BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY OF OHIO

REGULAR AUDIT

FOR THE YEAR ENDED JUNE 30, 2011

Dave Yost • Auditor of State

BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY OF OHIO

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INDEPENDENT ACCOUNTANTS' REPORT

Buckeye Tobacco Settlement Financing Authority of Ohio
30 East Broad Street, 34th Floor
Columbus, Ohio 43215

To the Authority:

We have audited the accompanying financial statements of the governmental activities and Debt Service Fund of the Buckeye Tobacco Settlement Financing Authority of Ohio (the Authority), a blended component unit of the State of Ohio, as of and for the year ended June 30, 2011, which collectively comprise the Authority's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the Comptroller General of the United States' *Government Auditing Standards*. Those standards require that we plan and perform the audit to reasonably assure whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the Authority's financial statements are intended to present the financial position and the changes in financial position of only the Authority. They do not purport to, and do not, present fairly the financial position of the State of Ohio as of June 30, 2011, or the changes in its financial position and cash flows, where applicable, of its proprietary fund types for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities and Debt Service Fund of the Buckeye Tobacco Settlement Financing Authority, as of June 30, 2011, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 30, 2011, on our consideration of the Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. While we did not opine on the internal control over financial reporting or on compliance, that report describes the scope of our testing of internal control over financial reporting and compliance and the results of that testing. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*. You should read it in conjunction with this report in assessing the results of our audit.

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Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information accounting principles generally accepted in the United States of America requires. We have applied certain limited procedures, consisting principally of inquiries of management regarding the methods of measuring and presenting the required supplementary information. However, we did not audit the information and express no opinion on it.

Dave Yost
Auditor of State

September 30, 2011

BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY
FRANKLIN COUNTY, OHIO

(A COMPONENT UNIT OF THE STATE OF OHIO)

MANAGEMENT'S DISCUSSION & ANALYSIS
JUNE 30, 2011

(Unaudited)

As management of the Buckeye Tobacco Settlement Financing Authority (the "Authority"), we are providing this overview of the Authority's financial activities for the fiscal year ended June 30, 2011. Please read this overview in conjunction with the Authority's basic financial statements, which follow.

The Authority is included within the State of Ohio's Comprehensive Annual Financial Report as a blended component unit of the primary government. The Authority uses a governmental bond service fund to report its financial position and results of operations. We believe these financial statements present all activities for which the Authority is financially responsible.

THE AUTHORITY

The Ohio General Assembly enacted House Bill 119, effective June 30, 2007, which created the Authority for the sole purpose of purchasing and receiving any assignment of tobacco settlement receipts (TSRs) pursuant to the Tobacco Master Settlement Agreement (the "MSA") and issuing obligations to provide financing of essential State functions and facilities. The Authority entered into a *Purchase and Sale Agreement*, dated October 1, 2007, between the State and the Authority, wherein the State transferred to the Authority all of its rights and interests under the MSA and the Consent Decree and Final Judgment between all participating States and the participating Tobacco manufacturers. These rights include the State's share of all TSRs received on or after October 29, 2007 and in perpetuity to be received under the MSA, but specifically exclude any right to or interest in amounts withheld before October 29, 2007 by the cigarette manufacturers when they exercised the market share loss provisions of the MSA. These moneys are on deposit in an escrow account until pending litigation between the States and the manufacturers is resolved.

FINANCIAL HIGHLIGHTS

Key financial highlights for fiscal year 2011 are as follows:

- The assets of the Authority exceeded its liabilities at the close of the most recent fiscal year by $32.3 million (net assets).
- The Authority's total net assets decreased by $69.7 million, or 68.3% during fiscal year 2011.
- During fiscal year 2011, the Authority made principal payments totaling $23.8 million and interest payments totaling $276.0 million on the outstanding Series 2007 bonds. Of the $23.8 million of principal payments, $1.4 million were turbo redemptions.
- Interest earnings totaled $2.6 million during fiscal year 2011.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Authority's basic financial statements. These basic financial statements are comprised of two components: 1) combined government-wide and fund financial statements, and 2) notes to the financial statements. For most governmental entities, the government-wide and fund financial statements are presented separately; however, since the Authority is comprised of only one bond service fund, we are presenting both types of financial statements on one combined set of financial statements, as described below:

OVERVIEW OF THE FINANCIAL STATEMENTS (CONTINUED)

- ***Governmental Fund Balance Sheet/Statement of Net Assets***

  The column labeled "Governmental Bond Service Fund" presents information on the Authority's assets, liabilities, and fund balance using the modified-accrual basis of accounting. The fund is an accounting device that the State of Ohio uses to keep track of specific sources of funding and spending for particular purposes. The fund balance may serve as a useful measure of the Authority's net resources available for spending at the end of the fiscal year.

  The column labeled "Government-wide Statement of Net Assets" presents information on the Authority's assets and liabilities, with the difference between the two reported as *net assets*. Such information is presented on the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Authority is improving or deteriorating.

- ***Statement of Governmental Fund Revenues, Expenditures, and Changes in Fund Balance/Statement of Activities***

  The column labeled "Governmental Bond Service Fund" presents information on near-term inflows, outflows, and balances of expendable resources. Such information is presented on the modified-accrual basis of accounting.

  The column labeled "Government-wide Statement of Activities" presents information showing how the Authority's net assets changed during the most recent fiscal year. Such information is presented on the accrual basis of accounting. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows.

Because the focus of fund financial statements is narrower than that of government-wide financial statements, it is useful to compare the information presented on a fund basis with similar information presented on a government-wide basis. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. The combined government-wide and fund financial statements include a reconciliation to facilitate this comparison (see column labeled "Reconciliation").

FINANCIAL ANALYSIS OF THE AUTHORITY

Table 1 below is a summary of the Authority's net assets as of June 30, 2011 with comparative amounts to the prior fiscal year.

