



TSASC, INC.

A COMPONENT UNIT OF THE CITY OF NEW YORK

Financial Statements
(Together with Independent Auditors' Report)

Years Ended June 30, 2012 and 2011

TSASC, INC.
FINANCIAL STATEMENTS
(Together with Independent Auditors' Report)
YEARS ENDED JUNE 30, 2012 AND 2011

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
TSASC, Inc.

We have audited the accompanying financial statements of the governmental activities of TSASC, Inc. ("TSASC"), a component unit of The City of New York, as of and for the years ended June 30, 2012 and 2011, as listed in the table of contents. These financial statements are the responsibility of TSASC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities of TSASC, Inc. as of June 30, 2012 and 2011 and the respective changes in financial position thereof for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis information on pages 2 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Marks Paneth & Shron LLP

New York, NY
September 27, 2012

TSASC, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2012 AND 2011

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is a narrative overview and analysis of the financial activities of TSASC, Inc. ("TSASC") for the fiscal years ended June 30, 2012 and 2011. It should be read in conjunction with TSASC's government-wide financial statements, governmental funds financial statements and the notes to the financial statements. The financial statements consist of four parts: (1) management's discussion and analysis (this section); (2) the government-wide financial statements, (3) the governmental funds financial statements; and (4) the notes to the financial statements.

The government-wide financial statements, which include the statements of net assets (deficit) and the statements of activities, are presented to display information about the reporting entity as a whole, in accordance with Governmental Accounting Standards Board ("GASB") standards. This is to provide the reader with a broad overview of TSASC's finances. The government-wide financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Accordingly, revenue is recognized when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows.

TSASC's governmental funds financial statements are presented using the current financial resources measurement focus and the modified accrual basis of accounting, in which revenue is recognized when it becomes susceptible to accrual; that is, when it becomes both measurable and available to finance expenditures in the current fiscal period. As such, revenues are considered available if received within two months after the fiscal year end. Expenditures are recognized when the related liability is incurred, except for interest on bonds payable, which is recognized when due.

The reconciliations of the governmental funds balance sheets to the statements of net assets (deficit) and the reconciliations of the governmental funds statements of revenues, expenditures and changes in fund balances to the statements of activities are presented to assist the reader in understanding the differences between government-wide and fund financial statements.

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS – GOVERNMENT-WIDE FINANCIAL STATEMENTS

On February 8, 2006, TSASC issued \$1.35 billion of Series 2006-1 bonds, the proceeds of which were used to restructure all of TSASC's outstanding indebtedness. After the restructuring, 62.6% of TSASC's annual collection of Tobacco Settlement Revenues ("TSR") and the related interest earnings are transferred to the TSASC Tobacco Settlement Trust (the "Trust"), as owner of the Residual Certificate. The City of New York (The "City") is the beneficial owner of the Trust and the funds received by the Trust, net of the Trust's expenses, are transferred to The City. During fiscal years 2012 and 2011, the Trust transferred to The City \$117.2 million and \$114.9 million, respectively.

The Amended and Restated Indenture dated January 1, 2006, (the "Indenture") provides that a defined portion of the TSRs and other revenues (collectively, "Collections") are applied to the payment of the Series 2006-1 debt service. The proportion of Collections pledged to the payment of the Series 2006-1 debt service is currently 37.4% and is subject to reduction at June 1, 2024, and at each June 1st thereafter, depending on the magnitude of cumulative bond redemptions under the Series 2006-1 bond turbo redemption feature. The turbo redemption feature requires all the pledged Collections, after funding of operating costs, be applied to the payment of principal and interest on the Series 2006-1 bonds.

The Master Settlement Agreement ("MSA"), dated November 23, 1998, is an industry-wide settlement of litigation between participating cigarette manufacturers and 46 States (the "Settling States"), including the State of New York (the "State"). The MSA governs the amount of TSRs received by TSASC, which is 3.4% of total TSRs paid by the participating cigarette manufacturers.

TSASC, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
JUNE 30, 2012 AND 2011

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS – GOVERNMENT-WIDE FINANCIAL STATEMENTS (continued)

The following summarizes the activities of TSASC for the years ended June 30,

	2012	Restated	2010	Variance	
		2011		2012/2011	2011/2010
	-----in thousands-----			-----in thousands-----	
Revenues:					
Tobacco settlement revenue	\$ 183,168	\$ 184,531	\$ 185,580	\$ (1,363)	\$ (1,049)
Investment earnings	1,875	685	89	1,190	596
Total revenues	185,043	185,216	185,669	(173)	(453)
Expenses:					
Transfer to Trust	114,667	115,520	121,192	(853)	(5,672)
Interest expense	64,533	64,786	65,171	(253)	(385)
Other	5,824	6,224	6,202	(400)	22
Total expenses	185,024	186,530	192,565	(1,506)	(6,035)
Change in net assets	19	(1,314)	(6,896)	1,333	5,582
Net deficit, beginning of year	(1,074,181)	(1,024,665)	(1,017,769)	(49,516)	(6,896)
Restatement of beginning net deficit	-	(48,202)	-	48,202	(48,202)
Net deficit, end of year	\$ (1,074,162)	\$ (1,074,181)	\$ (1,024,665)	\$ 19	\$ (49,516)

Tobacco Settlement Revenues received during the fiscal year are based upon tobacco sales of the previous calendar year; adjusted by factors such as inflation, volume, and disputed amounts deposited by the participating cigarette manufacturers into a MSA disputed escrow account. TSASC earned TSRs of approximately \$183.2 million, \$184.5 million, and \$185.6 million in fiscal years 2012, 2011, and 2010, respectively. TSRs decreased by approximately \$1.4 million in fiscal year 2012 compared to fiscal year 2011, and decreased by approximately \$1.0 million in fiscal year 2011 compared to fiscal year 2010. The variances in TSRs from one year to another are caused by fluctuations in tobacco sales and cigarette manufactures depositing funds into the MSA disputed escrow account.

