BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY OF OHIO

REGULAR AUDIT

FOR THE YEAR ENDED JUNE 30, 2012

Dave Yost • Auditor of State

BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY OF OHIO

TABLE OF CONTENTS

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, 2012, 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 opinions 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 opinions.

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, 2012, 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, 2012, 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 October 1, 2012, 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.

88 East Broad Street, Tenth Floor, Columbus, Ohio 43215-3506
Phone: 614-466-3402 or 800-443-925 Fax: 614-728-7199
www.auditor.state.oh.us

Accounting principles generally accepted in the United States of America require this presentation to include *Management's Discussion and Analysis*, as listed in the table of contents, to supplement the basic financial statements. Although this information is not part of the basic financial statements, the Governmental Accounting Standards Board considers it essential 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 other assurance.

Dave Yost

Dave Yost
Auditor of State

October 1, 2012

BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY
FRANKLIN COUNTY, OHIO

(A COMPONENT UNIT OF THE STATE OF OHIO)

MANAGEMENT'S DISCUSSION & ANALYSIS
JUNE 30, 2012

(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, 2012. 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 2012 are as follows:

- The liabilities of the Authority exceeded its assets at the close of the most recent fiscal year by ($39.3 million) (net deficit).
- The Authority's total net assets decreased by $71.5 million, or 221.7% during fiscal year 2012.
- The Authority's net asset deficit is a result of bonds payable and other liabilities exceeding recognized assets. The bonds are recognized as a liability, while the resources to repay the bonds, the future TSRs, are not recognized as assets until the underlying sales of tobacco products are known.
- During fiscal year 2012, the Authority made principal payments totaling $20.3 million and interest payments totaling $274.9 million on the outstanding Series 2007 bonds.
- Accretion of the discount on the Authority's capital appreciation bonds exceeded principal payments on the other bonds, causing the total net carrying value of the bonds to increase during fiscal year 2012.
- Interest earnings totaled $0.7 million during fiscal year 2012.

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, 2012 with comparative amounts to the prior fiscal year.

Table 1: Summary of Net Assets – Comparative Analysis

	2012	2011	% Change
Assets			
Cash and Investments	$ 519,155,950	$ 519,333,878	0.0%
Interest Receivable	38,207	25,342	50.8%
Tobacco Settlement Receivable	321,615,692	283,059,111	13.6%
Deferred Bond Issuance Costs	20,406,093	21,027,039	-3.0%
Deferred Payments to State	4,625,232,010	4,699,357,471	-1.6%
Total Assets	5,486,447,952	5,522,802,841	
Liabilities			
Accrued Interest	27,453,788	27,224,765	0.8%
Bonds Payable	5,498,236,287	5,463,310,819	0.6%
Total Liabilities	5,525,690,075	5,490,535,584	
Net Assets (Deficit)			
Restricted for Debt Service	-	31,963,747	-100.0%
Unrestricted Net Assets	(39,242,123)	303,510	-13029.4%
	$ (39,242,123)	$ 32,267,257	

Approximately 84.3% 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 2012. 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 $34.9 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, 2012 with comparative amounts to the prior fiscal year.

Table 2: Summary of Activities – Comparative Analysis

	2012	2011	% Change
Revenues			
Tobacco Settlement	$ 333,148,138	$ 334,862,201	-0.5%
Interest Income	667,651	2,618,389	-74.5%
Total Revenues	333,815,789	337,480,590	
Expenses			
General Government	105,971	111,641	-5.1%
Interest	330,944,637	332,563,169	-0.5%
Amortization of Deferred Payments to State	74,125,461	74,506,840	-0.5%
Total Expenses	405,176,069	407,181,650	
Other Financing Sources (Uses)			
Transfers to Other State Agencies	(149,100)	-	100.0%
Change in Net Assets	(71,509,380)	(69,701,060)	
Beginning Net Assets	32,267,257	101,968,317	
Ending Net Assets (Deficit)	$ (39,242,123)	$ 32,267,257	

TSRs account for approximately 99.8% of total general revenues of the Authority. TSRs remained consistent from fiscal year 2011 to 2012. Interest Income decreased by approximately $2.0 million due to overall decreasing 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.