Table 1: Summary of Net Assets – Comparative Analysis

	2011	2010	% Change
Assets			
Cash and Investments	$ 519,333,878	$ 527,266,304	-1.5%
Interest Receivable	25,342	23,734	6.8%
Tobacco Settlement Receivable	283,059,111	237,486,797	19.2%
Deferred Bond Issuance Costs	21,027,039	22,280,166	-5.6%
Deferred Payments to State	4,699,357,471	4,773,864,311	-1.6%
Total Assets	5,522,802,841	5,560,921,312	
Liabilities			
Accrued Interest	27,224,765	27,036,217	0.7%
Bonds Payable	5,463,310,819	5,431,916,778	0.6%
Total Liabilities	5,490,535,584	5,458,952,995	
Net Assets			
Restricted for Debt Service	31,963,747	101,826,270	-68.6%
Unrestricted Net Assets	303,510	142,047	113.7%
	$ 32,267,257	$ 101,968,317	

Approximately 85.1% of the Authority's assets are comprised of a deferred charge for the bond proceeds that were paid to the State of Ohio for funding of long-lived capital projects at state-supported institutions of higher education and to pay the State's share of the cost of rebuilding elementary and secondary school facilities across the State. The deferred charge is being amortized over the future payment period for expected tobacco settlement receipts. Thus, the deferred charge decreased by approximately 1.6% during fiscal year 2011. The remaining assets consist mainly of cash and investments restricted for payment of the bond obligations, a tobacco settlement receivable, and deferred bond issuance costs.

Future Tobacco Settlement Receipts (TSRs) are dependent on many factors including future tobacco consumption and the financial capability of the Original Participating Manufacturers (the "OPMs"), as defined in Note 1 to the basic financial statements, and consequently, except as noted above, TSRs do not meet asset recognition criteria under accounting principles generally accepted in the United States of America ("GAAP").

Approximately 99.5% of the Authority's liabilities consist of the principal balance, net of discount, of the Bonds outstanding, with the remaining liability being accrued interest payable on those Bonds at the end of the fiscal year. The carrying amount of the bonds increased during the fiscal year by $31.4 million due to a combination of principal payments, accretion of the net original issue discount, and accretion of the discount on capital appreciation bonds.

FINANCIAL ANALYSIS OF THE AUTHORITY (CONTINUED)

Table 2 below summarizes the Authority's Statement of Activities for the period ending June 30, 2011 with comparative amounts to the prior fiscal year.

Table 2: Summary of Activities – Comparative Analysis

	2011	2010	% Change
Revenues			
Tobacco Settlement	$ 334,862,201	$ 336,259,255	-0.4%
Interest Income	2,618,389	735,083	256.2%
Total Revenues	337,480,590	336,994,338	
Expenses			
General Government	111,641	99,131	12.6%
Interest	332,563,169	330,624,295	0.6%
Amortization of Deferred Payments to State	74,506,840	74,817,684	-0.4%
Total Expenses	407,181,650	405,541,110	
Other Financing Sources (Uses)			
Transfers to Other State Agencies	-	(1,197,000)	-100.0%
Change in Net Assets	(69,701,060)	(69,743,772)	
Beginning Net Assets	101,968,317	171,712,089	
Ending Net Assets	$ 32,267,257	$ 101,968,317	

TSRs account for approximately 99.2% of total general revenues of the Authority. TSRs remained consistent from fiscal year 2010 to 2011. Interest Income increased by approximately $1.9 million due to overall increasing rates of return.

The Authority's expenses consisted primarily of interest payments on the outstanding bond obligations, 81.7% of total expenses, and amortization of the deferred charge for bond proceeds transferred to the State, 18.3% of total expenses. Transfers to Other State Agencies decreased by 100% because the Authority did not pay Enforcement Expenses to the Ohio Attorney General's office as in the previous year.

Bond Service Fund

In regard to the Authority's Bond Service Fund, as of June 30, 2011, the amount of Deferred Payments to State comprised approximately 85.4% of total assets, with the remaining assets being cash and investments and the tobacco settlement receivable. The Fund's only liability was deferred tobacco settlement revenue.

During fiscal year 2011, significant activity in the Bond Service Fund included the receipt of TSRs and related interest earnings ($289.3 million), and the payment of debt principal ($23.8 million) and interest ($276.0 million).

BUDGETARY HIGHLIGHTS

The Authority annually adopts an operating budget as required by its by-laws; however, there is no legal requirement for the Authority to adopt a budget. Accordingly, budgetary information is not presented in this report.

LONG-TERM DEBT

On October 29, 2007, the Authority issued asset-backed bonds totaling $5.531 billion. The tax-exempt Tobacco Settlement Asset-Backed Bonds, Series 2007 are comprised of three series of bonds — the Tobacco Settlement Asset-Backed Bonds, Series 2007A, which are Senior Bonds (the ''Series 2007A Bonds''), the Tobacco Settlement Asset-Backed Bonds, Series 2007B, which are First Subordinate Capital Appreciation Bonds (the ''Series 2007B Bonds'') and the Tobacco Settlement Asset-Backed Bonds, Series 2007C, which are Second Subordinate Capital Appreciation Bonds. All of the Series 2007 Bonds other than the Series 2007A-1 Bonds are Turbo Term Bonds.

In November 2010, Standard & Poor's downgraded the ratings for certain series of bonds. Additionally, subsequent to year-end, on July 29, 2011, Fitch Ratings also downgraded the ratings for certain series of bonds. The series impacted and rating changes are detailed below:

	Standard & Poors		Fitch Ratings	
	Previous Rating	New Rating	Previous Rating	New Rating
Series 2007A-2, $200,000,000, due June 1, 2024	BBB	BB-	BBB-	B+
Series 2007A-2, $949,530,000, due June 1, 2024	BBB	BB-	BBB-	B+
Series 2007A-2, $687,600,000, due June 1, 2030	BBB	BB-	BBB-	BB-
Series 2007A-2, $505,200,000, due June 1, 2034	BBB	BB-	BBB-	BB+
Series 2007A-2, $250,000,000, due June 1, 2042	BBB	BB-	BBB+	BBB
Series 2007A-2, $750,000,000, due June 1, 2047	BBB	BB-	BBB-	BB+
Series 2007A-2, $1,383,715,000, due June 1, 2047	BBB	BB-	BBB-	BB+
Series 2007A-3, $274,751,138, due June 1, 2037	BBB	BB-	BB+	BB-
Series 2007B, $191,265,480, due June 1, 2047	no change		BB	B+
Series 2007C, $128,182,923, due June 1, 2052	no change		BB	B+

The Series 2007 Bonds are secured by and payable solely from TSRs and investment earnings pledged under the Indenture and amounts established and held in accordance with the Indenture. The Authority has covenanted to apply 100% of all surplus collections of TSRs, if any, to the special mandatory redemption ("Turbo Redemption") of the Series 2007 Bonds, other than the Series 2007A-1 Bonds, at the principal amount or accreted value thereof on each distribution date.

More information regarding long-term debt is set forth in Note 5 to the basic financial statements.

