TOBACCO SETTLEMENT AUTHORITY
(A Component Unit of the State of Washington)

Report of Independent Auditors
and Financial Statements
with Supplemental Information

June 30, 2011 and 2010

MOSS ADAMS LLP

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REPORT OF INDEPENDENT AUDITORS

To the Board of Directors
Tobacco Settlement Authority

We have audited the accompanying statements of net deficit of the Tobacco Settlement Authority (the Authority), at June 30, 2011 and 2010 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 Authority'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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, 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 Authority as of June 30, 2011 and 2010, 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 6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Authority'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 that collectively comprise the Authority's basic financial statements. The supplemental information on pages 16 through 18 is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplemental information, which is the responsibility of the Authority'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 basic financial statements taken as a whole.

Moss Adams LLP

Seattle, Washington
November 17, 2011

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, 2011 and 2010. 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 $41.6 million and $44 million were recognized as revenue in the fiscal years ended June 30, 2011 and 2010, respectively. In accordance with the GASB 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues,* $20.8 million TSRs applicable to cigarette sales between January 1, 2011 and June 30, 2011 were recorded as accrued TSR Receivable as of June 30, 2011 while $22.4 million TSRs applicable to cigarette sales between January 1, 2010 and June 30, 2010 were recorded as accrued TSR Receivable as of June 30, 2010. No additional bonds were issued during 2011.

During the fiscal year ended June 30, 2011:

- Total assets decreased by $2.4 million to $81.1 million primarily due to the decrease in the TSR receivable of $1.6 million and a $0.6 million decrease in cash equivalents and investments due to the use of available liquid assets for bond payments.

- At year-end, the Authority had total net bonds payable of $399.3 million, net of discounts. This represents a net decrease of $15.6 million, or 3.8%, resulting from principal payments on bonds.

- At June 30, 2011, the Authority had a reduction of $13.3 million (4.0%) in the Net Deficit over that of the previous fiscal year end.

- Bond interest expense decreased $1 million (3.5%) as bonds payable continued to decline.

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. 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 $320,389,594, an amount equal to the net deficit.

Economic Outlook

The volume of cigarette shipments is a major factor in determining the amount of TSRs. As shipments decline resulting in lower TSRs, the amount of time it will take to fully redeem the Authority's turbo term bonds is lengthened. Shipments of cigarettes have decreased at a rate faster than was predicted when the TSA's bonds were issued in 2002. Over the past few years this has been further magnified as significant increases in tobacco excise taxes have been enacted by many states as well as the federal government. Also, varying restrictions of public smoking exist in most states, further contributing to a decline in tobacco consumption. This annual decline is projected to be 3 to 4% in the near term. Based upon current projections, we expect the bonds to be paid in full in 2024.

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, 2011 and 2010 (in millions):

	2011	2010	Change	
Assets				
Cash and cash equivalents	$ 59.1	$ 59.6	$ (0.5)	(0.8%)
Investments	-	0.1	(0.1)	(100.0%)
Accrued TSR receivable	20.8	22.4	(1.6)	(7.1%)
Unamortized bond issuance costs	1.2	1.4	(0.2)	(14.3%)
Total assets	$ 81.1	$ 83.5	$ (2.4)	(2.9%)
Liabilities				
Accrued interest payable and other liabilities	$ 2.2	$ 2.3	$ (0.1)	(4.3%)
Bonds payable, net	399.3	414.9	(15.6)	(3.8%)
Total liabilities	401.5	417.2	(15.7)	(3.8%)
Net deficit	(320.4)	(333.7)	13.3	(4.0%)
Total liabilities and net deficit	$ 81.1	$ 83.5	$ (2.4)	(2.9%)

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, 2011 and 2010 (in millions):

	2011	2010	Change	
Revenues				
Tobacco settlement revenues	$ 41.6	$ 44.0	$ (2.4)	(5.5%)
Bond program interest	0.1	0.1	-	- %
Total revenues	$ 41.7	$ 44.1	$ (2.4)	(5.4%)
Expenses				
Bond program interest expense	$ 27.5	$ 28.5	$ (1.0)	(3.5%)
Other bond program expenses	0.8	0.9	(0.1)	(11.1%)
General and administrative	0.1	0.1	-	- %
Total expenses	$ 28.4	$ 29.5	$ (1.1)	(3.7%)
Change in net deficit	$ 13.3	$ 14.6	$ (1.3)	(8.9%)

TSRs of $41.6 million and $27.5 million in interest on debt are the primary components of total revenues and expenses, respectively, for the Restricted Bond Program.