Bond Service Fund

In regard to the Authority's Bond Service Fund, as of June 30, 2012, the amount of Deferred Payments to State comprised approximately 84.6% 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 2012, significant activity in the Bond Service Fund included the receipt of TSRs and related interest earnings ($295.3 million), and the payment of debt principal ($20.3 million) and interest ($274.9 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 both July 2011 and February 2012, Fitch Ratings downgraded the ratings for certain series of bonds. In January 2012, Standard and Poor's Ratings also downgraded the ratings for certain series of bonds. Additionally, in September 2011 and May 2012, Moody's downgraded the ratings for certain series of bonds and upgraded the ratings for other series. The series impacted and rating changes are detailed below:

	Standard & Poors		Fitch Ratings		Moody's	
	Previous Rating	New Rating	Previous Rating	New Rating	Previous Rating	New Rating
Series 2007A-1, Senior Current Interest Serial Bonds (various maturities)	No Change		No Change		Baa3	Baa1 to Aaa
Series 2007A-2, $200,000,000, due June 1, 2024	BB-	B-	B+	B	Baa3	B3
Series 2007A-2, $949,530,000, due June 1, 2024	BB-	B-	B+	B	Baa3	B3
Series 2007A-2, $687,600,000, due June 1, 2030	BB-	B-	BB-	B+	Baa3	B3
Series 2007A-2, $505,200,000, due June 1, 2034	BB-	B-	BB+	BB	Baa3	B3
Series 2007A-2, $250,000,000, due June 1, 2042	BB-	B-	BBB	BBB	Baa3	B3
Series 2007A-2, $750,000,000, due June 1, 2047	BB-	B-	BB+	BB	Baa3	B3
Series 2007A-2, $1,383,715,000, due June 1, 2047	BB-	B-	BB+	BB	Baa3	B3
Series 2007A-3, $274,751,138, due June 1, 2037	BB-	B-	BB-	B+	Baa3	B3
Series 2007B, $191,265,480, due June 1, 2047	no change		B+	B	no change	
Series 2007C, $128,182,923, due June 1, 2052	no change		B+	B	no change	

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 had a shortfall of $7.4 million in its debt service account in connection with its 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 are 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. A draw on the Reserve Account does not constitute an "Event of Default" under the Indenture.

Additionally, tobacco settlement collections were insufficient for the Authority to make $14.2 million in scheduled sinking fund installments, on June 1, 2012, related to two series of 2007A-2 turbo term bonds. This does not constitute an "Event of Default" under the Indenture. If collections are sufficient in fiscal year 2013, the Authority will make the previously scheduled payment on June 1, 2013.

Disputed Payments – As of June 30, 2012, the estimated tobacco settlement receivable includes $143.2 million for payments withheld from the Authority in fiscal years 2008 thru 2012 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. This reduction impacted 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, 2012

	Governmental Bond Service Fund Balance Sheet	Reconciliation (See Note 8)	Government-Wide Statement of Net Assets
Assets			
Cash and Cash Equivalents	$ 138,430	$ -	$ 138,430
Restricted Assets:			
Cash and Cash Equivalents	967,429	-	967,429
Investments	518,050,091	-	518,050,091
Accrued Interest Receivable	38,207	-	38,207
Tobacco Settlement Receivable	321,615,692	-	321,615,692
Deferred Bond Issuance Costs	-	20,406,093	20,406,093
Deferred Payments to State	4,625,232,010	-	4,625,232,010
Total Assets	5,466,041,859	20,406,093	5,486,447,952
Liabilities			
Accrued Interest Payable	-	27,453,788	27,453,788
Deferred Revenue	321,615,692	(321,615,692)	-
Bonds Payable, Net of Net Discount			
Due Within One Year	-	57,020,000	57,020,000
Due in More Than One Year	-	5,441,216,287	5,441,216,287
Total Liabilities	321,615,692	5,204,074,383	5,525,690,075
Fund Balance			
Restricted For Debt Service	5,144,287,737	(5,144,287,737)	-
Assigned	138,430	(138,430)	-
Net Assets (Deficit)			
Unrestricted	-	(39,242,123)	(39,242,123)
Total Fund Balance/Net Assets	5,144,426,167	(5,183,668,290)	(39,242,123)
Total Liabilities and Fund Balance/Net Assets	$ 5,466,041,859	$ 20,406,093	$ 5,486,447,952