ECONOMIC FACTORS AND OUTLOOK

Payment of debt service and orderly retirement of the bonds are conditioned exclusively on the Authority's receipt of TSRs. TSRs are contingent on among other things, the financial stability of the OPMs. In structuring the financial transaction for issuance of the Bonds, the Authority engaged the services of an independent consultant to develop a forecast of future tobacco rates of consumption and likely TSRs based on those forecasted rates of consumption. All future payments on the Bonds, including timely debt service, sinking fund installment payments, and turbo redemptions are contingent on future TSRs, and those TSRs are dependent on a number of factors, including rates of consumption of tobacco products and compliance by the tobacco companies who are parties to the Master Settlement Agreement with the terms of that agreement.

Due to declining tobacco settlement projections, the Authority anticipates a shortfall of up to $8.0 million in its debt service account in connection with its next debt service payment on December 1, 2011. However, as described in Note 2 to the basic financial statements, amounts on deposit in the Senior Liquidity Reserve Account will be available to pay the principal of and interest on the Series 2007A Bonds and any other Senior Bonds to the extent collections are insufficient for such purpose.

Disputed Payments – As of June 30, 2011, the estimated tobacco settlement receivable includes $105.7 million for payments withheld from the Authority in fiscal years 2008 thru 2011 by the cigarette manufacturers when they exercised the market share loss provisions of the Master Settlement Agreement (MSA). These moneys were either withheld by the cigarette manufacturers or are on deposit in an escrow account until pending litigation between the State and the manufacturers is resolved. The State contends it has met its obligations under the MSA and is due the payments withheld. As a result of the withheld payments and deposits into the disputed payments account, the Authority's share of payments under the MSA due was reduced. While this payment reduction resulted in a smaller Turbo Redemption of the Authority's tobacco securitization bonds than projected, the reduction did not impact the Authority's ability to meet its payment obligations when due.

CONTACTING THE AUTHORITY

Persons needing additional information concerning this report or otherwise needing to contact the Authority may do so by writing or telephoning Timothy S. Keen, Secretary of the Buckeye Tobacco Settlement Financing Authority, and Director of the Ohio Office of Budget and Management at 30 East Broad Street, 34th Floor, Columbus, Ohio 43215, (614) 466-4034.

BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY
FRANKLIN COUNTY, OHIO

(A COMPONENT UNIT OF THE STATE OF OHIO)

GOVERNMENTAL FUND BALANCE SHEET / STATEMENT OF NET ASSETS
JUNE 30, 2011

	Governmental Bond Service Fund Balance Sheet	Reconciliation (See Note 8)	Government-Wide Statement of Net Assets
Assets			
Cash and Cash Equivalents	$ 303,510	$ -	$ 303,510
Restricted Assets:			
Cash and Cash Equivalents	319,770,618	-	319,770,618
Investments	199,259,750	-	199,259,750
Accrued Interest Receivable	25,342	-	25,342
Tobacco Settlement Receivable	283,059,111	-	283,059,111
Deferred Bond Issuance Costs	-	21,027,039	21,027,039
Deferred Payments to State	4,699,357,471	-	4,699,357,471
Total Assets	5,501,775,802	21,027,039	5,522,802,841
Liabilities			
Accrued Interest Payable	-	27,224,765	27,224,765
Deferred Revenue	283,059,111	(283,059,111)	-
Bonds Payable, Net of Net Discount			
Due Within One Year	-	34,505,000	34,505,000
Due in More Than One Year	-	5,428,805,819	5,428,805,819
Total Liabilities	283,059,111	5,207,476,473	5,490,535,584
Fund Balance			
Restricted For Debt Service	5,218,413,181	(5,218,413,181)	-
Assigned	303,510	(303,510)	-
Net Assets			
Restricted For Debt Service	-	31,963,747	31,963,747
Unrestricted	-	303,510	303,510
Total Fund Balance/Net Assets	5,218,716,691	(5,186,449,434)	32,267,257
Total Liabilities and Fund Balance/Net Assets	$ 5,501,775,802	$ 21,027,039	$ 5,522,802,841

The notes to the financial statements are an integral part of this statement.

BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY
FRANKLIN COUNTY, OHIO

(A COMPONENT UNIT OF THE STATE OF OHIO)

STATEMENT OF GOVERNMENTAL FUND REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE / STATEMENT OF ACTIVITIES

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

	Governmental Bond Service Fund	Reconciliation (See Note 8)	Government-Wide Statement of Activities
General Revenues			
Tobacco Settlement	$ 289,289,887	$ 45,572,314	$ 334,862,201
Interest	2,618,389	-	2,618,389
Total General Revenues	291,908,276	45,572,314	337,480,590
Expenditures/Expenses			
General Government	111,641	-	111,641
Debt Service			
Principal	23,760,000	(23,760,000)	-
Interest	275,967,453	56,595,716	332,563,169
Amortization of Deferred Payments to State	74,506,840	-	74,506,840
Total Expenditures/Expenses	374,345,934	32,835,716	407,181,650
Net Change in Fund Balance/Net Assets	(82,437,658)	12,736,598	(69,701,060)
Fund Balance/Net Assets, Beginning of Year	5,301,154,349	(5,199,186,032)	101,968,317
Fund Balance/Net Assets, End of Year	$ 5,218,716,691	$ (5,186,449,434)	$ 32,267,257

The notes to the financial statements are an integral part of this statement.

1. Reporting Entity

The Buckeye Tobacco Settlement Financing Authority (the ''Authority'') is a body, both corporate and politic, constituting a public body, agency and instrumentality of the State of Ohio (the ''State''), separate and distinct from the State, performing essential functions of the State and created and governed by Sections 183.51 and 183.52 of the Ohio Revised Code.

The Ohio General Assembly enacted House Bill 119, effective June 30, 2007, which created the Authority for the sole purpose of purchasing and receiving any assignment of tobacco settlement receipts (TSRs) pursuant to the Tobacco Master Settlement Agreement (the "MSA") and issuing obligations to provide financing of essential State functions and facilities. The Authority entered into a *Purchase and Sale Agreement*, dated October 1, 2007, between the State and the Authority, wherein the State transferred to the Authority all of its rights and interests under the MSA and the Consent Decree and Final Judgment between all participating States and the participating Tobacco manufacturers. These rights include the State's share of all TSRs received on or after October 29, 2007 and in perpetuity to be received under the MSA, but specifically exclude any right to or interest in amounts withheld before October 29, 2007 by the cigarette manufacturers when they exercised the market share loss provisions of the MSA. These moneys are on deposit in an escrow account until pending litigation between the States and the manufacturers is resolved.

