

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
FINANCIAL AUDIT AND COMPLIANCE EXAMINATION

For the Two Years Ended June 30, 2012

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
FINANCIAL AUDIT AND COMPLIANCE EXAMINATION
For the Two Years Ended June 30, 2012

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STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
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AGENCY OFFICIALS

Chairman of the Board (6/20/12 to Current)	Jerome Stermer
Chairman of the Board (10/29/10 to 6/7/12)	David Vaught
Board Member (10/15/10 to Current)	Rory Hoskins
Board Member (10/15/10 to Current)	Jennifer Woodard
Chief Financial Officer (10/29/10 to Current)	John Sinsheimer
Secretary (6/20/11 to 11/15/12)	James Prichard
Secretary (10/29/10 to 6/20/11)	Kacy Bassett

Authority's office is located at:

James R. Thompson Center
100 W. Randolph St.
Chicago, IL 60601



MANAGEMENT ASSERTION LETTER

3/25/13

Honorable William G. Holland
Auditor General
State of Illinois
Iles Park Plaza
740 East Ash
Springfield, IL 62703-3154

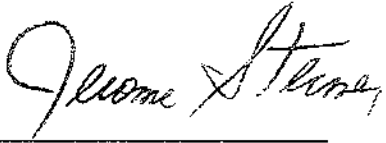
Dear Mr. Holland:

We are responsible for the identification of, and compliance with, all aspects of laws, regulations, contracts, or grant agreements that could have a material effect on the operations of the Railsplitter Tobacco Settlement Authority (Authority). We are responsible for and we have established and maintained an effective system of, internal controls over compliance requirements. We have performed an evaluation of the Authority's compliance with the following assertions during the two-year period ended June 30, 2012. Based on this evaluation, we assert that during the years ended June 30, 2011 and June 30, 2012, the Authority has materially complied with the assertions below.

- A. The Authority has obligated, expended, received and used public funds in accordance with the purpose for which such funds have been appropriated or otherwise authorized by law.
- B. The Authority has obligated, expended, received and used public funds in accordance with any limitations, restrictions, conditions or mandatory directions imposed by law upon such obligation, expenditure, receipt or use.
- C. The Authority has complied, in all material respects, with applicable laws and regulations, including the State uniform accounting system, in its financial and fiscal operations.
- D. Revenues and receipts collected by the Authority are in accordance with applicable laws and regulations and the accounting and recordkeeping of such revenues and receipts is fair, accurate and in accordance with law.
- E. Money or negotiable securities or similar assets handled by the Authority on behalf of the State or held in trust by the Authority have been properly and legally administered, and the accounting and recordkeeping relating thereto is proper, accurate and in accordance with law.

Yours very truly,

Railsplitter Tobacco Settlement Authority



Jerome Sterner, Chairman



John Sinsheimer, CFO

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
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COMPLIANCE REPORT

SUMMARY

The compliance testing performed during this examination was conducted in accordance with *Government Auditing Standards* and in accordance with the Illinois State Auditing Act.

ACCOUNTANTS' REPORT

The Independent Accountants' Report on State Compliance, on Internal Control Over Compliance and on Supplementary Information for State Compliance Purposes does not contain scope limitations, disclaimers, or other significant non-standard language.

SUMMARY OF FINDINGS

<u>Number of</u>	<u>Current</u>
<u>Findings</u>	<u>Report</u>
Repeated findings	0
Prior recommendations implemented	N/A
or not repeated	N/A

This is the first financial audit and compliance examination of the Railsplitter Tobacco Settlement Authority.

PRIOR FINDINGS NOT REPEATED

The Railsplitter Tobacco Settlement Authority did not have any prior year findings.

EXIT CONFERENCE

The findings and recommendations appearing in this report were discussed with Authority personnel at an exit conference on March 7, 2013. Attending were:

Office of the Auditor General
Courtney Dzierwa, Audit Manager
Stacie Amling, State Auditor

Railsplitter Tobacco Settlement Authority
John Sinsheimer, Chief Financial Officer
Jessica Akey, GOMB Bond Analyst

Responses to the recommendations were provided by Ms. Jessica Akey in correspondence dated March 19, 2013.

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OFFICE OF THE AUDITOR GENERAL
WILLIAM G. HOLLAND

INDEPENDENT ACCOUNTANTS' REPORT ON STATE COMPLIANCE AND
ON INTERNAL CONTROL OVER COMPLIANCE

Honorable William G. Holland
Auditor General
State of Illinois

And

Board of Directors
Railsplitter Tobacco Settlement Authority

Compliance

We have examined the State of Illinois, Railsplitter Tobacco Settlement Authority's compliance with the requirements listed below, as more fully described in the Audit Guide for Financial Audits and Compliance Attestation Engagements of Illinois State Agencies (Audit Guide) as adopted by the Auditor General, during the two years ended June 30, 2012. The management of the State of Illinois, Railsplitter Tobacco Settlement Authority is responsible for compliance with these requirements. Our responsibility is to express an opinion on the State of Illinois, Railsplitter Tobacco Settlement Authority's compliance based on our examination.

- A. The State of Illinois, Railsplitter Tobacco Settlement Authority has obligated, expended, received, and used public funds in accordance with the purpose for which such funds have been appropriated or otherwise authorized by law.
- B. The State of Illinois, Railsplitter Tobacco Settlement Authority has obligated, expended, received, and used public funds in accordance with any limitations, restrictions, conditions or mandatory directions imposed by law upon such obligation, expenditure, receipt or use.
- C. The State of Illinois, Railsplitter Tobacco Settlement Authority has complied, in all material respects, with applicable laws and regulations, including the State uniform accounting system, in its financial and fiscal operations.
- D. Revenues and receipts collected by the State of Illinois, Railsplitter Tobacco Settlement Authority are in accordance with applicable laws and regulations and the accounting and recordkeeping of such revenues and receipts is fair, accurate and in accordance with law.

- E. Money or negotiable securities or similar assets handled by the State of Illinois, Railsplitter Tobacco Settlement Authority on behalf of the State or held in trust by the State of Illinois, Railsplitter Tobacco Settlement Authority have been properly and legally administered and the accounting and recordkeeping relating thereto is proper, accurate, and in accordance with law.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants; the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States; the Illinois State Auditing Act (Act); and the Audit Guide as adopted by the Auditor General pursuant to the Act; and, accordingly, included examining, on a test basis, evidence about the State of Illinois, Railsplitter Tobacco Settlement Authority's compliance with those requirements listed in the first paragraph of this report and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on the State of Illinois, Railsplitter Tobacco Settlement Authority's compliance with specified requirements.

In our opinion, the State of Illinois, Railsplitter Tobacco Settlement Authority complied, in all material respects, with the compliance requirements listed in the first paragraph of this report during the two years ended June 30, 2012.

Internal Control

Management of the State of Illinois, Railsplitter Tobacco Settlement Authority is responsible for establishing and maintaining effective internal control over compliance with the requirements listed in the first paragraph of this report. In planning and performing our examination, we considered the State of Illinois, Railsplitter Tobacco Settlement Authority's internal control over compliance with the requirements listed in the first paragraph of this report as a basis for designing our examination procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with the Audit Guide, issued by the Illinois Office of the Auditor General, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the State of Illinois, Railsplitter Tobacco Settlement Authority's internal control over compliance.

A deficiency in an entity's internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with the requirements listed in the first paragraph of this report on a timely basis. *A material weakness in an entity's internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a requirement listed in the first paragraph of this report will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material

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

As required by the Audit Guide, immaterial findings excluded from this report have been reported in a separate letter.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, agency management, and the Board of Directors, and is not intended to be and should not be used by anyone other than these specified parties.



BRUCE L. BULLARD, CPA

Director of Financial and Compliance Audits

March 25, 2013

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OFFICE OF THE AUDITOR GENERAL
WILLIAM G. HOLLAND

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Honorable William G. Holland
Auditor General
State of Illinois

And

Board of Directors
Railsplitter Tobacco Settlement Authority

We have audited the financial statements of the governmental activities and major fund of the State of Illinois, Railsplitter Tobacco Settlement Authority, as of and for the years ended June 30, 2011 and June 30, 2012, which collectively comprise the State of Illinois, Railsplitter Tobacco Settlement Authority's basic financial statements and have issued our report thereon dated March 25, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the State of Illinois, Railsplitter Tobacco Settlement Authority is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the State of Illinois, Railsplitter Tobacco Settlement Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State of Illinois, Railsplitter Tobacco Settlement Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of Illinois, Railsplitter Tobacco Settlement Authority's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to


prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Illinois, Railsplitter Tobacco Settlement Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, agency management, and the Board of Directors, and is not intended to be and should not be used by anyone other than these specified parties.


BRUCE L. BULLARD, CPA
Director of Financial and Compliance Audits

March 25, 2013

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
FINANCIAL AUDIT AND COMPLIANCE EXAMINATION
For the Two Years Ended June 30, 2012

FINANCIAL STATEMENT REPORT

SUMMARY

The audit of the accompanying financial statements of the Railsplitter Tobacco Settlement Authority was performed by staff of the Office of the Auditor General.

Based on their audit, the auditors expressed an unqualified opinion on the agency's basic financial statements.

