



REPORT OF INDEPENDENT AUDITORS
AND FINANCIAL STATEMENTS WITH
SUPPLEMENTAL INFORMATION

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

June 30, 2018 and 2017

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Report of Independent Auditors

To the Board of Directors
Tobacco Settlement Authority

Report on the Financial Statements

We have audited the accompanying financial statements of the Tobacco Settlement Authority, which comprise the statements of net position as of June 30, 2018 and 2017, 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 we have 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 the Tobacco Settlement Authority as of June 30, 2018 and 2017, and the changes in its net position and results of 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, 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, 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
November 14, 2018

Tobacco Settlement Authority

(A Component Unit of the State of Washington)

Management's Discussion and Analysis

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, 2018 and 2017. This overview and analysis is required by accounting principles generally accepted in the United States of America (GAAP) as promulgated by the Governmental Accounting Standards Board (GASB).

Financial Highlights

Tobacco Settlement Revenues (TSRs) of \$33.7 million and \$39.8 million were recognized as revenue in the fiscal years ended June 30, 2018 and 2017, respectively. In accordance with GASB 48, Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues, \$16.4 million of TSRs applicable to cigarette sales between January 1, 2018, and June 30, 2018, were recorded as accrued TSR Receivable as of June 30, 2018, while \$18.0 million of TSRs applicable to cigarette sales between January 1, 2017, and June 30, 2017, were recorded as accrued TSR Receivable as of June 30, 2017.

Significant year over year changes from June 30, 2017 to June 30, 2018, include:

- TSR receivables decreased by \$1.6 million (8.9%) to \$16.4 million primarily due to cigarette sale declines.
- At year-end, the Authority had total net bonds payable of \$192.8 million, net of premiums. This represents a net decrease of \$29.6 million (13.3%) resulting from principal payments on bonds from maturities and a current defeasance completed near year end.
- At June 30, 2018, the Authority had an increase of \$24.6 million (15.0%) in net position over that of the previous fiscal year end.
- Bond interest expense decreased \$1.6 million (12.5%) 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 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 information. These supplemental statements separate the financial statements into the Restricted Bond Fund and General Operating Fund.

Tobacco Settlement Authority

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Management's Discussion and Analysis

Overview of the Financial Statements (continued)

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 deferred outflows and all liabilities and deferred inflows associated with the operation of these funds are included on the statements of net position. The statements of revenue, 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.

Management believes that the present value amount of TSRs that will be collected over time is \$139.6 million, an amount equal to the net deficit position.

Economic Outlook

The volume of cigarette shipments is the major factor in determining the amount of TSRs received by the Authority. Shipments of cigarettes over the history of the Authority have declined more rapidly than originally predicted when its bonds were issued in 2002. Factors influencing demand over that period have been significant increases in state and federal tobacco excise taxes, greater restrictions on public smoking, and the rise in popularity of e-Cigarettes. According to data from industry sources, cigarette shipments during 2016 declined 2.39%. Authority staff consider the industry information available to them each year when accruing estimated TSRs to be received as revenue.

During 2018, due to favorable market conditions, the Authority refinanced a portion of the Series 2013 refunding bonds, reducing the required total debt service. Cigarette consumption information included in the Official Statement for the 2018 Refunding Bonds reports an average decline of 3.910% between the years 2008 and 2017. The TSA Refunding bonds remaining outstanding were modeled to withstand a decline in consumption of as much as 9.088% annually.

Tobacco Settlement Authority
(A Component Unit of the State of Washington)
Management's Discussion and Analysis

Financial Analysis of the Authority

Statements of Net Position

The following table summarizes the changes in assets and deferred outflows, liabilities and deferred inflows, and net position between the years ended June 30, 2018 and 2017 (in millions):

