Financial Statements
June 30, 2022 and 2021

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

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**Independent Auditor's Report**

To the Board of Directors
Tobacco Settlement Authority
Seattle, Washington

**Report on the Audit of the Financial Statements**

***Opinion***

We have audited the financial statements of the business type activities of the Tobacco Settlement Authority (the Authority), a discretely presented component unit of the State of Washington, as of and for the year ended June 30, 2022, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the respective financial position of the Authority, as of June 30, 2022, and the respective changes in financial position, and where applicable, cash flows, thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Basis for Opinion***

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Authority and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Emphasis of Matter***

As discussed in Notes 1 and 2 to the financial statements, the Authority's repayment of long-term debt is dependent on several factors, including the continued financial capability of participating cigarette manufacturers to pay tobacco settlement revenues and future cigarette consumption. Our opinion is not modified with respect to this matter.

***Other Matter***

The financial statements of the Authority for the year ended June 30, 2021, were audited by another auditor, who expressed an unmodified opinion on those statements on November 16, 2021.

***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America; and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Authority's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

***Auditor's Responsibilities for the Audit of the Financial Statements***

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinions. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Authority's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Authority's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that management's discussion and analysis be presented to supplement the basic financial statements. Such information is the responsibility of management and, 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.

***Supplementary Information***

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Authority's basic financial statements. The supplemental schedules of program net position, program revenues, expenses, and changes in program net position, and program cash flows 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 basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic 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 basic financial statements as a whole.

Eide Bailly LLP

Boise, Idaho
December 19, 2022

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, 2022 and 2021 (FY 2022 and FY 2021, respectively). This discussion 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 $36.9 million and $37.9 million were recognized as revenue in the fiscal years ended June 30, 2022 and 2021, respectively. In accordance with GASB 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, TSRs of $18.1 million and $17.9 million were recorded as accrued TSR Receivable applicable to cigarette sales between January 1, 2022 and June 30, 2022 and January 1, 2021, and June 30, 2021, respectively.

Other significant changes as of June 30, 2022 or for the year then ended include:

- Funds requested for operations in the current fiscal year were $254,400. This represents an increase of $165.4 thousand (186.0%) to assure there would be sufficient operating revenues in light of the 2004 Non-Participating Manufacturer (NPM) adjustment discussed further in Note 8.
- An uncollectible allowance and corresponding expense totaling $10,220,000 was recorded in the current fiscal year recognizing the likelihood of an NPM adjustment discussed further in Note 8.
- Total bonds payable were $63.3 million, net of premiums. This represents a decrease of $34.6 million (35.3%) from the prior year resulting from principal payments on bonds from maturities and redemptions.
- Net position increased $24.2 million (52.9%) over the prior year.
- Bond interest expense decreased $1.8 million (28.6%) due to the continued decline in total bonds outstanding.
- Interest income increased by $58 thousand as interest rates on deposited funds increased in the latter part of the fiscal year.

**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 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.

The financial statements of the Authority have been prepared in accordance 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 and the Authority has applied all its applicable 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 $21.6 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. Authority staff consider the industry information available to them each year when accruing estimated TSRs to be received. Factors influencing demand since the Authority's bonds were issued in 2002 have been significant increases in state and federal tobacco excise taxes, greater restrictions on public smoking, and the rise in popularity of e-Cigarettes. Shipments of cigarettes have generally declined more rapidly than originally predicted, however there was little change in calendar year 2020 as compared to the prior year.