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OFFICE OF THE AUDITOR GENERAL
WILLIAM G. HOLLAND

INDEPENDENT AUDITORS' REPORT

Honorable William G. Holland
Auditor General
State of Illinois

And

Board of Directors
Railsplitter Tobacco Settlement Authority

We have audited the accompanying financial statements of the governmental activities and major fund of the State of Illinois, Railsplitter Tobacco Settlement Authority, as of and for the years ended June 30, 2011 and June 30, 2012 which collectively comprise the State of Illinois, Railsplitter Tobacco Settlement Authority's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the State of Illinois, Railsplitter Tobacco Settlement Authority's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate for the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the State of Illinois, Railsplitter Tobacco Settlement Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 1, the financial statements of the State of Illinois, Railsplitter Tobacco Settlement Authority are intended to present the financial position and changes in financial position of the governmental activities and major fund of the State that is attributable to the transactions of the State of Illinois, Railsplitter Tobacco Settlement Authority. They do not purport to, and do not,

present fairly the financial position of the State of Illinois as of June 30, 2011 and June 30, 2012 and its changes in financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, and major fund of the State of Illinois, Railsplitter Tobacco Settlement Authority, as of June 30, 2011 and June 30, 2012, and the respective changes in financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 25, 2013 on our consideration of the State of Illinois, Railsplitter Tobacco Settlement Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.


Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 15 through 23 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 audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State of Illinois, Railsplitter Tobacco Settlement Authority's basic financial statements. The accompanying supplementary information for the years ended June 30, 2011 and June 30, 2012, in State Compliance Schedules 1 and 2 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The accompanying supplementary information for the years ended June 30, 2011 and June 30, 2012, in State Compliance Schedules 1 and 2 have been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional

procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the accompanying supplementary information for the years ended June 30, 2011 and June 30, 2012 in State Compliance Schedules 1 and 2 is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The accompanying supplementary information in the Analysis of Operations Section is presented for the purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, the Comptroller, agency management, and the Board of Directors, and is not intended to be and should not be used by anyone other than these specified parties.


Bruce L. Bullard, CPA
Director of Financial and Compliance Audits

March 25, 2013

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
For the Two Years Ended June 30, 2012

The Management's Discussion and Analysis is designed to explain significant financial issues, provide an overview of the Authority's financial activity, identify changes in the Authority's financial position, and identify individual issues and concerns. This document should be read in conjunction with the financial statements.

The Authority was legally established on July 1, 2010 and has completed its first two years of operations.

FINANCIAL HIGHLIGHTS

The Authority's total assets of governmental activities were \$1.44 billion as of June 30, 2012. In addition, the Authority reported total cash and cash equivalents of \$101 million, investments of \$91 million, and deferred charges of \$1.1 billion as of June 30, 2012. The Authority's total assets of governmental activities were \$1.54 billion as of June 30, 2011. The Authority reported total cash and cash equivalents of \$48 million, investments of \$142 million, and deferred charges of \$1.2 billion as of June 30, 2011.

As of June 30, 2012, the Authority reported liabilities of \$1.5 billion, principal of which was \$1.45 billion in revenue bonds payable. This resulted in a net asset deficit of \$74.7 million at June 30, 2012. As of June 30, 2011, the Authority reported liabilities of \$1.6 billion, principal of which was \$1.5 billion in revenue bonds payable. This resulted in a net asset deficit of \$37.7 million at June 30, 2011.

The Authority does not conduct any business-type activities.

Revenues

During fiscal year 2012, the governmental activities revenues totaled \$276.2 million. This consisted of \$275.4 million of recognized tobacco settlement revenues, and \$.8 million in net investment income. During fiscal year 2011, the governmental activities revenues totaled \$402.5 million. This consisted of \$402.7 million of recognized tobacco settlement revenues, offset by \$.2 million in net investment losses.

Cost of Authority Program

During fiscal year 2012, the governmental activities expenses totaled \$313.2 million. Of this amount, \$133.2 million was for residual tobacco settlement payments to the state, \$100.4 million was amortization of the tobacco settlement deferred charges and \$80 million was interest expense. During fiscal year 2011, the governmental activities expenses totaled \$440.2 million. Of this amount, \$248.4 million was for residual tobacco settlement payments to the state, \$146.7

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
For the Two Years Ended June 30, 2012

million was amortization of the tobacco settlement deferred charges, and \$45 million was interest expenses.

Major Fund – Railsplitter Tobacco Settlement Authority Governmental Fund

For fiscal year 2012, the revenues reported for the governmental fund (\$273.9 million) varied from revenues recognized for governmental activities (\$276.2 million). The difference between the amount recorded in the governmental fund and the amount reported in the government wide statement of activities pertains to the change in revenue that was deferred in the fund because it was not collected in the availability period (TSRs receivable). At the fund level, expenditures totaled \$372.6 million. Included in this total is \$133.2 million for residual tobacco settlement payments to the state, \$100.4 million was amortization of the tobacco settlement deferred charges, and \$139.0 million for interest expense and principal retirement. The principal difference between expenditures in the governmental fund and expenses in governmental activities pertains to debt related items.

For fiscal year 2011, the revenues reported for the governmental fund (\$268.2 million) varied from revenues recognized for governmental activities (\$402.5 million). The difference between the amount recorded in the governmental fund and the amount reported in the government wide statement of activities pertains to revenue that was deferred in the fund because it was not collected in the availability period (TSRs receivable). The fund also reports other financing sources of \$1.5 billion, representing proceeds from the issuance of revenue bonds. At the fund level, expenditures totaled \$443.7 million. Included in this total is \$248.4 million for residual tobacco settlement payments to the state, \$146.8 million was amortization of the tobacco settlement deferred charges, \$38 million for interest expense, and \$10.2 million for issuance costs.

USING THIS ANNUAL REPORT

In the past, the primary focus of local government financial statements was summarized by fund type and presented on a current financial resource basis. Now, financial statements are presented from two perspectives: government-wide and major fund. These perspectives allow the user to address relevant questions, broaden a basis for comparison and enhance the Authority's accountability.

Government-Wide Financial Statements

The government-wide financial statements are designed to emulate the corporate sector in that government and business-type activities are consolidated into columns, which add to a total for the primary government. In the case of the Authority, there are currently no activities that are

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
For the Two Years Ended June 30, 2012

classified as business-type. The focus of the Statement of Net Assets is designed to be similar to bottom line results for the Authority and its governmental-type activities. This statement combines and consolidates the governmental fund's current financial resources (short-term spendable resources) with long-term obligations using the accrual basis of accounting and economic resources measurement focus.

The Statement of Activities is focused on both the gross and net cost of governmental activities, which are supported primarily by the tobacco settlement revenues. This Statement is intended to summarize and simplify the user's analysis of the cost of governmental services.

Fund Financial Statement

The Governmental Major Fund presentation is presented on a sources and uses of liquid resources basis. The flow and availability of liquid resources is a clear and appropriate focus of any analysis of a government. Funds are established for various purposes and the Fund Financial Statement allows the demonstration of sources and uses and compliance associated therewith.

GOVERNMENT-WIDE STATEMENT

Condensed Statement of Net Assets
As of June 30, 2012 and 2011

	Governmental Activities	Governmental Activities
	2012	2011
Current and other assets	\$ 1,440,887,332	\$ 1,536,802,442
Total assets	1,440,887,332	1,536,802,442
Current liabilities	129,055,259	124,044,408
Noncurrent liabilities	1,386,543,841	1,450,471,359
Total liabilities	1,515,599,100	1,574,515,767
Net Assets:		
Unrestricted	(74,711,868)	(37,713,325)
Total net assets	\$ (74,711,868)	\$ (37,713,325)

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Net assets are defined as the amount by which assets exceed liabilities. Net assets can be a useful indicator of a government's financial condition. Liabilities exceeded assets by \$74.7 million and \$37.7 million as of June 30, 2012 and 2011, respectively.

There are several transactions that will affect the comparability of the Statement of Net Assets summary presentation for the Authority.

- 1) Net Results of Activities – which will impact (increase/decrease) current assets and unrestricted net assts.
- 2) Borrowing of Capital – which will increase current assets and long-term debt.
- 3) Spending Borrowed Proceeds on New Capital – which will reduce current assets and increase noncurrent assets.
- 4) Principal Payment on Debt – which will reduce current assets and reduce long-term debt.
- 5) Reduction of Noncurrent Assets through Amortization – which will reduce noncurrent assets and unrestricted net assets.

The decrease in net assets from 2011 to 2012 was a result of several factors. Total current and other assets decreased by \$96 million. The decrease was due to the amortization of the deferred charges (Bond payment to State) of \$100 million, offset by a \$2.3 million increase in tobacco settlement revenues receivable compared to the prior year. Total liabilities decreased by \$58.9 million, primarily due to the bond principal retirement of \$59.3 million in 2012. This was offset slightly by an increase in excess tobacco settlement revenues owed to the State as of year-end.

