobacco bonds are trading at record effective interest rates and significant discounts to par value in the secondary market, however, there is no direct affect to the TSA at this time.

In September 2006, the GASB issued Statement No. 48 *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues* effective for financial statement periods beginning on or after December 15, 2006. For transactions after that date, this statement requires the Authority to recognize the purchase of TSR's from the State of Washington as a purchase of a future revenue stream as well as recognize a deferred charge on its Statement of Net Deficit. The statement does not require the Authority to apply the provisions of statement to the previous transaction. Application to prior transactions would require restatement with application of the cumulative impact to the beginning net assets of the earliest year reported in the comparative statements. The initial impact of electing to implement GASB 48 for the existing transaction would result in a positive net asset position at restatement with an annual reduction in net assets (or a loss on bond operations each year) until the bond is fully redeemed. Management believes that restatement would not offer any significant value to the readers of the TSA financial statements who are accustomed to the current presentation. Further, management believes that such implementation would limit historical comparability and its predictive value. Therefore, prospective application of this section of the statement will be implemented.

FINANCIAL ANALYSIS OF THE AUTHORITY

Statements of Net Deficit

The following table summarizes the changes in assets, liabilities, and net deficits between the years ended June 30, 2008 and 2007 (in millions):

	2008	2007	Change	
Assets				
Cash and cash equivalents	$ 15.4	$ 16.5	$ (1.1)	(6.7%)
Investments	46.0	45.9	0.1	0.2%
Accrued TSR receivable	24.0	20.1	3.9	19.4%
Unamortized bond issuance costs	1.7	1.8	(0.1)	(5.6%)
Total assets	$ 87.1	$ 84.3	$ 2.8	3.3%
Liabilities				
Accrued interest payable and other liabilities	$ 2.5	$ 2.6	$ (0.1)	(3.8%)
Bonds payable, net	457.9	479.5	(21.6)	(4.5%)
Total liabilities	460.4	482.1	(21.7)	(4.5%)
Net deficit	(373.3)	(397.8)	24.5	(6.2%)
Total liabilities and net deficit	$ 87.1	$ 84.3	$ 2.8	3.3%

Statements of Revenues, Expenses, and Changes in Net Deficit

The following table summarizes the activities in revenues and expenses between the years ended June 30, 2008 and 2007 (in millions):

	2008	2007	Change	
Revenues				
Tobacco settlement revenues	$ 54.5	$ 38.7	$ 15.8	40.8%
Bond program interest	2.7	2.7	-	- %
Total revenues	$ 57.2	$ 41.4	$ 15.8	38.2%
Expenses				
Bond program interest expense	$ 31.3	$ 31.9	$ (0.6)	(1.9%)
Other bond program expenses	1.2	0.7	0.5	71.4%
General and administrative	0.1	0.1	-	- %
Total expenses	$ 32.6	$ 32.7	$ (0.1)	(0.3%)
Change in net deficit	$ 24.6	$ 8.7	$ 15.9	182.8%

Tobacco settlement revenues (TSRs) of $54.5 million and $31.3 million in interest on debt are the primary components of total revenues and expenses, respectively, for the Restricted Bond Program. TSRs increased by $15.8 million during fiscal year 2008, primarily due to recognition of the first annual strategic contribution payment.

During fiscal year 2008 revenue received for general operations included interest earned on investments. General operating expenses within the General Operating Fund ($79,533) for the fiscal year 2008 is comprised of allocable salaries and wages and other general and administrative expenses.

DEBT ADMINISTRATION

The Authority has long-term debt obligations of $457.9 million, net of bond discounts at June 30, 2008. The Authority's bond funds are held by a trustee who ensures that bond resolution requirements are met, including payments of debt service and funding of necessary reserves. At June 30, 2008, amounts held by the trustee represent full funding of these requirements.

The bonds were sold pursuant to a Purchase and Sale Agreement between the Authority and the State of Washington in which TSRs ($30 million by July 1, 2003, and 29.2% of the TSRs thereafter) were purchased by the Authority for a one-time cash distribution of $450 million to the State of Washington. The bonds are solely secured by the "right to receive" TSRs from major tobacco companies under the Master Settlement Agreement. The Bonds consist of Serial Bonds and Turbo Term Bonds. The Turbo Term Bonds are subject to redemption in accordance with the schedule of Sinking Fund Installments and, in addition, are subject to mandatory redemption to the extent that the funds remain on each payment date after meeting all current bond obligations ("Turbo Redemptions").

