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

Report of Independent Auditors
and Financial Statements
with Supplemental Information

June 30, 2012 and 2011

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 position of the Tobacco Settlement Authority (the Authority), at June 30, 2012 and 2011 and the related statements of revenues, expenses, and changes in net position 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, 2012 and 2011, 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.

As discussed in Note 2 to the financial statements, the Authority adopted the accounting requirements of Governmental Accounting Standards Board (GASB) Statement No. 65, which resulted in the restatement of previously reported amounts for the year ended June 30, 2011.

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

Our audits were conducted for the purpose of forming an opinion on the financial statements. The supplemental schedules of program net position, results of program revenues, expenses, and changes in program net position, and program cash flows on pages 18 through 20 are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplemental schedules of program net position, results of program revenues, expenses, and changes in program net position and program cash flows are fairly stated in all material respects in relation to the financial statements as a whole.

Moss Adams LLP

Seattle, Washington
October 12, 2012

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, 2012 and 2011. 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 $44.7million and $41.6 million were recognized as revenue in the fiscal years ended June 30, 2012 and 2011, respectively. In accordance with the GASB 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues,* $21.4 million TSRs applicable to cigarette sales between January 1, 2012 and June 30, 2012 were recorded as accrued TSR Receivable as of June 30, 2012 while $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. No additional bonds were issued during 2012.

Significant year over year changes from June 30, 2011 to June 30, 2012 include:

- Total assets increased by $0.1 million to $80 million primarily due to the increase in the TSR receivable of $0.6 million and a $0.5 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 $382.1 million, net of discounts. This represents a net decrease of $17.2 million, or 4.3%, resulting from principal payments on bonds.
- At June 30, 2012, the Authority had an increase of $17.3 million (5.4%) in net position over that of the previous fiscal year end.
- Bond interest expense decreased $1 million (3.6%) as bonds payable continued to decline.
- General administrative expense increased $278 thousand due to costs of pursuing a claim against Lehman Brothers for lost interest on reserve funds caused by their default on the forward purchase investment agreement.

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 Position 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 Position.

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. During 2012, the Authority adopted recently issued GASB statements No. 63 and 65 which changed the accounting for certain bond related activity. In accordance with the transition provisions of these statements, the Authority has elected to early adopt these statements and the changes in accounting related to them were applied retrospectively for the prior years presented. Please see Note 2 for additional information. 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 Position. The operating statements for all funds present increases (e.g., revenues) and decreases (e.g., expenses) in net fund position. 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 $304,271,230, an amount equal to the net deficit position.

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% 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 Position

The following table summarizes the changes in assets, liabilities, and net position between the years ended June 30, 2012 and 2011 (in millions):

	2012	2011 (as restated)	Change	
Assets				
Cash and cash equivalents	$ 58.6	$ 59.1	$ (0.5)	(0.8%)
Accrued TSR and other receivables	21.4	20.8	0.6	2.9%
Total assets	$ 80.0	$ 79.9	$ 0.1	0.1%
Liabilities				
Accrued interest payable and other liabilities	$ 2.2	$ 2.2	$ -	- %
Bonds payable, net	382.1	399.3	(17.2)	(4.3%)
Total liabilities	384.3	401.5	(17.2)	(4.3%)
Net position	(304.3)	(321.6)	17.3	(5.4%)
Total liabilities and net position	$ 80.0	$ 79.9	$ 0.1	0.1%

Statements of Revenues, Expenses, and Changes in Net Position

The following table summarizes the activities in revenues and expenses between the years ended June 30, 2012 and 2011 (in millions):

	2012	2011 (as restated)	Change	
Revenues				
Tobacco settlement revenues	$ 44.7	$ 41.6	$ 3.1	7.5%
Bond program interest	0.1	0.1	-	- %
Total revenues	$ 44.8	$ 41.7	$ 3.1	7.4%
Expenses				
Bond program interest expense	$ 26.5	$ 27.5	$ (1.0)	(3.6%)
Other bond program expenses	0.6	0.6	-	- %
General and administrative	0.4	0.1	0.3	300.0%
Total expenses	$ 27.5	$ 28.2	$ (0.7)	(2.5%)
Change in net position	$ 17.3	$ 13.5	$ 3.8	28.1%

TSRs of $44.7 million and $26.5 million in interest on debt are the primary components of total revenues and expenses, respectively, for the Restricted Bond Program.

