Report of Independent Auditors
and Financial Statements with
Supplemental Information for

Tobacco Settlement Authority
(A Component Unit of the State of Washington)

June 30, 2013 and 2012

MOSS-ADAMS LLP

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REPORT OF INDEPENDENT AUDITORS

To the Board of Directors
Tobacco Settlement Authority

Report on Financial Statements

We have audited the accompanying financial statements of the Tobacco Settlement Authority (the Authority), which comprise the statements of net position as of June 30, 2013 and 2012, and the related statements of revenues, expenses, and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our 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 from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Tobacco Settlement Authority as of June 30, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the accompanying Management's Discussion and Analysis on pages 3 through 8 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplemental Information

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 19 through 21 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 24, 2013

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, 2013 and 2012. This overview and analysis is required by accounting principles generally accepted in the United States of America ("GAAP") and the Governmental Accounting Standards Board ("GASB").

FINANCIAL HIGHLIGHTS

Tobacco Settlement Revenues ("TSRs") of $44.1 million and $44.7 million were recognized as revenue in the fiscal years ended June 30, 2013 and 2012, respectively. In accordance with the GASB 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues,* $21.3 million TSRs applicable to cigarette sales between January 1, 2013 and June 30, 2013 were recorded as accrued TSR Receivable as of June 30, 2013 while $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. No additional bonds were issued during 2013.

Significant year over year changes from June 30, 2012 to June 30, 2013 include:

- Total assets decreased by $0.7 million to $79.3 million primarily due to the decrease in the 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 $364.1 million, net of discounts. This represents a net decrease of $18 million, or 4.7%, resulting from principal payments on bonds.

- At June 30, 2013, the Authority had an increase of $17.4 million (5.7%) in net position over that of the previous fiscal year end.

- Bond interest expense decreased $1.1 million (4.2%) as bonds payable continued to decline.

- General administrative expense increased $84 thousand primarily 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.

OVERVIEW OF THE FINANCIAL STATEMENTS (CONTINUED)

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. 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 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 $286,816,326, 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, 2013 and 2012 (in millions):

	2013	2012	Change	
Assets				
Cash and cash equivalents	$ 58.0	$ 58.6	$ (0.6)	(1.0%)
Accrued TSR and other receivables	21.3	21.4	(0.1)	(0.5%)
Total assets	$ 79.3	$ 80.0	$ (0.7)	(0.9%)
Liabilities				
Accrued interest payable and other liabilities	$ 2.1	$ 2.2	$ (0.1)	(4.5%)
Bonds payable, net	364.1	382.1	(18.0)	(4.7%)
Total liabilities	366.2	384.3	(18.1)	(4.7%)
Net position	(286.9)	(304.3)	17.4	(5.7%)
Total liabilities and net position	$ 79.3	$ 80.0	$ (0.7)	(0.9%)

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, 2013 and 2012 (in millions):

	2013	2012	Change	
Revenues				
Tobacco settlement revenues	$ 44.1	$ 44.7	$ (0.6)	(1.3%)
Bond program interest	-	0.1	(0.1)	(100.0%)
Total revenues	$ 44.1	$ 44.8	$ (0.7)	(1.6%)
Expenses				
Bond program interest expense	$ 25.4	$ 26.5	$ (1.1)	(4.2%)
Other bond program expenses	0.8	0.6	0.2	33.3%
General and administrative	0.5	0.4	0.1	25.0%
Total expenses	$ 26.7	$ 27.5	$ (0.8)	(2.9%)
Change in net position	$ 17.4	$ 17.3	$ 0.1	0.6%

FINANCIAL ANALYSIS OF THE AUTHORITY (CONTINUED)

TSRs of $43.9 million and $25.4 million in interest on debt are the primary components of total revenues and expenses, respectively, for the Restricted Bond Program.