The Authority does not own or report any capital assets.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
For the Two Years Ended June 30, 2012

The following table reports revenues and expenses for the current year:

Condensed Statement of Activities
Year Ended June 30, 2012 and 2011

	<u>Governmental Activities</u>	<u>Governmental Activities</u>
	<u>2012</u>	<u>2011</u>
Revenues		
Program revenues		
Tobacco settlement revenues	\$275,468,104	\$402,665,649
General revenue		
Investment income (loss)	774,557	(194,432)
Total revenue	<u>276,242,661</u>	<u>402,471,217</u>
Expenses		
Excess residual payments to State	133,160,074	248,428,756
Amortization of deferred charges - TSRs	100,393,132	146,749,715
Professional fees	58,000	-
Debt service - interest	79,629,998	45,006,071
Total expenses	<u>313,241,204</u>	<u>440,184,542</u>
Change in net assets	(36,998,543)	(37,713,325)
Net assets - beginning	<u>(37,713,325)</u>	<u>-</u>
Net assets - ending	<u>\$ (74,711,868)</u>	<u>\$ (37,713,325)</u>

There are several impacts on revenues and expenses for the Authority as reflected below:

Revenues:

- 1) Changing Patterns in Tobacco Settlement Revenues –TSRs may experience significant changes periodically and are less predictable than many governmental revenues and often distort year-to-year comparisons.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
For the Two Years Ended June 30, 2012

- 2) Market Impacts on Investment Income – Market conditions may cause investment income to fluctuate.

Expenses:

- 1) Interest Rates – The revenue bonds were issued at fixed rates that vary over the life of the debt from 3.00% to 6.25%, depending on maturity date. This will be seen in year to year comparisons of interest expense.
- 2) Changing Patterns in Tobacco Settlement Revenues – Changes in TSRs will cause a corresponding change in the excess residual payments to the State. Changes in TSRs also impact the amortization of the deferred charges.

For the fiscal year ended June 30, 2012, revenues from all activities totaled \$276.2 million compared with \$402.4 million in the prior year. The reason for the seemingly large decrease in TSR revenues relates to the timing of the establishment of the Authority. In FY 2011, the Authority received all of the TSR that were measured for the period of January 1, 2010 through December 31, 2011, plus an accrual for the six month period from January 1, 2011 through June 30, 2011, resulting in 18 months of TSR revenues in its first year of operation. The results for FY 2012 reflect the period of July 1, 2011 through June 30, 2012 (12 months of revenue). On a going forward basis, it is unlikely there will be such large variances in the TSR revenues recognized from year to year.

Total expenses for the year ended June 30, 2012 were \$313.2 million compared to \$440.2 million in the previous year. The \$126.9 million decrease (29%) is mostly attributable to the decrease in the residual tobacco settlement revenues paid/owed to the State. The amount of this excess residual is directly tied to the TSR revenues for the year, and the large decrease in the expense is in line with the large decrease in the related revenue. Additionally, amortization related to the deferred TSR charges declined by \$46 million (31%). The amortization of deferred TSR charges is also a function of tobacco settlement revenues.

FINANCIAL ANALYSIS OF THE AUTHORITY'S FUNDS

Governmental Funds

The focus of the Authority's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. In particular, unassigned fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. Restricted fund balance represents amounts for which the Authority has little or no spending discretion, as outside constraints limit how these funds may be used.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
For the Two Years Ended June 30, 2012

At June 30, 2012, the governmental fund reported restricted fund balance of \$1.2 billion, compared with \$1.3 billion as of June 30, 2011. The \$99 million decrease is mainly due to the amortization of the deferred charges as previously discussed.

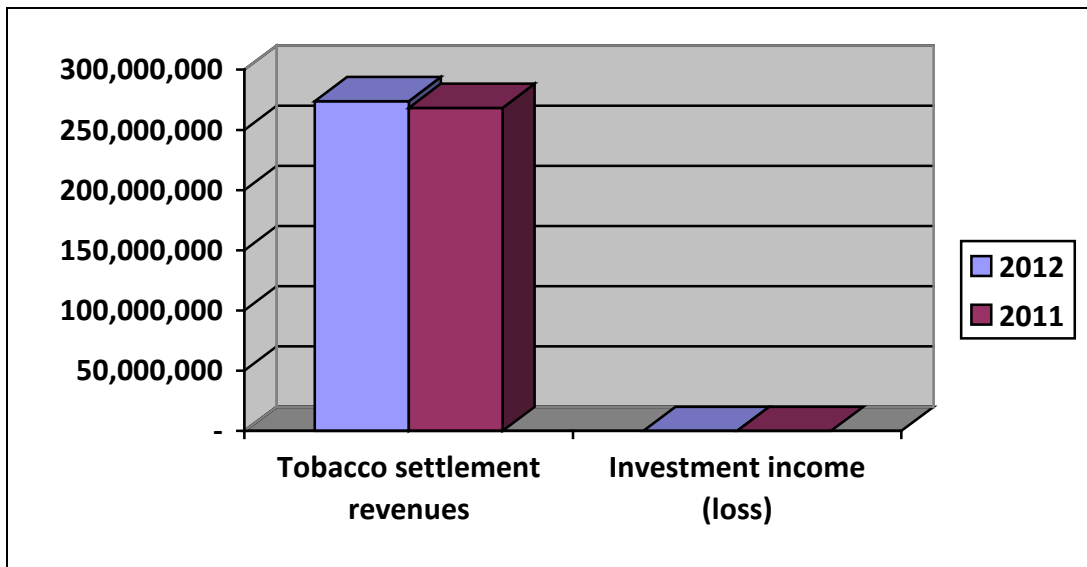
Fund balance is presented as restricted because the trust indenture pertaining to the Authority's revenue bonds strictly limits how all resources in the fund may be used.

Total revenues for the Governmental Fund for 2012 were \$273.9 million. Total revenues and other financing sources for the governmental fund for fiscal year 2011 were \$1.78 billion. In 2011, other financing sources included the bond proceeds received from the issuance of the 2010 bonds. On a modified accrual basis (essentially cash basis) TSRs increased \$4.7 million compared to the prior year. Additionally, investment income in 2012 of \$.775 million, compared favorably with the \$.194 million loss recognized in 2011.

Total expenditures for the governmental fund for the year ended June 30, 2012 and 2011, were \$372.6 and \$443.7 million, respectively. The \$71 million decrease is mainly due to the reduced portion paid/owed to the state for excess TSR's (\$115 million decrease), reduced amortization of the TSR deferred charges (\$46 million decrease), offset by the first principal payment made in 2012 of \$59.3 million. Additionally, interest paid in 2012 of \$79.6 million, exceeded the 2011 amount of \$38.3 million.

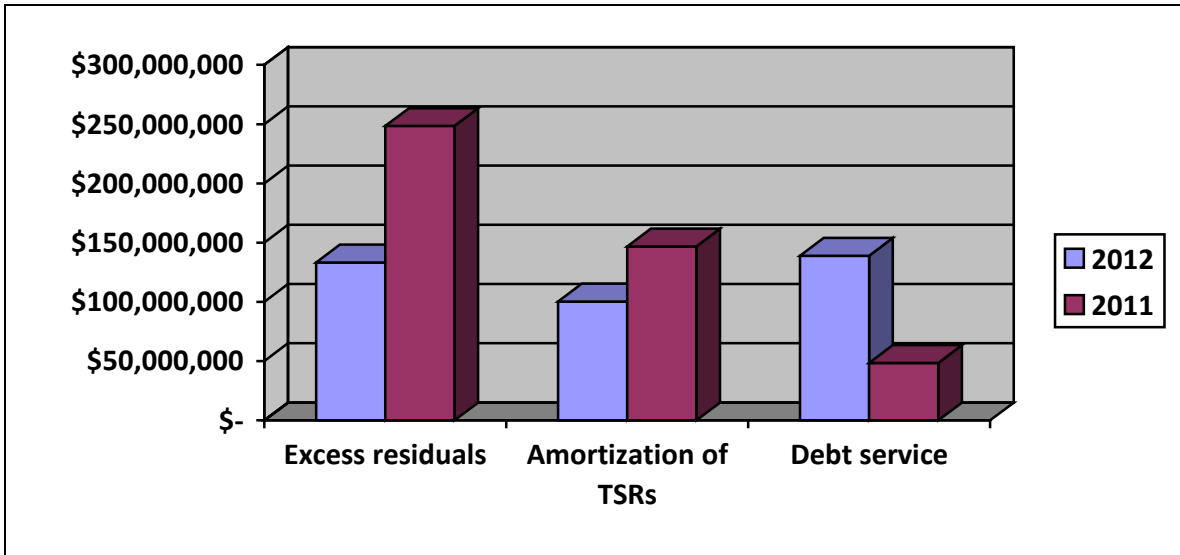
See the charts that follow.

**Revenues – by Type (Governmental Fund)
Year Ended June 30, 2012**



STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
For the Two Years Ended June 30, 2012

**Expenditures –by Type (Governmental Fund)
Year Ended June 30, 2012 and 2011**



Outstanding Debt

In December 2010, the Authority issued \$1,503,460,000 Tobacco Settlement Revenue Bonds pursuant to a purchase and sale agreement between the Authority and the State of Illinois (State). Of the total \$1.51 billion in bond proceeds, \$1.35 billion was paid to the State of Illinois in fiscal year 2011. An additional amount of \$308,209 was paid in FY2012. The remaining amounts were deposited in 4 restricted accounts held by the bond trustee and are generally restricted for the payment of debt issuance costs, interest and principal.

The Series 2010 Revenue Bonds received a rating of A from Standard & Poor’s.