Investment earnings increased in fiscal year 2012 when compared to fiscal year 2011 by approximately \$1.2 million and increased by approximately \$596 thousand in fiscal year 2011 compared to fiscal year 2010 primarily because of fluctuations of interest rates on long-term investments held in TSASC's debt service reserve account.

Transfers to the Trust decreased in fiscal years 2012 and 2011 primarily because of the decrease in TSRs, as previously discussed. Interest expense decreased in fiscal years 2012 and 2011 because the declining amount of bond principal outstanding resulted in reduced bond interest costs each year. Other expenses are composed primarily of the amortization of deferred bond refunding costs and the costs of issuance relating to the fiscal year 2006 restructuring of debt.

The restatement of beginning net deficit in fiscal year 2011 was made to recognize accrued TSR payments due to the Trust, as discussed in Note 2.

TSASC, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
JUNE 30, 2012 AND 2011

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS – GOVERNMENT-WIDE FINANCIAL STATEMENTS (continued)

The following summarizes TSASC's assets, liabilities, and net deficit as of June 30,

	2012	Restated 2011	2010	Variance	
	-----in thousands-----			2012/2011	2011/2010
				-----in thousands-----	
Assets:					
Total assets - non-capital	\$ 201,063	\$ 204,835	\$ 204,077	\$ (3,772)	\$ 758
Liabilities:					
Current liabilities	5,259	5,296	5,290	(37)	6
Long-term liabilities:					
Bonds payable	1,252,750	1,260,290	1,265,305	(7,540)	(5,015)
Other	17,216	13,430	(41,853)	3,786	55,283
Total liabilities	1,275,225	1,279,016	1,228,742	(3,791)	50,274
Net assets (deficit):					
Unrestricted	(1,074,162)	(1,074,181)	(1,024,665)	19	(49,516)
Net deficit, end of year	<u>\$ (1,074,162)</u>	<u>\$ (1,074,181)</u>	<u>\$ (1,024,665)</u>	<u>\$ 19</u>	<u>\$ (49,516)</u>

TSASC's total assets for the fiscal years 2012, 2011, and 2010 primarily consisted of investments restricted for debt service and of TSRs due to TSASC as of June 30, 2012. The decrease in total assets in fiscal year 2012 was due to the reduction of estimated TSRs receivable, which is based on decreased current year TSRs collections.

Bonds payable decreased by \$7.5 million in fiscal year 2012 and \$5.0 million in fiscal year 2011 due to the turbo redemption of the Series 2006-1 bonds during fiscal years 2012 and 2011. Other liabilities are the remaining unamortized bond discount, TSRs payable to the Trust, and deferred bond refunding costs related to the issuance of the Series 2006-1 bonds. The \$55.2 million difference in other liabilities in fiscal year 2011 when compared to fiscal year 2010 is primarily due to the recognition of accrued TSRs payable to the Trust of \$48.2 million, for which a restatement of the fiscal year 2011 beginning net deficit was made (see Note 2). Fiscal year 2010 was not restated.

The net deficits are due to the issuance of the Series 2006-1 bonds. These bonds will be paid from future TSRs, with the final maturity occurring in fiscal year 2042.

TSASC, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
JUNE 30, 2012 AND 2011

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS - GOVERNMENTAL FUNDS FINANCIAL STATEMENTS

TSASC reports governmental activity using two funds: (1) a general fund ("GF") and (2) a debt service fund ("DSF"). In fiscal year 2011, TSASC implemented Governmental Accounting Standards Board Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* ("GASB 54"). GASB 54 resulted in the creation of a general fund and the restatement of those activities that were formerly presented in the debt service fund and now reported in a general fund. As such, TSASC accounts for its transfers to the Trust and operating expenditures, and the portion of the TSRs revenue used to pay for those activities in accordance with the Indenture, in the GF.

The following summarizes the changes in the GF for the years ended June 30,

	2012	2011	2010	2012/2011	2011/2010
	-----in thousands-----			-----in thousands-----	
Revenues:					
Tobacco settlement revenue	\$ 117,641	\$ 115,524	\$ 121,700	\$ 2,117	\$ (6,176)
Investment earnings	5	5	11	-	(6)
Total revenues	<u>117,646</u>	<u>115,529</u>	<u>121,711</u>	<u>2,117</u>	<u>(6,182)</u>
Expenditures:					
Transfer to Trust	117,171	114,894	121,192	2,277	(6,298)
Other	477	715	503	(238)	212
Total expenditures	<u>117,648</u>	<u>115,609</u>	<u>121,695</u>	<u>2,039</u>	<u>(6,086)</u>
Change in fund balance	(2)	(80)	16	78	(96)
Fund balances, beginning of year	<u>735</u>	<u>815</u>	<u>799</u>	<u>(80)</u>	<u>16</u>
Fund balances, end of year	<u>\$ 733</u>	<u>\$ 735</u>	<u>\$ 815</u>	<u>\$ (2)</u>	<u>\$ (80)</u>

TSRs revenues for the GF fluctuate each year, as the amount recorded in the GF is primarily composed of TSRs collected and estimated as receivable at year end, as previously discussed. As the majority of TSRs recorded in the GF belongs to the Trust and are also recorded as expenditures, there is very little net impact on the GF fund balance.

