



**BUCKEYE TOBACCO SETTLEMENT
FINANCING AUTHORITY OF OHIO**

REGULAR AUDIT

FOR THE YEAR ENDED JUNE 30, 2015



Dave Yost • Auditor of State

BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY OF OHIO

Basic Financial Statements

For the Year Ended June 30, 2015

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Dave Yost • Auditor of State

INDEPENDENT AUDITOR'S REPORT

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

To the Authority:

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and Debt Service Fund of the Buckeye Tobacco Settlement Financing Authority (the Authority), a blended component unit of the State of Ohio, as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for preparing and fairly presenting these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes designing, implementing, and maintaining internal control relevant to preparing and fairly presenting financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to opine on these financial statements based on our audit. We audited in accordance with auditing standards generally accepted in the United States of America and the financial audit standards in the Comptroller General of the United States' *Government Auditing Standards*. Those standards require us to plan and perform the audit to reasonably assure the financial statements are free from material misstatement.

An audit requires obtaining evidence about financial statement amounts and disclosures. The procedures selected depend on our judgment, including assessing the risks of material financial statement misstatement, whether due to fraud or error. In assessing those risks, we consider internal control relevant to the Foundation's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not to the extent needed to opine on the effectiveness of the Foundation's internal control. Accordingly, we express no opinion. An audit also includes evaluating the appropriateness of management's accounting policies and the reasonableness of their significant accounting estimates, as well as our evaluation of the overall financial statement presentation.

We believe the audit evidence we obtained is sufficient and appropriate to support our audit opinions.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and Debt Service Fund of the Buckeye

Tobacco Settlement Financing Authority, as of June 30, 2015, and the respective changes in financial position thereof for the year then ended in accordance with the accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements of the Authority present the financial position and the changes in financial position thereof for the governmental activities and Debt Service Fund of only the transactions of the Buckeye Tobacco Settlement Financing Authority. They do not purport to, and do not, present fairly the financial position of the State of Ohio as of June 30, 2015, or the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America. We did not modify our opinion regarding this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require this presentation to include *Management's discussion and analysis*, 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 applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, consisting of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, to the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not opine or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to opine or provide any other assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 6, 2015, 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. That report describes the scope of our internal control testing over financial reporting and compliance, and the results of that testing, and does not opine on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.



Dave Yost
Auditor of State
Columbus, Ohio

October 6, 2015

Buckeye Tobacco Settlement Financing Authority
Franklin County, Ohio
(A Component Unit of the State of Ohio)

Management Discussion and Analysis
June 30, 2015
(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, 2015. 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 2015 are as follows:

- The liabilities of the Authority exceeded its assets at the close of the most recent fiscal year by \$297.8 million (net position).
- The Authority’s total net position decreased by \$84.9 million, or 40% during fiscal year 2015.
- The Authority’s net position is a result of bonds payable and other liabilities exceeding recognized assets and deferred outflows of resources. 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 2015, the Authority made principal payments totaling \$26.6 million and interest payments totaling \$295.7 million on the outstanding Series 2007 bonds.
- The total net carrying value of the bonds increased \$14.3 million during fiscal year 2015 primarily due to accretion on the capital appreciation bonds exceeding the amount of principal paid on the other bonds.
- Interest earnings totaled \$1.1 million during fiscal year 2015.

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Management Discussion and Analysis
June 30, 2015
(Unaudited)

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:

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

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 Position" presents information on the Authority's assets and deferred outflows of resources and liabilities and deferred inflows of resources, with the difference between the two reported as *net position*. 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 position 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 position changed during the most recent fiscal year. Such information is presented on the accrual basis of accounting. All changes in net position 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").

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(Unaudited)

FINANCIAL ANALYSIS OF THE AUTHORITY

Table 1 below is a summary of the Authority's net position as of June 30, 2015 with comparative amounts to the prior fiscal year.