The Authority and the State of Washington covenanted to do and perform all acts and things permitted by law and the Bond Indenture which are necessary or desirable in order to ensure that interest paid on the Tax-Exempt Bonds will be excluded from gross income for federal income tax purposes and shall take no action that would result in such interest not being excluded from gross income for federal income tax purposes.

The Authority has no general obligations bonds and does not currently have an issuer credit rating.

Additional information on the Authority's long-term liabilities can be found in Note 5 of this report.

COMPARISON OF FISCAL YEARS 2007 WITH 2006

Statements of Net Deficit

The following table summarizes the changes in combined net deficits between ended June 30, 2007 and 2006 (in millions):

	2007	2006	Change	
Assets				
Cash and cash equivalents	$ 16.5	$ 16.4	$ 0.1	0.6%
Investments	45.9	45.9	-	- %
Accrued TSR receivable	20.1	18.1	2.0	11.0%
Unamortized bond issuance costs	1.8	1.9	(0.1)	(5.3%)
Total assets	$ 84.3	$ 82.3	$ 2.0	2.4%
Liabilities				
Accrued interest payable and other liabilities	$ 2.6	$ 2.7	$ (0.1)	(3.7%)
Bonds payable, net	479.5	486.2	(6.7)	(1.4%)
Total liabilities	482.1	488.9	(6.8)	(1.4%)
Net deficit	(397.8)	(406.6)	8.8	(2.2%)
Total liabilities and net deficit	$ 84.3	$ 82.3	$ 2.0	2.4%

Statements of Revenues, Expenses and Changes in Net Deficit

The following table summarizes the combined changes in net deficit between the fiscal years 2007 and 2006 (in millions):

	2007	2006	Change	
Revenues				
Tobacco settlement revenues	$ 38.7	$ 34.8	$ 3.9	11.2%
Bond program interest	2.7	2.5	0.2	8.0%
Total revenues	$ 41.4	$ 37.3	$ 4.1	11.0%
Expenses				
Bond program interest expense	$ 31.9	$ 32.2	$ (0.3)	(0.9%)
Other bond program expenses	0.7	0.8	(0.1)	(12.5%)
General and administrative	0.1	0.1	-	- %
Total expenses	$ 32.7	$ 33.1	$ (0.4)	(1.2%)
Change in net deficit	$ 8.7	$ 4.2	$ 4.5	107.1%

During the fiscal year ended June 30, 2007 the Authority's combined total assets increased by $2.0 million primarily due to increases in TSR receivable balances (due to the expected receipt of the first annual strategic contribution payment. Combined total net income of $8.7 million for fiscal year 2007 represented an increase in net income of $4.1 million from fiscal year 2006. This increase was primarily attributable to the increase in tobacco settlement revenues of $3.9 million).

Questions and inquiries may be directed to the Senior Director of Finance or the Senior Controller at Tobacco Settlement Authority, 1000 Second Avenue, Suite 2700, Seattle, WA, 98104 or 206-464-7139.

TOBACCO SETTLEMENT AUTHORITY
(A Component Unit of the State of Washington)
STATEMENTS OF NET DEFICIT
JUNE 30, 2008 AND 2007

ASSETS

	2008	2007
CASH AND CASH EQUIVALENTS	$ 15,363,073	$ 16,431,761
INVESTMENTS	46,034,106	45,930,588
TSR RECEIVABLE	24,048,013	20,082,188
UNAMORTIZED BOND ISSUANCE COSTS	1,636,597	1,804,814
PREPAID FEES AND INTEREST RECEIVABLE	34,925	5,606
TOTAL ASSETS	$ 87,116,714	$ 84,254,957

LIABILITIES AND NET DEFICIT

	2008	2007
ACCRUED INTEREST PAYABLE	$ 2,516,191	$ 2,625,372
ACCOUNTS PAYABLE AND OTHER LIABILITIES	14,716	14,941
BONDS PAYABLE		
Current interest bonds	467,575,000	490,195,000
Unamortized bond discount	(9,712,706)	(10,711,019)
	457,862,294	479,483,981
TOTAL LIABILITIES	460,393,201	482,124,294
TOTAL NET DEFICIT	(373,276,487)	(397,869,337)
TOTAL LIABILITIES AND NET DEFICIT	$ 87,116,714	$ 84,254,957

See accompanying notes.