During fiscal year 2013, revenue received for general operations included other income of $250,000 representing a draw from TSR's. General operating expense for fiscal year 2013 within the General Operating Fund ($196,384) included $120,137 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 $76,247 is comprised of allocable salaries and wages, and other general and administrative expenses.

DEBT ADMINISTRATION

The Authority has long-term debt obligations of $364.1 million, net of bond discounts at June 30, 2013. 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, 2013, 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 2012 WITH 2011

Statements of Net Position

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

	2012	2011	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 combined changes in net position between the fiscal years 2012 and 2011 (in millions):

	2012	2011	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%

COMPARISON OF FISCAL YEARS 2012 WITH 2011 (CONTINUED)

During the fiscal year ended June 30, 2012, the Authority's combined total assets increased by $0.1 million primarily due to the increase in TSRs receivable ($0.6 million) and a $0.5 million decrease in cash equivalents and investments. Combined total net income of $17.3 million for fiscal year 2012 represents an increase from fiscal year 2011 of $3.8 million. The increase is attributable to an increase in TSRs of $3.1 million, and 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.

	June 30,	
ASSETS	2013	2012
CASH AND CASH EQUIVALENTS	$ 58,009,511	$ 58,622,266
TSR RECEIVABLE	21,310,577	21,416,205
PREPAID FEES AND INTEREST RECEIVABLE	15,561	19,258
TOTAL ASSETS	$ 79,335,649	$ 80,057,729
LIABILITIES AND NET POSITION		
ACCRUED INTEREST PAYABLE	$ 2,021,413	$ 2,124,558
ACCOUNTS PAYABLE AND OTHER LIABILITIES	74,954	114,121
BONDS PAYABLE		
Interest bonds	369,900,000	388,775,000
Unamortized bond discount	(5,844,392)	(6,684,720)
	364,055,608	382,090,280
TOTAL LIABILITIES	366,151,975	384,328,959
TOTAL NET POSITION	(286,816,326)	(304,271,230)
TOTAL LIABILITIES AND NET POSITION	$ 79,335,649	$ 80,057,729

See accompanying notes.

TOBACCO SETTLEMENT AUTHORITY
(A Component Unit of the State of Washington)
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

	Years Ended June 30,	
	2013	2012
REVENUES		
Tobacco settlement revenues and other fee income	$ 44,129,051	$ 44,740,839
Non operating revenues - interest income	39,375	60,636
	44,168,426	44,801,475
EXPENSES		
Interest on debt	25,390,310	26,426,925
Amortization of bond discount	840,328	625,665
General and administrative	482,884	398,717
	26,713,522	27,451,307
CHANGE IN NET POSITION	17,454,904	17,350,168
NET POSITION		
Beginning of year	(304,271,230)	(321,621,398)
End of year	$ (286,816,326)	$ (304,271,230)

See accompanying notes.

STATEMENTS OF CASH FLOWS

	Years Ended June 30, 2013	2012
OPERATING ACTIVITIES		
Cash received from tobacco settlement and other revenues	$ 44,234,790	$ 44,148,577
Cash paid for general and administrative expenses	(522,604)	(305,641)
Net cash from operating activities	43,712,186	43,842,936
INVESTING ACTIVITIES		
Cash received from interest income	43,515	59,394
NONCAPITAL FINANCING ACTIVITIES		
Principal repayment on bonds	(18,875,000)	(17,865,000)
Cash paid for bond interest expense	(25,493,456)	(26,511,756)
Net cash used for financing activities	(44,368,456)	(44,376,756)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(612,755)	(474,426)
CASH AND CASH EQUIVALENTS		
Beginning of year	58,622,266	59,096,692
End of year	$ 58,009,511	$ 58,622,266
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Excess of revenues over expenses	$ 17,454,904	$ 17,350,168
Adjustments to reconcile operating income to net cash provided by operating activities		
Amortization of bond discount	840,328	625,665
Cash paid for bond interest expense	25,493,456	26,511,756
Cash received from interest income	(43,515)	(59,394)
Changes in assets and liabilities		
(Increase) decrease in TSR receivable	105,628	(592,472)
(Increase) decrease in prepaid fees and other receivables	3,697	(10,724)
Increase (decrease) in accounts payable and other liabilities	(39,167)	102,769
Decrease in accrued interest payable	(103,145)	(84,832)
Net cash from operating activities	$ 43,712,186	$ 43,842,936

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 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. GASB is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The Authority has applied all applicable GASB pronouncements.