Table 1
Net Position

| | <u>2015</u> | <u>2014</u> | <u>% Change</u> |
|---------------------------------------|-------------------------|-------------------------|---------------------|
| Assets | | | |
| Cash and Investments | \$ 454,225,351 | \$ 528,458,140 | -14.0% |
| Interest Receivable | 25,477 | 28,793 | -11.5% |
| Tobacco Settlement Receivable | 431,098,955 | 394,128,240 | 9.4% |
| <i>Total Assets</i> | <u>885,349,783</u> | <u>922,615,173</u> | |
| Deferred Outflows of Resources | | | |
| Deferred Payments to State | <u>4,406,566,813</u> | <u>4,478,388,152</u> | -1.6% |
| Liabilities | | | |
| Accounts Payable | 2,340 | 37,240 | -93.7% |
| Accrued Interest | 27,914,008 | 27,788,864 | 0.5% |
| Due to State Agencies | 0 | 38,619,477 | -100.0% |
| Bonds Payable | <u>5,561,795,212</u> | <u>5,547,460,610</u> | 0.3% |
| <i>Total Liabilities</i> | <u>5,589,711,560</u> | <u>5,613,906,191</u> | |
| Net Position | | | |
| Unrestricted Net Position | <u>(297,794,964)</u> | <u>(212,902,866)</u> | 39.9% |
| <i>Total Net Position</i> | <u>\$ (297,794,964)</u> | <u>\$ (212,902,866)</u> | |

Approximately 83% of the Authority's assets and deferred outflows are comprised of deferred payments 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 outflow is being amortized over the future payment period for expected tobacco settlement receipts. Thus, the deferred outflow decreased by approximately 2% during fiscal year 2015. The remaining assets consist mainly of cash and investments restricted for payment of the bond obligations, and the tobacco settlement receivable for estimated collections from January–June 2015, to be received during fiscal year 2016.

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

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America (“GAAP”). The increase in the tobacco settlement receivable is directly related to the amount of disputed payments withheld from the 2015 TSRs.

Approximately 99% of the Authority’s liabilities consist of the principal balance, net of discounts and premium, 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 \$14.3 million due to a combination of principal payments, amortization of the net original issue discounts and premiums, and accretion of the discount on capital appreciation bonds.

For 2014, the Authority reported \$38.6 million in due to state agencies. This amount represents the amount of 2003’s NPM adjustment to Ohio in which Ohio was found “diligent” in a September 2013 arbitration case. This amount was received during fiscal year 2014, however was not distributed to the State of Ohio until August 2014.

Table 2 below summarizes the Authority’s Statement of Activities for the period ending June 30, 2015 with comparative amounts to the prior fiscal year.

Table 2
Change in Net Position

| | <u>2015</u> | <u>2014</u> | <u>% Change</u> |
|--|-------------------------|-------------------------|---------------------|
| Revenues | | | |
| Tobacco Settlement | \$ 322,792,534 | \$ 323,851,958 | -0.3% |
| Interest Income | 1,091,939 | 1,063,622 | 2.7% |
| <i>Total Revenues</i> | <u>323,884,473</u> | <u>324,915,580</u> | |
| Expenses | | | |
| General Government | 164,442 | 163,919 | 0.3% |
| Interest | 336,790,790 | 335,351,927 | 0.4% |
| Amortization of Deferred Payments to State | 71,821,339 | 72,057,061 | -0.3% |
| <i>Total Expenses</i> | <u>408,776,571</u> | <u>407,572,907</u> | |
| <i>Increase (Decrease) in Net Position</i> | (84,892,098) | (82,657,327) | |
| <i>Net Position Beginning of Year</i> | <u>(212,902,866)</u> | <u>(130,245,539)</u> | |
| <i>Net Position End of Year</i> | <u>\$ (297,794,964)</u> | <u>\$ (212,902,866)</u> | 39.9% |

TSRs account for approximately 99.7% of total general revenues of the Authority. TSRs decreased slightly from fiscal year 2014 to 2015.

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The Authority's expenses consisted primarily of interest payments and the related amortized/accreted amounts on the outstanding bond obligations (approximately 82% of total expenses), and amortization of the deferred outflows for bond proceeds transferred to the State (approximately 18% of total expenses).