The MSA is an industry wide settlement of litigation between the Settling States and the Original Participating Manufacturers (the "OPMs") and was entered into between the attorneys general of the Settling States and the OPMs on November 23, 1998. The MSA provides for other tobacco companies, referred to as Subsequent Participating Manufacturers (the "SPMs"), to become parties to the MSA. The four OPMs together with the SPMs are referred to as the Participating Manufacturers (the "PMs"). The settlement represents the resolution of a large potential financial liability of the PMs for smoking related injuries, the costs of which have been borne and will likely continue to be borne by cigarette consumers. Pursuant to the MSA, the Settling States agreed to settle all their past, present, and future smoking related claims against the PMs in exchange for agreements and undertakings by the PMs concerning a number of issues. These issues include, among others, making payments to the Settling States, abiding by more stringent advertising restrictions, and funding educational programs, all in accordance with the terms and conditions set forth in the MSA.

On October 29, 2007 the Authority successfully securitized 100% of the projected TSRs for the subsequent 45 years through the issuance of five series of Tobacco Settlement Asset-Backed Bonds, Series 2007, aggregating in amount $5.531 billion. The Authority has pledged future TSR's, including related investment earnings, and net of specified operating and enforcement expenses, to repay the bonds, which are payable through 2052. Net TSR's for fiscal year 2011 were $291,796,635. Annual principal and interest payments on the bonds will require 100% of the net TSR's. Total principal and interest paid for fiscal year 2011 was $299,727,453. As of June 30, 2011, the total principal and interest remaining to be paid on the bonds was $18,379,947,855.

The Bonds were issued on a tax-exempt basis to fund long-lived capital projects at state-supported institutions of higher education and to pay the State's share of the cost of rebuilding elementary and secondary school facilities across the State. Pursuant to a "Residual Certificate," after the Bonds, and any related operating expenses, have been fully paid, any remaining TSRs will become payable to the State.

The Authority is a blended component unit of the State (the primary government), which uses funds to report on its combined financial position and results of its operations.

1. Reporting Entity (Continued)

The Authority is governed by a three member board of directors, consisting of the Governor, the Treasurer of State, and the Director of Budget and Management, and officers who by law perform the functions of such offices during any vacancy therein, and, as applicable, includes officers or employees acting as designees. The Governor serves as Chairman, the Treasurer of State serves as Treasurer, and the Director of Budget and Management serves as Secretary. The Authority may, upon recommendation of the Director of Budget and Management, appoint an Assistant Secretary and may, upon recommendation of the Treasurer of State, appoint an Assistant Treasurer, who may but need not be members of the Authority, to serve at the pleasure of the Authority.

2. Summary of Significant Accounting Policies

The financial statements of the Authority have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial principles. The most significant of the Authority's accounting policies are described below.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

GASB Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments, requires government-wide financial statements to be prepared using the accrual basis of accounting and the economic resources measurement focus. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Government-wide financial statements (i.e., the statement of net assets and the statement of activities) do not provide information by fund. Specifically, the statement of net assets includes non-current liabilities, which are not included in the fund statements. Tobacco Settlement Revenues ("TSRs"), interest income, and other items not properly included among program revenues are reported as general revenues. The Authority has no program revenues.

In addition to the government-wide financial statements, the Authority prepares financial statements for its only governmental fund. Governmental fund financial statements use the modified accrual basis of accounting and the current financial resources measurement focus. TSRs are recognized as soon as they are considered measurable and available. Revenues are considered available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Authority considers revenues to be available if they are collected within 60 days after the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred. The Authority reports one governmental fund – the Bond Service Fund – which was created in the bond proceedings for the obligations and is used to account for all financial resources of the Authority.

As permitted by GASB Statement No. 34 the Authority's financial statements include separate Statement of Net Assets and Statement of Activities columns reporting the financial activities using the accrual basis of accounting, in addition to the Bond Service Fund column reporting the financial activities using the modified accrual basis of accounting.

When both restricted and unrestricted resources are available for use, it is the Authority's policy to use restricted resources first, then unrestricted resources as they are needed. Assigned amounts are considered to have been spent when an expenditure is incurred for operating expenses of the Authority. Annually, the Authority prepares an Officer's Certificate indicating the amount of assigned fund balance to be used for operating expenditures of the Authority for the ensuing fiscal year.

2. Summary of Significant Accounting Policies (Continued)

Asset Recognition Criteria for TSRs.

The Authority has implemented GASB Technical Bulletin No. 2004-1: Tobacco Settlement Recognition and Financial Reporting Entity Issues (the "Bulletin"), effective July 1, 2003. The Bulletin requires the Authority to recognize TSRs when the event giving rise to recognition occurs (the domestic shipment of cigarettes by the tobacco manufacturers) in the government-wide financial statements, and when the event occurs and the TSRs become available in the fund financial statements. Other than the asset recognition criteria required by Bulletin No. 2004-1, future collections are not measurable and are therefore not recorded as assets in either the government-wide financial statements or the governmental fund financial statements.

Cash and Cash Equivalents

Cash includes cash on hand, demand deposits, and short term investments with maturities of three months or less from the date acquired by the Authority.

Investments

Investments are recorded on the statement of net assets and the balance sheet at fair value. All investment income, including changes in the fair value of investments, is reported as revenue in the statement of activities and the statement of revenues, expenditures, and changes in fund balance.

Pursuant to Ohio Revised Code Section 183.51(S) and otherwise provided in the trust Indenture, moneys to the credit of the Authority may be invested by or on behalf of the Authority only in one or more of the following:

a. Notes, bonds, or other direct obligations of the United States or of any agency or instrumentality of the United States, or in no-front-end-load money market mutual funds consisting exclusively of those obligations, or in repurchase agreements, including those issued by any fiduciary, secured by those obligations, or in collective investment funds consisting exclusively of those obligations;

b. Demand, trust and time deposits, money market deposit accounts or certificates of deposit of, or bankers' acceptances issued by, any bank or trust company, savings and loan association, or savings bank, payable on demand or on a specified date no more than three months after the date of issuance thereof;

c. Certificates, notes, warrants, bonds, obligations, or other evidences of indebtedness of a state or a political subdivision thereof;

d. Commercial or finance company paper including both noninterest-bearing discount obligations and interest bearing obligations payable on demand or on a specific date not more than 270 days after the date of issuance thereof;

e. Securities bearing interest or sold at a discount (payable on demand or on a specified date no more than three months after the date of issuance thereof) that are issued by any corporation incorporated under the laws of the United States of America or any state thereof;

2. Summary of Significant Accounting Policies (Continued)

f. Units of taxable or tax-exempt money market funds which funds are regulated investment companies;

g. Investment agreements, forward purchase agreements or guaranteed investment contracts;

h. A surety, guaranty, letter of credit, liquidity agreement, agreement to purchase securities of the Authority or other similar agreement provided in lieu of or in substitution for amounts in the Senior Liquidity Reserve Account;

i. The treasurer of state's pooled investment program under section 135.45 of the Revised Code;

j. Other investment agreements or repurchase agreements that are consistent with the ratings on the obligations.