TOBACCO SETTLEMENT AUTHORITY
(A Component Unit of the State of Washington)
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET DEFICIT
YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
REVENUES		
Tobacco settlement revenues and other fee income	$ 54,479,709	$ 38,740,416
Non operating revenues - interest income	2,732,979	2,674,891
	57,212,688	41,415,307
EXPENSES		
Interest on debt	31,337,275	31,892,871
Amortization of bond discount	998,313	596,125
Amortization of bond issuance costs	168,217	100,448
General and administrative	116,033	115,768
	32,619,838	32,705,212
CHANGE IN NET DEFICIT	24,592,850	8,710,095
NET DEFICIT		
Beginning of year	(397,869,337)	(406,579,432)
End of year	$ (373,276,487)	$ (397,869,337)

See accompanying notes.

TOBACCO SETTLEMENT AUTHORITY
(A Component Unit of the State of Washington)
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
OPERATING ACTIVITIES		
Cash received from tobacco settlement revenues	$ 50,537,411	$ 36,738,436
Cash paid for general and administrative expenses	(120,315)	(105,847)
Net cash from operating activities	50,417,096	36,632,589
INVESTING ACTIVITIES		
Cash received from interest income	2,580,672	2,652,584
NONCAPITAL FINANCING ACTIVITIES		
Principal repayment on bonds	(22,620,000)	(7,315,000)
Cash paid for bond interest expense	(31,446,456)	(31,932,494)
Net cash from financing activities	(54,066,456)	(39,247,494)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,068,688)	37,679
CASH AND CASH EQUIVALENTS		
Beginning of year	16,431,761	16,394,082
End of year	$ 15,363,073	$ 16,431,761
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
Excess of revenues over expenses	$ 24,592,850	$ 8,710,095
Adjustments to reconcile operating income to net cash provided by operating activities		
Amortization of bond discount	998,313	596,125
Amortization of bond issuance costs	168,217	100,448
Cash paid for bond interest expense	31,446,456	31,932,494
Cash received from interest income	(2,580,672)	(2,652,584)
Changes in assets and liabilities		
TSR receivable	(3,965,825)	(2,024,931)
Prepaid fees and interest receivable	(29,319)	4,698
Accounts payable and other liabilities	(225)	5,867
Accrued interest payable	(109,181)	(39,623)
Other	(103,518)	-
Net cash from operating activities	$ 50,417,096	$ 36,632,589

See accompanying notes.

Note 1 - Organization, Program Funds and Description of Business

The Tobacco Settlement Authority (the "Authority") was formed in April 2002 pursuant to legislation passed by the Washington State Legislature in March 2002 (RCW 43.340) and signed into law by Governor Gary Locke. It is a public instrumentality separate and distinct from the State. However, because the State appoints the governing body and is entitled to the resources of the Authority, the financial accountability criteria as defined by the Governmental Accounting Standards Board ("GASB") have been met. As such, the Authority is presented as a blended component unit of the State in its Comprehensive Annual Financial Report ("CAFR").

The Authority board consists of five directors. The chair of the Authority is appointed by, and serves at the pleasure of, the governor. The term of the directors, other than the chair, are four years from the date of their appointment.

The Authority was created to issue bonds to securitize a portion of the future revenue stream available under the Master Settlement Agreement ("MSA") in order to generate $450 million of cash for the State of Washington (the "State") in the 2002-2004 biennium. In November 2002, $517 million of bonds were issued and $450 million was deposited by the Authority into the State general fund in exchange for acquiring 29.2% of the State's tobacco revenue settlement stream. The final maturity of the bonds is in 2032, however at the date of bond closing, it was estimated that the bonds would remain outstanding for a 17-year period.

Payment on the bonds is an obligation only of the Authority and not an obligation of the State of Washington. Neither the faith and credit nor the taxing power of the State of Washington or any municipal corporation, subdivision or agency of the State is pledged to the payment of the bonds.