Bond Service Fund

In regards to the Authority's Bond Service Fund as of June 30, 2015, assets and deferred outflows reported were identical to those reported at the accrual basis level.

During fiscal year 2015, significant activity in the Bond Service Fund included the receipt of TSRs and related interest earnings (\$286.9 million), and the payment of debt principal (\$26.6 million) and interest (\$295.7 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 \$5.532 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.

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Moody's (July 2014) and the S&P (January 2015) upgraded the ratings for the following Current Interest Serial Bonds:

| <u>Series</u> | <u>Principal</u> | <u>CUSIP</u> | <u>Maturity</u> | <u>Moody's Ratings</u> | | <u>S&P</u> | |
|---------------|------------------|--------------|-----------------|------------------------|-------------------|------------------------|-------------------|
| | | | | <u>Previous Rating</u> | <u>New Rating</u> | <u>Previous Rating</u> | <u>New Rating</u> |
| 2007A-1-10 | 26,640,000 | 118217AK4 | 6/1/2015 | No change | | BBB | BBB+ |
| 2007A-1-11 | 35,000,000 | 118217AL2 | 6/1/2016 | A1 | Aa1 | BBB | BBB+ |
| 2007A-1-12 | 38,995,000 | 118217AM0 | 6/1/2017 | A3 | A1 | BBB | BBB+ |

The Series 2007 Bonds are secured by and payable solely from TSRs and investment earnings pledged under the Trust Indenture and amounts established and held in accordance with the Trust 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.

Tobacco settlement collections were insufficient for the Authority to make the following scheduled sinking fund installment payments related to two series of 2007A-2 turbo term bonds:

| <u>Payment Date</u> | <u>Principal</u> |
|---------------------|-----------------------|
| <u>at June 1</u> | |
| 2012 | \$ 14,210,000 |
| 2013 | 30,490,000 |
| 2014 | 26,660,000 |
| 2015 | 29,600,000 |
| | <u>\$ 100,960,000</u> |

This does not constitute an "Event of Default" under the Trust Indenture. If collections are sufficient in fiscal year 2016, the Authority will make the previously scheduled sinking fund payments on June 1, 2016.

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Tobacco Settlement Receipts have significantly underperformed original estimates due to continued NPM adjustments being taken by the manufacturers, the loss of the SLRA Forward Delivery Agreement and its guaranteed investment income and higher than forecast consumption decline. Continued underperformance of Tobacco Settlement Receipts in conjunction with the inability to access balances in the Disputed Payment Accounts could threaten the ability of the Authority to pay its rated debt service on its stated schedule.

Disputed Payments – As of June 30, 2015, the estimated tobacco settlement receivable includes \$259.8 million for payments withheld from the Authority in fiscal years 2008 thru 2015 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.

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Buckeye Tobacco Settlement Financing Authority
Franklin County, Ohio
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Governmental Fund Balance Sheet/Statement of Net Position
June 30, 2015