In exchange for the \$1.35 billion in bond proceeds, the State sold to the Authority its rights to substantially all Tobacco Settlement Revenues (TSRs), made pursuant to the Master Settlement Agreement entered into with participating tobacco product manufacturers. These TSRs have been pledged to pay principal and interest on the bonds. TSRs received that are in excess of a specified formula are defined as “Residual Revenues” and are paid back to the State. TSRs collected in FY 2012 were sufficient to pay the upcoming and current interest requirements on the debt. Residual revenues of \$133.2 million and \$248.4 million were returned to the State during fiscal years 2012 and 2011, respectively.

Additional information as well as the debt service requirements associated with this issue are outlined in Note 5 of these Financial Statements.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
For the Two Years Ended June 30, 2012

Economic Factors and a Look to the Future

The tobacco settlement revenues received in FY2011 (cash received) of \$268,443,766 was significantly less than the anticipated amount of \$305,203,078. The tobacco settlement revenues received in FY2012 (cash received) of \$273,126,658 was less than the anticipated amount of \$293,166,933. The amount of TSRs received each year can fluctuate greatly and are difficult to predict.

CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide citizens, customers, investors and creditors with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the money it receives. Questions concerning this report may be directed to John Sinsheimer, James R. Thompson Center, 100 W Randolph St, Chicago, IL 60601.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
STATEMENT OF NET ASSETS AND GOVERNMENTAL FUND BALANCE SHEET
For the Year Ended June 30, 2012

	Governmental <u>Fund - RTSA</u>	<u>Adjustments</u>	Statement of <u>Net Assets</u>
Assets			
Current:			
Cash and cash equivalents			
Assets account	\$ 474	\$ -	\$ 474
Operating sub-account	192,016	-	192,016
Attorney General sub-account	5,000,157	-	5,000,157
Debt service account	38,741,518	-	38,741,518
Debt service reserve account	<u>56,812,738</u>	<u>-</u>	<u>56,812,738</u>
Total cash and cash equivalents	100,746,903	-	100,746,903
Investments - U.S. Treasury notes	91,097,989	-	91,097,989
Receivables			
Tobacco settlement revenues (TSRs)	<u>136,563,329</u>	<u>-</u>	<u>136,563,329</u>
Total current assets	328,408,221	-	328,408,221
Noncurrent:			
Deferred charges - bond issuance costs	-	9,313,649	9,313,649
Deferred charges - payment to State	<u>1,103,165,362</u>	<u>-</u>	<u>1,103,165,362</u>
Total assets	<u>\$ 1,431,573,583</u>	<u>\$ 9,313,649</u>	<u>\$ 1,440,887,232</u>
Liabilities			
Current:			
Deferred revenues - TSRs	\$ 136,563,329	\$ (136,563,329)	\$ -
Accrued interest payable	-	6,456,678	6,456,678
Due to state - residual TSRs	59,048,581	-	59,048,581
Revenue bonds payable	<u>-</u>	<u>63,550,000</u>	<u>63,550,000</u>
Total current liabilities	195,611,910	(66,556,651)	129,055,259
Noncurrent:			
Revenue bonds payable, net			
of unamortized premium of \$6,008,841	<u>-</u>	<u>1,386,543,841</u>	<u>1,386,543,841</u>
Total liabilities	<u>195,611,910</u>	<u>1,319,987,190</u>	<u>1,515,599,100</u>
Fund Balance/Net Assets			
Fund balance - restricted for debt service	1,235,961,673	(1,235,961,673)	-
Net assets - unrestricted deficit	<u>-</u>	<u>(74,711,868)</u>	<u>(74,711,868)</u>
Total fund balance/net assets	<u>1,235,961,673</u>	<u>(1,310,673,541)</u>	<u>\$ (74,711,868)</u>
Total liabilities and fund balances	<u>\$ 1,431,573,583</u>	<u>\$ 9,313,649</u>	

See Notes to Financial Statements.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
STATEMENT OF NET ASSETS AND GOVERNMENTAL FUND BALANCE SHEET
For the Year Ended June 30, 2011

	Governmental <u>Fund - RTSA</u>	<u>Adjustments</u>	Statement of <u>Net Assets</u>
Assets			
Current:			
Cash and cash equivalents			
Assets account	\$ 409	\$ -	\$ 409
Operating sub-account	250,009	-	250,009
Attorney General sub-account	2,500,092	-	2,500,092
Debt service account	39,800,007	-	39,800,007
Debt service reserve account	5,002,426	-	5,002,426
Cost of issuance account	<u>308,203</u>	<u>-</u>	<u>308,203</u>
Total cash and cash equivalents	47,861,146	-	47,861,146
Investments - U.S. Treasury notes	141,570,328	-	141,570,328
Receivables			
Tobacco settlement revenues (TSRs)	<u>134,221,883</u>	<u>-</u>	<u>134,221,883</u>
Total current assets	323,653,357	-	323,653,357
Noncurrent:			
Deferred charges - bond issuance costs	-	9,898,800	9,898,800
Deferred charges - payment to State	<u>1,203,250,285</u>	<u>-</u>	<u>1,203,250,285</u>
Total assets	<u>\$ 1,526,903,642</u>	<u>\$ 9,898,800</u>	<u>\$1,536,802,442</u>
Liabilities			
Current:			
Deferred revenues - TSRs	\$ 134,221,883	\$ (134,221,883)	\$ -
Accrued interest payable	-	6,633,244	6,633,244
Due to state - residual TSRs	58,036,164	-	58,036,164
Revenue bonds payable	<u>-</u>	<u>59,375,000</u>	<u>59,375,000</u>
Total current liabilities	192,258,047	(68,213,639)	124,044,408
Noncurrent:			
Revenue bonds payable, net			
of unamortized premium of \$6,386,359	<u>-</u>	<u>1,450,471,359</u>	<u>1,450,471,359</u>
Total liabilities	<u>192,258,047</u>	<u>1,382,257,720</u>	<u>1,574,515,767</u>
Fund Balance/Net Assets			
Fund balance - restricted for debt service	1,334,645,595	(1,334,645,595)	-
Net assets - unrestricted deficit	<u>-</u>	<u>(37,713,325)</u>	<u>(37,713,325)</u>
Total fund balance/net assets	<u>1,334,645,595</u>	<u>(1,372,358,920)</u>	<u>\$ (37,713,325)</u>
Total liabilities and fund balances	<u>\$ 1,526,903,642</u>	<u>\$ 9,898,800</u>	

See Notes to Financial Statements.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
**RECONCILIATION OF THE GOVERNMENTAL FUND BALANCE SHEET
TO THE STATEMENT OF NET ASSETS**
For the Year Ended June 30, 2012

Total fund balances - governmental fund	\$ 1,235,961,673
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Amounts reported for governmental activities in the
Statement of Net Assets are different because:

Revenues in the Statement of Activities that do not provide current financial resources are deferred in the funds	136,563,329
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Some assets and liabilities reported in the Statement of Net
Assets do not provide current financial resources or require
the use of current financial resources and, therefore, are not
reported as assets or liabilities in governmental funds.

These amounts consist of:

Bonds payable	(1,444,085,000)
Accrued interest payable	(6,456,678)
Unamortized bond issuance costs	9,313,649
Unamortized bond premium	(6,008,841)
	(6,008,841)

Net assets of governmental activities	\$ (74,711,868)
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See Notes to Financial Statements.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
**RECONCILIATION OF THE GOVERNMENTAL FUND BALANCE SHEET
TO THE STATEMENT OF NET ASSETS**
For the Year Ended June 30, 2011

Total fund balances - governmental fund \$ 1,334,645,595

Amounts reported for governmental activities in the
Statement of Net Assets are different because:

Revenues in the Statement of Activities that do not provide
current financial resources are deferred in the funds 134,221,883

Some assets and liabilities reported in the Statement of Net
Assets do not provide current financial resources or require
the use of current financial resources and, therefore, are not
reported as assets or liabilities in governmental funds.

These amounts consist of:

Bonds payable	(1,503,460,000)
Accrued interest payable	(6,633,244)
Unamortized bond issuance costs	9,898,800
Unamortized bond premium	<u>(6,386,359)</u>

Net assets of governmental activities \$ (37,713,325)

See Notes to Financial Statements.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
**STATEMENT OF ACTIVITIES AND GOVERNMENTAL REVENUES,
EXPENDITURES AND CHANGES IN FUND BALANCES**
For the Year Ended June 30, 2012

	Governmental Fund - RTSA	Adjustments	Statement of Activities
Expenditures/expenses			
Excess residual payments to state	\$ 133,160,074	\$ -	\$ 133,160,074
Amortization of deferred charges - TSRs	100,393,132	-	100,393,132
Professional fees	58,000	-	58,000
Debt service - principal retirement	59,375,000	(59,375,000)	-
Debt service - interest	79,598,931	31,067	79,629,998
Total expenditures/expenses	<u>372,585,137</u>	<u>(59,343,933)</u>	<u>313,241,204</u>
Program revenues			
Tobacco settlement revenues (TSRs)	<u>273,126,658</u>	<u>2,341,446</u>	<u>275,468,104</u>
Net program revenues (expenditures/expenses)	(99,458,479)	61,685,379	(37,773,100)
General revenues			
Investment income (loss)	<u>774,557</u>	<u>-</u>	<u>774,557</u>
Net change in fund balance/net assets	(98,683,922)	61,685,379	(36,998,543)
Fund balance/net assets July 1, 2011	<u>1,334,645,595</u>	<u>(1,372,358,920)</u>	<u>(37,713,325)</u>
Fund balance/net assets June 30, 2012	<u>\$ 1,235,961,673</u>	<u>\$ (1,310,673,541)</u>	<u>\$ (74,711,868)</u>