The Authority includes two funds; the Restricted Bond Fund and General Operating Fund. The Restricted Bond Fund accounts for the tobacco revenue settlement stream and the debt service transactions. The General Operating Fund accounts for the fiscal activities of the ongoing program responsibilities of the Authority. The Authority's fiscal year begins on July 1 and ends on June 30.

Administrative and technical support for the Authority is provided by the Washington State Housing Finance Commission, which was reimbursed for its costs from the proceeds of the sale of the bonds. Accounting and staff services are to be provided until the bonds are retired with further reimbursements for services to be drawn, as necessary, from the revenues used to repay the debt.

Note 2 - Summary of Significant Accounting Policies

The financial statements of the Authority have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to governmental units. The GASB is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The Authority has applied all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989 (unless they conflict with or contradict GASB pronouncements): Statements and Interpretations of the Financial Accounting Standards Board, Accounting Principles Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures.

The most significant of the Authority's accounting policies are described below.

Measurement Focus and Basis of Accounting - All program and general operating funds of the Authority are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of these funds are included on the statement of net assets. The statement of revenues, expenses and changes in net assets for all funds present increases (e.g., revenues) and decreases (e.g., expenses) in net fund equity. These funds utilize the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Unclassified Balance Sheet - The Authority's business cycle is greater than one year. As such, all assets and liabilities as shown on the statement of net deficit are unclassified.

Cash and Cash Equivalents - Cash deposits held in the bond issue are held in the corporate trust departments of commercial banks (the "Trustee") in the bond issue's name. Cash deposits held by the general operating fund are entirely covered by Federal Depository Insurance Corporation (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission ("PDPC").

For purposes of the statement of cash flows, the Authority considers all highly liquid, interest-bearing instruments purchased with an original maturity of three months or less that are readily convertible to cash to be cash and cash equivalents.

Investments - Investments are comprised of certificates of deposits and guaranteed investment contracts as of June 30, 2008 and 2007, and are stated at cost since the redemption terms are not affected by market rates. The Authority's Trustee holds all of the Authority's investments in the name of the Authority.

Unamortized Bond Issuance Costs and Discounts - Unamortized bond issuance costs and unamortized bond discounts are amortized using the bonds outstanding method over the expected term of the life of the bonds.

Note 2 - Summary of Significant Accounting Policies (Continued)

Bonds Payable - Current interest serial and term bonds are stated at their principal amount outstanding, net of unamortized bond discount.

Income Taxes - The Authority is exempt from federal income taxes under Internal Revenue Code (IRC) Section 115(a) and accordingly, no provision for income taxes was made for the years ended June 30, 2008 and 2007.

Tobacco Settlement Revenues - The purchase and sale agreement between the Authority and the State of Washington conveyed the right to the first $30 million of the tobacco settlement revenues ("TSRs") for the fiscal year ended June 30, 2003. Effective July 1, 2003, 29.2% of the tobacco settlement revenues received by the State are to be deposited with the Authority until such time as the bond obligations are fully paid.

As currently required by Statement No. 48 *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, the event that results in the recognition of an asset and revenue is the domestic shipment of cigarettes. The Authority estimates accrued TSRs that derive from sales of cigarettes from January 1 to June 30, according to the annual TSR payments that are based on cigarette sales from the preceding calendar year and historical payment trends. TSR revenues recognized for 2008 and 2007 included an accrual of $24,048,013 and $20,082,188, respectively.

Other Fee Income - The Authority is entitled to receive operating funds each year from TSRs as outlined in the bond indenture. However, the Authority has the option to deliver an officer's certificate to the Trustee on or before April 15 of each year certifying changes to the amount of operating funds to be drawn. For fiscal years 2008 and 2007, the Authority delivered officer certificates to the Trustee directing that no operating funds be disbursed for those years.

Use of Estimates - The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions in determining the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

Note 2 - Summary of Significant Accounting Policies (Continued)

Net Deficit - The net deficit balances of $373,276,487 at June 30, 2008 and $397,869,337 at June 30, 2007 reflect unrestricted net deficits as defined by GASB Statement No. 34. This balance is comprised of amounts from two funds. The general operating fund has a net asset balance of $567,600 at June 30, 2008 and $626,703 at June 30, 2007. The restricted bond fund has a net deficit balance of $373,844,087 at June 30, 2008 and $398,496,040 at June 30, 2007. Although, prior to the issuance of GASB No. 48, which is effective for years beginning on or after December 15, 2006, generally accepted accounting principles precludes recognition of the TSRs to be collected over time, management believes that the present value of the TSR's allocated to the Authority approximates the net deficit.