During fiscal year 2011, revenue received for general operations included interest earned on investments. General operating expense within the General Operating Fund ($84,174) for the fiscal year 2011 is comprised of allocable salaries and wages, legal expenses and other general and administrative expenses.

DEBT ADMINISTRATION

The Authority has long-term debt obligations of $399.3 million, net of bond discounts at June 30, 2011. 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, 2011, amounts held by the trustee and future receipts of TSRs 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 2010 WITH 2009

Statements of Net Deficit

The following table summarizes the changes in combined net deficits between fiscal years ended June 30, 2010 and 2009 (in millions):

	2010	2009	Change	
Assets				
Cash and cash equivalents	$ 59.6	$ 60.0	$ (0.4)	(0.7%)
Investments	0.1	0.3	(0.2)	(66.7%)
Accrued TSR receivable	22.4	24.4	(2.0)	(8.2%)
Unamortized bond issuance costs	1.4	1.5	(0.1)	(6.7%)
Total assets	$ 83.5	$ 86.2	$ (2.7)	(3.1%)
Liabilities				
Accrued interest payable and other liabilities	$ 2.3	$ 2.4	$ (0.1)	(4.2%)
Bonds payable, net	414.9	432.1	(17.2)	(4.0%)
Total liabilities	417.2	434.5	(17.3)	(4.0%)
Net deficit	(333.7)	(348.3)	14.6	(4.2%)
Total liabilities and net deficit	$ 83.5	$ 86.2	$ (2.7)	(3.1%)

Statements of Revenues, Expenses and Changes in Net Deficit

The following table summarizes the combined changes in net deficit between the fiscal years 2010 and 2009 (in millions):

	2010	2009	Change	
Revenues				
Tobacco settlement revenues	$ 44.0	$ 55.0	$ (11.0)	(20.0%)
Bond program interest	0.1	1.3	(1.2)	(92.3%)
Total revenues	$ 44.1	$ 56.3	$ (12.2)	(21.7%)
Expenses				
Bond program interest expense	$ 28.5	$ 30.1	$ (1.6)	(5.3%)
Other bond program expenses	0.9	1.1	(0.2)	(18.2%)
General and administrative	0.1	0.2	(0.1)	(50.0%)
Total expenses	$ 29.5	$ 31.4	$ (1.9)	(6.1%)
Change in net deficit	$ 14.6	$ 24.9	$ (10.3)	(41.4%)

During the fiscal year ended June 30, 2010, the Authority's combined total assets decreased by $2.7 million primarily due to the decrease in TSRs receivable ($2.0 million) and a $0.4 million decrease in cash equivalents. Combined total net income of $14.6 million for fiscal year 2010 represented a decrease in total revenue of $12.2 million from fiscal year 2009. This decrease was attributable to the decrease of TSRs of $11 million coupled with a decrease in interest income ($1.2 million) as the reserve funds were invested in short term money market funds during all of 2010 with yields less than that of the investment agreement terminated due to provider default in mid-2009.

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.

ASSETS	2011	2010
CASH AND CASH EQUIVALENTS	$ 59,096,692	$ 59,599,759
INVESTMENTS	-	125,000
TSR RECEIVABLE	20,823,733	22,394,149
UNAMORTIZED BOND ISSUANCE COSTS	1,231,804	1,339,563
PREPAID FEES AND INTEREST RECEIVABLE	8,533	13,845
TOTAL ASSETS	$ 81,160,762	$ 83,472,316
LIABILITIES AND NET DEFICIT		
ACCRUED INTEREST PAYABLE	$ 2,209,390	$ 2,294,453
ACCOUNTS PAYABLE AND OTHER LIABILITIES	11,352	36,999
BONDS PAYABLE		
Interest bonds	406,640,000	422,855,000
Unamortized bond discount	(7,310,386)	(7,949,900)
	399,329,614	414,905,100
TOTAL LIABILITIES	401,550,356	417,236,552
TOTAL NET DEFICIT	(320,389,594)	(333,764,236)
TOTAL LIABILITIES AND NET DEFICIT	$ 81,160,762	$ 83,472,316