See Notes to Financial Statements.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
**STATEMENT OF ACTIVITIES AND GOVERNMENTAL REVENUES,
EXPENDITURES AND CHANGES IN FUND BALANCES**
For the Year Ended June 30, 2011

	Governmental Fund - RTSA	Adjustments	Statement of Activities
Expenditures/expenses			
Excess residual payments to state	\$ 248,428,756	\$ -	\$ 248,428,756
Amortization of deferred charges - TSRs	146,749,715	-	146,749,715
Debt service - issue costs	10,240,138	(10,240,138)	-
Debt service - interest	38,251,709	6,754,362	45,006,071
Total expenditures/expenses	443,670,318	(3,485,776)	440,184,542
Program revenues			
Tobacco settlement revenues (TSRs)	268,443,766	134,221,883	402,665,649
Net program revenues (expenditures/expenses)	(175,226,552)	137,707,659	(37,518,893)
General revenues			
Investment income (loss)	(194,432)	-	(194,432)
Change in fund balance/net assets	(175,420,984)	137,707,659	(37,713,325)
Other financing sources			
Debt issuance	1,503,460,000	(1,503,460,000)	-
Debt premium	6,606,579	(6,606,579)	-
	1,510,066,579	(1,510,066,579)	-
Net change in fund balance/net assets	1,334,645,595	(1,372,358,920)	(37,713,325)
Fund balance/net assets July 1, 2010	-	-	-
Fund balance/net assets June 30, 2011	\$ 1,334,645,595	\$ (1,372,358,920)	\$ (37,713,325)

See Notes to Financial Statements.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE – GOVERNMENTAL FUND TO THE STATEMENT
OF ACTIVITIES**

For the Year Ended June 30, 2012

Net change in fund balances - total governmental fund \$ (98,683,922)

Amounts reported for governmental activities in the Statement of
Activities are different because:

Revenues in the Statement of Activities that do not provide current
financial resources are not reported as revenues in the funds. 2,341,446

The issuance of long-term debt provides current financial resources
to governmental funds, while the repayment of the principal of
long-term debt consumes current financial resources of
governmental funds. These transactions however, have no effect
on net assets.

Debt retirement 59,375,000

Some expenses reported in the Statement of Activities do not
require the use of current financial resources and, therefore, are
not reported as expenditures in governmental funds. These
activities consist of:

Amortization of bond premium and issuance costs (207,633)

Increase in interest payable 176,566

Change in net assets of governmental activities \$ (36,998,543)

See Notes to Financial Statements.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE – GOVERNMENTAL FUND TO THE STATEMENT
OF ACTIVITIES**

For the Year Ended June 30, 2011

Net change in fund balances - total governmental fund	\$ 1,334,645,595
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Amounts reported for governmental activities in the Statement of
Activities are different because:

Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds.	134,221,883
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The issuance of long-term debt provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes current financial resources of governmental funds. These transactions however, have no effect on net assets.

Debt issuance	(1,503,460,000)
Debt premium	(6,606,579)
Debt issuance costs	10,240,138

Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds. These activities consist of:

Amortization of bond premium and issuance costs	(121,119)
Increase in interest payable	(6,633,243)

Change in net assets of governmental activities	<u>\$ (37,713,325)</u>
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See Notes to Financial Statements.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
For the Two Years Ended June 30, 2012

Note 1. Summary of Significant Accounting Policies

The Railsplitter Tobacco Settlement Authority (Authority) was created by 30 ILCS 171 on July 1, 2010 as a special purpose corporation which has a body corporate and politic of, but is legally independent and separate from the State of Illinois.

The Authority was established to sell revenue bonds, repayment of which is supported solely by future tobacco settlement revenues (TSRs) (pledged revenues). Rights to approximately \$4.1 billion of the State's TSRs were relinquished by the State of Illinois (State) to the Authority in exchange for a significant portion of the revenue bond proceeds (\$1.35 billion) and a residual certificate. The residual certificate represents the State's ownership in excess TSRs to be received by the Authority during the term of the Sales Agreement. Residual TSRs are defined as all pledged revenues that are in excess of amounts needed to pay annual debt service and fund the various accounts established under the trust indenture (see Note 5). The Sales Agreement continues until the Authority's liabilities (including the bonds) have been met or otherwise discharged. The \$1,503,460,000 bond issuance and the resulting \$1,350,000,000 payment to the State Treasurer occurred on December 8, 2010. An additional payment of \$308,209, representing unused bond issuance cost reserves, was paid to the State in December 2011.

The Authority is governed by a three member board consisting of the State's Budget Director and two other members appointed by the Governor. The financial statements of the Authority have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the Authority's accounting policies are described below.

Reporting Entity

Accounting principles generally accepted in the United States of America require the reporting entity to include (1) the primary government, (2) organizations for which the primary government is financially accountable, and (3) other organizations for which the nature and significance of their relationship with the primary government are such that the exclusion would cause the reporting entity's financial statements to be misleading or incomplete. Based on these criteria there are no potential component units which should be included with the Authority's financial statements; however, the Authority is considered to be a component unit of the State of Illinois. These financial statements are included in the State's comprehensive annual financial report.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
For the Two Years Ended June 30, 2012

Note 1. Summary of Significant Accounting Policies (Continued)

Government-wide and Fund Financial Statements

Government-wide Financial Statements: The government-wide Statement of Net Assets and Statement of Activities report the overall financial activity of the Authority. The financial activities of the Authority consist only of governmental activities, which are primarily supported by TSRs.

The Statement of Net Assets presents the Authority's assets and liabilities with the difference reported in three potential categories:

Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds and other debt that are attributable to the acquisition, construction, or improvement of those assets, if any. The Authority does not report any capital assets as of June 30, 2011 or June 30, 2012.

Restricted net assets result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation. 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.

Unrestricted net assets consist of net assets that do not meet the criteria of the two preceding categories.

The Statement of Activities demonstrates the degree to which the direct expenses of the Authority are offset by program revenues. Direct expenses are those that are clearly identifiable with the Authority's principal function. Program revenues include (a) charges paid by the recipients of goods or services offered by the programs (including fines and fees), and (b) grants and contributions that are restricted to meeting the operational requirements of a particular program. Tobacco settlement revenues are considered program revenues because the trust indenture restricts use of those revenues to debt repayment (including reserve requirements). Revenues that are not classified as program revenues, such as investment income, are presented as general revenues.

Fund Financial Statements: Separate financial statements are provided for the Authority's governmental fund.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
For the Two Years Ended June 30, 2012

Note 1. Summary of Significant Accounting Policies (Continued)

Measurement Focus and Basis of Accounting and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flow takes place. On an accrual basis, revenues from tobacco settlements are recognized when the Authority has a legal claim to the resources. Interest income is recorded as it is earned.

Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be 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 of the end of the fiscal year. Tobacco settlement revenues for the periods of January 1, 2011 through June 30, 2011 and January 1, 2012 through June 30, 2012 have been estimated and accrued. These revenues will not be collected, however, within 60 days subsequent to year end, and accordingly have been deferred in the governmental fund.

Expenditures generally are recorded when the liability is incurred, as under accrual accounting. However, accrued interest on long-term debt is not reported as expenditures in governmental funds.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board.

Use of Estimates

The preparation of financial statements 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

The “Deferred charges – payment to the State” is being amortized over the life of the agreement based on the estimated amount of tobacco settlement revenues expected to be collected over the life of the bonds, as detailed in the debt issuance prospectus. Actual receipts could differ significantly from this estimated total of \$4,125,334,734.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
For the Two Years Ended June 30, 2012

Note 1. Summary of Significant Accounting Policies (Continued)

Investments

Investments are reported at fair value based on quoted market prices.

Deferred Revenue

Governmental funds report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period.

Deferred Charges – Payment to the State

In accordance with GASB Statement 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, the amount paid to the State under the Sales Agreement has been deferred and will be recognized as an expense ratably over the life of the agreement. For this purpose, the Authority has used an amortization rate of 36.445% of recognized TSRs. The rate used represents the ratio of the bond proceeds (\$1,503,460,000) to the total estimated TSRs sold to the Authority by the State (\$4,125,334,734).

Long-term Obligations

In the government-wide financial statements, long-term debt is reported as liabilities. Bond premiums are reported net of bonds payable and amortized over the life of the bonds using the straight-line method. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt using the straight line method.

In the fund financial statements, governmental funds recognize bond premiums as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuance are also reported as other financing sources. Issuance costs whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Fund Balance and Net Assets

As of June 30, 2011, the governmental fund of the Authority reported \$1,334,645,595 of fund balance that is restricted for the retirement of debt principal and interest, or restricted for various debt reserve requirements. As of June 30, 2012, the governmental fund of the Authority reported \$1,235,961,673 of fund balance that is restricted for the retirement of debt principal and interest, or restricted for various debt reserve requirements. The Authority considers restricted amounts

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
For the Two Years Ended June 30, 2012

Note 1. Summary of Significant Accounting Policies (Continued)

to have been spent first when an expenditure is incurred for purposes for which both unrestricted and restricted fund balance is available. As of June 30, 2011, the Authority has reported its net deficit of \$37,713,325 as unrestricted on the government-wide statement of net assets. As of June 30, 2012, the Authority has reported its net deficit of \$74,711,868 as unrestricted on the government wide statement of net assets.