| | Governmental Bond Service Fund Balance Sheet | Reconciliation (See Note 8) | Government- Wide Statement of Net Position |
|---|---|--|---|
| Assets | | | |
| Cash and Cash Equivalents | \$ 468,897 | \$ 0 | \$ 468,897 |
| Accrued Interest Receivable | 31 | 0 | 31 |
| Restricted Assets: | | | |
| Cash and Cash Equivalents | 374,178 | 0 | 374,178 |
| Investments | 453,382,276 | 0 | 453,382,276 |
| Accrued Interest Receivable | 25,446 | 0 | 25,446 |
| Tobacco Settlement Receivable | 431,098,955 | 0 | 431,098,955 |
| <i>Total Assets</i> | <u>885,349,783</u> | <u>0</u> | <u>885,349,783</u> |
| Deferred Outflows of Resources | | | |
| Deferred Payments to State | <u>4,406,566,813</u> | <u>0</u> | <u>4,406,566,813</u> |
| Liabilities | | | |
| Accounts Payable | 2,340 | 0 | 2,340 |
| Accrued Interest Payable | 0 | 27,914,008 | 27,914,008 |
| Bonds Payable, Net of Net Discount | | | |
| Due Within One Year | 0 | 35,000,000 | 35,000,000 |
| Due in More Than One Year | 0 | 5,526,795,212 | 5,526,795,212 |
| <i>Total Liabilities</i> | <u>2,340</u> | <u>5,589,709,220</u> | <u>5,589,711,560</u> |
| Deferred Inflows of Resources | | | |
| Unavailable Revenue | <u>431,098,955</u> | <u>(431,098,955)</u> | <u>0</u> |
| Fund Balance | | | |
| Restricted For Debt Service | 4,860,348,713 | (4,860,348,713) | 0 |
| Assigned | 466,588 | (466,588) | 0 |
| Net Position | | | |
| Unrestricted | <u>0</u> | <u>(297,794,964)</u> | <u>(297,794,964)</u> |
| <i>Total Fund Balance/Net Position</i> | <u>4,860,815,301</u> | <u>(5,158,610,265)</u> | <u>(297,794,964)</u> |
| <i>Total Liabilities, Deferred Inflows of Resources and Fund Balance/Net Position</i> | <u>\$ 5,291,916,596</u> | <u>\$ 0</u> | <u>\$ 5,291,916,596</u> |

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

Buckeye Tobacco Settlement Financing Authority
Franklin County, Ohio
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Statement of Governmental Fund Revenues, Expenditures and Changes In
Fund Balances/Statement of Activities

For the Fiscal Year Ended June 30, 2015

| | Governmental Bond Service Fund | Reconciliation (See Note 8) | Government- Wide Statement of Activities |
|--|---|--|---|
| General Revenues | | | |
| Tobacco Settlement | \$ 285,821,819 | \$ 36,970,715 | \$ 322,792,534 |
| Interest | 1,091,939 | 0 | 1,091,939 |
| <i>Total General Revenues</i> | <u>286,913,758</u> | <u>36,970,715</u> | <u>323,884,473</u> |
| Expenditures/Expenses | | | |
| General Government | 164,442 | 0 | 164,442 |
| Debt Service | | | |
| Principal | 26,640,000 | (26,640,000) | 0 |
| Interest | 295,691,044 | 41,099,746 | 336,790,790 |
| Amortization of Deferred Payments to State | 71,821,339 | 0 | 71,821,339 |
| <i>Total Expenditures/Expenses</i> | <u>394,316,825</u> | <u>14,459,746</u> | <u>408,776,571</u> |
| <i>Net Change in Fund Balance/Net Position</i> | (107,403,067) | 22,510,969 | (84,892,098) |
| <i>Fund Balance/Net Position, Beginning of Year,</i> | <u>4,968,218,368</u> | <u>(5,181,121,234)</u> | <u>(212,902,866)</u> |
| <i>Fund Balance/Net Position, End of Year</i> | <u><u>\$ 4,860,815,301</u></u> | <u><u>\$ (5,158,610,265)</u></u> | <u><u>\$ (297,794,964)</u></u> |

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

Buckeye Tobacco Settlement Financing Authority
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Notes to the Basic Financial Statements
June 30, 2015

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 (modified accrual basis) for fiscal year 2015 were \$286,749,316. This amount consists of the total general revenues of \$286,913,758 less general government expenditures of \$164,442. Annual principal and interest payments on the bonds will require 100% of the net TSR’s. Total principal and interest paid for fiscal year 2015 was \$322,331,044. As of June 30, 2015, the total principal and interest remaining to be paid on the bonds was \$17,546,335,769.

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(A Component Unit of the State of Ohio)

Notes to the Basic Financial Statements
June 30, 2015

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.

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 position and the statement of activities) do not provide information by fund. Specifically, the statement of net position includes non-current liabilities, which are not included in the fund statements. Tobacco Settlement Receipts ("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.