**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 FY 2022 and FY 2021 (in millions):

| | 2022 | 2021 | Change | |
|---|---|---|---|---|
| Assets | | | | |
| Cash and cash equivalents | $ 33.9 | $ 34.5 | $ (0.6) | (1.7%) |
| Accrued TSR and other receivables | 18.2 | 17.9 | 0.3 | 1.7% |
| Allowance for Uncollectible TRS | (10.2) | - | (10.2) | 100.0% |
| Total assets | 41.9 | 52.4 | (10.5) | (20.0%) |
| Deferred outflow of resources | 0.4 | 0.7 | (0.3) | (42.9%) |
| Total Assets And Deferred Outflow Of Resources | $ 42.3 | $ 53.1 | $ (10.8) | (20.3%) |
| Liabilities | | | | |
| Accrued interest payable and other liabilities | $ 0.3 | $ 0.4 | $ (0.1) | (25.0%) |
| Bonds payable, net | 63.3 | 97.9 | (34.6) | (35.3%) |
| Total liabilities | 63.6 | 98.3 | (34.7) | (35.3%) |
| Deferred inflow of resources | 0.3 | 0.6 | (0.3) | (50.0%) |
| Net deficit position | (21.6) | (45.8) | 24.2 | 52.8% |
| Total Liabilities And Net Position | $ 42.3 | $ 53.1 | $ (10.8) | (20.3%) |

*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, 2022 and 2021:

| | 2022 | 2021 | Change | |
|---|---|---|---|---|
| Revenues | | | | |
| Tobacco settlement revenues and other income | $ 37.2 | $ 37.9 | $ (0.7) | (1.8%) |
| Interest income | 0.1 | - | 0.1 | 100.0% |
| Total revenues | $ 37.3 | $ 37.9 | $ (0.6) | (1.6%) |
| Expenses | | | | |
| Bond program interest expense | $ 4.5 | $ 6.3 | $ (1.8) | (28.6%) |
| Other bond program expenses | (2.1) | (2.9) | 0.8 | (27.6%) |
| Uncollectible TSR | 10.2 | - | 10.2 | #DIV/0! |
| General and administrative | 0.4 | 0.2 | 0.2 | 100.0% |
| Total expenses | $ 13.0 | $ 3.6 | $ 9.4 | 261.1% |
| Change In Net Position | $ 24.3 | $ 34.3 | $ (10.0) | (29.2%) |

TSRs of $36.9 million, $4.5 million of interest on debt, and the uncollectible TSR expense of $10.2 million are the primary components of total revenues and expenses, respectively, for the Restricted Bond Program.

In the General Operating Fund FY 2022 revenue included other income of $254.4 thousand representing a draw from TSRs. Expenses were $98.6 thousand comprised of allocable salaries and wages, and other general and administrative expenses.

**Debt Administration**

At June 30, 2021, the Authority has long-term debt obligations of $97.9 million, net of bond premium. The 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. Amounts held by the trustee and future receipts of TSRs represent full funding of these requirements.

At June 30, 2022, the Authority has long-term debt obligations of $63.3 million, net of bond premium. The 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. Amounts held by the trustee and future receipts of TSRs represent full funding of these requirements.

In 2002, a Purchase and Sale Agreement between the Authority and the State of Washington was executed 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 Authority issued its 2002 series bonds to fund this payment. 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 whose 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 take all actions 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.

**Comparison of Fiscal Years 2021 with 2020**

*Statements of Net Position*

The following table summarizes the changes in assets and deferred outflows, liabilities and deferred inflows, and net position between FY 2021 and FY 2020 (in millions):

| | 2021 | 2020 | Change | |
|---|---|---|---|---|
| Assets | | | | |
| Cash and cash equivalents | $ 34.5 | $ 35.9 | $ (1.4) | (3.9%) |
| Accrued TSR and other receivables | 17.9 | 16.6 | 1.3 | 7.8% |
| Total assets | 52.4 | 52.5 | (0.1) | (0.2%) |
| Deferred Outflow Of Resources | 0.7 | 1.1 | (0.4) | (36.4%) |
| Total Assets And Deferred Outflow Of Resources | $ 53.1 | $ 53.6 | $ (0.5) | (0.9%) |
| Liabilities | | | | |
| Accrued interest payable and other liabilities | $ 0.4 | $ 0.6 | $ (0.2) | (33.3%) |
| Bonds payable, net | 97.9 | 132.3 | (34.4) | (26.0%) |
| Total liabilities | 98.3 | 132.9 | (34.6) | (26.0%) |
| Deferred Inflow Of Resources | 0.6 | 0.8 | (0.2) | (25.0%) |
| Net Deficit Position | (45.8) | (80.1) | 34.3 | (42.8%) |
| Total Liabilities And Net Position | $ 53.1 | $ 53.6 | $ (0.5) | (0.9%) |

During FY 2021, the Authority's combined total assets and deferred outflows of resources decreased by $0.5 million partly due to the decrease in cash and equivalents held in reserve ($1.4 million). The Authority's total liabilities decreased by $34.6 million, resulting from principal payments and maturities. The Authority's net position improved by $34.3 million, primarily due to the decrease in total liabilities.