Residual Tobacco Settlement Revenues

As part of the consideration for the sale to the Authority by the State of the pledged settlement payments, the Authority issued a residual certificate to the State. In accordance with the provisions of the Trust Indenture, upon payment in full of the deposits required by the Trust Indenture (see Note 5), the remaining balance of pledged revenues shall be transferred to the State as owner of the residual certificate. During the year ended June 30, 2011, \$190,392,592 of residual revenues was paid to the State and \$58,036,164 was recorded as a liability to the State as of year-end. During the year ended June 30, 2012, \$132,147,657 of residual revenues was paid to the State. Of this amount, \$58,036,164 pertained to FY11. An additional amount of \$59,048,581 was recorded as a liability to the State as of year-end.

New Governmental Accounting Standards

The Governmental Accounting Standards Board (GASB) has issued the following statements:

Statement No. 61 – *The Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and No. 34*. This Statement modifies certain requirements for inclusion of component units in the financial reporting entity. This Statement also amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances. This Statement also clarifies the reporting of equity interests in legally separate organizations. The Authority is required to implement the provisions of this Statement for the year ending June 30, 2013. Management has not currently determined what impact, if any, these Statements may have on its financial statements.

Statement No. 62 – *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The objective of this Statement is to incorporate into the GASB’s authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements:

1. Financial Accounting Standards Board (FASB) Statements and Interpretations
2. Accounting Principles Board Opinions

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
For the Two Years Ended June 30, 2012

Note 1. Summary of Significant Accounting Policies (Continued)

3. Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure

The Authority is required to implement the provisions of this statement for the year ended June 30, 2013.

Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This statement amends the net asset reporting requirements in GASB34, by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The Authority is required to implement the provisions of this statement for the year ended June 30, 2013.

Statement No. 65, *Items Previously Recorded as Assets and Liabilities*. This statement reclassifies, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources (expenses) or inflows of resources (revenues), items that were previously reported as assets or liabilities. The Authority is required to implement the provisions of this statement for the year ended June 30, 2014.

Note 2. Cash and Cash Equivalents, and Investments

The Authority maintains various cash equivalent accounts, established in accordance with the trust indenture for specific purposes. At June 30, 2011, all of the Authority's cash equivalents of \$47,861,146 were invested in a money market portfolio comprised of U.S. Treasury bills, bonds, notes and repurchase agreements. Additionally, the Authority held \$141,570,328 in U.S. Treasury notes. At June 30, 2012, all of the Authority's cash equivalents of \$100,746,903 were invested in a money market portfolio comprised of U.S. Treasury bills, bonds, notes and repurchase agreements. Additionally, the Authority held \$91,097,989 in U.S. Treasury notes.

Authorized Deposits and Investments

The Authority is permitted by the Public Funds Investment Act (30 ILCS 235) to engage in a wide variety of investment activities. These include:

- bonds, notes, certificates of indebtedness, treasury bills or other securities guaranteed by the United States Government;
- bonds, notes, debentures, or other similar obligations of the United States of America, its agencies and its instrumentalities;

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
For the Two Years Ended June 30, 2012

Note 2. Cash and Cash Equivalents, and Investments (Continued)

- interest-bearing savings accounts, certificates of deposit, interest-bearing time deposits or any other investments that constitute direct obligations of any bank;
- short-term obligations of certain qualified United States Corporations;
- short-term discount obligations of the Federal National Mortgage Association;
- shares or other securities legally issued by certain state or federal savings and loans associations;
- insured dividend-bearing share accounts and certain other accounts of chartered credit unions;
- certain money market mutual funds;
- the Illinois funds investment pool; and
- repurchase agreements that meet certain instrument and transactions requirements.

The Trust Indenture for the Series 2010 Revenue Bonds authorizes the Authority to invest in the following, to the extent permitted by the Public Funds Investment Act:

- Direct obligations of, or obligations the principal of and the interest on which are unconditionally guaranteed by, the United States of America and which are entitled to the full faith and credit thereof;
- Bonds, notes, debentures, or other obligations or securities issued by a federal government agency that is rated “AAA” (or equivalent) by Standard & Poor’s and Fitch, or if not rated by both of them, so rated by one of them and in the equivalent category by another nationally recognized rating agency;
- Prime commercial paper of a corporation incorporated under the laws of any state of the United States of America with assets exceeding \$500,000,000 if (i) such obligations are rated at the time of purchase rated “A-1” and “F1” by Standard & Poor’s and Fitch, respectively, or if not rated by both of them, so rated by one of them and in the equivalent category by another nationally recognized rating agency and which mature not later than 180 days from the date of purchase, (ii) such purchases do not exceed 10% of the corporation’s outstanding obligations and (iii) no more than one-third of the public agency’s funds may be invested in short-term obligations of corporations;
- Bankers’ acceptances issued by a domestic bank or a federally chartered domestic office of a foreign bank which are eligible for purchase by the Federal Reserve System, rated “A-1” and “F1” by Standard & Poor’s and Fitch, respectively or, if not rated by either of them, rated in the equivalent category by another nationally recognized rating agency;
- Demand deposits, including interest bearing money market accounts, time deposits, trust funds, trust accounts, overnight bank deposits and interest-bearing deposits of depository institutions, including the Trustee or any of its affiliates, rated in the equivalent category by another nationally recognized rating agency or which are fully FDIC-insured;

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
For the Two Years Ended June 30, 2012

Note 2. Cash and Cash Equivalents, and Investments (Continued)

- Shares in diversified open-end, no load investment funds, provided such funds are registered under the Investment Company Act of 1940, which is a money market mutual fund, which has been rated “AAAm” and “AAAm-G” or the equivalent by Standard & Poor’s and Fitch, or if not rated by either of them, rated in the equivalent category by another nationally recognized rating agency, and such fund is limited to obligations described above and to agreements to repurchase such obligations, including those for which the Trustee or an affiliate performs services for a fee, whether as a custodian, transfer agent, investment advisor or otherwise;
- Federally insured or collateralized certificates of deposit issued by banks (which may include the Trustee) which are state chartered banks, federally chartered banks or foreign banks with domestic offices. Collateralized certificates of deposit shall be collateralized by obligations described in the first and second paragraphs above, which such obligations at all times have a market value (exclusive of accrued interest) at least equal to a minimum of one hundred and two percent (102%) of such bank deposits so secured, including interest;
- Repurchase agreements relating to securities of the type specified in the first and second paragraph above; provided that such securities in an amount at least equal to a market value at all times of at least one hundred and two percent (102%) of the amount of the agreements shall be delivered as security for such agreements to the account of the Trustee to be held therein during the term of the agreements; and
- Any other obligations conforming to the requirements of the Public Funds Investment Act, so long as such obligations are rated at least in the two highest rating categories of each of Standard & Poor’s and Fitch, or if not rated by both of them, so rated by one of them and in the equivalent category by another nationally recognized rating agency.

The Authority does not have a policy that further limits its permitted deposits and investments. The Authority adheres to the Public Funds Investment Act and Trust Indenture identified above and has not adopted any additional policies addressing custodial risk, interest rate risk or credit risk.

Credit Risk, including 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 that are in the possession of an outside party. The Authority’s investments are all held by the Trustee, BNY Mellon, in the name of the Authority. The money market investments were rated AAAM and Aaa-mf by Standard & Poor’s and Moody’s, respectively. The U.S. Treasury notes were rated AAA and Aaa by Standard & Poor’s and Moody’s, respectively.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
For the Two Years Ended June 30, 2012

Note 2. Cash and Cash Equivalents, and Investments (Continued)

Interest Rate Risk

Interest rate risk is the risk that the fair value of investments will decrease as a result of an increase in interest rates. The Authority's investments in the money market account are highly liquid with a weighted average maturity that is less than one month. The Authority's investments in U.S. Treasury notes had the following maturities:

<u>Maturity Date</u>	<u>Investments Held at 6/30/12</u> <u>Note Amount</u>	<u>Investments Held at 6/30/11</u> <u>Note Amount</u>
11/15/2011	N/A	\$47,488,330
11/15/2012	\$45,334,860	\$46,946,331
11/15/2013	<u>\$45,763,129</u>	<u>\$47,135,667</u>
	<u>\$91,097,989</u>	<u>\$141,570,328</u>

Note 3. Receivables – Tobacco Settlement Revenues (TSRs)

The Master Settlement Agreement (MSA) is an industry-wide settlement of litigation between the settling states (including Illinois), and the tobacco product manufacturers (PMs), dated November 23, 1998. The settlement represents the resolution of a large potential financial liability of the PMs for smoking related injuries. 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, funding educational programs and more.

Under the MSA, annual payments are required each April 15th in perpetuity and are based on several factors, including the volume of domestic cigarette shipments during the previous calendar year.