	2011	2010
REVENUES		
Tobacco settlement revenues and other fee income	$ 41,587,579	$ 43,990,379
Non operating revenues - interest income	101,166	130,771
	41,688,745	44,121,150
EXPENSES		
Interest on debt	27,446,155	28,494,162
Amortization of bond discount	639,514	778,804
Amortization of bond issuance costs	107,760	131,230
General and administrative	120,674	122,341
	28,314,103	29,526,537
CHANGE IN NET DEFICIT	13,374,642	14,594,613
NET DEFICIT		
Beginning of year	(333,764,236)	(348,358,849)
End of year	$ (320,389,594)	$ (333,764,236)

STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2011 AND 2010

	2011	2010
OPERATING ACTIVITIES		
Cash received from tobacco settlement and other revenues	$ 43,159,539	$ 45,987,053
Cash paid for general and administrative expenses	(146,321)	(113,875)
Net cash from operating activities	43,013,218	45,873,178
INVESTING ACTIVITIES		
Cash received from sales of investments	125,000	225,000
Cash received from interest income	104,934	137,377
Net cash from financing activities	229,934	362,377
NONCAPITAL FINANCING ACTIVITIES		
Principal repayment on bonds	(16,215,000)	(18,025,000)
Cash paid for bond interest expense	(27,531,219)	(28,581,781)
Net cash used for financing activities	(43,746,219)	(46,606,781)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(503,067)	(371,226)
CASH AND CASH EQUIVALENTS		
Beginning of year	59,599,759	59,970,985
End of year	$ 59,096,692	$ 59,599,759
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Excess of revenues over expenses	$ 13,374,642	$ 14,594,613
Adjustments to reconcile operating income to net cash provided by operating activities		
Amortization of bond discount	639,514	778,804
Amortization of bond issuance costs	107,760	131,230
Cash paid for bond interest expense	27,531,219	28,581,781
Cash received from interest income	(104,934)	(137,377)
Changes in assets and liabilities		
Decrease in TSR receivable	1,570,416	1,991,392
Decrease in prepaid fees and other receivables	5,311	11,638
Increase (decrease) in accounts payable and other liabilities	(25,647)	8,716
Decrease in accrued interest payable	(85,063)	(87,619)
Net cash from operating activities	$ 43,013,218	$ 45,873,178

See accompanying notes to the financial statements.

Note 1 - Organization, Program Funds and Description of Business

The Tobacco Settlement Authority (the "Authority") was formed in April 2002 pursuant to legislation enacted by the Washington State Legislature (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, each appointed by the governor. The chair of the Authority serves at the pleasure of the governor while the remaining directors serve terms of 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") among participating cigarette manufacturers and 46 states and six other U.S. jurisdictions ("Settling States") 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. For further information on the MSA, see Note 6.

Payment on the bonds is a sole obligation 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 is reimbursed for its costs from the TSA's operating fund. 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.

Note 2 - Summary of Significant Accounting Policies (Continued)

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 deficit 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 Restricted Bond Fund 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 as of June 30, 2010. The Authority's Trustee held all of the Authority's investments in the name of the Authority. There were no investments outstanding at June 30, 2011.

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

Bonds Payable - Serial and Turbo 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, 2011 and 2010.

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 and 29.2% of the TSRs thereafter. They are to be deposited with the Authority's Trustee on its behalf until such time as the bond obligations are fully paid.

Note 2 - Summary of Significant Accounting Policies (Continued)

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 transaction. However, the Statement permits, but 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, so retrospective application of this section of the Statement was not implemented.

In this case, GASB 48 provides that 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 TSRs payment that are based on cigarette sales from the preceding calendar year and historical payment trends. TSRs recognized for 2011 and 2010 included an accrual of $20,823,733 and $22,394,149, 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 2011 and 2010, the Authority delivered officer's 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.