The Authority has not adopted a formal investment policy because the Indenture contains these investment restrictions.

Restricted Assets

The bond indenture states that the trustee shall establish and maintain certain segregated trust accounts which include a "Collection Account," into which the Trustee will deposit all collections, and a "Bond Service Fund." The "Bond Service Fund" includes the following subaccounts:

(1) Senior Debt Service Account
(2) Senior Liquidity Reserve Account
(3) Partial Lump Sum Payment Account
(4) Senior Turbo Redemption Account
(5) First Subordinate Turbo Redemption Account
(6) Second Subordinate Turbo Redemption Account
(7) Fully Subordinate Turbo Redemption Account

The Senior Liquidity Reserve Account was originally funded in the amount of $389,231,603 which level is required to be maintained for so long as any Series 2007A Bonds or any other Senior Bonds remain outstanding. However, the Senior Liquidity Reserve Requirement may be amended by the Authority in connection with the issuance of Refunding Bonds or Additional Bonds. Amounts on deposit in the Senior Liquidity Reserve Account will be available to pay the Principal of and interest on the Series 2007A Bonds and any other Senior Bonds to the extent Collections are insufficient for such purpose. Amounts in the Senior Liquidity Reserve Account will not be available to make Sinking Fund Installments or Turbo Redemptions on any Bonds. Unless an event of default has occurred, amounts withdrawn from the Senior Liquidity Reserve Account will be replenished from collections.

Deferred Payments to State

The Authority transferred bond proceeds to State agencies to fund capital projects at state-supported institutions of higher education and to pay the State's share of the cost of rebuilding elementary and secondary school facilities across the State. Pursuant to GASB Statement No. 48, the Authority has set up a deferred charge for the amount of bond proceeds used to fund the capital projects. The deferred charge is being amortized over the projected payment period of future TSRs.

2. Summary of Significant Accounting Policies (Continued)

Deferred Bond Issuance Costs

A significant portion of bond issuance costs, the underwriter's takedown, was specifically related to the Authority's capital appreciation bonds and has been allocated to those bonds only, based on final accreted value at maturity. The remaining bond issuance costs have been allocated to each bond series in proportion to the initial face value of each series to the total face value of the bonds. Deferred bond issuance costs are being amortized on a straight-line basis over the life of each bond series up until the projected final turbo redemption date (see Note 5) for each series. The annual amortization expense is included in interest expense on the Statement of Activities.

Net Discount on Bonds Payable

Each bond series was issued with either a discount or premium, which is being amortized on a straight-line basis over the life of each bond series up until the projected final turbo redemption date (see Note 5) for each series. The net discount on bonds payable is a reduction of bonds payable on the Statement of Net Assets. The annual amortization expense is included in interest expense on the Statement of Activities.

Accrued Liabilities and Long-Term Obligations

All payables, accrued liabilities and long-term obligations are reported in the government-wide financial statements. In general, governmental fund payables and accrued liabilities that, once incurred, are paid in a timely manner and in full from current financial resources are reported as obligations of the funds. Bonds are recognized as a liability on the fund financial statements when due. Accrued interest payable is the amount of interest on the bonds accrued from the most recent interest payment date, June 1st, to the end of the fiscal year.

Budgeting Process

The Authority is not required by law or regulation to follow a legal budget or to present a budgetary statement.

Transfers to State Agencies

The Trust Indenture establishes a mechanism for the ongoing funding of the costs incurred or to be incurred (including reserves for the same) by the office of the Attorney General of the State with respect to enforcement of the MSA, the Qualifying Statute, the Consent Decree and related legislation ("Enforcement Expenses"). The Authority's funding of Enforcement Expenses is subject to an annual Enforcement Expense Transfer Cap of (i) $2.5 million through the Fiscal Year ending June 30, 2013 and (ii) thereafter $2 million, which $2 million will be indexed for inflation as set forth in the Indenture. There were no Enforcement Expenses paid during fiscal year 2011.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

3. Deposits and Investments

Deposits. The Authority had no deposits as of June 30, 2011.

Investments. All of the Authority's investments are held by the trustee in several accounts in the name of the Authority. The following schedule reflects the Authority's investments at their fair values, and associated credit risks and maturities as of June 30, 2011.

Investments

	Credit Rating	Fair Value	% of Total	Maturity: 3 months or less	Maturity: 3 to 9 months
Money Market Funds					
Fidelity Governmental Fund	AAA	$ 130,074,129	25.0%	$ 130,074,129	
Commercial Paper					
Credit Agricole	P-1/A-1+	100,000,000	19.3%	100,000,000	
Intesa Funding LLC	P-1/A-1+	90,000,000	17.3%	90,000,000	
U.S. Bank N.A. Open	P-1/A-1+	199,259,749	38.4%		199,259,749
Total Investments		$ 519,333,878	100.0%	$ 320,074,129	$ 199,259,749

Interest Rate Risk – The Authority limits investments in money market funds to those that are payable on demand or on a specified date no more than three months after the date of issuance. The Indenture requires that investments in commercial paper mature in not more than 270 days from the date of issuance.

Custodial Credit Risk – Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, the Authority will not be able to recover the value of the investments or collateral securities that are in the possession of an outside party. At June 30, 2011, all of the Authority's investments were held by the Trustee, U.S. Bank, and were not insured.

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation to the Authority. Credit risk ratings are not required for obligations of the U.S. government or those obligations explicitly guaranteed by the U.S. government. The Indenture limits investments in Commercial Paper to those rated at least "A-1" by S&P, and "P-1" by Moody's. All other investments are limited to either those same ratings, or the three highest rating categories of each rating agency.

Concentration of Credit Risk – is the risk of loss attributed to the magnitude of the government's investment in a single issuer. The Authority does not have a policy that limits concentration of credit risk in regard to the money market fund and commercial paper described above.

4. Restricted Assets

As of June 30, 2011, the Authority had restricted cash/cash equivalent and investment balances in the following accounts:

The Liquidity Reserve Account	$389,260,255
Collection Account	3,923
Senior Debt Service Account	129,766,190
Total	$519,030,368

Other restricted assets included accrued interest and the tobacco settlement receivable.