	2018	2017	Change	
Assets				
Cash and cash equivalents	\$ 36.7	\$ 37.9	\$ (1.2)	(3.2%)
Accrued TSR and other receivables	16.4	18.0	(1.6)	(8.9%)
Total assets	53.1	55.9	(2.8)	(5.0%)
Deferred outflow of resources	2.0	3.2	(1.2)	(37.5%)
Total assets and deferred outflow of resources	\$ 55.1	\$ 59.1	\$ (4.0)	(6.8%)
Liabilities				
Accrued interest payable and other liabilities	\$ 0.6	\$ 0.9	\$ (0.3)	(33.3%)
Bonds payable, net	192.8	222.4	(29.6)	(13.3%)
Total liabilities	193.4	223.3	(29.9)	(13.4%)
Deferred inflow of resources	1.3	-	1.3	100.0%
Net position	(139.6)	(164.2)	24.6	15.0%
Total liabilities and net position	\$ 55.1	\$ 59.1	\$ (4.0)	(6.8%)

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, 2018 and 2017 (in millions):

	2018	2017	Change	
Revenues				
Tobacco settlement and other revenues	\$ 34.1	\$ 40.1	\$ (6.0)	(15.0%)
Bond interest and program revenue	0.5	0.2	0.3	(100.0%)
Total revenues	\$ 34.6	\$ 40.3	\$ (5.7)	(14.1%)
Expenses				
Bond program interest expense	\$ 11.2	\$ 12.8	\$ (1.6)	(12.5%)
Other bond program expenses	(1.3)	(2.7)	1.4	(51.9%)
General and administrative	0.1	0.1	-	-
Total expenses	\$ 10.0	\$ 10.2	\$ (0.2)	(2.0%)
Change in net position	\$ 24.6	\$ 30.1	\$ (5.5)	(18.3%)

Tobacco Settlement Authority

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Management's Discussion and Analysis

Financial Analysis of the Authority (continued)

TSRs of \$33.7 million and \$11.2 million of interest on debt are the primary components of total revenues and expenses, respectively, for the Restricted Bond Program.

During fiscal year 2018, revenue received for general operations included other income of \$19.3 thousand representing a draw from TSR's and \$2.2 thousand of interest income. General operating expense for fiscal year 2018 within the General Operating Fund was \$54.3 thousand comprised of allocable salaries and wages, and other general and administrative expenses.

Debt Administration

The Authority has long-term debt obligations of \$192.8 million, net of bond premium at June 30, 2018. 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, 2018, amounts held by the trustee and future receipts of TSRs represent full funding of these requirements.

The 2002 series 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. During fiscal year 2014, the Series 2002 bonds were refunded by the Series 2013 Refunding Bonds under the existing Purchase and Sale Agreement with the State. On June 20, 2018, the Authority issued \$43,630,000 of Series 2018 Refunding Bonds. The proceeds (including bond premium) were used to refund \$47,645,000 of the Series 2013 Refunding Bonds. The Series 2013 and 2018 Refunding 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. The Serial Bonds with maturity dates 2024-2033 include optional call provisions, allowing the application of TSRs received in excess of the required 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 obligation 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 the Authority's financial statements.

Tobacco Settlement Authority
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Management's Discussion and Analysis

Comparison of Fiscal Years 2017 with 2016

Statements of Net Position

The following table summarizes the changes in combined net position between fiscal years ended June 30, 2017 and 2016 (in millions):

	2017	2016	Change	
Assets				
Cash and cash equivalents	\$ 37.9	\$ 38.8	\$ (0.9)	(2.3%)
Accrued TSR and other receivables	18.0	22.3	(4.3)	(19.3%)
Total assets	55.9	61.1	(5.2)	(8.5%)
Deferred outflow of resources	3.2	3.8	(0.6)	(15.8%)
Total assets and deferred outflow of resources	\$ 59.1	\$ 64.9	\$ (5.8)	(8.9%)
Liabilities				
Accrued interest payable and other liabilities	\$ 0.9	\$ 1.0	\$ (0.1)	(10.0%)
Bonds payable, net	222.4	258.2	(35.8)	(13.9%)
Total liabilities	223.3	259.2	(35.9)	(13.9%)
Net position	(164.2)	(194.3)	30.1	(15.5%)
Total liabilities and net position	\$ 59.1	\$ 64.9	\$ (5.8)	(8.9%)

During the fiscal year ended June 30, 2017, the Authority's combined total assets and deferred outflows of resources decreased by \$5.8 million primarily due to the decrease in TSRs and other receivables (\$4.3 million).