The remaining TSRs not transferred are used for operations and fluctuate slightly. However, in fiscal year 2011 a notable increase of \$212 thousand in other expenditures was primarily due to an arbitrage rebate payment to the United States Treasury.

TSASC, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
JUNE 30, 2012 AND 2011

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS - GOVERNMENTAL FUNDS FINANCIAL STATEMENTS (continued)

The following summarizes the changes in TSASC's DSF for the years ended June 30,

	2012	2011	2010	Variance	
				2012/2011	2011/2010
	-----in thousands-----				
Revenues:					
Tobacco settlement revenue	\$ 69,527	\$ 68,007	\$ 71,880	\$ 1,520	\$ (3,873)
Investment earnings	1,870	680	78	1,190	602
Total revenues	71,397	68,687	71,958	2,710	(3,271)
Expenditures:					
Interest expenditure	63,236	63,474	63,870	(238)	(396)
Principal amount of bonds retired	7,540	5,015	8,385	2,525	(3,370)
Total expenditures	70,776	68,489	72,255	2,287	(3,766)
Change in fund balance	621	198	(297)	423	495
Fund balance, beginning of year	117,264	117,066	117,363	198	(297)
Fund balance, end of year	\$ 117,885	\$ 117,264	\$ 117,066	\$ 621	\$ 198

TSRs recorded in the DSF for fiscal years 2012, 2011 and 2010 were based on the amount collected and available to pay debt service obligations, pursuant to the Indenture. Investment earnings increased in fiscal year 2011 due primarily to sales of investments. Interest expenditures were lower in fiscal year 2012 and 2011 because the declining amount of bond principal outstanding resulted in reduced bond interest costs each year. Principal payments on bonds are based on the turbo redemption (see Note 1) terms of the Indenture.

The following summarizes GF assets, liabilities, and fund balances as of June 30,

	2012	2011	2010	Variance	
				2012/2011	2011/2010
	-----in thousands-----				
Assets:					
Cash and cash equivalents and investments	\$ 584	\$ 593	\$ 647	\$ (9)	\$ (54)
Tobacco settlement revenue receivable	46,324	48,828	48,202	(2,504)	626
Prepaid expenditures	168	168	168	-	-
Total assets	\$ 47,076	\$ 49,589	\$ 49,017	\$ (2,513)	\$ 572
Liabilities:					
Deferred tobacco settlement revenue	\$ 46,324	\$ 48,828	\$ 48,202	\$ (2,504)	\$ 626
Other	19	26	-	(7)	26
Total liabilities	46,343	48,854	48,202	(2,511)	652
Fund Balance:					
Nonspendable prepaid expenditure	168	168	168	-	-
Unassigned	565	567	647	(2)	(80)
Total fund balance	733	735	815	(2)	(80)
Total liabilities and fund balance	\$ 47,076	\$ 49,589	\$ 49,017	\$ (2,513)	\$ 572

TSASC, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
JUNE 30, 2012 AND 2011

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS - GOVERNMENTAL FUNDS FINANCIAL STATEMENTS (continued)

The GF assets at June 30, 2012, 2011 and 2010, totaled approximately \$47.1 million, \$49.6 million, and \$49.0 million, respectively. The decrease in total assets in fiscal year 2012 was primarily due to the reduction of estimated TSRs receivable, which was based on decreased current year TSRs collections, as previously discussed. As the majority of the assets recorded in the GF are TSRs receivable belonging to the Trust, which are also recorded as a liability, there is little net impact on the GF fund balance.

Prepaid expenditures represent the value of prepaid insurance.

The following summarizes the DSF assets, liabilities, and fund balances as of June 30,

	2012	2011	2010	Variance	
				2012/2011	2011/2010
	-----in thousands-----			-----in thousands-----	
Assets:					
Cash and cash equivalents and investments	\$ 117,885	\$ 117,264	\$ 117,066	\$ 621	\$ 198
Tobacco settlement revenue receivable	27,676	29,172	28,798	(1,496)	374
Total assets	\$ 145,561	\$ 146,436	\$ 145,864	\$ (875)	\$ 572
Liabilities:					
Deferred tobacco settlement revenue	\$ 27,676	\$ 29,172	\$ 28,798	\$ (1,496)	\$ 374
Total liabilities	27,676	29,172	28,798	(1,496)	374
Fund Balance:					
Restricted for debt service	117,885	117,264	117,066	621	198
Total fund balance	117,885	117,264	117,066	621	198
Total liabilities and fund balance	\$ 145,561	\$ 146,436	\$ 145,864	\$ (875)	\$ 572

The fluctuations of assets and liabilities from year to year are primarily due to changes in TSRs receivable, as previously discussed.

In July 2011, Fitch Ratings ("Fitch") completed a review of tobacco settlement securitization entities based upon the 2011 MSA payments. As a result, Fitch downgraded several tobacco settlement bonds, including a portion of TSASC's debt. The 2022 term bond was affirmed at BBB+. However, the 2026 term bond was downgraded to BBB- and the 2034 and 2042 term bonds were downgraded to BB.

In January 2012, S&P downgraded TSASCs 2022 term bonds to BB+, 2026 term bond to B+, 2034 term bond to B, and 2042 term bond to B-. In August 2012, Fitch downgraded TSASC's 2022 term bonds to BBB, 2026 term bonds to BB-, and its 2034 and 2042 term bonds to B+.

This financial report is designed to provide a general overview of TSASC's finances. Questions concerning any of the information in this report or requests for additional financial information should be directed to Raymond Orlando, Manager of Investor Relations, TSASC, Inc., 255 Greenwich Street, New York, NY 10007.