5. Bonds Payable

The Authority is authorized by the Ohio General Assembly to issue and to sell obligations, the aggregate principal amount of which shall not exceed six billion dollars, exclusive of obligations issued to refund, renew, or advance refund other obligations issued or incurred.

On October 29, 2007, the Authority issued asset-backed bonds totaling $5,531,594,541 pursuant to an indenture between the Authority and U.S. Bank National Association, as trustee, dated as of October 1, 2007 (the "Indenture"). The bonds are special revenue obligations of the Authority and are payable solely from the Pledged Tobacco Receipts and the other Collateral pledged under the Indenture.

The tax-exempt Tobacco Settlement Asset-Backed Bonds, Series 2007 are comprised of three series of bonds — the Tobacco Settlement Asset-Backed Bonds, Series 2007A, which are Senior Bonds (the ''Series 2007A Bonds''), the Tobacco Settlement Asset-Backed Bonds, Series 2007B, which are First Subordinate Capital Appreciation Bonds (the ''Series 2007B Bonds'') and the Tobacco Settlement Asset-Backed Bonds, Series 2007C, which are Second Subordinate Capital Appreciation Bonds (the ''Series 2007C Bonds'' and together with the Series 2007A Bonds and the Series 2007B Bonds, the ''Series 2007 Bonds''). The Series 2007A Bonds consist of three subseries — the Series 2007A-1 Bonds which are fixed rate serial bonds, the Series 2007A-2 Bonds which are fixed rate current interest turbo term bonds and the Series 2007A-3 Bonds which are capital appreciation turbo term bonds until their conversion date at which time they will become fixed rate current interest turbo term bonds. All of the Series 2007 Bonds other than the Series 2007A-1 Bonds are Turbo Term Bonds.

No payments will be made with respect to first subordinate bonds, including the Series 2007B Bonds, before all senior bonds, including the Series 2007A Bonds, are paid or redeemed in full. No payments will be made with respect to second subordinate bonds, including the Series 2007C Bonds, before all senior bonds, including the Series 2007A Bonds and the first subordinate bonds, including the Series 2007B Bonds, are paid or redeemed in full.

Failure to pay interest when due or the principal of a senior bond on its maturity date will constitute a payment default, which is an event of default under the Indenture. However, failure to pay sinking fund installments or turbo redemptions on the senior bonds will not constitute an event of default under the indenture unless collections are sufficient and available therefor.

5. Bonds Payable (Continued)

Due to a number of factors, including actual shipments of cigarettes in the United States, the amount of available collections may fluctuate from year to year. As a result, collections received by the Authority may be insufficient to pay principal or sufficient to pay principal but insufficient for sinking fund installments or turbo redemptions. In either event, the Authority will have no obligation to make sinking fund installments or turbo redemptions beyond the amount of available collections.

The Tobacco Settlement Asset-Backed Bonds, Series 2007, are comprised of the following:

Serial Bonds	
Series 2007A-1 Senior Current Interest Serial Bonds	$ 211,350,000
Term Bonds	
Series 2007A-2 Senior Current Interest Turbo Term Bonds due June 1, 2024, with interest of 5.375%. Projected Final Turbo Redemption Date: June 1, 2017.	200,000,000
Series 2007A-2 Senior Current Interest Turbo Term Bonds due June 1, 2024, with interest of 5.125%. Projected Final Turbo Redemption Date: June 1, 2017.	949,530,000
Series 2007A-2 Senior Current Interest Turbo Term Bonds due June 1, 2030, with interest of 5.875%. Projected Final Turbo Redemption Date: June 1, 2020.	687,600,000
Series 2007A-2 Senior Current Interest Turbo Term Bonds due June 1, 2034, with interest of 5.750%. Projected Final Turbo Redemption Date: June 1, 2022.	505,200,000
Series 2007A-2 Senior Current Interest Turbo Term Bonds due June 1, 2042, with interest of 6.000%. Projected Final Turbo Redemption Date: June 1, 2026.	250,000,000
Series 2007A-2 Senior Current Interest Turbo Term Bonds due June 1, 2047, with interest of 6.500%. Projected Final Turbo Redemption Date: June 1, 2028.	750,000,000
Series 2007A-2 Senior Current Interest Turbo Term Bonds due June 1, 2047, with interest of 5.875%. Projected Final Turbo Redemption Date: June 1, 2028.	1,383,715,000
Series 2007A-3 Senior Convertible Capital Appreciation Turbo Term Bonds due June 1, 2037, with interest after the conversion date of 6.250%. Projected Final Turbo Redemption Date: June 1, 2023.	274,751,138
Series 2007B First Subordinate Capital Appreciation Turbo Term Bonds due June 1, 2047. Projected Final Turbo Redemption Date: June 1, 2030.	191,265,480
Series 2007C Second Subordinate Capital Appreciation Turbo Term Bonds due June 1, 2052. Projected Final Turbo Redemption Date: June 1, 2031.	128,182,923
Total Bonds Issued	$5,531,594,541

5. Bonds Payable (Continued)

Interest on the Series 2007A-1 Bonds and Series 2007A-2 Bonds is payable semiannually on each June 1 and December 1. Interest on the Series 2007A-3 Bonds will not be paid currently prior to December 1, 2012 (the ‘‘Conversion Date’’) but will be compounded and accrete to, but not including, the Conversion Date. Thereafter, interest on the Series 2007A-3 Bonds will be paid currently on each June 1 and December 1 until maturity or earlier prepayment. Interest on the Series 2007B Bonds and the Series 2007C Bonds will not be payable currently and will accrete from the delivery date and be compounded on June 1, 2008 and thereafter on each December 1 and June 1 until maturity or earlier redemption.

$5,050,000,000 of the bond proceeds were transferred to the State to fund long-lived capital projects at state-supported institutions of higher education and to pay the State’s share of the cost of rebuilding elementary and secondary school facilities across the State.

Capital Appreciation Turbo Term Bonds

The Capital Appreciation Turbo Term Bonds (Series 2007A-3, 2007B, and 2007C) represent bonds that were issued at stated interest rates significantly below their effective interest rates, resulting in a substantial discount. The implicit interest, i.e. discount (unaccreted appreciation), is not paid until the bonds begin to mature. Therefore, the net value of the bonds “accretes” each year.