Rebateable Arbitrage - No arbitrage rebates are owed to the United States Treasury for the years ended June 30, 2008 and 2007.

New Accounting Pronouncements - In September 2006, the GASB issued Statement No. 48 *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues* effective for financial statements periods beginning on or after December 15, 2006. This statement requires the Authority to recognize the purchase of TSR's from the State of Washington as a purchase of a future revenue stream as well as recognize a deferred charge on its Statement of Net Deficit for any future transactions. However, the statement does not require the Authority to apply the statement to previous transactions. Application to prior transactions would require restatement with application of the cumulative impact to the beginning net assets of the earliest year reported in the comparative statements. The initial impact of electing to implement GASB 48 for the existing transaction would result in a positive net asset position at restatement with an annual reduction in net assets (or a loss on bond operations each year) until the bond is fully redeemed. Management believes that restatement would not offer any significant value to the readers of the TSA financial statements since they are accustomed to the current presentation. Further, management believes that such implementation would limit historical comparability and, therefore its, predictive value. Therefore, prospective application of this section of the statement will be implemented.

Note 3 - Investments

Bond Issue Investment Policy - The trust indenture for the bond issue outlines the permitted investments. Although all of the program funds must be used for program purposes, certain funds have been restricted for payment of debt service as required by the indenture.

Operations Investment Policy - The Authority can invest in nongovernmental investments including certificates of deposit, banker's acceptances and repurchase agreements.

Note 3 - Investments (Continued)

In addition, the following governmental investments are eligible:

1. Treasury bills, notes and other obligations issued by the United States Department of the Treasury and backed by the full faith and credit of the U.S. government.

2. Federal Home Loan Bank notes and bonds.

3. Federal Land Bank bonds.

4. Federal National Mortgage Association notes, debentures and guaranteed certificates of participation.

5. The obligations of certain government-sponsored corporations whose obligations are eligible as collateral for advances to member banks as determined by the Board of Governors of the Federal Reserve System.

6. Shares of mutual funds with portfolios consisting of only U.S. government bonds or U.S. government guaranteed bonds issued by federal agencies with average maturities less than four years.

As of June 30, 2008, the Authority held a guaranteed investment agreement in its Bond Fund with Lehman Brothers (counterparty) totaling $45,534,106, net, with a term of 30 years. There is a concentration of credit risk; however, the agreement is fully collateralized with the securities of issuers with ratings of A1 (Moody's), A+ (Standard & Poor's) or A (Fitch). The collateral is held by a trustee in the name of the Authority and, therefore, is not exposed to custodial credit risk. The guaranteed investment agreement has redemption terms that do not consider market rates and income is based on contractual interest rates; accordingly, these agreements are reported at cost. There is interest rate risk in that the favorable rate may not be available in the market if the agreement terminates.

As of June 30, 2008 and 2007, the Authority, in its General Operating Fund, held Certificate of Deposits with Bank of America totaling $500,000 with original maturities from 4 to 12 months with rates ranging from 2.11% to 2.43% and 4.80% to 4.91% for 2008 and 2007, respectively.

All other excess funds are held as cash and cash equivalents.

Note 4 - Contracted Staff Services

The Washington State Housing Finance Commission provides staff and other administrative services to the Authority. Total charges were $24,671 and $27,605 for the years ended June 30, 2008 and 2007, respectively. The Authority has no directly hired staff and as such has no pension obligations. The Authority had fees payable totaling $5,067 and $6,097 with the Washington State Housing Finance Commission at June 30, 2008 and 2007, respectively.

Note 5 - Bonds Payable

The bonds are limited obligations of the Authority payable solely from 29.2% TSRs, and secured by a right to receive TSRs for Washington State, restricted investments, and undisbursed bond proceeds and the earnings thereon held under the indenture authorizing the bonds.