*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, 2021 and 2020:

| | 2021 | 2020 | Change | |
|---|---|---|---|---|
| Revenues | | | | |
| Tobacco settlement and other revenues | $ 37.9 | $ 34.4 | $ 3.5 | 10.2% |
| Interest and program revenue | - | 0.9 | (0.9) | (100.0%) |
| Total revenues | $ 37.9 | $ 35.3 | $ 2.6 | 7.4% |
| Expenses | | | | |
| Bond program interest expense | $ 6.3 | $ 7.7 | $ (1.4) | (18.2%) |
| Other bond program expenses | (2.9) | (2.9) | - | --% |
| General and administrative | 0.2 | 0.2 | - | --% |
| Total expenses | $ 3.6 | $ 5.0 | $ (1.4) | (28.0%) |
| Change In Net Position | $ 34.3 | $ 30.3 | $ 4.0 | 13.2% |

The change in net position of $34.3 million for FY 2021 represents an increase of $4.0 million over the FY 2020 change of $30.3 million. The increase is primarily attributable to 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.

| | 2022 | 2021 |
|---|---|---|
| Assets and Deferred Outflow of Resources | | |
| Cash and cash equivalents | $ 33,890,116 | $ 34,531,804 |
| TSR receivable | 18,148,988 | 17,877,790 |
| Allowance for Uncollectible TSR | (10,220,000) | - |
| Prepaid fees and interest receivable | 35,684 | 9,601 |
| Total assets | 41,854,788 | 52,419,195 |
| Deferred Outflow of Resources | | |
| Unamortized loss on refunded debt | 441,653 | 691,168 |
| Total Assets and Deferred Outflow of Resources | $ 42,296,441 | $ 53,110,363 |
| Liabilities, Deferred Inflow of Resources, and Net Position | | |
| Accrued interest payable | $ 252,773 | $ 389,795 |
| Accounts payable and other liabilities | 6,542 | 19,398 |
| Bonds payable | | |
| Interest bonds | 60,075,000 | 92,590,000 |
| Unamortized bond premium | 3,229,689 | 5,352,197 |
| Total bonds payable | 63,304,689 | 97,942,197 |
| Total liabilities | 63,564,004 | 98,351,390 |
| Deferred Inflow of Resources | | |
| Unamortized gain on refunded debt | 306,634 | 559,637 |
| Total Net Deficit Position | (21,574,197) | (45,800,664) |
| Total Liabilities, Deferred Inflow of Resources, and Net Position | $ 42,296,441 | $ 53,110,363 |

| | 2022 | 2021 |
|---|---|---|
| Revenues | | |
| Tobacco settlement revenues and other income | $ 37,196,646 | $ 37,878,203 |
| Interest income | 71,304 | 12,835 |
| Total revenues | 37,267,950 | 37,891,038 |
| Expenses | | |
| Interest on debt | 4,537,027 | 6,320,249 |
| Amortization of bond premium | (2,122,508) | (2,946,475) |
| Bad debt expense | 10,220,000 | - |
| General and administrative | 406,964 | 219,645 |
| Total expenses | 13,041,483 | 3,593,419 |
| Change in Net Position | 24,226,467 | 34,297,619 |
| Net Position, Beginning of Year | (45,800,664) | (80,098,283) |
| Net Position, End of Year | $ (21,574,197) | $ (45,800,664) |