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Management's Discussion and Analysis

Comparison of Fiscal Years 2017 with 2016 (continued)

Statements of Revenues, Expenses and Changes in Net Position

The following table summarizes the combined changes in net position between the fiscal years 2017 and 2016 (in millions):

	<u>2017</u>	<u>2016</u>	<u>Change</u>	
Revenues				
Tobacco settlement and other revenues	\$ 40.1	\$ 46.8	\$ (6.7)	(14.3%)
Bond interest and program revenue	<u>0.2</u>	<u>-</u>	<u>0.2</u>	100.0%
Total revenues	<u>\$ 40.3</u>	<u>\$ 46.8</u>	<u>\$ (6.5)</u>	(13.9%)
Expenses				
Bond program interest expense	\$ 12.8	\$ 14.7	\$ (1.9)	(12.9%)
Other bond program expenses	(2.7)	(2.8)	0.1	(3.6%)
General and administrative	<u>0.1</u>	<u>0.2</u>	<u>(0.1)</u>	(50.0%)
Total expenses	<u>\$ 10.2</u>	<u>\$ 12.1</u>	<u>\$ (1.9)</u>	(15.7%)
Change in net position	<u>\$ 30.1</u>	<u>\$ 34.7</u>	<u>\$ (4.6)</u>	(13.3%)

The change in net position of \$30.1 million for fiscal year 2017 represents a decrease of \$4.6 million over the fiscal year 2016 change of \$34.7 million. The decrease is primarily attributable to the reduction in TSRs, partially offset by the realized savings in bond interest.

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

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

	June 30,	
ASSETS AND DEFERRED OUTFLOW OF RESOURCES	2018	2017
CASH AND CASH EQUIVALENTS	\$ 36,745,871	\$ 37,905,850
TSR RECEIVABLE	16,410,696	17,956,373
PREPAID FEES AND INTEREST RECEIVABLE	57,068	26,898
TOTAL ASSETS	53,213,635	55,889,121
DEFERRED OUTFLOW OF RESOURCES		
Unamortized loss on refunded debt	1,964,493	3,209,735
TOTAL ASSETS AND DEFERRED OUTFLOW OF RESOURCES	\$ 55,178,128	\$ 59,098,856
LIABILITIES, DEFERRED INFLOW OF RESOURCES AND NET POSITION		
ACCRUED INTEREST PAYABLE	\$ 641,714	\$ 890,473
ACCOUNTS PAYABLE AND OTHER LIABILITIES	12,969	8,153
BONDS PAYABLE		
Interest bonds	178,465,000	208,745,000
Unamortized bond premium	14,302,756	13,669,678
	192,767,756	222,414,678
TOTAL LIABILITIES	193,422,439	223,313,304
DEFERRED INFLOW OF RESOURCES		
Unamortized gain on refunded debt	1,355,851	-
TOTAL NET POSITION	(139,600,162)	(164,214,448)
TOTAL LIABILITIES, DEFERRED INFLOW OF RESOURCES AND NET POSITION	\$ 55,178,128	\$ 59,098,856

Tobacco Settlement Authority
(A Component Unit of the State of Washington)
Statements of Revenues, Expenses, and Changes in Net Position

	Years Ended June 30,	
	2018	2017
REVENUES		
Tobacco settlement revenues and other income	\$ 34,092,723	\$ 40,103,475
Interest income	516,548	146,136
	<u>34,609,271</u>	<u>40,249,611</u>
EXPENSES		
Interest on debt	11,190,624	12,820,402
Amortization of bond premium	(2,379,864)	(2,699,281)
Cost of issuance	1,082,631	-
General and administrative	101,594	153,894
	<u>9,994,985</u>	<u>10,275,015</u>
CHANGE IN NET POSITION	24,614,286	29,974,596
NET POSITION		
Beginning of year	<u>(164,214,448)</u>	<u>(194,189,044)</u>
End of year	<u><u>\$ (139,600,162)</u></u>	<u><u>\$ (164,214,448)</u></u>