	June 30, 2011 Accreted Book Value	Ultimate Maturity Value	Maturity/ Conversion Date
Series 2007A-3 Senior Convertible Capital Appreciation Turbo Term Bonds	$342,658,198	$ 375,800,000	December 1, 2012
Series 2007B First Subordinate Capital Appreciation Turbo Term Bonds	246,971,070	3,207,000,000	June 1, 2047
Series 2007C Second Subordinate Capital Appreciation Turbo Term Bonds	166,969,278	3,417,300,000	June 1, 2052

5. Bonds Payable (Continued)

Changes in bonds payable during the year ended June 30, 2011 were as follows:

	Serial Bonds	Term Bonds	Capital Appreciation Term Bonds	Total
Balance, July 1, 2010	$ 180,939,376	$ 4,543,685,023	$ 707,292,379	$ 5,431,916,778
Add: Accretion of Discount	-	7,557,316	-	7,557,316
Accretion of Discount on Capital Appreciation Bonds	-	-	49,306,167	49,306,167
Less: Amortization of Premium	(221,442)	(1,488,000)	-	(1,709,442)
Principal Payments	(22,345,000)	(1,415,000)	-	(23,760,000)
Balance, June 30, 2011	$ 158,372,934	$ 4,548,339,339	$ 756,598,546	$ 5,463,310,819

The bonds are subject to the following debt service to maturity requirements:

Fiscal Year	Principal	Interest
2012	$ 34,505,000	$ 274,874,200
2013	42,810,000	273,223,819
2014	50,655,000	271,092,944
2015	56,240,000	268,515,269
2016	64,165,000	265,653,394
2017-2021	514,935,000	1,265,553,725
2022-2026	630,545,000	1,109,702,344
2027-2031	584,335,000	940,508,906
2032-2036	391,165,000	771,037,744
2037-2041	1,104,853,198	691,898,590
2042-2046	1,308,830,000	346,402,244
2047-2051	559,661,070	2,979,086,405
2052	166,969,278	3,250,330,722
Total	5,509,668,546	12,707,880,306
	(46,357,728)	Less: Net discount on bonds payable
	$ 5,463,310,818	Bonds payable

5. Bonds Payable (Continued)

The preceding schedule includes (i) serial bond maturities that the Authority must pay as of specific distribution dates in order to avoid an event of default under the indenture, (ii) turbo term bond sinking fund installments that the Authority must pay according to the terms of the indenture, and (iii) capital appreciation turbo term bond maturities, including the capital appreciation component of the Series 2007A-3 Bonds.

On December 1, 2012 the Series 2007A-3 Senior Convertible Capital Appreciation Turbo Term Bonds convert to fixed rate current interest turbo term bonds with a final maturity date of June 1, 2037. As of the conversion date, the Authority will be required to make the following sinking fund installment payments on the new fixed rate current interest turbo term bonds:

	2007A-3 Sinking Fund Requirements	
	Principal	**Interest**
2013	$ -	$ 11,743,750
2014	-	23,487,500
2015	-	23,487,500
2016	-	23,487,500
2017-2021	-	117,437,500
2022-2026	-	117,437,500
2027-2031	-	117,437,500
2032-2036	115,300,000	110,231,250
2037-2041	260,500,000	8,493,750
Total	$ 375,800,000	$ 553,243,750

Turbo Redemptions

The Authority has covenanted to apply 100% of all surplus collections of TSRs, if any, to the special mandatory redemption ("Turbo Redemption") of the Series 2007 Bonds, other than the Series 2007A-1 Bonds, at the principal amount or accreted value thereof on each distribution date (or a special redemption date pursuant to the Indenture) in accordance with the payment priorities as further set forth in the Indenture. Turbo Redemptions are not scheduled amortization payments and are to be made only from surplus collections, if any. Failure to pay Turbo Redemptions on turbo term bonds will not constitute an event of default. Amounts in the Senior Liquidity Reserve Account will not be available to make Turbo Redemptions.

Turbo Redemptions, if any, of the first subordinate bonds, including the Series 2007B Bonds, will not occur until the senior bonds, including the Series 2007A Bonds, are fully paid. Turbo Redemptions, if any, of the second subordinate bonds, including the Series 2007C Bonds, will not occur until the senior bonds, including the Series 2007A Bonds, and first subordinate bonds, including the Series 2007B Bonds, are fully paid. Turbo Redemptions of the turbo term bonds will be applied to redeem such bonds at the principal amount or accreted value thereof, together with accrued interest, without premium; provided, that Turbo Redemptions of capital appreciation bonds will be applied to redeem such bonds at their accreted value as of the redemption date, without premium.

6. Contingencies and Commitments

While the Authority's share of the total base payments to the states through 2052 will not change over time, estimating the amount of annual payments that actually will be received in any given year can be complex, since under the terms of the MSA, payments are subject to a number of adjustment factors, including an inflation adjustment, a volume adjustment, and a potential adjustment for market share losses of participating manufacturers. Some of these adjustments, such as the inflation adjustment, result in the Authority receiving higher payments. Other factors such as the volume adjustment and the market share adjustment can work to reduce the amount of the Authority's annual payments.

In addition to the base payments, the Authority receives payments from the Strategic Contribution Fund. The Strategic Contribution Fund was established to reward states that played leadership roles in the tobacco litigation and settlement negotiations. Allocations from the fund are based on a state's contribution to the litigation and settlement with the tobacco companies. These payments are also subject to the adjustment factors outlined in the MSA.

During fiscal year 2011, the Authority received $289,229,818 (excludes amounts released from disputed payment accounts in connection with prior fiscal year deposits into those accounts), which is $89,655,686 or 23.7 percent less than the pre-adjusted base and strategic contribution fund payments for the year. As of June 30, 2011, the estimated tobacco settlement receivable included $105,657,154 for payments withheld from the Authority in fiscal years 2008 through 2011 by the cigarette manufacturers when they exercised the market share loss provisions of the MSA. These moneys were either withheld or are on deposit in an escrow account until pending litigation between the States and the manufacturers is resolved. The Authority contends it has met its obligations under the MSA and is due the payments withheld.