**** END ****

TSASC, INC.
STATEMENTS OF NET ASSETS (DEFICIT)
AS OF JUNE 30, 2012 AND 2011

	2012	Restated 2011
	(in thousands)	
ASSETS:		
Restricted cash and cash equivalents	\$ 22	\$ 119
Unrestricted cash and cash equivalents	110	94
Restricted investments	117,863	117,145
Unrestricted investments	474	499
Tobacco settlement revenue receivable	74,000	78,000
Unamortized bond issuance costs	8,426	8,810
Prepaid expenses	168	168
	TOTAL ASSETS	204,835
	201,063	204,835
LIABILITIES:		
Accrued expenses	19	26
Accrued interest payable	5,240	5,270
Remittance payable to the Trust	46,324	48,828
Bonds payable	1,252,750	1,260,290
Unamortized bond discount	(29,108)	(30,435)
Unamortized deferred bond refunding costs	-	(4,963)
	TOTAL LIABILITIES	1,279,016
	1,275,225	1,279,016
NET ASSETS (DEFICIT):		
Unrestricted	(1,074,162)	(1,074,181)
	TOTAL DEFICIT	\$ (1,074,181)
	\$ (1,074,162)	\$ (1,074,181)

The accompanying notes are an integral part of these financial statements.

TSASC, INC.
STATEMENTS OF ACTIVITIES
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011

	2012	Restated 2011
	(in thousands)	
REVENUES:		
Tobacco settlement revenue:		
Tobacco settlement revenue - pledged	\$ 68,505	\$ 69,641
Tobacco settlement revenue - unpledged	114,663	114,890
Total tobacco settlement revenue	183,168	184,531
Investment earnings	1,875	685
TOTAL REVENUES	185,043	185,216
EXPENSES:		
Transfer to Trust	114,667	115,520
Interest expense	64,533	64,786
General and administrative expenses	477	715
Amortization of deferred bond refunding costs	4,963	5,124
Amortization of bond issuance costs	384	385
TOTAL EXPENSES	185,024	186,530
CHANGE IN DEFICIT	19	(1,314)
DEFICIT - beginning of year	(1,074,181)	(1,024,665)
Restatement of beginning net assets (Note 2)	-	(48,202)
DEFICIT - end of year	\$ (1,074,162)	\$ (1,074,181)

The accompanying notes are an integral part of these financial statements.

TSASC, INC.
GOVERNMENTAL FUNDS BALANCE SHEET
AS OF JUNE 30, 2012

	(in thousands)		
	General Fund	Debt Service Fund	Total Governmental Funds
ASSETS:			
Restricted cash and cash equivalents	\$ -	\$ 22	\$ 22
Unrestricted cash and cash equivalents	110	-	110
Restricted investments	-	117,863	117,863
Unrestricted investments	474	-	474
Tobacco settlement revenue receivable	46,324	27,676	74,000
Prepaid expenditure	168	-	168
	TOTAL ASSETS	\$ 145,561	\$ 192,637
LIABILITIES AND FUND BALANCE:			
LIABILITIES:			
Accounts payable	\$ 19	\$ -	\$ 19
Deferred tobacco settlement revenue	46,324	27,676	74,000
	TOTAL LIABILITIES	27,676	74,019
FUND BALANCE:			
Nonspendable: Prepaid insurance	168	-	168
Restricted for debt service	-	117,885	117,885
Unassigned	565	-	565
	TOTAL FUND BALANCE	117,885	118,618
	TOTAL LIABILITIES AND FUND BALANCE	\$ 145,561	\$ 192,637

The accompanying notes are an integral part of these financial statements.

TSASC, INC.
GOVERNMENTAL FUNDS BALANCE SHEET
AS OF JUNE 30, 2011

	(in thousands)		
	General Fund	Debt Service Fund	Total Governmental Funds
ASSETS:			
Restricted cash and cash equivalents	\$ -	\$ 119	\$ 119
Unrestricted cash and cash equivalents	94	-	94
Restricted investments	-	117,145	117,145
Unrestricted investments	499	-	499
Tobacco settlement revenue receivable	48,828	29,172	78,000
Prepaid expenditure	168	-	168
	TOTAL ASSETS	\$ 146,436	\$ 196,025
LIABILITIES AND FUND BALANCE:			
LIABILITIES:			
Accounts payable	\$ 26	\$ -	\$ 26
Deferred tobacco settlement revenue	48,828	29,172	78,000
	TOTAL LIABILITIES	29,172	78,026
FUND BALANCE:			
Nonspendable: Prepaid insurance	168	-	168
Restricted for debt service	-	117,264	117,264
Unassigned	567	-	567
	TOTAL FUND BALANCE	117,264	117,999
	TOTAL LIABILITIES AND FUND BALANCE	\$ 146,436	\$ 196,025

The accompanying notes are an integral part of these financial statements.

TSASC, INC.
RECONCILIATIONS OF GOVERNMENTAL FUNDS BALANCE SHEETS
TO THE STATEMENTS OF NET ASSETS (DEFICIT)
AS OF JUNE 30, 2012 AND 2011