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

	Years Ended June 30,	
	2018	2017
OPERATING ACTIVITIES		
Cash received from tobacco settlement and other revenues	\$ 35,640,558	\$ 44,483,261
Cash paid for bond program expenses	(1,129,931)	(28,000)
Cash paid for general and administrative expenses	(49,446)	(122,780)
Net cash from operating activities	34,461,181	44,332,481
INVESTING ACTIVITIES		
Cash received from interest income	484,187	125,364
NONCAPITAL FINANCING ACTIVITIES		
Proceeds from issuance of bonds	48,692,963	-
Principal repayment on bonds	(73,910,000)	(33,050,000)
Cash paid for bond interest expense	(10,888,310)	(12,324,300)
Net cash used for financing activities	(36,105,347)	(45,374,300)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,159,979)	(916,455)
CASH AND CASH EQUIVALENTS		
Beginning of year	37,905,850	38,822,305
End of year	\$ 36,745,871	\$ 37,905,850
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Excess of revenues over expenses	\$ 24,614,286	\$ 29,974,596
Adjustments to reconcile operating income to net cash provided by operating activities		
Amortization of bond premium	(2,379,864)	(2,699,281)
Amortization of loss on refunded debt	551,072	633,810
Cash paid for bond interest expense	10,888,311	12,324,300
Cash received from interest income	(484,187)	(125,363)
Changes in assets and liabilities		
(Increase) decrease in TSR receivable	1,545,677	4,378,883
Decrease in prepaid fees and other receivables	(30,171)	(19,870)
Increase (decrease) in accounts payable and other liabilities:	(243,943)	3,114
Decrease in accrued interest payable	-	(137,708)
Net cash from operating activities	\$ 34,461,181	\$ 44,332,481

Tobacco Settlement Authority

(A Component Unit of the State of Washington)

Notes to 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 generate a one-time payment of \$450 million for the State of Washington (the State) in the 2002-2004 biennium by issuing bonds securitizing a portion of the future revenue stream available under the Master Settlement Agreement (MSA) among participating cigarette manufacturers and Settling States. The Settling States included the state of Washington, 45 other states and six other U.S. jurisdictions. 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 a one-time payment of \$30 million at bond closing and 29.2% of the State's Tobacco Settlement Revenues (TSRs) received on or after July 1, 2003. The final maturity of the Series 2002 Bonds was 2032. On October 17, 2013, \$334,700,000 in refunding bonds were issued. The bond proceeds were used to currently refund all 2002 bonds. The structure of the Series 2013 Refunding Bonds provided a reduced interest rate with a final scheduled maturity in 2033. On June 20, 2018, \$46,630,000 in refunding bonds were issued. The proceeds were used to partially refund the Series 2013 Refunding Bonds, providing a further reduction in interest rate. The expected maturity of both series of Refunding Bonds is 2023. 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's financial operations are accounted for in two funds, the Restricted Bond Fund and General Operating Fund. The Restricted Bond Fund accounts for the receipt of the Authority's TSRs and of the payments related to servicing the bonds. The General Operating Fund accounts for the fiscal activities of the ongoing program administration responsibilities of the Authority. It is funded by draws, as necessary, from the TSRs used to repay the debt. 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 Authority's operating fund. Accounting and staff services are to be provided until the bonds are retired.

Tobacco Settlement Authority
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Notes to Financial Statements

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 deferred outflows and all liabilities and deferred inflows 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 and deferred inflows are incurred.

Unclassified statement of net position – 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 department of a commercial bank (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. Cash and cash equivalents by fund as of June 30, 2018 and 2017, are:

	2018	2017
Cash and cash equivalents		
Restricted Bond Fund	\$ 36,580,719	\$ 37,712,710
General Operating Fund	165,152	193,140
Total cash and cash equivalents	\$ 36,745,871	\$ 37,905,850

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, 2018 or 2017.