| | 2022 | 2021 |
|---|---|---|
| Operating Activities | | |
| Cash received from tobacco settlement and other revenues | $ 36,925,448 | $ 36,599,432 |
| Cash paid for bond program expenses | (308,400) | (142,970) |
| Cash paid for general and administrative expenses | (112,298) | (82,590) |
| Net Cash from Operating Activities | 36,504,750 | 36,373,872 |
| Investing Activities | | |
| Cash received from interest income | 46,100 | 13,870 |
| Noncapital Financing Activities | | |
| Principal repayment on bonds | (32,515,000) | (31,435,000) |
| Cash paid for bond interest expense | (4,677,538) | (6,293,175) |
| Net Cash used for Financing Activities | (37,192,538) | (37,728,175) |
| Net Decrease In Cash And Cash Equivalents | (641,688) | (1,340,433) |
| Cash and Cash Equivalents, Beginning of Year | 34,531,804 | 35,872,237 |
| Cash and Cash Equivalents, End of Year | $ 33,890,116 | $ 34,531,804 |
| Reconciliation Of Changes In Net Position To Net Cash Cash from Operating Activities | | |
| Excess (deficit) of revenues over expenses | $ 24,226,467 | $ 34,297,619 |
| Adjustments to reconcile operating income to net cash from operating activities | | |
| Amortization of bond premium | (2,122,508) | (2,946,475) |
| Amortization of (gain) loss on refunded debt | (3,488) | 161,710 |
| Cash paid for bond interest expense | 4,677,538 | 6,293,175 |
| Cash received from interest income | (46,100) | (13,870) |
| Changes in assets and liabilities | | |
| TSR receivable | (271,198) | (1,278,771) |
| Uncollectible TSR | 10,220,000 | - |
| Prepaid fees and other receivables | (26,083) | (715) |
| Accounts payable and other liabilities | (12,856) | (4,164) |
| Accrued interest payable | (137,022) | (134,637) |
| Net Cash from Operating Activities | $ 36,504,750 | $ 36,373,872 |

## Note 1 - Principal Business Activity

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 Annual Comprehensive Financial Report.

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 (the “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 the 2013 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 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 July 1 and ends 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, see Note 5.

## Note 2 - Summary of Significant Accounting Policies

The financial statements of the Authority have been prepared in accordance 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, 2022 and 2021, are:

| | 2022 | 2021 |
|---|---|---|
| Cash and Cash Equivalents | | |
| Restricted bond fund | $ 33,586,996 | $ 34,370,945 |
| General operating fund | 303,120 | 160,859 |
| Total Cash and Cash Equivalents | $ 33,890,116 | $ 34,531,804 |

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 investments in the name of the Authority, however, there were no investments outstanding at June 30, 2022 and 2021.

*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, 2022 and 2021.

*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 2022 and 2021 included an accrual of $18,148,988 and $17,877,790, 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 2022 and 2021, the Authority delivered officer's certificates to the Trustee requesting operating funds of $254,400 and $88,970, respectively, be disbursed which were received by the Authority prior to the fiscal years' end.

*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 deficit position* – The net deficit position balances of $21,574,197 at June 30, 2022, and $45,800,664 at June 30, 2021, 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 $306,492 at June 30, 2022, and $150,497 at June 30, 2021. The restricted bond fund has a net deficit balance of $21,880,689 at June 30, 2022, and $45,951,161 at June 30, 2021. Management believes that the present value of future 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, 2022 and 2021.

## 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.

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, 2022 and 2021, 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 $35,414 and $40,559 for the years ended June 30, 2022 and 2021, respectively. The Authority has no directly hired staff and as such has no pension obligations. The Authority had fees payable totaling $6,541 and $8,503 with the Washington State Housing Finance Commission at June 30, 2022 and 2021, respectively.

## Note 5 - Bonds Payable

The bonds are limited obligations of the Authority, publicly traded, and 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.

Events of default on the bonds include failure of the Authority to pay, when due, any interest on the bonds, principal maturity, or sinking fund installment, to observe or perform any other provision of the indenture not corrected within 60 days of written notice by the bond indenture Trustee, or a material breach by the State of its covenants. If any of these occur, the Trustee may, and upon written request of holders of at least 25% in the principal amount of the bonds outstanding shall, enforce the rights of the Bondholders and require the Issuer and the State to carry out their respective agreements with the Bondholders.