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, 2013 or June 30, 2012.

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 discounts are expensed at issuance.

Bonds Payable - Serial and Turbo Term bonds are stated at their principal amount outstanding, net of unamortized bond discount.

Note 2 - Summary of Significant Accounting Policies (Continued)

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, 2013 and 2012.

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.

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 TSRs 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 2013 and 2012 included an accrual of $21,310,577 and $21,416,205, 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 2013 and 2012, the Authority delivered officer's certificates to the Trustee requesting operating funds of $250,000 and $150,000, respectively, be disbursed which were received by the Authority prior to the fiscal years' end.

Note 2 - Summary of Significant Accounting Policies (Continued)

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 $286,816,326 at June 30, 2013 and $304,271,230 at June 30, 2012 reflect unrestricted net deficit positions as defined by GASB Statement No. 34. This balance is comprised of amounts from two funds. The general operating fund had a net position balance of $238,684 at June 30, 2013 and $184,982 at June 30, 2012. The restricted bond fund has a net deficit balance of $287,055,010 at June 30, 2013 and $304,456,212 at June 30, 2012. Management believes that the present value of the TSRs 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, 2013 and 2012.

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.

Note 3 - Investments (Continued)

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 $40,061 and $44,716 for the years ended June 30, 2013 and 2012, respectively. The Authority has no directly hired staff and as such has no pension obligations. The Authority had fees payable totaling $16,560 and $22,412 with the Washington State Housing Finance Commission at June 30, 2013 and 2012, 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, 2013, the Authority had outstanding bonds of $369.9 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
2014	$ 11,690,000	$ 24,256,950	$ 35,946,950
2015	8,330,000	23,497,100	31,827,100
2016	16,820,000	22,955,650	39,775,650
2017	18,075,000	21,862,350	39,937,350
2018	14,390,000	20,687,475	35,077,475
2019-2023	86,570,000	88,185,775	174,755,775
2024-2028	99,090,000	59,037,688	158,127,688
2029-2032	114,935,000	17,459,856	132,394,856
	$ 369,900,000	$ 277,942,844	$ 647,842,844

Note 5 - Bonds Payable (Continued)

Changes in bonds outstanding during the fiscal year ended June 30, 2013 are summarized in the following table:

Balance at June 30, 2012	Issued	Redeemed	Balance at June 30, 2013
$ 388,775,000	$ -	$ 18,875,000	$ 369,900,000

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 $286,816,326 an amount equal to the net deficit position. 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, 2013 and January 1 to June 30, 2012.

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.

Note 7 - Contingencies (Continued)

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.

Note 8 - Subsequent Events

In October 2013, the Authority issued $334,700,000 in refunding bonds in order to currently refund the 2002 bonds totaling $369,900,000.