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Notes to Financial Statements

Note 2 – Summary of Significant Accounting Policies (continued)

Deferred outflow and inflow of resources – In addition to assets and liabilities, the statement of net position, when applicable, will report a separate section for deferred outflow and inflow of resources. Deferred outflow of resources represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense) until then. Similarly, deferred inflows represent the expected savings of net position that apply to future period(s). The excess of costs and the excess of savings incurred over the carrying value of bonds refunded on early extinguishment of debt is amortized, using the bonds outstanding method, over the shorter of the remaining life of the old bonds or the life of the new issue and recorded as a deferred outflow of resources.

Unamortized bond discounts and premium – Unamortized bond discounts and premiums 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 Bonds are stated at their principal amount outstanding, net of unamortized bond premium.

Income taxes – The Authority is exempt from federal income taxes under Internal Revenue Code Section 115(a) and accordingly, no provision for income taxes was made for the years ended June 30, 2018 and 2017.

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 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 Bond Trustee and used in accordance with the bond indenture to redeem bonds and pay costs until such time as the bond and other obligations are fully paid.

The Authority has elected to continue recognition of its Purchase and Sale Agreement of Tobacco Assets on its previous transactions consistent with its treatment prior to the issuance of GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues* as allowed by the statement. Therefore, the Authority does not recognize a deferred inflow of resources related to the purchase of this future revenue stream from the State. The Authority recognizes TSRs as an asset and revenue based on 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 2018 and 2017 included an accrual of \$16,410,696 and \$17,956,373, 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 2018 and 2017, the Authority delivered officer's certificates to the Trustee requesting operating funds of \$19,300 and \$67,000, respectively, be disbursed which were received by the Authority prior to the fiscal years' end.

Tobacco Settlement Authority
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Notes to Financial Statements

Note 2 – Summary of Significant Accounting Policies (continued)

Use of estimates – The preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP) 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 \$139,600,162 at June 30, 2018, and \$164,214,448 at June 30, 2017, 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 has a net position balance of \$158,666 at June 30, 2018, and \$191,502 at June 30, 2017. The restricted bond fund has a net deficit balance of \$139,758,828 at June 30, 2018, and \$164,405,950 at June 30, 2017. 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, 2018 and 2017.

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.

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Notes to Financial Statements

Note 3 – Investments (continued)

The Authority measures investments at fair value on a reoccurring basis and categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. However, as of the years ended June 30, 2018 and 2017, the Authority held no investments as all excess funds were 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 \$28,028 and \$27,069 for the years ended June 30, 2018 and 2017, respectively. The Authority has no directly hired staff and as such has no pension obligations. The Authority had fees payable totaling \$12,546 and \$7,356 with the Washington State Housing Finance Commission at June 30, 2018 and 2017, respectively.

Note 5 – Bonds Payable

The bonds are limited obligations of the Authority payable solely from its TSRs received and due from the State secured by the purchase and sale agreement as described in Note 2, restricted investments, and undisbursed bond proceeds and the earnings thereon held under the indenture authorizing the bonds.

Bond defeasance – On June 20, 2018, the Authority issued Series 2018 Tobacco Settlement Refunding bonds of \$43,630,000 with an effective interest rate of 3.09%. The bond proceeds were used to refund \$47,645,000 of outstanding 2013 Tobacco Settlement Authority Bonds. As a result of the current refunding, the Authority reduced its total debt service requirements by \$17,548,768, which resulted in an economic gain (the difference between the present value of the debt service payments on the old and new debt) of \$8,655,545. As of June 30, 2018, the Authority had outstanding bonds of approximately \$178.5 million. The bonds bear interest rates ranging from 5.00% to 5.25% and mature in varying amounts through 2033. Future principal and interest requirements are shown in the following table.