A schedule of pre-adjusted base payments and payments from the Strategic Contribution Fund for the Authority in future years follows:

Year Ending	Base Payments	Strategic Contribution Fund	Total Payments
2012	$ 359,652,251	$ 23,693,731	$ 383,345,982
2013	363,783,359	23,965,886	387,749,245
2014	367,788,676	24,229,755	392,018,431
2015	371,683,890	24,486,370	396,170,260
2016	376,306,539	24,790,908	401,097,447
2017-2021	2,136,347,649	25,096,152	2,161,443,801
2022-2026	2,316,649,200	-	2,316,649,200
2027-2031	2,472,970,884	-	2,472,970,884
2032-2036	2,640,789,782	-	2,640,789,782
2037-2041	2,812,832,804	-	2,812,832,804
2042-2046	2,993,719,747	-	2,993,719,747
2047-2051	3,187,255,848	-	3,187,255,848
2052	662,283,048	-	662,283,048
Total	$ 21,062,063,677	$ 146,262,802	$ 21,208,326,479

The State has an ownership interest in excess TSRs to be received by the Authority after the Bonds, and related operating expenses, have been fully paid. The ownership interest is evidenced by a "Residual Certificate." Since the *Purchase and Sale Agreement* entered into between the State and the Authority includes all TSRs received after June 30, 2007, and in perpetuity to be received under the MSA, the amount of excess TSRs cannot be estimated.

7. Other Credit Risks

The Series 2007 Bonds are secured by and payable solely from TSRs and investment earnings pledged under the Indenture and amounts established and held in accordance with the Indenture. The Series 2007 Bonds are payable only from the assets of the Authority. In the event that the assets of the Authority have been exhausted, no amounts will thereafter be paid on the Series 2007 Bonds. The Series 2007 Bonds are not legal or moral obligations of the State, and no recourse may be had thereto for payment of amounts owing on the Series 2007 Bonds. The Authority has no taxing power.

Certain smokers, consumer groups, cigarette manufacturers, cigarette importers, cigarette distributors, native American tribes, taxpayers, taxpayers' groups, and other parties have instituted litigation against various tobacco manufacturers, including the PMs, as well as certain of the Settling States and other public entities. The lawsuits allege, among other things, that the MSA violates certain provisions of the United States Constitution, state constitutions, the Federal antitrust laws, Federal civil rights laws, state consumer protection laws, and unfair competition laws, certain of which actions, if ultimately successful, could result in a determination that the MSA is void or unenforceable. The lawsuits seek, among other things, an injunction against one or more of the Settling States from collecting any monies under the MSA and barring the PMs from collecting cigarette price increases related to the MSA and/or a determination that the MSA is void or unenforceable. In addition, class action lawsuits have been filed in several Federal and state courts alleging that under the Federal Medicaid law, any amount of tobacco settlement funds that the Settling States receive in excess of what they paid through the Medicaid program to treat tobacco related diseases should be paid directly to Medicaid recipients. To date, no such lawsuits have been successful or are on appeal. The enforcement of the terms of the MSA may, however, continue to be challenged in the future. In the event of an adverse court ruling, the Authority may not have adequate financial resources to make payment on the Series 2007 Bonds.

8. Financial Statement Reconciliation

The following is a detailed explanation for the amounts included in the "Reconciliation" column of the accompanying financial statements:

A. Governmental Fund Balance Sheet / Statement of Net Assets

Total Fund Balance for Governmental Funds	$ 5,218,716,691
Total Net Assets of Governmental Activites is different because:	
Some of the Authority's revenues are collected after year-end but are not available soon enough to pay for the current period's (within 60 days of year-end) expenditures, and therefore, are deferred in the funds.	
Tobacco Settlement Revenue	283,059,111
Long term liabilities and related accounts are not due and payable in the current period and therefore are not reported in the governmental funds:	
Deferred Bond Issuance Costs	21,027,039
Accrued Interest Payable	(27,224,765)
Bonds Payable, net of discount	(5,463,310,819)
Total Net Assets of Governmental Activities	$ 32,267,257

8. Financial Statement Reconciliation (Continued)

B. Statement of Governmental Fund Revenues, Expenditures, and Change in Fund Balance / Statement of Activities

Net Change in Fund Balance - Total Governmental Funds	$ (82,437,658)
The change in net assets of governmental activities is different because:	
Some of the Authority's revenues are collected after year-end but are not available soon enough to pay for the current period's (within 60 days of year-end) expenditures, and therefore, are deferred in the funds. This amount represents the change in beginning and end of year deferred revenues.	45,572,314
The issuance of long-term debt (e.g. bonds, leases) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets.	
Bond Principal Repayments	23,760,000
Governmental funds report the effect of long-term debt issuance costs, premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in thestatement of activities:	
Accrued Interest	(188,548)
Amortization of Bond issuance Costs	(1,253,127)
Amortization of Net Discount on Bonds	(5,847,874)
Accretion of Capital Appreciation Bonds	(49,306,167)
Total Interest Expense	(56,595,716)
Change in Net Assets of Governmental Activities	$ (69,701,060)

9. New Accounting Pronouncements

During the fiscal year, the Authority implemented GASB Statement No. 54, “Fund Balance Reporting and Governmental Fund Type Definitions,” which impacted the Authority’s classification of fund balance for its governmental bond service fund. See Note 2 for the Authority’s policy on the use of fund balance. No other new accounting pronouncements had a significant impact on the Authority’s financial statements.

INDEPENDENT ACCOUNTANTS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS REQUIRED BY *GOVERNMENT AUDITING STANDARDS*

Buckeye Tobacco Settlement Financing Authority of Ohio
30 East Broad Street, 34th Floor
Columbus, Ohio 43215

To the Authority:

We have audited the financial statements of the governmental activities and Debt Service Fund of the Buckeye Tobacco Settlement Financing Authority of Ohio (the Authority), a component unit of the State of Ohio, as of and for the year ended June 30, 2011, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated September 30, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the Comptroller General of the United States' *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our audit procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of opining on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we have not opined on the effectiveness of the Authority's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, when performing their assigned functions, to prevent, or detect and timely correct misstatements. A *material weakness* is a deficiency, or combination of internal control deficiencies resulting in more than a reasonable possibility that a material misstatement of the Authority's financial statements will not be prevented, or detected and timely corrected.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider material weaknesses, as defined above.

Compliance and Other Matters

As part of reasonably assuring whether the Authority's financial statements are free of material misstatement, we tested its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could directly and materially affect the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express an opinion. The results of our tests disclosed no instances of noncompliance or other matters we must report under *Government Auditing Standards*.

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We intend this report solely for the information and use of the Authority's management and its members and the Ohio General Assembly. We intend it for no one other than these specified parties.

Dave Yost
Auditor of State

September 30, 2011

Dave Yost • Auditor of State

BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY OF OHIO

FRANKLIN COUNTY

CLERK'S CERTIFICATION

This is a true and correct copy of the report which is required to be filed in the Office of the Auditor of State pursuant to Section 117.26, Revised Code, and which is filed in Columbus, Ohio.

Susan Babbitt

CLERK OF THE BUREAU

CERTIFIED
OCTOBER 20, 2011