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As permitted by GASB Statement No. 34 the Authority's financial statements include separate Statement of Net Position 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.

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 position 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 as 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

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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;
- 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 Trust Indenture contains these investment restrictions. Interest revenue represents interest received during the fiscal year, offset by the change in fair market value of investments and the net change in interest receivable (earned in June but paid in July).

Tobacco Settlement Receivable

Tobacco Settlement Receivable is calculated based on the subsequent year's estimated amount of the 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 (See Note 6). This amount is adjusted downward based upon an estimated historical adjustment rate of actual collections as compared to these payments (prior 5-year average). For the year ending June 30, 2015 this rate was 14.579%. Only 50% of the amount is reported as a receivable, which represents receipts estimated for the period of January 1 through June 30.

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Restricted Assets

The bond Trust 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 Inflows of Resources and Deferred Outflows of Resources

A deferred inflow of resources is an acquisition of assets by the Authority that is applicable to a future reporting period. A deferred outflow of resources is a consumption of assets by the Authority that is applicable to a future reporting period.

Tobacco Settlement Receipts received or recognized before the eligibility requirements are met and are recorded as deferred inflows of resources in governmental funds. On governmental fund financial statements, receivables that will not be collected within the available period have been reported as a deferred inflow of resources.

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 and reported as a deferred outflow of resources on the financial statements.

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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 Position. 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 Trust 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, 2015.

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, 2015.

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| | | Investments | | | | | | |
|----------------------------|------------------------------------|---------------|---------------|---------------|--------------------|---------------|----------------------|-----------------------|
| | | S&P | Moody's | Fitch | Fair | % of | Maturity | |
| | | <u>Rating</u> | <u>Rating</u> | <u>Rating</u> | <u>Value</u> | <u>Total</u> | <u>< 3 months</u> | <u>3-9 months</u> |
| <u>Money Market Funds:</u> | | | | | | | | |
| | Morgan Stanley Liq Prime Instl Fds | Not provided | Aaa-mf | Not provided | 843,075 | 0.2% | \$ 843,075 | \$ 0 |
| <u>Commercial Paper:</u> | | | | | | | | |
| | Abbey National Na LLC | A-1 | P-1 | F1 | 83,615,163 | 18.4% | 0 | 83,615,163 |
| | Credit Agricole Crpin | A-1 | P-1 | F1 | 79,871,200 | 17.6% | 0 | 79,871,200 |
| | JP Morgan Securities | A-1 | P-1 | F1+ | 31,189,704 | 6.9% | 0 | 31,189,704 |
| | Ing US Funding LLC | A-1 | P-1 | Not Rated | 43,230,287 | 9.5% | 0 | 43,230,287 |
| | USB Na-Conv- Mo | A-1+ | P-1 | F1+ | 149,582,182 | 32.9% | 0 | 149,582,182 |
| | Natixix NY C P | A-1 | P-1 | F1 | 65,893,740 | 14.5% | 0 | 65,893,740 |
| <u>Total Investments</u> | | | | | <u>454,225,351</u> | <u>100.0%</u> | <u>\$ 843,075</u> | <u>\$ 453,382,276</u> |

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 Trust 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 Na 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 Na 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, 2015, 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 Trust Indenture limits investments in Commercial Paper to those rated at least "A-1" by S&P, "P-1" by Moody's, and "F1" by Fitch (if rated by Fitch). 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.

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4. Restricted Assets

As of June 30, 2015, the Authority had restricted cash/cash equivalent and investment balances in the following accounts:

| | |
|-----------------------------|-----------------------|
| Collection Account | \$ 325 |
| Senior Debt Service Account | 111,149,490 |
| Liquidity Reserve Account | 342,606,639 |
| | <u>\$ 453,756,454</u> |

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 a Trust Indenture between the Authority and U.S. Bank National Association, as trustee, dated as of October 1, 2007 (the "Trust 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 Trust 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.

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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 Trust Indenture. However, failure to pay sinking fund installments or turbo redemptions on the senior bonds will not constitute an event of default under the Trust Indenture unless collections are sufficient and available therefor.