As of June 30, 2008, the Authority had outstanding bonds of $467.6 million. The bonds bear interest rates ranging from 5.25% to 6.625% and mature in varying amounts through 2032. Future principal and interest requirements are shown in the following table.

Years Ending June 30,	Principal Redemptions	Interest Requirements	Total
2009	$ 10,060,000	$ 30,194,294	$ 40,254,294
2010	9,620,000	29,666,144	39,286,144
2011	13,285,000	29,161,094	42,446,094
2012	14,325,000	28,330,781	42,655,781
2013	7,650,000	27,542,906	35,192,906
2014 - 2018	73,540,000	126,614,156	200,154,156
2019 - 2023	91,005,000	100,210,831	191,215,831
2024 - 2028	127,265,000	66,547,100	193,812,100
2029 - 2033	120,825,000	18,354,563	139,179,563
	$ 467,575,000	$ 456,621,869	$ 924,196,869

Balance at July 1, 2007	Issued	Redeemed	Balance at June 30, 2008
$ 490,195,000	$ -	$ 22,620,000	$ 467,575,000

Note 6 - Tobacco Settlement Revenues

TSRs consist of the amounts to be received under the terms of a Master Settlement Agreement 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 national MSA requires annual payments by the four largest tobacco companies to the participating States; up to $206 billion will be received during the first 25 years of the agreement. The State of Washington is scheduled to receive approximately $4 billion during the first 25 years.

Management believes that the present value of the amount of TSRs that will be collected by the Authority from the State of Washington over time is $373,276,487, an amount equal to the net deficit. However, prior to GASB No. 48 which is effective for years beginning on or after December 15, 2006, accounting principles generally accepted in the United States of America did not allow these future revenues to be recorded in the financial statements. As such, the only TSRs receivable recorded in the accompanying financial statements are those estimated to accrue due to cigarette shipments from January 1 to June 30, 2008.

Note 7 - 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 Participating Manufacturers ("PMs"), as well as certain of the Settling States 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, certain of which 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 Authority may not have adequate financial resources to make payment on the Series 2002 Revenue Bond.

Note 7 - Contingencies (Continued)

Members of the Authority's board of directors and persons acting on the Authority'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, and shall have the indemnification rights under the provisions of the Authority's Public Officials and Employees Liability insurance policy.

Note 8 - Subsequent Event

Lehman Brothers Holding Company (LBH) provides a guarantee on the investment agreement discussed in Note 3. On September 15, 2008, LBH declared bankruptcy, and their rating was downgraded below the required A3/A- which triggers default. Because collateral is held in the Authority's name by the Trustee in an amount approximating the carrying amount of the reserve agreement, the Authority believes the risk of exposure is limited to the loss of interest on the retained, liquidated collateral if market interest is below that guaranteed through the agreement. The Authority has been advised that a potential reduction to the rate of interest on the reserve agreement is not expected to have any significant impact to repayment of the bonds outstanding. The Authority continues to monitor the market and its impact on the agreement and will take action to minimize any realized loss.

SUPPLEMENTAL INFORMATION

TOBACCO SETTLEMENT AUTHORITY
(A Component Unit of the State of Washington)
SCHEDULE OF PROGRAM NET ASSETS (DEFICIT)
JUNE 30, 2008 AND 2007

ASSETS	Restricted Bond Fund	General Operating Fund	Total 2008	Total 2007
CASH AND CASH EQUIVALENTS	$ 15,287,323	$ 75,750	$ 15,363,073	$ 16,431,761
INVESTMENTS	45,534,106	500,000	46,034,106	45,930,588
TSR RECEIVABLE	24,048,013	-	24,048,013	20,082,188
UNAMORTIZED BOND ISSUANCE COSTS	1,636,597	-	1,636,597	1,804,814
PREPAID FEES AND INTEREST RECEIVABLE	28,359	6,566	34,925	5,606
TOTAL ASSETS	$ 86,534,398	$ 582,316	$ 87,116,714	$ 84,254,957
LIABILITIES AND NET DEFICIT				
ACCRUED INTEREST PAYABLE	$ 2,516,191	$ -	$ 2,516,191	$ 2,625,372
ACCOUNTS PAYABLE AND OTHER LIABILITIES	-	14,716	14,716	14,941
BONDS PAYABLE				
Current interest bonds	467,575,000	-	467,575,000	490,195,000
Unamortized bond discount	(9,712,706)	-	(9,712,706)	(10,711,019)
	457,862,294	-	457,862,294	479,483,981
TOTAL LIABILITIES	460,378,485	14,716	460,393,201	482,124,294
TOTAL NET DEFICIT	(373,844,087)	567,600	(373,276,487)	(397,869,337)
TOTAL LIABILITIES AND NET DEFICIT	$ 86,534,398	$ 582,316	$ 87,116,714	$ 84,254,957