During fiscal year 2012, revenue received for general operations included other income of $150,000 representing a draw from TSR's. General operating expense for fiscal year 2012 within the General Operating Fund ($212,217) included $134,080 of legal and financial advisor fees for mediation arising from the Lehman Brothers bankruptcy. Lehman was the provider of the reserve fund contract for the TSA's bonds. The remaining $78,137 is comprised of allocable salaries and wages, and other general and administrative expenses.

DEBT ADMINISTRATION

The Authority has long-term debt obligations of $382.1 million, net of bond discounts at June 30, 2012. 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, 2012, amounts held by the trustee and future receipts of TSRs represent full funding of these requirements.

The bonds were sold in 2002 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 2011 WITH 2010

Statements of Net Position

The following table summarizes the changes in combined net position between fiscal years ended June 30, 2011 and 2010 (in millions):

	2011 (as restated)	2010 (as restated)	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%)
Total assets	$ 79.9	$ 82.1	$ (2.2)	(2.7%)
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 position	(321.6)	(335.1)	13.5	(4.0%)
Total liabilities and net position	$ 79.9	$ 82.1	$ (2.2)	(2.7%)

Statements of Revenues, Expenses and Changes in Net Position

The following table summarizes the combined changes in net position between the fiscal years 2011 and 2010 (in millions):

	2011 (as restated)	2010 (as restated)	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	0.6	0.8	(0.2)	(25.0%)
General and administrative	0.1	0.1	-	- %
Total expenses	$ 28.2	$ 29.4	$ (1.2)	(4.1%)
Change in net position	$ 13.5	$ 14.7	$ (1.2)	(8.2%)

During the fiscal year ended June 30, 2011, the Authority's combined total assets decreased by $2.2 million primarily due to the decrease in TSRs receivable ($1.6 million) and a $0.5 million decrease in cash equivalents and investments. Combined total net income of $13.5 million for fiscal year 2011 represents a decrease from fiscal year 2010 of $1.2 million. The decrease is attributable to a reduction in TSRs of $2.4 million, partially offset by a decrease in interest expense of $1.0 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.

ASSETS	2012	2011 (as restated)
CASH AND CASH EQUIVALENTS	$ 58,622,266	$ 59,096,692
TSR RECEIVABLE	21,416,205	20,823,733
PREPAID FEES AND INTEREST RECEIVABLE	19,258	8,533
TOTAL ASSETS	$ 80,057,729	$ 79,928,958
LIABILITIES AND NET POSITION		
ACCRUED INTEREST PAYABLE	$ 2,124,558	$ 2,209,390
ACCOUNTS PAYABLE AND OTHER LIABILITIES	114,121	11,352
BONDS PAYABLE		
Interest bonds	388,775,000	406,640,000
Unamortized bond discount	(6,684,720)	(7,310,386)
	382,090,280	399,329,614
TOTAL LIABILITIES	384,328,959	401,550,356
TOTAL NET POSITION	(304,271,230)	(321,621,398)
TOTAL LIABILITIES AND NET POSITION	$ 80,057,729	$ 79,928,958

TOBACCO SETTLEMENT AUTHORITY
(A Component Unit of the State of Washington)
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
YEARS ENDED JUNE 30, 2012 AND 2011

	2012	2011 (as restated)
REVENUES		
Tobacco settlement revenues and other fee income	$ 44,740,839	$ 41,587,579
Non operating revenues - interest income	60,636	101,166
	44,801,475	41,688,745
EXPENSES		
Interest on debt	26,426,925	27,446,155
Amortization of bond discount	625,665	639,514
General and administrative	398,717	120,674
	27,451,307	28,206,343
CHANGE IN NET POSITION	17,350,168	13,482,402
NET POSITION		
Beginning of year	(321,621,398)	(335,103,800)
End of year	$ (304,271,230)	$ (321,621,398)

See accompanying notes to the financial statements.

STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2012 AND 2011

	2012	2011 (as restated)
OPERATING ACTIVITIES		
Cash received from tobacco settlement and other revenues	$ 44,148,577	$ 43,159,539
Cash paid for general and administrative expenses	(305,641)	(146,321)
Net cash from operating activities	43,842,936	43,013,218
INVESTING ACTIVITIES		
Cash received from sales of investments	-	125,000
Cash received from interest income	59,394	104,934
Net cash from financing activities	59,394	229,934
NONCAPITAL FINANCING ACTIVITIES		
Principal repayment on bonds	(17,865,000)	(16,215,000)
Cash paid for bond interest expense	(26,511,756)	(27,531,219)
Net cash used for financing activities	(44,376,756)	(43,746,219)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(474,426)	(503,067)
CASH AND CASH EQUIVALENTS		
Beginning of year	59,096,692	59,599,759
End of year	$ 58,622,266	$ 59,096,692
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Excess of revenues over expenses	$ 17,350,168	$ 13,482,402
Adjustments to reconcile operating income to net cash provided by operating activities		
Amortization of bond discount	625,665	639,514
Cash paid for bond interest expense	26,511,756	27,531,219
Cash received from interest income	(59,394)	(104,934)
Changes in assets and liabilities		
(Increase) decrease in TSR receivable	(592,472)	1,570,416
(Increase) decrease in prepaid fees and other receivables	(10,724)	5,311
Increase (decrease) in accounts payable and other liabilities	102,769	(25,647)
Decrease in accrued interest payable	(84,832)	(85,063)
Net cash from operating activities	$ 43,842,936	$ 43,013,218

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. 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 administration 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 position. The statement of revenues, expenses and changes in net position for all funds present increases (e.g., revenues) and decreases (e.g., expenses) in net fund position. 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 Position 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 - The Authority's Trustee holds all of the Authority's investments in the name of the Authority, however there were no investments outstanding at June 30, 2012 or June 30, 2011.

Unamortized Bond Discounts - Unamortized bond discounts are amortized using the bonds outstanding method over the expected life of the bonds.

Bond Issuance Costs - Bond issuance costs, including underwriter's fees are expensed at issuance.

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, 2012 and 2011.

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 until all of the bonds are redeemed. 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 Position 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 position 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 position at restatement with an annual reduction in net position (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 2012 and 2011 included an accrual of $21,416,205 and $20,823,733, 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 year 2012, the Authority delivered an officer's certificate to the Trustee requesting operating funds of $150,000 be disbursed which were received by the Authority during the year ended June 30, 2012.

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 Position - The net deficit position balances of $304,271,230 at June 30, 2012 and $321,621,398 (as restated) at June 30, 2011 reflect net deficit positions. This balance is comprised of amounts from two funds. The general operating fund has a net position balance of $184,982 at June 30, 2012 and $246,984 at June 30, 2011. The restricted bond fund has a net position balance of $304,456,212 at June 30, 2012 and $321,868,382 (as restated) at June 30, 2011. Management believes that the present value of the TSR's allocated to the Authority approximates the net deficit position.

Arbitrage Rebate - No arbitrage rebate is owed to the United States Treasury for the years ended June 30, 2012 and 2011.

Note 2 - Summary of Significant Accounting Policies (Continued)

Recent Accounting Pronouncement

In June 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows, Deferred Inflows, and Net Position*. The statement establishes standards for reporting deferred outflows of resources, deferred inflows of resources, and net position, elements of financial statements identified and defined by previously issued Concepts Statement 4. The requirements in this statement will improve financial reporting by standardizing presentation of these elements. The statement is effective for financial statements of periods beginning after December 15, 2011, however the Authority has adopted this new pronouncement in the current year. The effect to the Authority's adoption of this statement is limited to the reclassification of Net Assets (Deficit) to Net Position.