	2012	Restated 2011
	(in thousands)	
Total fund balances - governmental funds	\$ 118,618	\$ 117,999
Amounts reported for governmental activities in the statements of net assets (deficit) are different because:		
Costs of bond issuance are reported as expenditures in the governmental funds financial statements upon issuance. However, in the statements of net assets (deficit) the costs of bond issuance are reported as capitalized assets and amortized over the life of the bonds.	8,426	8,810
Bond discounts are reported as other financing uses in the governmental fund financial statements upon issuance. However, in the statements of net assets (deficit), bond discounts are reported as a component of bonds payable and amortized over the life of the bonds.	29,108	30,435
Deferred tobacco settlement revenue accrued but not received within two months after year end is deferred in the governmental funds financial statements because it's not currently available; however it is recognized as revenue and not deferred in the statements of net assets (deficit).	74,000	78,000
Costs of bond refundings are reported as expenditures in the debt service fund financial statements. However, in the statements of net assets (deficit), those costs and the related gain or loss are deferred and amortized over the shorter of the remaining life of the old debt or the life of the new debt.	-	4,963
Some liabilities are not due and payable in the current period from financial resources available currently at year-end and are therefore not reported in the governmental funds financial statements, but are reported in the statements on net assets (deficit). Those liabilities consist of:		
Bonds payable	(1,252,750)	(1,260,290)
Accrued interest payable	(5,240)	(5,270)
Remittance payable to the Trust	(46,324)	(48,828)
	-	4,963
Net deficit of governmental activities	\$ (1,074,162)	\$ (1,074,181)

The accompanying notes are an integral part of these financial statements.

TSASC, INC.
GOVERNMENTAL FUNDS
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
FOR THE YEAR ENDED JUNE 30, 2012

	(in thousands)		
	General Fund	Debt Service Fund	Total Governmental Funds
REVENUES:			
Tobacco settlement revenue:			
Tobacco settlement revenue - pledged	\$ 474	\$ 69,527	\$ 70,001
Tobacco settlement revenue - unpledged	117,167	-	117,167
Total tobacco settlement revenue	117,641	69,527	187,168
Investment earnings	5	1,870	1,875
TOTAL REVENUES	117,646	71,397	189,043
EXPENDITURES:			
Transfer to Trust:			
Tobacco settlement revenue and interest earnings	117,171	-	117,171
Interest expenditure	-	63,236	63,236
Principal amount of bonds retired	-	7,540	7,540
General and administrative	477	-	477
TOTAL EXPENDITURES	117,648	70,776	188,424
Excess (deficiency) of expenditures over revenues	(2)	621	619
NET CHANGES IN FUND BALANCES	(2)	621	619
FUND BALANCES - beginning of year	735	117,264	117,999
FUND BALANCES - end of year	\$ 733	\$ 117,885	\$ 118,618

The accompanying notes are an integral part of these financial statements.

TSASC, INC.
GOVERNMENTAL FUNDS
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
FOR THE YEAR ENDED JUNE 30, 2011

	(in thousands)		
	General Fund	Debt Service Fund	Total Governmental Funds
REVENUES:			
Tobacco settlement revenue:			
Tobacco settlement revenue - pledged	\$ 634	\$ 68,007	\$ 68,641
Tobacco settlement revenue - unpledged	114,890	-	114,890
Total tobacco settlement revenue	<u>115,524</u>	<u>68,007</u>	<u>183,531</u>
Investment earnings	<u>5</u>	<u>680</u>	<u>685</u>
TOTAL REVENUES	<u>115,529</u>	<u>68,687</u>	<u>184,216</u>
EXPENDITURES:			
Transfer to Trust:			
Tobacco settlement revenue and interest earnings	114,894	-	114,894
Interest expenditure	-	63,474	63,474
Principal amount of bonds retired	-	5,015	5,015
General and administrative	<u>715</u>	<u>-</u>	<u>715</u>
TOTAL EXPENDITURES	<u>115,609</u>	<u>68,489</u>	<u>184,098</u>
Excess (deficiency) of expenditures over revenues	<u>(80)</u>	<u>198</u>	<u>118</u>
NET CHANGES IN FUND BALANCES	(80)	198	118
FUND BALANCES - beginning of year	<u>815</u>	<u>117,066</u>	<u>117,881</u>
FUND BALANCES - end of year	<u>\$ 735</u>	<u>\$ 117,264</u>	<u>\$ 117,999</u>

The accompanying notes are an integral part of these financial statements.

TSASC, INC.
**RECONCILIATIONS OF THE GOVERNMENTAL FUNDS STATEMENTS OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES TO THE STATEMENTS OF ACTIVITIES
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

	2012	Restated 2011
	(in thousands)	
Net change in fund balances - governmental funds	\$ 619	\$ 118
Amounts reported for governmental activities in the statements of activities are different because:		
Tobacco settlement revenue not available in the current period is deferred in governmental funds financial statements and included in revenue in the statements of activities.	(4,000)	1,000
Repayment of bond principal is an expenditure in the governmental funds financial statements, but the repayment reduces bonds payable on the statements of net assets (deficit).	7,540	5,015
The governmental funds report the cost of bond issuance and refunding bond issuance costs as expenditures upon issuance. However, on the statements of activities, the costs of bond issuance are amortized over the life of the bond.	(384)	(385)
The governmental funds report bond discounts as other financing uses upon issuance. However, on the statements of activities, bond discounts are amortized to interest expense over the life of the bond.	(1,327)	(1,331)
Costs of bond refundings are reported as expenditures in the debt service fund financial statements. However, in the statements of net assets (deficit), those costs and the related gain or loss are deferred and amortized over the shorter of the remaining life of the old debt or the life of the new debt on the statements of activities.	(4,963)	(5,124)
Interest is reported on the statement of activities on the accrual basis. However, interest is reported as an expenditure in the governmental funds financial statements when the outlay of financial	30	19
Transfer to the Trust is reported in the statement of activities on the accrual basis, but is reported only as an expenditure in the general fund when the payment is actually made.	2,504	(626)
Change in net assets (deficit) - governmental activities	\$ 19	\$ (1,314)

The accompanying notes are an integral part of these financial statements.