As of June 30, 2022, the Authority had outstanding bonds of approximately $60.1 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 |
|---|---|---|---|
| 2023 | $ 26,735,000 | $ 3,033,275 | $ 29,768,275 |
| 2024 | 21,530,000 | 1,696,525 | 23,226,525 |
| 2025 | - | 620,025 | 620,025 |
| 2026 | - | 620,025 | 620,025 |
| 2027 | - | 620,025 | 620,025 |
| 2028–2032 | 4,360,000 | 3,100,125 | 7,460,125 |
| 2033–2037 | 7,450,000 | 391,125 | 7,841,125 |
| | $ 60,075,000 | $ 10,081,125 | $ 70,156,125 |

Changes in bonds outstanding during the fiscal year ended June 30, 2022 and 2021, are summarized in the following table:

| Balance at June 30, 2020 | Issued | Redeemed | Balance at June 30, 2021 |
|---|---|---|---|
| $ 124,025,000 | $ - | $ 31,435,000 | $ 92,590,000 |

| Balance at June 30, 2021 | Issued | Redeemed | Balance at June 30, 2022 |
|---|---|---|---|
| $ 92,590,000 | $ - | $ 32,515,000 | $ 60,075,000 |

## 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 $21,574,197, 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, 2022, and January 1 to June 30, 2021.

## 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 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. 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.

## Note 8 - Subsequent Events

On September 1, 2021, the Washington State Office of the Attorney General (the "AG") notified the TSA of the "Common Case Findings and State Specific Finding and Interim Award for the State of Washington" (the "Interim Award") regarding the 2004 Non-Participating Manufacturer (the "NPM") Adjustment Proceedings. In it, the arbitration panel found that "Washington failed to diligently enforce its Qualifying Statute during calendar year 2004 and, therefore, is subject to and NPM Adjustment pursuant to Section IX(d)(2)(B) of the Master Settlement Agreement."

On August 1, 2022, the AG reported at the Authority's board meeting that the estimated future potential impact of the 2004 NPM Adjustment to the State's 2023 TSRs as approximately $33.8 to $34.3 million. As such, a proportional share has been recorded as an allowance against the Authority's TSR receivable for Fiscal Year 2023 totaling $10,220,000.

June 30, 2022

Supplementary Information Tobacco Settlement Authority

# (A Component Unit of the State of Washington)

Schedules of Program Net Position
June 30, 2022 and 2021

| | Restricted Bond Fund | General Operating Fund | 2022 | 2021 |
|---|---|---|---|---|
| Assets and Deferred Outflow of Resources of Resources | | | | |
| Cash and cash equivalents | $ 33,586,996 | $ 303,120 | $ 33,890,116 | $ 34,531,804 |
| TSR receivable | 18,148,988 | - | 18,148,988 | 17,877,790 |
| Allowance for uncollectible accounts | (10,220,000) | - | (10,220,000) | - |
| Prepaid fees and interest receivable | 25,770 | 9,914 | 35,684 | 9,601 |
| Total assets | 41,541,754 | 313,034 | 41,854,788 | 52,419,195 |
| Deferred Outflow of Resources | | | | |
| Unamortized loss on refunded debt | 441,653 | - | 441,653 | 691,168 |
| Total Assets and Deferred Outflow of Resources | $ 41,983,407 | $ 313,034 | $ 42,296,441 | $ 53,110,363 |
| Liabilities, Deferred Inflow Of Resources, And Net Position | | | | |
| Accrued interest payable | $ 252,773 | $ - | $ 252,773 | $ 389,795 |
| Accounts payable and other liabilities | - | 6,542 | 6,542 | 19,398 |
| Bonds payable | | | | |
| Interest bonds | 60,075,000 | - | 60,075,000 | 92,590,000 |
| Unamortized bond premium | 3,229,689 | - | 3,229,689 | 5,352,197 |
| Total bonds payable | 63,304,689 | - | 63,304,689 | 97,942,197 |
| Total liabilities | 63,557,462 | 6,542 | 63,564,004 | 98,351,390 |
| Deferred Inflow Of Resources | | | | |
| Unamortized gain on refunded debt | 306,634 | - | 306,634 | 559,637 |
| Total Net Deficit Position | (21,880,689) | 306,492 | (21,574,197) | (45,800,664) |
| Total Liabilities, Deferred Inflow of Resources and Net Position | $ 41,983,407 | $ 313,034 | $ 42,296,441 | $ 53,110,363 |