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, 2012

	Governmental Bond Service Fund	Reconciliation (See Note 8)	Government-Wide Statement of Activities
General Revenues			
Tobacco Settlement	$ 294,591,557	$ 38,556,581	$ 333,148,138
Interest	667,651	-	667,651
Total General Revenues	295,259,208	38,556,581	333,815,789
Expenditures/Expenses			
General Government	105,971	-	105,971
Debt Service			
Principal	20,295,000	(20,295,000)	-
Interest	274,874,200	56,070,437	330,944,637
Amortization of Deferred Payments to State	74,125,461	-	74,125,461
Total Expenditures/Expenses	369,400,632	35,775,437	405,176,069
Excess (Deficiency) of General Revenues Over (Under) Expenditures/Expenses	(74,141,424)	2,781,144	(71,360,280)
Other Financing Sources (Uses)			
Transfers to State Agencies	(149,100)	-	(149,100)
Total Other Financing Sources (Uses)	(149,100)	-	(149,100)
Net Change in Fund Balance/Net Assets	(74,290,524)	2,781,144	(71,509,380)
Fund Balance/Net Assets, Beginning of Year	5,218,716,691	(5,186,449,434)	32,267,257
Fund Balance/Net Assets (Deficit), End of Year	$ 5,144,426,167	$ (5,183,668,290)	$ (39,242,123)

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 certain 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 2012 were $295,004,137. Annual principal and interest payments on the bonds will require 100% of the net TSR's. Total principal and interest paid for fiscal year 2012 was $295,169,200. As of June 30, 2012, the total principal and interest remaining to be paid on the bonds was $17,923,114,125.

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 final maturity 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 final maturity 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.

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, 2012.

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, 2012.

Investments

	Credit Rating	Fair Value	% of Total	Maturity	
				3 months or less	3 to 9 months
Money Market Funds					
Fidelity Governmental Fund	AAAm	$ 1,105,859	0.2%	$ 1,105,859	$ -
Commercial Paper					
U.S. Bank N.A. Open	P-1/A-1	232,456,889	44.8%	-	232,456,889
U.S. Bank N.A. 31 Day Puttable	P-1/A-1	149,002,070	28.7%	-	149,002,070
Bank of Nova Scotia	P-1/A-1+	44,851,950	8.6%	-	44,851,950
General Electric Capital Corp	P-1/A-1+	46,887,232	9.0%	-	46,887,232
JP Morgan Chase Co.	P-1/A-1	44,851,950	8.6%	-	44,851,950
Total Investments		$ 519,155,950	100.0%	$ 1,105,859	$ 518,050,091

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. The final maturity dates of the U.S. Bank commercial paper investments are between three and nine months, as shown above. However, the U.S. Bank N.A. Open commercial paper is an investment with a daily maturity, thus the Authority can redeem funds the same day from this investment. The U.S. Bank 31 Day Puttable commercial paper is an investment with a rolling maturity of 31 days, thus the Authority can redeem funds 31 days after notice is given to U.S. Bank.

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, 2012, 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, 2012, the Authority had restricted cash/cash equivalent and investment balances in the following accounts:

The Liquidity Reserve Account	$382,394,524
Collection Account	2
Senior Debt Service Account	136,622,994
Total	$519,017,520

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, 2012 Accreted Book Value	Ultimate Maturity Value	Maturity/ Conversion Date
Series 2007A-3 Senior Convertible Capital Appreciation Turbo Term Bonds	$364,409,502	$ 375,800,000	December 1, 2012
Series 2007B First Subordinate Capital Appreciation Turbo Term Bonds	265,186,830	3,207,000,000	June 1, 2047
Series 2007C Second Subordinate Capital Appreciation Turbo Term Bonds	179,715,807	3,417,300,000	June 1, 2052

5. Bonds Payable (Continued)

Changes in bonds payable during the year ended June 30, 2012 were as follows:

	Serial Bonds	Term Bonds	Capital Appreciation Term Bonds	Total
Balance, July 1, 2011	$ 158,372,934	$ 4,548,339,339	$ 756,598,546	$ 5,463,310,819
Add: Accretion of Discount	-	3,419,923	-	3,419,923
Accretion of Discount on Capital Appreciation Bonds	-	-	52,713,593	52,713,593
Less: Amortization of Premium	(221,442)	(691,606)	-	(913,048)
Principal Payments	(20,295,000)	-	-	(20,295,000)
Balance, June 30, 2012	$ 137,856,492	$ 4,551,067,656	$ 809,312,139	$ 5,498,236,287

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

Fiscal Year	Principal	Interest
2013	$ 57,020,000	$ 273,958,294
2014	50,655,000	271,092,944
2015	56,240,000	268,515,269
2016	64,165,000	265,653,394
2017	71,490,000	262,396,000
2018-2022	574,080,000	1,239,005,038
2023-2027	611,410,000	1,075,577,413
2028-2032	596,240,000	906,321,769
2033-2037	632,169,502	759,936,254
2038-2042	978,430,000	612,487,769
2043-2047	1,670,471,830	3,208,498,651
2048-2052	179,715,807	3,237,584,193
Total	5,542,087,139	$ 12,381,026,988
	(43,850,852)	Less: Net discount on bonds payable
	$ 5,498,236,287	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	-	23,487,500
2018-2022	-	117,437,500
2023-2027	-	117,437,500
2028-2032	-	117,437,500
2033-2037	375,800,000	95,237,500
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 2012, the Authority received $294,561,886 (excludes amounts released from disputed payment accounts in connection with prior fiscal year deposits into those accounts), which is $88,784,095 or 23.2 percent less than the pre-adjusted base and strategic contribution fund payments for the year. As of June 30, 2012, the estimated tobacco settlement receivable included $143,239,696 for payments withheld from the Authority in fiscal years 2008 through 2012 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 (as reported in the October 2007 Offering Circular for the bonds) for the Authority in future years follows:

Year Ending	Base Payments	Strategic Contribution Fund	Total Payments
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	380,939,909	25,096,152	406,036,061
2018-2022	2,207,289,125	-	2,207,289,125
2023-2027	2,346,281,254	-	2,346,281,254
2028-2032	2,505,976,593	-	2,505,976,593
2033-2037	2,674,512,171	-	2,674,512,171
2038-2042	2,848,790,187	-	2,848,790,187
2043-2047	3,030,813,529	-	3,030,813,529
2048-2052	3,228,246,194	-	3,228,246,194
Total	$ 20,702,411,426	$ 122,569,071	$ 20,824,980,497

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	$ 5,144,426,167
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	321,615,692
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	20,406,093
Accrued Interest Payable	(27,453,788)
Bonds Payable, net of discount	(5,498,236,287)
Total Net Assets (Deficit) of Governmental Activities	$ (39,242,123)

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	$ (74,290,524)
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.	38,556,581
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	20,295,000
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	(229,023)
Amortization of Bond issuance Costs	(620,946)
Amortization of Net Discount on Bonds	(2,506,875)
Accretion of Capital Appreciation Bonds	(52,713,593)
Total Interest Expense	(56,070,437)
Change in Net Assets of Governmental Activities	$ (71,509,380)

9. Change in Estimate

For fiscal year 2012, the Authority extended the periods over which it amortizes both deferred bond issuance costs and bond discounts and premiums as they apply to the Series 2007A-2 turbo term bonds, Series 2007A-3 Senior Convertible Capital Appreciation Turbo Term Bonds, and the 2007B and 2007C Capital Appreciation Turbo Term Bonds. Previously, these amounts were amortized on a straight-line basis over the life of each bond series up until the projected final turbo redemption date for each series.

Due to declining tobacco settlement projections making future turbo redemptions less likely, the final maturity dates pursuant to the rated debt service schedules more accurately reflect the life of each bond series. Thus, the amortization periods have been extended to the final maturity date for each series. This change has been applied prospectively, and for fiscal year 2012, has resulted in a decrease in the annual amortization of bond issuance costs (included in interest expense) in the amount of $632,182, and a decrease in the amortization of the net discount on bonds payable (also included in interest expense) in the amount of $3,340,998. Net assets as of June 30, 2012 increased by $3,973,180 due to this change in estimate.

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 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, 2012, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated October 1, 2012. 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*.

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

October 1, 2012

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 16, 2012