Years Ending June 30,	Principal Redemptions	Interest Requirements	Total
2019	\$ 13,665,000	\$ 8,967,053	\$ 22,632,053
2020	13,970,000	8,398,938	22,368,938
2021	13,880,000	7,700,437	21,580,437
2022	25,110,000	7,006,437	32,116,437
2023	26,735,000	5,750,937	32,485,937
2024-2028	21,530,000	17,764,938	39,294,938
2029-2033	63,575,000	10,844,400	74,419,400
	<u>\$ 178,465,000</u>	<u>\$ 66,433,140</u>	<u>\$ 244,898,140</u>

Tobacco Settlement Authority
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Notes to Financial Statements

Note 5 – Bonds Payable (continued)

Changes in bonds outstanding during the fiscal year ended June 30, 2018, are summarized in the following table:

Balance at June 30, 2017	Issued	Redeemed	Balance at June 30, 2018
\$ 208,745,000	\$ 43,630,000	\$ 73,910,000	\$ 178,465,000

Note 6 – Master Settlement Agreement and Tobacco Settlement Revenues

The Master Settlement Agreement is a tobacco industry-wide settlement of litigation between the Settling States and the Original Participating Manufacturers 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 over time is \$139,600,162, 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, 2018, and January 1 to June 30, 2017.

Note 7 – Contingencies

Certain parties, including smokers, smokers' rights organizations, consumer groups, cigarette manufacturers, cigarette importers, cigarette distributors, Native American tribes, taxpayers, taxpayers' groups and other parties have filed actions against some, and in certain cases all, of the signatories to the MSA, alleging, among other things, that the MSA and related legislation including the Settling States' Qualifying Statutes, Allocable Share Release Amendments and Complementary Legislation as well as other legislation such as "Contraband Statutes" are void or unenforceable under certain provisions of law, such as the U.S. Constitution, state constitutions, federal antitrust laws, state consumer protection laws, bankruptcy laws, federal cigarette advertising and labeling law, and unfair competition laws. Certain of the lawsuits further sought, among other relief, an injunction against one or more of the Settling States from collecting any moneys under the MSA and barring the Participating Manufacturers (PMs) from collecting cigarette price increases related to the MSA. 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.

Tobacco Settlement Authority
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Notes to Financial Statements

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 its outstanding bonds.

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

ASSETS AND DEFERRED OUTFLOW OF RESOURCES	Restricted Bond Fund	General Operating Fund	June 30,	
			2018	2017
CASH AND CASH EQUIVALENTS	\$ 36,580,719	\$ 165,152	\$ 36,745,871	\$ 37,905,850
TSR RECEIVABLE	16,410,696	-	16,410,696	17,956,373
PREPAID FEES AND INTEREST RECEIVABLE	50,585	6,483	57,068	26,898
TOTAL ASSETS	53,042,000	171,635	53,213,635	55,889,121
DEFERRED OUTFLOW OF RESOURCES				
Unamortized loss on refunded debt	1,964,493	-	1,964,493	3,209,735
TOTAL ASSETS AND DEFERRED OUTFLOW OF RESOURCES	\$ 55,006,493	\$ 171,635	\$ 55,178,128	\$ 59,098,856
LIABILITIES, DEFERRED INFLOW OF RESOURCES AND NET POSITION				
ACCRUED INTEREST PAYABLE	\$ 641,714	\$ -	\$ 641,714	\$ 890,473
ACCOUNTS PAYABLE AND OTHER LIABILITIES	-	12,969	12,969	8,153
BONDS PAYABLE				
Interest bonds	178,465,000	-	178,465,000	208,745,000
Unamortized bond premium	14,302,756	-	14,302,756	13,669,678
	192,767,756	-	192,767,756	222,414,678
TOTAL LIABILITIES	193,409,470	12,969	193,422,439	223,313,304
DEFERRED INFLOW OF RESOURCES				
Unamortized Gain on refunded debt	1,355,851	-	1,355,851	-
TOTAL NET POSITION	(139,758,828)	158,666	(139,600,162)	(164,214,448)
TOTAL LIABILITIES, DEFERRED INFLOW OF RESOURCES AND NET POSITION	\$ 55,006,493	\$ 171,635	\$ 55,178,128	\$ 59,098,856