TSASC, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012 AND 2011

NOTE 1 – ORGANIZATION AND NATURE OF ACTIVITIES

TSASC, Inc. (“TSASC”) is a special purpose, local development corporation organized under the Not-For-Profit Corporation Law of the State of New York (the “State”). TSASC is an instrumentality of, but separate and apart from, The City of New York (“The City”). TSASC is governed by a Board of five directors, consisting of the following officials of The City: the Director of Management and Budget (who also serves as Chairperson), the Commissioner of Finance, the Corporation Counsel of The City, the Comptroller and the Speaker of the Council. Although legally separate from The City, TSASC is a component unit of The City and is included in The City’s financial statements as a blended component unit in accordance with Governmental Accounting Standards Board (“GASB”) standards.

Pursuant to a Purchase and Sale Agreement with The City, The City sold to TSASC all of its future right, title and interest in the Tobacco Settlement Revenues (“TSRs”) under the Master Settlement Agreement (“MSA”) and the Decree and Final Judgment (the “Decree”). The MSA resolved cigarette smoking-related litigation between the Settling States and the Participating Manufacturers (“PMs”), released the PMs from past and present smoking-related claims, and provided for a continuing release of future smoking-related claims, in exchange for certain payments to be made to the Settling States, as well as certain tobacco advertising and marketing restrictions, among other things. The Decree, which was entered by the Supreme Court of the State, allocated to The City a share of the TSRs under the MSA. The future right, title and interest of The City to the TSRs were sold to TSASC.

The purchase price of The City’s future right, title and interest in the TSRs was financed by the issuance of a series of bonds and the Residual Certificate. Prior to the restructuring of TSASC’s debt (discussed below) the Residual Certificate represented the entitlement to receive all TSRs after payment of debt service, operating expenses and certain other costs as set forth in the original bond indenture.

Under the Amended and Restated Indenture dated January 1, 2006 (the “Indenture”), the Residual Certificate represents the entitlement to receive all amounts in excess of specified percentages of TSRs and other revenues (collectively, “Collections”) used to fund debt service and operating expenses of TSASC. The Collections in excess of the specified percentages will be transferred to the TSASC Tobacco Settlement Trust (the “Trust”), as owner of the Residual Certificate and then to The City as the beneficial owner of the Trust. The Indenture allows transfers to the Trust after December 6, 2007.

The Indenture provides that a specified percentage of Collections are pledged (“Pledged”) and required to be applied to the payment of debt service and operating costs. The Pledged percentage is 37.4% and is subject to reduction on June 1, 2024, and at each June 1st thereafter, depending on the magnitude of cumulative bond redemptions under the turbo redemption feature (“turbo”) of the Series 2006-1 bonds. The turbo requires all Pledged Collections, after payment of operating costs, to be applied to payment of principal of and interest on the Series 2006-1 bonds.

TSASC does not have any employees; its affairs are administered by employees of The City and of another component unit of The City, for which TSASC pays a management fee, rent and overhead based on its allocated share of personnel and overhead costs.

TSASC, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
JUNE 30, 2012 AND 2011

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

- A. The government-wide financial statements of TSASC, which include the statements of net assets (deficit) and the statements of activities, are presented to display information about the reporting entity as a whole, in accordance with GASB standards. The government-wide financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

TSASC's governmental funds financial statements are presented using the current financial resources measurement focus and the modified accrual basis of accounting, in which revenue is recognized when it becomes susceptible to accrual; that is, when it becomes both measurable and available to finance expenditures in the current fiscal period. Expenditures are recognized when the related liability is incurred, except for interest on bonds payable, which is recognized when due.

TSASC uses two governmental funds for reporting its activities: a debt service fund ("DSF") and a general fund ("GF"). The DSF is used to account for the accumulation of resources for payment of principal and interest on debt and the GF is used to account for all financial resources not accounted for in the DSF, which are TSASC's unpledged TSRs due to The City, and administrative and operating expenditures. Fund balances are classified as either: 1) nonspendable, 2) restricted, 3) committed, 4) assigned, or 5) unassigned in accordance with GASB Statement 54.

The Board of Directors of TSASC (the "Board") constitutes TSASC's highest level of decision-making authority. When resolutions are adopted by the Board that constrain fund balances for a specific purpose, such resources are accounted for and reported as committed for such purpose; unless and until a subsequent resolution altering the commitment is adopted by the Board.

Fund balances which are constrained for use for a specific purpose, based on the direction of any officer of TSASC who is duly authorized under TSASC's bond indenture to direct the movement of such funds, are accounted for and reported as assigned for such purpose unless and until a subsequent authorized action by the same or another duly authorized officer, or by the Board, is taken which removes or changes the assignment.

When both restricted and unrestricted resources are available for use for a specific purpose, it is TSASC's policy to use restricted resources first then unrestricted resources as they are needed. When committed, assigned, or unassigned resources are available for use for a specific purpose, it is TSASC's policy to use committed resources first, then assigned resources, and then unassigned resources as they are needed.