TOBACCO SETTLEMENT AUTHORITY
(A Component Unit of the State of Washington)
SCHEDULE OF PROGRAM REVENUES, EXPENSES, AND CHANGES IN PROGRAM NET ASSETS (DEFICIT)
YEARS ENDED JUNE 30, 2008 AND 2007

	Restricted Bond Fund	General Operating Fund	Total 2008	Total 2007
REVENUES				
Tobacco settlement revenues and other fee income	$ 54,479,709	$ -	$ 54,479,709	$ 38,740,416
Non operating revenues - interest income	2,712,549	20,430	2,732,979	2,674,891
	57,192,258	20,430	57,212,688	41,415,307
EXPENSES				
Interest on debt	31,337,275	-	31,337,275	31,892,871
Amortization of bond discount	998,313	-	998,313	596,125
Amortization of bond issuance costs	168,217	-	168,217	100,448
General and administrative	36,500	79,533	116,033	115,768
	32,540,305	79,533	32,619,838	32,705,212
CHANGE IN NET DEFICIT	24,651,953	(59,103)	24,592,850	8,710,095
NET DEFICIT				
Beginning of year	(398,496,040)	626,703	(397,869,337)	(406,579,432)
End of year	$ (373,844,087)	$ 567,600	$ (373,276,487)	$ (397,869,337)

TOBACCO SETTLEMENT AUTHORITY
(A Component Unit of the State of Washington)
SCHEDULE OF PROGRAM CASH FLOWS
YEARS ENDED JUNE 30, 2008 AND 2007

	Restricted Bond Fund	General Operating Fund	Total 2008	Total 2007
OPERATING ACTIVITIES				
Cash received from tobacco settlement and other revenues	$ 50,513,884	$ 23,527	$ 50,537,411	$ 36,738,436
Cash paid for general and administrative expenses	(36,500)	(83,815)	(120,315)	(105,847)
Net cash from (used for) operating activities	50,477,384	(60,288)	50,417,096	36,632,589
INVESTING ACTIVITIES				
Cash received from interest income	2,580,672	-	2,580,672	2,652,584
NONCAPITAL FINANCING ACTIVITIES				
Principal repayment on bonds	(22,620,000)	-	(22,620,000)	(7,315,000)
Cash paid for bond interest expense	(31,446,456)	-	(31,446,456)	(31,932,494)
Net cash used for financing activities	(54,066,456)	-	(54,066,456)	(39,247,494)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,008,400)	(60,288)	(1,068,688)	37,679
CASH AND CASH EQUIVALENTS				
Beginning of year	16,295,723	136,038	16,431,761	16,394,082
End of year	$ 15,287,323	$ 75,750	$ 15,363,073	$ 16,431,761
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES				
Excess of revenues over expenses	$ 24,651,953	$ (59,103)	$ 24,592,850	$ 8,710,095
Adjustments to reconcile operating income to net cash provided by operating activities				
Amortization of bond discount	998,313	-	998,313	596,125
Amortization of bond issue costs	168,217	-	168,217	100,448
Cash paid for bond interest expense	31,446,456	-	31,446,456	31,932,494
Cash received from interest income	(2,580,672)	-	(2,580,672)	(2,652,584)
Changes in assets and liabilities				
Increase in TSR	(3,965,825)	-	(3,965,825)	(2,024,931)
Decrease (increase) in prepaid fees and interest receivable	(28,359)	(960)	(29,319)	4,698
Increase (decrease) in accounts payable and other liabilities	-	(225)	(225)	5,867
Decrease in accrued interest payable	(109,181)	-	(109,181)	(39,623)
Other	(103,518)	-	(103,518)	-
Net cash from operating activities	$ 50,477,384	$ (60,288)	$ 50,417,096	$ 36,632,589