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,	
			2018	2017
REVENUES				
Tobacco settlement revenues and other income	\$ 34,073,423	\$ 19,300	\$ 34,092,723	\$ 40,103,475
Interest income	514,390	2,158	516,548	146,136
	<u>34,587,813</u>	<u>21,458</u>	<u>34,609,271</u>	<u>40,249,611</u>
EXPENSES				
Interest on debt	11,190,624	-	11,190,624	12,820,402
Cost of issuance	1,082,631	-	1,082,631	-
Amortization of bond premium	(2,379,864)	-	(2,379,864)	(2,699,281)
General and administrative	47,300	54,294	101,594	153,894
	<u>9,940,691</u>	<u>54,294</u>	<u>9,994,985</u>	<u>10,275,015</u>
CHANGE IN NET POSITION	24,647,122	(32,836)	24,614,286	29,974,596
Beginning of year	<u>(164,405,950)</u>	<u>191,502</u>	<u>(164,214,448)</u>	<u>(194,189,044)</u>
End of year	<u>\$ (139,758,828)</u>	<u>\$ 158,666</u>	<u>\$ (139,600,162)</u>	<u>\$ (164,214,448)</u>

Tobacco Settlement Authority
(A Component Unit of the State of Washington)
Schedule of Program Cash Flows

	Restricted Bond Fund	General Operating Fund	Years Ended June 30,	
			2018	2017
OPERATING ACTIVITIES				
Cash received from tobacco settlement and other revenues	\$ 35,619,100	\$ 21,458	\$ 35,640,558	\$ 44,483,261
Cash paid for bond program expenses	(1,129,931)	-	(1,129,931)	(28,000)
Cash paid for general and administrative expenses	-	(49,446)	(49,446)	(122,780)
Net cash from (used for) operating activities	<u>34,489,169</u>	<u>(27,988)</u>	<u>34,461,181</u>	<u>44,332,481</u>
INVESTING ACTIVITIES				
Cash received from interest income	<u>484,187</u>	<u>-</u>	<u>484,187</u>	<u>125,364</u>
NONCAPITAL FINANCING ACTIVITIES				
Proceeds from issuance of bonds	48,692,963	-	48,692,963	-
Principal repayment on bonds	(73,910,000)	-	(73,910,000)	(33,050,000)
Cash paid for bond interest expense	<u>(10,888,310)</u>	<u>-</u>	<u>(10,888,310)</u>	<u>(12,324,300)</u>
Net cash from (used for) financing activities	<u>(36,105,347)</u>	<u>-</u>	<u>(36,105,347)</u>	<u>(45,374,300)</u>
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,131,991)	(27,988)	(1,159,979)	(916,455)
CASH AND CASH EQUIVALENTS				
Beginning of year	<u>37,712,710</u>	<u>193,140</u>	<u>37,905,850</u>	<u>38,822,305</u>
End of year	<u>\$ 36,580,719</u>	<u>\$ 165,152</u>	<u>\$ 36,745,871</u>	<u>\$ 37,905,850</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES				
Excess of revenues over expenses	\$ 24,647,122	\$ (32,836)	\$ 24,614,286	\$ 29,974,596
Adjustments to reconcile operating income to net cash provided by operating activities				
Amortization of bond premium	(2,379,864)	-	(2,379,864)	(2,699,281)
Amortization of loss on refunded debt	551,072	-	551,072	633,810
Cash paid for bond interest expense	10,888,311	-	10,888,311	12,324,300
Cash received from interest income	(484,187)	-	(484,187)	(125,363)
Changes in assets and liabilities				
(Increase) decrease in TSR receivable	1,545,677	-	1,545,677	4,378,883
(Increase) decrease in prepaid fees and other receivables	(30,203)	32	(30,171)	(19,870)
Increase (decrease) in accounts payable and other liabilities	(248,759)	4,816	(243,943)	3,114
Decrease in accrued interest payable	-	-	-	(137,708)
Net cash from (used for) operating activities	<u>\$ 34,489,169</u>	<u>\$ (27,988)</u>	<u>\$ 34,461,181</u>	<u>\$ 44,332,481</u>