In March 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This statement provides guidance on the reclassifying certain items as deferred outflows of resources or deferred inflows of resources. The statement further requires reclassification of certain items previously recorded as assets and liabilities as expenses or revenues. The specific accounts impacting the Authority are detailed below.

Bond Issuance Costs: Previous standards required that certain costs associated with the issuance of bonds, including underwriter's fees, be recognized as an asset and amortized over the life of the bond. Statement No. 65 requires that bond issuance costs be fully expensed at issuance.

The statement is effective for financial statements of periods beginning after December 15, 2012 with the effects of the accounting change to be applied retroactively, by restating the financial statements. The Authority has adopted this new pronouncement in the current year and, accordingly, has restated amounts of effected items within the financial statements as of June 30, 2011:

	As Previously Reported	Change	As Restated
Statement of Net Position			
Unamortized Bond Issuance Costs	$ 1,231,804	$ (1,231,804)	$ -
Statement of Revenues, Expenses and Changes in Net Position			
Amortization of Bond Issuance Costs	$ (107,760)	$ 107,760	$ -
Excess of Revenues over (under) Expenses	$ 13,374,642	$ 107,760	$ 13,482,402
Net Position			
Beginning of year	$ (333,764,236)	$ (1,339,564)	$ (335,103,800)
End of year	$ (320,389,594)	$ (1,231,804)	$ (321,621,398)

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.

All 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 $44,716 and $27,471 for the years ended June 30, 2012 and 2011, respectively. The Authority has no directly hired staff and as such has no pension obligations. The Authority had fees payable totaling $22,412 and $5,997 with the Washington State Housing Finance Commission at June 30, 2012 and 2011, 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.

Note 5 - Bonds Payable (Continued)

As of June 30, 2012, the Authority had outstanding bonds of $388.8 million. The bonds bear interest rates ranging from 6.50% 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
2013	$ -	$ 25,494,700	$ 25,494,700
2014	12,315,000	25,494,700	37,809,700
2015	8,755,000	24,694,225	33,449,225
2016	17,675,000	24,125,150	41,800,150
2017	18,995,000	22,976,275	41,971,275
2018-2022	85,765,000	98,253,400	184,018,400
2023-2027	94,070,000	68,195,450	162,265,450
2028-2032	151,200,000	28,366,263	179,566,263
	$ 388,775,000	$ 317,600,163	$ 706,375,163

Changes in bonds outstanding during the fiscal year ended June 30, 2012 are summarized in the following table:

Balance at June 30, 2011	Issued	Redeemed	Balance at June 30, 2012
$ 406,640,000	$ -	$ 17,865,000	$ 388,775,000

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 $304,271,230, 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, 2012 and January 1 to June 30, 2011.

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

TOBACCO SETTLEMENT AUTHORITY
(A Component Unit of the State of Washington)
SCHEDULE OF PROGRAM NET POSITION
JUNE 30, 2012 AND 2011

	Restricted Bond Fund	General Operating Fund	Total	
ASSETS			2012	2011 (as restated)
CASH AND CASH EQUIVALENTS	$ 58,337,186	$ 285,080	$ 58,622,266	$ 59,096,692
TSR RECEIVABLE	21,416,205	-	21,416,205	20,823,733
PREPAID FEES AND INTEREST RECEIVABLE	5,235	14,023	19,258	8,533
TOTAL ASSETS	$ 79,758,626	$ 299,103	$ 80,057,729	$ 79,928,958
LIABILITIES AND NET DEFICIT				
ACCRUED INTEREST PAYABLE	$ 2,124,558	$ -	$ 2,124,558	$ 2,209,390
ACCOUNTS PAYABLE AND OTHER LIABILITIES	-	114,121	114,121	11,352
BONDS PAYABLE				
Interest bonds	388,775,000	-	388,775,000	406,640,000
Unamortized bond discount	(6,684,720)	-	(6,684,720)	(7,310,386)
	382,090,280	-	382,090,280	399,329,614
TOTAL LIABILITIES	384,214,838	114,121	384,328,959	401,550,356
TOTAL NET POSITION	(304,456,212)	184,982	(304,271,230)	(321,621,398)
TOTAL LIABILITIES AND NET POSITION	$ 79,758,626	$ 299,103	$ 80,057,729	$ 79,928,958