Net Deficit - The net deficit balances of $320,389,594 at June 30, 2011 and $333,764,236 at June 30, 2010 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 $246,984 at June 30, 2011 and $330,902 at June 30, 2010. The restricted bond fund has a net deficit balance of $320,636,578 at June 30, 2011 and $334,095,138 at June 30, 2010. Management believes that the present value of the TSR's allocated to the Authority approximates the net deficit.

Arbitrage Rebate - No arbitrage rebate is owed to the United States Treasury for the years ended June 30, 2011 and 2010.

Note 2 - Summary of Significant Accounting Policies (Continued)

Recent Accounting Pronouncement - In December 2010, GASB issued Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements, which incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements. The requirements in this statement will improve financial reporting by contributing to the GASB's efforts to codify all sources of generally accepted accounting principles for state and local governments so that they derive from a single source. It will eliminate the need for financial statement preparers and auditors to determine which FASB and AICPA pronouncement provisions apply to state and local governments, thereby resulting in a more consistent application of applicable guidance in financial statements of state and local governments. This statement is effective for financial statement for periods beginning after December 15, 2011. The Authority has adopted this new pronouncement in the current year and the adoption of this statement does not have a material effect on the Authority's financial statements.

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.

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.

Note 3 - Investments (Continued)

As of June 30, 2010, the Authority, in its General Operating Fund, held Certificate of Deposits (CDs) with Bank of America totaling $125,000, with original maturities from 4 to 12 months with a rate of 1.05%. The CDs matured during the fiscal year ending June 30, 2011 and were not replaced.

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 $27,471 and $29,650 for the years ended June 30, 2011 and 2010, respectively. The Authority has no directly hired staff and as such has no pension obligations. The Authority had fees payable totaling $5,997 and $34,507 with the Washington State Housing Finance Commission at June 30, 2011 and 2010, 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, 2011, the Authority had outstanding bonds of $406.6 million. The bonds bear interest rates ranging from 5.50% 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
2012	$ 14,325,000	$ 26,512,675	$ 40,837,675
2013	-	25,724,800	25,724,800
2014	12,315,000	25,724,800	38,039,800
2015	8,755,000	24,924,325	33,679,325
2016	17,675,000	24,355,250	42,030,250
2017-2021	85,380,000	104,953,600	190,333,600
2022-2026	88,730,000	74,863,800	163,593,800
2027-2031	164,320,000	39,252,462	203,572,462
2031-2032	15,140,000	1,003,025	16,143,025
	$ 406,640,000	$ 347,314,737	$ 753,954,737

Balance at July 1, 2010	Issued	Redeemed	Balance at June 30, 2011
$ 422,855,000	$ -	$ 16,215,000	$ 406,640,000

Note 6 - Master Settlement Agreement and Tobacco Settlement Revenues

The Master Settlement Agreement is an industry-wide settlement of litigation between the Settling States and the Original Participating Manufacturers ("OPMs") and was entered into by the parties on November 23, 1998. Tobacco Settlement Revenues consist of the amounts to be received under the terms of the Master Settlement Agreement.

The MSA requires annual payments by the four largest tobacco companies to the Settling States; up to $206 billion was to be received during the first 25 years of the agreement. The State of Washington was initially 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 approximately $320,389,594, an amount equal to the net deficit. However, prior to GASB 48, which was 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, 2011 and January 1 to June 30, 2010.

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.

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.

SUPPLEMENTAL INFORMATION

ASSETS	Restricted Bond Fund	General Operating Fund	Total 2011	Total 2010
CASH AND CASH EQUIVALENTS	$ 58,842,681	$ 254,011	$ 59,096,692	$ 59,599,759
INVESTMENTS	-	-	-	125,000
TSR RECEIVABLE	20,823,733	-	20,823,733	22,394,149
UNAMORTIZED BOND ISSUANCE COSTS	1,231,804	-	1,231,804	1,339,563
PREPAID FEES AND INTEREST RECEIVABLE	4,208	4,325	8,533	13,845
TOTAL ASSETS	$ 80,902,426	$ 258,336	$ 81,160,762	$ 83,472,316
LIABILITIES AND NET DEFICIT				
ACCRUED INTEREST PAYABLE	$ 2,209,390	$ -	$ 2,209,390	$ 2,294,453
ACCOUNTS PAYABLE AND OTHER LIABILITIES	-	11,352	11,352	36,999
BONDS PAYABLE				
Interest bonds	406,640,000	-	406,640,000	422,855,000
Unamortized bond discount	(7,310,386)	-	(7,310,386)	(7,949,900)
	399,329,614	-	399,329,614	414,905,100
TOTAL LIABILITIES	401,539,004	11,352	401,550,356	417,236,552
TOTAL NET ASSETS (DEFICIT)	(320,636,578)	246,984	(320,389,594)	(333,764,236)
TOTAL LIABILITIES AND NET ASSETS (DEFICIT)	$ 80,902,426	$ 258,336	$ 81,160,762	$ 83,472,316