SUPPLEMENTAL INFORMATION

ASSETS	Restricted Bond Fund	General Operating Fund	June 30, 2013	June 30, 2012
CASH AND CASH EQUIVALENTS	$ 57,710,425	$ 299,086	$ 58,009,511	$ 58,622,266
TSR RECEIVABLE	21,310,577	-	21,310,577	21,416,205
PREPAID FEES AND INTEREST RECEIVABLE	1,009	14,552	15,561	19,258
TOTAL ASSETS	$ 79,022,011	$ 313,638	$ 79,335,649	$ 80,057,729
LIABILITIES AND NET POSITION				
ACCRUED INTEREST PAYABLE	$ 2,021,413	$ -	$ 2,021,413	$ 2,124,558
ACCOUNTS PAYABLE AND OTHER LIABILITIES	-	74,954	74,954	114,121
BONDS PAYABLE				
Interest bonds	369,900,000	-	369,900,000	388,775,000
Unamortized bond discount	(5,844,392)	-	(5,844,392)	(6,684,720)
	364,055,608	-	364,055,608	382,090,280
TOTAL LIABILITIES	366,077,021	74,954	366,151,975	384,328,959
TOTAL NET POSITION	(287,055,010)	238,684	(286,816,326)	(304,271,230)
TOTAL LIABILITIES AND NET POSITION	$ 79,022,011	$ 313,638	$ 79,335,649	$ 80,057,729

TOBACCO SETTLEMENT AUTHORITY
(A Component Unit of the State of Washington)
SCHEDULE OF PROGRAM REVENUES, EXPENSES, AND CHANGES IN PROGRAM NET POSITION

	Restricted Bond Fund	General Operating Fund	Years Ended June 30, 2013	2012
REVENUES				
Tobacco settlement revenues and other fee income	$ 43,879,051	$ 250,000	$ 44,129,051	$ 44,740,839
Non operating revenues - interest income	39,289	86	39,375	60,636
	43,918,340	250,086	44,168,426	44,801,475
EXPENSES				
Interest on debt	25,390,310	-	25,390,310	26,426,925
Amortization of bond discount	840,328	-	840,328	625,665
General and administrative	286,500	196,384	482,884	398,717
	26,517,138	196,384	26,713,522	27,451,307
CHANGE IN NET POSITION	17,401,202	53,702	17,454,904	17,350,168
NET POSITION				
Beginning of year	(304,456,212)	184,982	(304,271,230)	(321,621,398)
End of year	$ (287,055,010)	$ 238,684	$ (286,816,326)	$ (304,271,230)

	Restricted Bond Fund	General Operating Fund	Years Ended June 30, 2013	2012
OPERATING ACTIVITIES				
Cash received from tobacco settlement and other revenues	$ 43,984,680	$ 250,110	$ 44,234,790	$ 44,148,577
Cash paid for general and administrative expenses	(286,500)	(236,104)	(522,604)	(305,641)
Net cash from operating activities	43,698,180	14,006	43,712,186	43,842,936
INVESTING ACTIVITIES				
Cash received from interest income	43,515	-	43,515	59,394
NONCAPITAL FINANCING ACTIVITIES				
Principal repayment on bonds	(18,875,000)	-	(18,875,000)	(17,865,000)
Cash paid for bond interest expense	(25,493,456)	-	(25,493,456)	(26,511,756)
Net cash from financing activities	(44,368,456)	-	(44,368,456)	(44,376,756)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(626,761)	14,006	(612,755)	(474,426)
CASH AND CASH EQUIVALENTS				
Beginning of year	58,337,186	285,080	58,622,266	59,096,692
End of year	$ 57,710,425	$ 299,086	$ 58,009,511	$ 58,622,266
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES				
Excess of revenues over expenses	$ 17,401,202	$ 53,702	$ 17,454,904	$ 17,350,168
Adjustments to reconcile operating income to net cash provided by operating activities				
Amortization of bond discount	840,328	-	840,328	625,665
Cash paid for bond interest expense	25,493,456	-	25,493,456	26,511,756
Cash received from interest income	(43,515)	-	(43,515)	(59,394)
Changes in assets and liabilities				
(Increase) decrease in TSR receivable	105,628	-	105,628	(592,472)
(Increase) decrease in prepaid fees and other receivables	4,226	(529)	3,697	(10,724)
Increase (decrease) in accounts payable and other liabilities	-	(39,167)	(39,167)	102,769
Decrease in accrued interest payable	(103,145)	-	(103,145)	(84,832)
Net cash from operating activities	$ 43,698,180	$ 14,006	$ 43,712,186	$ 43,842,936