- B. Investments, including accrued interest, are reported at fair value as of the reporting date.
- C. TSASC records TSRs receivable at June 30th. The TSRs receivable is expected to be received the following April and is based on an estimate of cigarette sales for the six month period from January 1 to June 30. As it is not expected to be received within two months of the fiscal year end, the revenue related to the TSRs receivable is deferred in the governmental funds financial statements. Per the Indenture, 62.6% of TSRs receivable is due to the Trust. As such a concurring payable is recorded in the government-wide financial statements.
- D. Bond premiums, discounts and issuance costs are capitalized and amortized over the life of the related debt using the interest method in the government-wide financial statements. The governmental funds financial statements recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

TSASC, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
JUNE 30, 2012 AND 2011

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

- E. Deferred bond refunding costs represent the accounting loss incurred in advance refunding of outstanding bonds in the government-wide financial statements. The deferred bond refunding costs are amortized over the shorter of the remaining life of the old debt or the life of the new debt. In the governmental funds financial statements, costs of the bond refundings are reported as expenditures when incurred.
- F. Interest expense is recognized on the accrual basis in the government-wide financial statements. Interest expenditures are recognized when due in the governmental funds financial statements.
- G. The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires TSASC's management to make estimates and assumptions in determining the reported amounts of assets and liabilities, as of the date of the financial statements and the amounts of revenues and expenditures/expenses during the reporting period. Actual results could differ from those estimates.
- H. As a component unit of The City, TSASC implements new GASB standards in the same fiscal year as they are implemented by The City. The following are discussions of the standards requiring implementation in the current year and standards which will or may impact TSASC in the future years.
- In November 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Agreements* ("GASB 60"). GASB 60 establishes the financial reporting for service concession agreements, which are a type of public-private or public-public partnership. GASB 60 is effective for financial statement periods beginning after December 15, 2011. As TSASC has not entered into any service concession agreements, GASB 60 is not expected to have an impact on TSASC's financial statements.
 - In November 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus – An Amendment of GASB Statements No. 14 and No. 34* ("GASB 61"). GASB 61 amends existing standards relating to the composition and reporting of the governmental financial reporting entity. GASB 61 is effective for financial statement periods beginning after June 15, 2012, but is not expected to have an impact on TSASC or its status as a blended component unit of The City.
 - In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 GASB and AICPA Pronouncements* ("GASB 62"). GASB 62 incorporates a large volume of FASB and AICPA accounting pronouncements into the GASB hierarchy of generally accepted accounting principles for US state and local governments. GASB 62 is effective for financial statement periods beginning after December 15, 2011. TSASC has not completed the process of evaluating GASB 62, but does not expect it to have an impact on its financial statements.
 - In June 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* ("GASB 63"). GASB 63 establishes new reporting requirements of two elements (deferred outflows of resources and deferred inflows of resources) and renames the Statement of Net Assets to Statement of Net Position, as well as reported Net Assets, and components thereof, to Net Position. GASB 63 is effective for financial statements for periods beginning after December 15, 2011. TSASC has not completed the process of evaluating GASB 63, but it is expected to change only the formatting and renaming of TSASC's financial statements to Net Position and components thereof, with no overall financial impact.

TSASC, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
JUNE 30, 2012 AND 2011

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

- In June 2011, GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provision* (“GASB 64”). GASB 64 clarifies the existing requirements for the termination of hedge accounting upon default or termination of a swap counterparty or swap counterparty’s credit support provider. GASB 64 is effective for financial statements for periods beginning after June 15, 2011. As TSASC has not entered into any such agreements, GASB 64 does not have an impact on its financial statements.
 - In March 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities* (“GASB 65”). GASB 65 establishes accounting and reporting standards that reclassify certain items that are currently reported as assets and liabilities to deferred outflows of resources or deferred inflows of resources and recognize certain items currently being reported as assets and liabilities as outflows and inflow of resources. In addition, it limits the use of the term deferred in the financial statement presentation. The provisions of GASB 65 are effective for financial statement for periods beginning after December 15, 2012. TSASC has not completed the process of evaluating GASB 65, but it expects to change its accounting on how debt issuance cost is recognized and reported in the government-wide financial statements in that the carrying value of cost of issuance will not be reported on the statement of net assets, resulting in a restatement of beginning net assets upon implementation.
 - In March 2012, GASB issued Statement No. 66, *Technical Corrections-2012 an amendment of GASB Statements No. 10 and No. 62* (“GASB 66”). GASB 66 resolves conflicting accounting and reporting guidance that resulted from the issuance of two pronouncements, Statement No. 54 *Fund Balance Reporting and Governmental Fund Type Definitions*, and Statement No. 62 *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The provisions of GASB 66 are effective for financial statements period beginning after December 15, 2012. TSASC has not completed the process of evaluating GASB 66, but does not expect it to have an impact on its financial statements.
 - In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans* (“GASB 67”). Although TSASC has not completed the process of evaluating GASB 67, it does not expect GASB 67 to have an impact as the Statement relates to pension plans.
 - In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions* (“GASB 68”). GASB 68 establishes standards of accounting and financial reporting for defined benefit pensions and defined contribution pensions provided to the employees of state and local governmental employers. The requirements of GASB 68 are effective for fiscal years beginning after June 15, 2014. TSASC has not completed the process of evaluating GASB 68, but does not expect it to have an impact on its financial statements.
- I. A restatement to recognize accrued TSRs due to the Trust resulted in an increase the fiscal year 2011 beginning net deficit by \$48.2 million. In addition, the restatement resulted in a decrease of \$626 thousand to the change in deficit for the year ended June 30, 2011. TSRs are payable once a year and as such any amount earned by year-end, but not collected, is accrued as receivable in the TSASC government-wide financial statements. Per the Indenture, 62.6% of TSRs are due to the Trust; therefore 62.6% of accrued TSRs receivable are payable to the Trust. Before this restatement, TSASC’s government-wide financial statements did not reflect the payable.

TSASC, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
JUNE 30, 2012 AND 2011

NOTE 3 – CASH AND CASH EQUIVALENTS

TSASC's cash and cash equivalents consist of bank deposits and money market funds.