| | Restricted Bond Fund | General Operating Fund | 2022 | 2021 |
|---|---|---|---|---|
| Revenues | | | | |
| Tobacco settlement revenues and other income | $ 36,942,246 | $ 254,400 | $ 37,196,646 | $ 37,878,203 |
| Interest income | 71,145 | 159 | 71,304 | 12,835 |
| Total revenues | 37,013,391 | 254,559 | 37,267,950 | 37,891,038 |
| Expenses | | | | |
| Interest on debt | 4,537,027 | - | 4,537,027 | 6,320,249 |
| Amortization of bond premium | (2,122,508) | - | (2,122,508) | (2,946,475) |
| Bad debt expense | 10,220,000 | - | 10,220,000 | - |
| General and administrative | 308,400 | 98,564 | 406,964 | 219,645 |
| Total expenses | 12,942,919 | 98,564 | 13,041,483 | 3,593,419 |
| Change in Net Position | 24,070,472 | 155,995 | 24,226,467 | 34,297,619 |
| Beginning of Year | (45,951,161) | 150,497 | (45,800,664) | (80,098,283) |
| End of Year | $ (21,880,689) | $ 306,492 | $ (21,574,197) | $ (45,800,664) |

| | Restricted Bond Fund | General Operating Fund | 2022 | 2021 |
|---|---|---|---|---|
| Operating Activities | | | | |
| Cash received from tobacco settlement and other revenues | $ 36,671,048 | $ 254,400 | $ 36,925,448 | $ 36,599,432 |
| Cash paid for bond program expenses | (308,400) | - | (308,400) | (142,970) |
| Cash paid general and administrative expenses | - | (112,298) | (112,298) | (82,590) |
| Net Cash from Operating Activities | 36,362,648 | 142,102 | 36,504,750 | 36,373,872 |
| Investing Activities | | | | |
| Cash received from interest income | 45,942 | 158 | 46,100 | 13,870 |
| Noncapital Financing Activities | | | | |
| Principal repayment on bonds | (32,515,000) | - | (32,515,000) | (31,435,000) |
| Cash paid for bond interest expense | (4,677,538) | - | (4,677,538) | (6,293,175) |
| Net Cash used for Financing Activities | (37,192,538) | - | (37,192,538) | (37,728,175) |
| Net (Decrease) Increase In Cash and Cash Equivalents | (783,948) | 142,260 | (641,688) | (1,340,433) |
| Cash and Cash Equivalents, Beginning of Year | 34,370,944 | 160,860 | 34,531,804 | 35,872,237 |
| Cash and Cash Equivalents, End of Year | $ 33,586,996 | $ 303,120 | $ 33,890,116 | $ 34,531,804 |
| Reconciliation Of Changes in Net Position to Net Cash from Operating Activities | | | | |
| Excess of revenues over expenses | $ 24,070,472 | $ 155,995 | $ 24,226,467 | $ 34,297,619 |
| Adjustments to reconcile operating income to net cash from operating activities | | | | |
| Amortization of bond premium | (2,122,508) | - | (2,122,508) | (2,946,475) |
| Amortization of loss on refunded debt | (3,488) | - | (3,488) | 161,710 |
| Cash paid for bond interest expense | 4,677,538 | - | 4,677,538 | 6,293,175 |
| Cash received from interest income | (45,942) | (158) | (46,100) | (13,870) |
| Changes in assets and liabilities | | | | |
| TSR receivable | (271,198) | - | (271,198) | (1,278,771) |
| Uncollectible TSR | 10,220,000 | - | 10,220,000 | - |
| Prepaid fees and other receivables | (25,204) | (879) | (26,083) | (715) |
| Accounts payable and other liabilities | - | (12,856) | (12,856) | (4,164) |
| Accrued interest payable | (137,022) | - | (137,022) | (134,637) |
| Net Cash from Operating Activities | $ 36,362,648 | $ 142,102 | $ 36,504,750 | $ 36,373,872 |