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 |
| 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. Converted December 1, 2012. | 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. | <u>128,182,923</u> |
| Total Bonds Issued | <u>\$ 5,531,594,541</u> |

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Interest on the Series 2007A-1, Series 2007A-2, and Series 2007A-3 Bonds is payable semiannually on each June 1 and December 1. 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 2007B and 2007C) represent bonds that were issued at stated interest rates significantly below their effective interest rates, resulting in a substantial discount. The Series 2007A-3 Senior Convertible Capital Appreciation Turbo Term Bonds converted to fixed rate current interest turbo term bonds, with a final maturity date of June 1, 2037, on December 1, 2012; therefore, they do not appear below. The implicit interest, i.e., discount (unaccreted appreciation), is not paid until the bonds begin to mature. Therefore, the net value of the bonds "accreted" each year.

| | June 30, 2015 Accreted Book Value | Ultimate Maturity Value | Maturity/ Conversion Date |
|--|---|-------------------------------|---------------------------------|
| Series 2007B First Subordinate Capital Appreciate Turbo Term Bonds | \$ 328,364,730 | \$ 3,207,000,000 | June 1, 2047 |
| Series 2007C Second Subordinate Capital Appreciate Turbo Term Bonds | 224,140,707 | 3,417,300,000 | June 1, 2052 |

Changes in bonds payable during the year ended June 30, 2015 were as follows:

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| | Serial Bonds | Term Bonds | Capital Appreciation Term Bonds | Total |
|--|----------------------|-------------------------|---------------------------------------|-------------------------|
| Balance, July 1, 2014 | \$ 101,188,608 | \$ 4,932,234,290 | \$ 514,037,712 | \$ 5,547,460,610 |
| Add: | | | | |
| Amortization of Discount | 0 | 3,419,923 | 0 | 3,419,923 |
| Accretion of Discount on Capital Appreciation Bonds | 0 | 0 | 38,467,725 | 38,467,725 |
| Less: | | | | |
| Amortization of Premium | (221,440) | (691,606) | 0 | (913,046) |
| Principal Payments | (26,640,000) | 0 | 0 | (26,640,000) |
| Balance, June 30, 2015 | <u>\$ 74,327,168</u> | <u>\$ 4,934,962,607</u> | <u>\$ 552,505,437</u> | <u>\$ 5,561,795,212</u> |

The bonds are subject to the following debt service to maturity requirements; however the years shown for Turbo Term Bonds represent the Turbo Redemption Dates beginning with fiscal year 2016. Amounts reported for fiscal year 2016 include the balances of unpaid Turbo Term Bonds sinking fund installments that had Redemption Dates of 2012-2015 (\$100,960,000) and the scheduled Turbo Term Bond sinking fund installment for 2016 (\$29,165,000).

| Fiscal Year | Serial Bond Maturities | | Turbo Term Bonds Class A-2 Sinking Fund Requirements | |
|-------------|------------------------|---------------------|---|-------------------------|
| | Principal | Interest | Principal | Interest |
| 2016 | \$ 35,000,000 | \$ 3,699,750 | \$ 130,125,000 | \$ 267,171,794 |
| 2017 | 38,995,000 | 1,949,750 | 32,495,000 | 260,446,250 |
| 2018 | 0 | 0 | 96,600,000 | 258,766,744 |
| 2019 | 0 | 0 | 106,240,000 | 253,773,981 |
| 2020 | 0 | 0 | 115,100,000 | 248,282,969 |
| 2021-2025 | 0 | 0 | 646,450,000 | 1,143,874,994 |
| 2026-2030 | 0 | 0 | 579,900,000 | 974,578,031 |
| 2031-2035 | 0 | 0 | 505,200,000 | 800,086,744 |
| 2036-2040 | 0 | 0 | 557,005,000 | 692,569,700 |
| 2041-2045 | 0 | 0 | 1,216,505,000 | 420,442,513 |
| 2046-2050 | 0 | 0 | 610,205,000 | 56,247,550 |
| 2051-2052 | 0 | 0 | 0 | 0 |
| Total | <u>\$ 73,995,000</u> | <u>\$ 5,649,500</u> | <u>\$ 4,595,825,000</u> | <u>\$ 5,376,241,269</u> |