As of June 30, 2012 and 2011, total cash and cash equivalents are summarized as follows:

	2012	2011
	(in thousands)	
Restricted for Debt Service:		
Cash--FDIC insured	\$ -	\$ 119
Cash equivalents (see note 4)	22	-
Total restricted	22	119
Unrestricted:		
Cash--FDIC insured	-	25
Cash equivalents (see note 4)	110	69
Total unrestricted	110	94
Total cash and cash equivalents	\$ 132	\$ 213

NOTE 4 – INVESTMENTS

The investments, including cash equivalents, as of June 30, 2012 and 2011 are summarized as follows:

	2012	2011
	(in thousands)	
Restricted for Debt Service:		
Money Market Funds	\$ 22	\$ -
Securities of U.S. government agencies (Maturing within one year)	84,541	94,446
Municipal Bonds--various states (Maturing over five years)	33,322	22,699
Total restricted	117,885	117,145
Unrestricted:		
Money Market Funds	110	69
Securities of U.S. government agencies (Maturing within one year)	474	499
Total unrestricted	584	568
Total investments including cash equivalents	118,469	117,713
Less amounts reported as cash equivalents (see note 3)	132	69
Total investments	\$ 118,337	\$ 117,644

TSASC, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
JUNE 30, 2012 AND 2011

NOTE 4 – INVESTMENTS (continued)

Each account of TSASC is held pursuant to the Indenture between TSASC and its Trustee and may be invested in securities or categories of investments that are specifically enumerated as permitted investments for such account pursuant to the Indenture.

Custodial credit risk: Is the risk that, in the event of the failure of the custodian, TSASC may not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. TSASC's investments are not collateralized. All investments are held in the Trustee's name by the Trustee.

Credit risk: All investments held by TSASC at June 30, 2012 and 2011 are obligations of, or guaranteed by, the United States of America, the Federal Home Loan Mortgage Corporation, the Federal Home Loan Bank System and general obligation municipal bonds rated by each rating agency in one of its three highest ratings categories.

Interest rate risk: TSASC's investments mature in less than one year, unless otherwise specified above. Investments with longer term maturities are not expected to be liquidated prior to maturity, thereby limiting exposure from rising interest rates. Of the \$33.3 million of municipal bonds held, \$20.1 million are subject to optional tender at par, thereby reducing TSASC exposure to interest rate risk.

NOTE 5 – BONDS PAYABLE

In accordance with the Indenture, Pledged Collections during fiscal years 2012 and 2011 were used to fund operating expenses; then to fund interest payments due on December 1, 2011 and 2010 and June 1, 2012, and 2011; then to fund and make turbo redemption payments. During fiscal years 2012 and 2011, turbo redemptions were \$7.5 million and \$5.0 million, respectively.

Outstanding bonds payable bear interest at rates ranging from 4.750% to 5.125%. A summary of changes in outstanding bonds in fiscal years 2012 and 2011 is as follows:

	Outstanding Principal Balance at <u>June 30, 2010</u>		Principal Retired or <u>Defeased</u>		Outstanding Principal Balance at <u>June 30, 2011</u>		Principal Retired or <u>Defeased</u>		Outstanding Principal Balance at <u>June 30, 2012</u>	
	<u>Issued</u>		<u>Issued</u>		<u>Issued</u>		<u>Issued</u>		<u>Issued</u>	
Series 2006-1	\$ 1,265,305	\$ -	\$ (5,015)	\$ 1,260,290	\$ -	\$ (7,540)	\$ 1,252,750			

Term bond maturities for these bonds represent the minimum amount of principal that TSASC must pay as of the specific distribution dates in order to avoid a default. The sinking fund principal payments represent the amount of principal that TSASC expects to pay from the pledged TSRs collected. If pledged TSRs collected exceed the principal and interest required under the term bond maturities, then the excess will be applied first to the sinking fund payment and then to turbo redemptions. Turbo redemption payments will be credited against both sinking fund installments and the term bond maturities in chronological order.

TSASC, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
JUNE 30, 2012 AND 2011

NOTE 5 – BONDS PAYABLE (continued)

Debt service requirements for term bond maturities and anticipated sinking fund principal payments, including principal and interest as of June 30, 2012 are as follows (in thousands):

	<u>Term Bond Maturities</u>			<u>Sinking Fund Principal Payments</u>		
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ended June 30,						
2013	\$ -	\$ 62,878	\$ 62,878	\$ -	\$ 62,878	\$ 62,878
2014	-	62,878	62,878	-	62,878	62,878
2015	-	62,878	62,878	9,455	62,878	72,333
2016	-	62,878	62,878	16,965	62,429	79,394
2017	-	62,878	62,878	18,715	61,623	80,338
2018 to 2022	183,310	314,390	497,700	138,175	291,166	429,341
2023 to 2027	137,765	263,966	401,731	176,700	254,068	430,768
2028 to 2032	-	236,413	236,413	226,510	205,111	431,621
2033 to 2037	372,650	180,515	553,165	290,390	142,286	432,676
2038 to 2042	559,025	143,250	702,275	375,840	59,807	435,647
	<u>\$ 1,252,750</u>	<u>\$ 1,452,924</u>	<u>\$ 2,705,674</u>	<u>\$ 1,252,750</u>	<u>\$ 1,265,124</u>	<u>\$ 2,517,874</u>

As of June 30, 2012 and 2011, TSASC has funded its debt service reserve accounts according to the Indenture requirements. As of June 30, 2012 and 2011, debt service accounts holdings totaled \$31.4 million and \$31.6 million, respectively.

As of June 30, 2012 and 2011, the TSASC Liquidity Reserve Account balances were \$86.4 million and \$85.6 million, respectively, and in compliance with the Indenture.

TSASC, on February 8, 2006, refunded, with Defeasance Collateral, bonds totaling \$1.1 billion of which \$381.7 million are still to be paid from the Defeasance Collateral held in the escrow account on deposit with TSASC's escrow trustee.

**** END ****