The Authority received \$268,443,766 in April 2011, under the MSA, pertaining to calendar year 2010. Additionally, the Authority has accrued \$134,221,883 in TSRs receivable for the period beginning January 1, 2011 and ending June 30, 2011. The amount accrued is considered earned but will not be received by the Authority until April 2012, and has been deferred in the governmental fund (unavailable).

The Authority received \$273,126,658 in April 2012, under the MSA, pertaining to calendar year 2011. Of this amount, \$134,221,883 was recorded as a receivable in FY2011 and pertains to the

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
For the Two Years Ended June 30, 2012

Note 3. Receivables – Tobacco Settlement Revenues (TSRs) (Continued)

period January 1, 2011 to June 30, 2011. Likewise, the Authority has accrued \$136,563,329 in TSRs receivable for the period beginning January 1, 2012 and ending June 30, 2012. The amount accrued is considered earned but will not be received by the Authority until April 2013, and has been deferred in the governmental fund (unavailable).

Note 4. Balances and Transactions with the State of Illinois – Related Party Transactions

Transactions and balances with the State of Illinois for the year ended June 30, 2011 are as follows:

Deferred Charges – payment to State - \$1,203,250,285 – this asset represents the payment made to the State on December 8, 2010 of \$1,350,000,000 less FY 2011 amortization of \$146,749,715. The deferred charges will be amortized over the life of the Sales Agreement which corresponds with the final maturity of the related revenue bonds.

Due to State – residual TSRs - \$58,036,164 – this liability represents the estimated amount that will be paid to the State upon receipt of the April 2012 TSRs, that pertain to the period beginning January 1, 2011 through June 30, 2011. Residual TSRs are estimated to be 43.24% of TSRs receivable.

Excess Residual Payment to State - \$248,428,756 – this expenditure/expense includes the residual payments made to the State in April 2011 of \$190,392,592, plus the accrued portion of the estimated residuals for the period beginning January 1, 2011 through June 30, 2011 of \$58,036,164.

Transactions and balances with the State of Illinois for the year ended June 30, 2012 are as follows:

Deferred Charges – payment to State – this \$1,103,165,362 asset represents the payment made to the State on December 8, 2010, and December 23, 2011 of \$1,350,000,000 and \$308,209, respectively, less accumulated amortization of \$247,142,847. The deferred charges will be amortized over the life of the Sales Agreement which corresponds with the final maturity of the related revenue bonds.

Due to State – residual TSRs – this \$59,048,581 liability represents the estimated amount that will be paid to the State upon receipt of the April 2013 TSRs that pertain to the period beginning January 1, 2012 through June 30, 2012. Residual TSRs are estimated to be 43.24% of TSRs receivable.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
For the Two Years Ended June 30, 2012

Note 4. Balances and Transactions with the State of Illinois – Related Party Transactions (Continued)

Excess Residual Payment to State – this \$133,160,074 expenditure/expense includes the residual payments made to the State in April 2012 of \$132,147,657, plus the accrued portion of the estimated residuals for the period beginning January 1, 2012 through June 30, 2012 of \$59,048,581, and less the prior year accrual of \$58,036,164.

Note 5. Long-Term Obligations

The following is a summary of long-term obligation activity associated with governmental activities for the year ended June 30, 2011:

	Balance July 1, 2010	Additions	Retirements	Balance June 30, 2011	Due Within One Year
Revenue Bonds Payable	\$ -	\$ 1,503,460,000	\$ -	\$ 1,503,460,000	\$ 59,375,000
Unamortized premium	-	6,606,579	220,220	6,386,359	-
	<u>\$ -</u>	<u>\$ 1,510,066,579</u>	<u>\$ 220,220</u>	<u>\$ 1,509,846,359</u>	<u>\$ 59,375,000</u>

The following is a summary of long-term obligation activity associated with governmental activities for the year ended June 30, 2012:

	Balance July 1, 2011	Additions	Retirements	Balance June 30, 2012	Due Within One Year
Revenue Bonds Payable	\$ 1,503,460,000	\$ -	\$ 59,375,000	\$1,444,085,000	\$63,550,000
Unamortized premium	6,386,359	-	377,518	6,008,841	-
	<u>\$ 1,509,846,359</u>	<u>\$ -</u>	<u>\$ 59,752,518</u>	<u>\$1,450,093,841</u>	<u>\$63,550,000</u>

The following is a summary of the Authority's Debt:

Revenue Bonds – On December 8, 2010, the Authority issued \$1,503,460,000 in Tobacco Settlement Revenue Bonds, series 2010. \$926,030,000 of the serial bonds is due in annual installments of \$59,375,000 to \$109,655,000 plus interest at variable rates ranging from 3.00% to 6.25% through June 1, 2024. \$216,915,999 term bonds at 5.5% interest are due on June 1, 2023 and \$360,515,000 term bonds at 6.00% are due on June 1, 2028.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
For the Two Years Ended June 30, 2012

Note 5. Long-Term Obligations (Continued)

As of June 30, 2011, debt service requirements to maturity on the outstanding debt, including interest, are as follows:

Year Ending June 30	Governmental Activities		
	Revenue Bonds		
	Principal	Interest	Total
2012	\$ 59,375,000	\$ 79,598,931	\$ 138,973,931
2013	63,550,000	77,480,131	141,030,131
2014	70,860,000	74,938,131	145,798,131
2015	76,820,000	71,868,756	148,688,756
2016	80,655,000	68,027,756	148,682,756
2017-2021	469,825,000	276,017,819	745,842,819
2022-2026	527,695,000	139,454,013	667,149,013
2027-2028	154,680,000	12,485,100	167,165,100
Total	<u>\$1,503,460,000</u>	<u>\$799,870,637</u>	<u>\$ 2,303,330,637</u>

As of June 30, 2012, debt service requirements to maturity on the outstanding debt, including interest, are as follows:

Year Ending June 30	Governmental Activities		
	Revenue Bonds		
	Principal	Interest	Total
2013	\$ 63,550,000	\$ 77,480,131	\$ 141,030,131
2014	70,860,000	74,938,131	145,798,131
2015	76,820,000	71,868,756	148,688,756
2016	80,655,000	68,027,756	148,682,756
2017	84,700,000	64,183,744	148,883,744
2018-2022	494,780,000	251,954,363	746,734,363
2023-2027	519,315,000	108,614,525	627,929,525
2028	53,405,000	3,204,300	56,609,300
Total	<u>\$1,444,085,000</u>	<u>\$720,271,706</u>	<u>\$ 2,164,356,706</u>

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
For the Two Years Ended June 30, 2012

Note 5. Long-Term Obligations (Continued)

Pledged Revenues

The Authority has pledged future tobacco settlement revenues (TSRs), net of specified operating expenditures, to repay the approximate \$1.5 billion in revenue bonds issued in December 2010. Proceeds from the bonds were used to pay issuance cost and to provide an approximate \$1.35 billion payment to the State of Illinois in exchange for rights to the State's future TSRs. The bonds are payable solely from TSRs and are payable through 2028. Annual principal and interest on the bonds are expected to require on average, less than 60% of net revenues. The total principal and interest remaining to be paid on the bonds is approximately \$2.2 billion as of June 30, 2012. Interest paid for FY 2011 and total TSRs received were \$38 million and \$268 million, respectively. Debt service paid for FY 2012 and total TSRs received were \$139 million and \$273 million, respectively.

Trust Indenture Agreement

On December 1, 2010, the Authority executed a Trust Indenture with the Trustee acting as fiduciary for the bondholders. The Indenture provides for the following transactions: a) the Authority's issuance of the Residual Certificate and the Bonds, including specifically the Series 2010 Bonds and b) the Authority's assignment and pledge to the Trustee, in trust for the benefit and security of the beneficiaries, of the Pledged Revenues (TSRs), Pledged Accounts and assets thereof to be received and held by the Trustee.

The Indenture establishes the following funds:

- (i) Tobacco Assets Account
- (ii) Pledged Revenues Account
- (iii) Operating Account
- (iv) Authority Operating Subaccount
- (v) State Attorney General Operating Subaccount
- (vi) Debt Service Account
- (vii) Debt Service Reserve Account
- (viii) Costs of Issuance Account
- (ix) Lump Sum Account
- (x) Residual Account
- (xi) Rebate Account

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
For the Two Years Ended June 30, 2012

Note 5. Long-Term Obligations (Continued)

Application of Tobacco Assets and Pledged Revenues

Under the Trust Indenture, upon the Bond closing date, the Attorney General of the State directed the MSA agent to pay all Tobacco Assets (tobacco settlement payments pursuant to the terms of the MSA) to the Trustee on behalf of the Authority. All Tobacco Assets received by the Trustee are required to be deposited in the Tobacco Assets Account. From there, the assets shall be transferred first to the Pledged Revenues Account then distributed as described below:

No later than five business days following each deposit of pledged revenues to the pledged revenues account (but in no event later than the next distribution date), the Trustee will withdraw pledged revenues on deposit in the pledged revenues account and transfer such amounts as follows and in the following order of priority; provided, however, that investment earnings on amounts in the funds and accounts (other than the debt service reserve account, investment earnings on which shall be retained therein until the amounts on deposit therein are at least equal to the debt service reserve requirement, and on the fifth business day preceding each distribution date amounts on deposit in the debt service reserve account in excess of the debt service requirement may, at the direction of the Authority, be deposited directly to the debt service account) will be deposited directly to the debt service account; and provided, further, that upon the occurrence of a payment default, pledged revenues shall be transferred as set forth in clauses (1), (2) and (4) below and then all remaining pledged revenues will be applied to make extraordinary prepayments:

- (1) (a) to the Authority operating subaccount, the amount required to pay (i) Trustee fees and expenses (including reasonable attorney's fees, if applicable) reasonably expected to be due during the next fiscal year and (ii) an amount specified by the Officer's certificate for operating expenses of the Authority (provided that such amounts paid pursuant to this clause (a) shall not exceed the operating cap and operating expenses shall not include any termination payments or loss amounts on related contracts) and (b) to the State Attorney general operating subaccount, the amount required to be deposited therein to fund such subaccount in an amount not to exceed \$2,500,000 for the next fiscal year;
- (2) To the Debt Service Account an amount sufficient to cause the amount therein (together with interest and earnings reasonably expected by the Authority to be received on investments in the debt service account on or prior to the next distribution date) to equal interest (including interest at the stated rate on the principal of outstanding bonds and on overdue interest, if any) due on the next succeeding distribution date;

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
For the Two Years Ended June 30, 2012

Note 5. Long-Term Obligations (Continued)

- (3) To the Debt Service Account, exclusive of the amount on deposit therein under clause (2) above, an amount sufficient to cause the amount therein (together with any partial lump sum payment to be applied to the payment of principal or Sinking Fund installments on the next succeeding June 1 and interest and earnings reasonably expected by the Authority to be received on investments in the Debt Service Account on or prior to the next succeeding June 1 to the extent not counted for purposes of clause (2) above), to equal the principal and Sinking Fund installments due on the next succeeding June 1;
- (4) To the Debt Service Account, exclusive of the amounts deposited therein pursuant to clauses (2) and (3) above, an amount sufficient to cause the amount on deposit therein (together with interest and earnings reasonably expected by the Authority to be received on investments in the Debt Service Account on or prior to the second succeeding distribution date to the extent not counted for purposes of clause (2) or (3) above) to equal interest (including interest at the stated rate on the principal of outstanding bonds and on overdue interest, if any) due on the second succeeding distribution date;
- (5) To replenish the Debt Service Reserve Account until the amount on deposit therein equals the debt service reserve requirement;
- (6) In the amounts and to the funds and accounts established by Series Supplement for Junior Payments; and
- (7) To the residual account, the remaining pledged revenues.

Note 6. Contingencies

As reported on page 24, the “Attorney General sub-account,” reported as cash and cash equivalents (\$5,000,157), exceeds the amount required to be deposited per the Trust Indenture (\$2,500,000). The Authority believes that the Attorney General will draw approximately \$2.5 million from the account before March 31, 2013.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
FINANCIAL AUDIT AND COMPLIANCE EXAMINATION
For the Two Years Ended June 30, 2012

SUPPLEMENTARY INFORMATION FOR STATE COMPLIANCE PURPOSES

SUMMARY

Supplementary Information for State Compliance Purposes presented in this section of the report includes the following:

- Fiscal Schedules and Analysis:
 - Analysis of Significant Account Balances
 - Analysis of Accounts Receivable

- Analysis of Operations (Unaudited):
 - Agency Functions and Planning Program (Unaudited)
 - Service Efforts and Accomplishments (Unaudited)

The accountants' report that covers the Supplementary Information for State Compliance Purposes presented in the Compliance Report Section states that it has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in the auditors' opinion, it is fairly stated in all material respects in relation to the basic financial statements as a whole from which it has been derived. The accountants' report also states the Analysis of Operations Section has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, they do not express an opinion or provide any assurance on it.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
ANALYSIS OF SIGNIFICANT ACCOUNT BALANCES
For the Two Years Ended June 30, 2012

Cash and Cash Equivalents, and Investments

Cash and cash equivalents of the Authority consist of cash in the bank and short-term cash investments. The Authority also holds investments in U.S. Treasury notes. The Authority's investments in U.S. Treasury notes were rated AAA and Aaa by Standard & Poor's and Moody's, respectively. See note 2 to the financial statements for the amount of each investment in U.S. Treasury notes and the maturity dates for those investments. The Authority's cash and cash equivalents, and investments are held by a trustee, Bank of New York Mellon.

	<u>2012</u>	<u>2011</u>
Cash and cash equivalents		
Assets account	\$ 474	\$ 409
Operating sub-account	192,016	250,009
Attorney General sub-account	5,000,157	2,500,092
Debt service account	38,741,518	39,800,007
Debt service reserve account	56,812,738	5,002,426
Cost of issuance account	<u>-</u>	<u>308,203</u>
Total cash and cash equivalents	100,746,903	47,861,146
Investments - U.S. Treasury Notes	<u>91,097,989</u>	<u>141,570,328</u>
	<u>\$ 191,844,892</u>	<u>\$ 189,431,474</u>

Cash and cash equivalents increased by \$52.9 million from June 30, 2011 to June 30, 2012. The increase is primarily a result of the increase in the debt service reserve account. During FY12, an investment in U.S. Treasury notes, totaling \$47.5 million, matured. The proceeds were deposited into the Debt Service Reserve Account. According to the Tobacco Settlement Revenue Bonds, Series 2010 Supplement, the Debt Service Reserve Requirement is \$146,768,256. The Debt Service Reserve consists of all cash and investments, as well as any interest earned on the investments.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
ANALYSIS OF ACCOUNTS RECEIVABLE
For the Two Years Ended June 30, 2012

The Authority's accounts receivable consist solely of tobacco settlement revenues (TSRs). The TSRs are received each April 15th according to the Master Settlement Agreement (MSA). The annual payments are based on several factors, including the volume of domestic cigarette shipments during the previous calendar year. The TSRs receivable at June 30 are the amounts accrued for the period beginning January 1 and ending June 30 of each year.

	2012	2011
Accounts Receivable		
Tobacco settlement revenues (TSRs)	\$ 136,563,329	\$ 134,221,883

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
ANALYSIS OF OPERATIONS (UNAUDITED)
For the Two Years Ended June 30, 2012

AGENCY FUNCTIONS AND PLANNING

FUNCTIONS

The Railsplitter Tobacco Settlement Authority (Authority) was created by the Railsplitter Tobacco Settlement Authority Act (Act) (30 ILCS 171) on July 1, 2010 as a special purpose corporation which is legally independent of and separate from the State of Illinois (State).

The Authority is governed by a three member board consisting of the State's Budget Director and two other members appointed by the Governor. The Authority has also appointed a Chief Financial Officer. The Authority's board meets semiannually to review the financial statements, developments in the tobacco bond market, and various other topics relevant to the operations of the Authority. Meeting minutes are taken and retained.

In December 2010, the Authority issued \$1,503,460,000 in Tobacco Settlement Revenue Bonds (Series 2010 Bonds) pursuant to a purchase and sale agreement between the Authority and the State. The Series 2010 Bonds received an "A" credit quality rating from Standard & Poor's at the time of issuance. Of the total \$1.51 billion in bond proceeds, \$1.35 billion was paid to the State in Fiscal Year 2011. The remaining bond proceeds were deposited into 4 accounts held by the bond trustee (Trustee) (The Bank of New York Mellon) and are generally restricted for the payment of debt issuance costs, interest, and principal.

In exchange for the \$1.35 billion in bond proceeds, the State sold to the Authority its rights to substantially all Tobacco Settlement Revenues (TSRs) received pursuant to the Master Settlement Agreement (MSA) entered into with participating tobacco product manufacturers. The TSRs have been pledged to pay principal and interest on the bonds and are received by the Trustee in April each year. The Trustee uses the TSRs received for the payment of fees, operating expenses, and debt service on the Series 2010 Bonds and the replenishment of the Debt Service Reserve Account. TSRs received in excess of a specified formula are defined as "residual revenues" and are paid back to the State. The residual revenues are then remitted to the State for deposit into the State Treasury. TSRs collected in Fiscal Years 2011 and 2012 exceeded amounts needed to pay current costs and debt service requirements on the Series 2010 Bonds. As a result, residual revenues of \$248.4 million and \$133.2 million were then remitted to the State during Fiscal Years 2011 and 2012, respectively.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
ANALYSIS OF OPERATIONS (UNAUDITED)
For the Two Years Ended June 30, 2012

FUNCTIONS, continued

The Trustee also maintains various cash equivalent accounts, established in accordance with the trust indenture, for specific purposes. At June 30, 2012, all of the Authority's cash equivalents were invested in a money market portfolio comprised of U.S. Treasury bills, bonds, notes, and repurchase agreements.

PLANNING

The Authority was designed as a single purpose entity to securitize the MSA payments. As a result, the Authority does not have formal written goals and objectives, but instead operates to fulfill its statutory responsibilities.

STATE OF ILLINOIS
RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
SERVICE EFFORTS AND ACCOMPLISHMENTS (UNAUDITED)
For the Two Years Ended June 30, 2012

As authorized by the Railsplitter Tobacco Settlement Authority Act (Act) (30 ILCS 171), the Railsplitter Tobacco Settlement Authority (Authority) issued bonds totaling \$1.5 billion in December 2010. The bonds held “A” credit quality ratings from Standard & Poor’s as of both June 30, 2011 and June 30, 2012.