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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 2015, the Authority received \$285,800,505 (excludes amounts released from disputed payment accounts in connection with prior fiscal year deposits into those accounts), which is \$110,369,754 or 27.9 percent less than the base and strategic contribution fund payments estimated at the time of the Series 2007 Bond issuance for fiscal year 2015. As of June 30, 2015, the estimated tobacco settlement receivable included \$259,788,694 for payments withheld from the Authority in fiscal years 2008 through 2015 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.

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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 | Strategic | | |
|-----------------|--------------------------|----------------------|--------------------------|
| Ending | Base | Contribution | Total |
| Payments | Fund | Payments | Payments |
| 2016 | \$ 376,306,539 | \$ 24,790,908 | \$ 401,097,447 |
| 2017 | 380,939,909 | 25,096,152 | 406,036,061 |
| 2018 | 431,324,517 | 0 | 431,324,517 |
| 2019 | 436,331,279 | 0 | 436,331,279 |
| 2020 | 441,188,642 | 0 | 441,188,642 |
| 2021-2025 | 2,287,979,837 | 0 | 2,287,979,837 |
| 2026-2030 | 2,440,318,177 | 0 | 2,440,318,177 |
| 2031-2035 | 2,607,356,008 | 0 | 2,607,356,008 |
| 2036-2040 | 2,777,330,243 | 0 | 2,777,330,243 |
| 2041-2045 | 2,956,977,661 | 0 | 2,956,977,661 |
| 2046-2050 | 3,146,926,287 | 0 | 3,146,926,287 |
| 2051-2052 | 1,316,176,402 | 0 | 1,316,176,402 |
| Total | <u>\$ 19,599,155,501</u> | <u>\$ 49,887,060</u> | <u>\$ 19,649,042,561</u> |

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 Trust Indenture and amounts established and held in accordance with the Trust 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

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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 Position

| | | |
|----------------------------------|----|---------------|
| Total Governmental Fund Balances | \$ | 4,860,815,301 |
|----------------------------------|----|---------------|

Net Position of Governmental Activities is different because:

Some of the Authority's assets are not available to pay for current period expenditures, and therefore, are reported as deferred inflows of resources:

| | | |
|----------------------------|--|-------------|
| Tobacco Settlement Revenue | | 431,098,955 |
|----------------------------|--|-------------|

Long term liabilities and related accounts are not due and payable in the current period and therefore are not reported in the governmental funds:

| | | | |
|--------------------------------|----|-----------------|-----------------|
| Accrued Interest Payable | \$ | (27,914,008) | |
| Bonds Payable, Net of Discount | | (5,561,795,212) | (5,589,709,220) |

| | | |
|---|----|---------------|
| Net Position of Governmental Activities | \$ | (297,794,964) |
|---|----|---------------|

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

| | | |
|---|----|---------------|
| Net Change in Fund Balance - Total Governmental Funds | \$ | (107,403,067) |
|---|----|---------------|

The change in net position of governmental activities is different because:

Some of the Authority's revenues in the statement of activities do not provide current financial resources: therefore they are not reported as revenues in the funds.

| | | |
|----------------------------|--|------------|
| Tobacco Settlement Revenue | | 36,970,715 |
|----------------------------|--|------------|

The issuance of long-term debt (e.g. bonds) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes current financial resources of governmental funds.

| | | |
|--|--|------------|
| | | 26,640,000 |
|--|--|------------|

Governmental funds report the effect of long-term debt premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities:

| | | | |
|---|----|--------------|--------------|
| Accrued Interest | \$ | (125,144) | |
| Amortization of Net Discount on Bonds | | (3,419,923) | |
| Amortization of Premium on Bonds | | 913,046 | |
| Accretion of Capital Appreciation Bonds | | (38,467,725) | (41,099,746) |
| | | | |

| | | |
|---|----|--------------|
| Change in Net Position of Governmental Activities | \$ | (84,892,098) |
|---|----|--------------|

9. Change in Accounting Principle

For the fiscal year ended June 30, 2015, the Authority has implemented Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*, GASB Statement No. 69, *Government Combinations and Disposals of Government Operations* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - An Amendment of GASB Statement No. 68*.