SCHEDULE OF PROGRAM REVENUES, EXPENSES, AND CHANGES IN PROGRAM NET ASSETS (DEFICIT)
YEARS ENDED JUNE 30, 2011 AND 2010

	Restricted Bond Fund	General Operating Fund	Total 2011	Total 2010
REVENUES				
Tobacco settlement revenues and other fee income	$ 41,587,579	$ -	$ 41,587,579	$ 43,990,379
Non operating revenues - interest income	100,910	256	101,166	130,771
	41,688,489	256	41,688,745	44,121,150
EXPENSES				
Interest on debt	27,446,155	-	27,446,155	28,494,162
Amortization of bond discount	639,514	-	639,514	778,804
Amortization of bond issuance costs	107,760	-	107,760	131,230
General and administrative	36,500	84,174	120,674	122,341
	28,229,929	84,174	28,314,103	29,526,537
CHANGE IN NET ASSETS (DEFICIT)	13,458,560	(83,918)	13,374,642	14,594,613
NET DEFICIT				
Beginning of year	(334,095,138)	330,902	(333,764,236)	(348,358,849)
End of year	$ (320,636,578)	$ 246,984	$ (320,389,594)	$ (333,764,236)

SCHEDULE OF PROGRAM CASH FLOWS
YEARS ENDED JUNE 30, 2011 AND 2010

	Restricted Bond Fund	General Operating Fund	Total 2011	Total 2010
OPERATING ACTIVITIES				
Cash received from tobacco settlement and other revenues	$ 43,157,996	$ 1,543	$ 43,159,539	$ 45,987,053
Cash paid for general and administrative expenses	(36,500)	(109,821)	(146,321)	(113,875)
Net cash from operating activities	43,121,496	(108,278)	43,013,218	45,873,178
INVESTING ACTIVITIES				
Cash received from sales of investments	-	125,000	125,000	225,000
Cash received from interest income	104,934	-	104,934	137,377
Net cash from financing activities	104,934	125,000	229,934	362,377
NONCAPITAL FINANCING ACTIVITIES				
Principal repayment on bonds	(16,215,000)	-	(16,215,000)	(18,025,000)
Cash paid for bond interest expense	(27,531,219)	-	(27,531,219)	(28,581,781)
Net cash from financing activities	(43,746,219)	-	(43,746,219)	(46,606,781)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(519,789)	16,722	(503,067)	(371,226)
CASH AND CASH EQUIVALENTS				
Beginning of year	59,362,470	237,289	59,599,759	59,970,985
End of year	$ 58,842,681	$ 254,011	$ 59,096,692	$ 59,599,759
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES				
Excess of revenues over expenses	$ 13,458,560	$ (83,918)	$ 13,374,642	$ 14,594,613
Adjustments to reconcile operating income to net cash provided by operating activities				
Amortization of bond discount	639,514	-	639,514	778,804
Amortization of bond issuance costs	107,760	-	107,760	131,230
Cash paid for bond interest expense	27,531,219	-	27,531,219	28,581,781
Cash received from interest income	(104,934)	-	(104,934)	(137,377)
Changes in assets and liabilities				
Decrease in TSR receivable	1,570,416	-	1,570,416	1,991,392
Decrease in prepaid fees and other receivables	4,024	1,287	5,311	11,638
Increase (decrease) in accounts payable and other liabilities	-	(25,647)	(25,647)	8,716
Decrease in accrued interest payable	(85,063)	-	(85,063)	(87,619)
Net cash from operating activities	$ 43,121,496	$ (108,278)	$ 43,013,218	$ 45,873,178