TOBACCO SETTLEMENT AUTHORITY
(A Component Unit of the State of Washington)
SCHEDULE OF PROGRAM REVENUES, EXPENSES, AND CHANGES IN PROGRAM NET POSITION
YEARS ENDED JUNE 30, 2012 AND 2011

	Restricted Bond Fund	General Operating Fund	Total 2012	Total 2011 (as restated)
REVENUES				
Tobacco settlement revenues and other fee income	$ 44,590,839	$ 150,000	$ 44,740,839	$ 41,587,579
Non operating revenues - interest income	60,421	215	60,636	101,166
	44,651,260	150,215	44,801,475	41,688,745
EXPENSES				
Interest on debt	26,426,925	-	26,426,925	27,446,155
Amortization of bond discount	625,665	-	625,665	639,514
General and administrative	186,500	212,217	398,717	120,674
	27,239,090	212,217	27,451,307	28,206,343
CHANGE IN NET POSITION	17,412,170	(62,002)	17,350,168	13,482,402
NET POSITION				
Beginning of year	(321,868,382)	246,984	(321,621,398)	(335,103,800)
End of year	$ (304,456,212)	$ 184,982	$ (304,271,230)	$ (321,621,398)

TOBACCO SETTLEMENT AUTHORITY
(A Component Unit of the State of Washington)
SCHEDULE OF PROGRAM CASH FLOWS
YEARS ENDED JUNE 30, 2012 AND 2011

	Restricted Bond Fund	General Operating Fund	Total 2012	Total 2011 (as restated)
OPERATING ACTIVITIES				
Cash received from tobacco settlement and other revenues	$ 43,998,367	$ 150,210	$ 44,148,577	$ 43,159,539
Cash paid for general and administrative expenses	(186,500)	(119,141)	(305,641)	(146,321)
Net cash from operating activities	43,811,867	31,069	43,842,936	43,013,218
INVESTING ACTIVITIES				
Cash received from sales of investments	-	-	-	125,000
Cash received from interest income	59,394	-	59,394	104,934
Net cash from financing activities	59,394	-	59,394	229,934
NONCAPITAL FINANCING ACTIVITIES				
Principal repayment on bonds	(17,865,000)	-	(17,865,000)	(16,215,000)
Cash paid for bond interest expense	(26,511,756)	-	(26,511,756)	(27,531,219)
Net cash from financing activities	(44,376,756)	-	(44,376,756)	(43,746,219)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(505,495)	31,069	(474,426)	(503,067)
CASH AND CASH EQUIVALENTS				
Beginning of year	58,842,681	254,011	59,096,692	59,599,759
End of year	$ 58,337,186	$ 285,080	$ 58,622,266	$ 59,096,692
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES				
Excess of revenues over expenses	$ 17,412,170	$ (62,002)	$ 17,350,168	$ 13,482,402
Adjustments to reconcile operating income to net cash provided by operating activities				
Amortization of bond discount	625,665	-	625,665	639,514
Cash paid for bond interest expense	26,511,756	-	26,511,756	27,531,219
Cash received from interest income	(59,394)	-	(59,394)	(104,934)
Changes in assets and liabilities				
(Increase) decrease in TSR receivable	(592,472)	-	(592,472)	1,570,416
(Increase) decrease in prepaid fees and other receivables	(1,026)	(9,698)	(10,724)	5,311
Increase (decrease) in accounts payable and other liabilities	-	102,769	102,769	(25,647)
Decrease in accrued interest payable	(84,832)	-	(84,832)	(85,063)
Net cash from operating activities	$ 43,811,867	$ 31,069	$ 43,842,936	$ 43,013,218