GASB Statement No. 68 requires recognition of the entire net pension liability and a more comprehensive measure of pension expense for defined benefit pensions and defined contribution pensions provided to the employees of state and local governmental employers through pension plans that are administered through trusts or equivalent arrangements. The implementation of GASB Statement No. 68 did not have an effect on the financial statements of the Authority.

GASB Statement No. 69 addresses accounting and financial reporting for government combinations (including mergers, acquisitions and transfers of operations) and disposals of government operations. The

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implementation of GASB Statement No. 69 did not have an effect on the financial statements of the Authority.

GASB Statement No. 71 amends paragraph 137 of GASB Statement No. 68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. The provisions of this Statement are required to be applied simultaneously with the provisions of Statement 68. The implementation of GASB Statement No. 71 did not have an effect on the financial statements of the Authority.

10. Subsequent Event

On July 7, 2015 Moody's issued a ratings change for the following Bonds:

| <u>Series</u> | <u>CUSIP</u> | <u>Maturity</u> | <u>Moody's Ratings</u> | |
|---------------|--------------|-----------------|------------------------|------------|
| | | | <u>Previous</u> | <u>New</u> |
| 2007A-1-11 | 118217AL2 | 6/1/2016 | Aa1 | Aaa |
| 2007A-1-12 | 118217AM0 | 6/1/2017 | A1 | Aa1 |
| 2007A-2-1 | 118217AN8 | 6/1/2024 | B3 | Caa1 |
| 2007A-2-2 | 118217AP3 | 6/1/2024 | B3 | Caa1 |
| 2007A-2-3 | 118217AQ1 | 6/1/2030 | B3 | Caa1 |
| 2007A-2-4 | 118217AR9 | 6/1/2034 | B3 | Caa1 |
| 2007-A-3 | 118217AV0 | 6/1/2037 | B3 | Caa1 |

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Dave Yost • Auditor of State

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

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

To the Authority:

We have audited, in accordance with auditing standards generally accepted in the United States and the Comptroller General of the United States' *Government Auditing Standards*, the financial statements of the governmental activities and Debt Service Fund of the Buckeye Tobacco Settlement Financing Authority, (the Authority), a blended component unit of the State of Ohio, as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements and have issued our report thereon dated October 6, 2015.

Internal Control Over Financial Reporting

As part of our financial statement audit, we considered the Authority's internal control over financial reporting (internal control) to determine the audit procedures appropriate in the circumstances to the extent necessary to support our opinion on the financial statements, but not to the extent necessary to opine on the effectiveness of the Authority's internal control. Accordingly, we have not opined on it.

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 a combination of internal control deficiencies resulting in a reasonable possibility that internal control will not prevent or detect and timely correct a material misstatement of the Authority's financial statements. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all internal control deficiencies that might be material weaknesses or significant deficiencies. Given these limitations, we did not identify any deficiencies in internal control that we consider material weaknesses. However, unidentified material weaknesses may exist.

Compliance and Other Matters

As part of reasonably assuring whether the Foundation'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, opining 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*.

Purpose of this Report

This report only describes the scope of our internal control and compliance testing and our testing results, and does not opine on the effectiveness of the Authority's internal control or on compliance. This report is an integral part of an audit performed under *Government Auditing Standards* in considering the Authority's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "Dave Yost". The signature is written in a cursive style with a large, looping initial "D".

Dave Yost
Auditor of State
Columbus, Ohio

October 6, 2015



Dave Yost • Auditor of State

OHIO BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY

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, 2015**