

**Tobacco Settlement Authority
(A Component Unit of the State of Iowa)**

Financial Report
June 30, 2021

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RSM US LLP

Independent Auditor's Report

Board of the Tobacco Settlement Authority

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and the General Fund of the Tobacco Settlement Authority (the Authority), a component unit of the State of Iowa, as of and for the year ended June 30, 2021, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America. This includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Authority's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the General Fund of the Tobacco Settlement Authority (a component unit of the State of Iowa) as of June 30, 2021, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require Management's Discussion and Analysis on pages 3 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our 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.

RSM US LLP

Des Moines, Iowa
February 7, 2022

**Tobacco Settlement Authority
(A Component Unit of the State of Iowa)**

**Management's Discussion and Analysis
Year Ended June 30, 2021**

We present the financial statements of the Tobacco Settlement Authority, a component unit of the State of Iowa (the Authority) and offer readers of these financial statements this narrative overview and analysis of the financial activities of the Authority for the year ended June 30, 2021.

Overview of the Authority

In 2001, the Authority purchased all payments required to be made by tobacco product manufacturers to the State of Iowa (the State) and the State's rights to receive such payments pursuant to the Master Settlement Agreement (Tobacco Settlement Revenues). The Authority issued approximately \$644 million of Tobacco Settlement Asset-Backed Bonds (Series 2001 Bonds) and pledged 78% of Tobacco Settlement Revenues to pay principal and interest on the bonds. As consideration for 78% of the payments, the Authority distributed approximately \$579 million of net proceeds to the State from the issuance of bonds. As consideration for the unpledged portion of Tobacco Settlement Revenues, the Authority has standing instructions for 22% of the Tobacco Settlement Revenues to be paid directly to the State.

In 2005, the Authority issued approximately \$832 million of Tobacco Settlement Asset-Backed Bonds. The proceeds of the 2005 bonds were used to refund the Series 2001 bonds, fund a debt service reserve account, pay costs of issuance and provide approximately \$154 million in net proceeds to the State. The Series 2005 bonds are special revenue obligations of the Authority secured solely by, and payable solely and only out of, the moneys, assets or revenues pledged by the Authority pursuant to the Series 2005 bond indenture, are not a general obligation or general indebtedness of the Authority and do not constitute an obligation or indebtedness of the State of Iowa or any political subdivision of the State of Iowa.

In 2017, the Authority received its last payment from the Strategic Contribution Fund. This fund was created under the Master Settlement Agreement to be paid to states over a ten-year period beginning April 2008 and to be allocated based on the efforts expended to resolve the state lawsuits against tobacco companies.

In fiscal year 2020, the primary activity of the Authority was the investment of bond reserves, the payment of administrative and enforcement expenses and the payment of principal and interest on the Series 2005 bonds. During the year, the Authority received \$38,513,383 in pledged Tobacco Settlement Revenues.

In 2021, the Authority issued approximately \$688.8 million of Tobacco Settlement Asset-Backed Bonds. The proceeds of the 2021 Bonds were used to refund the Series 2005 Bonds, fund a debt service reserve account and pay costs of issuance. The Series 2021 bonds are special revenue obligations of the Authority secured solely by, and payable solely and only out of, the moneys, assets or revenues pledged by the Authority pursuant to the Series 2021 bond indenture, are not a general obligation or general indebtedness of the Authority and do not constitute an obligation or indebtedness of the State of Iowa or any political subdivision of the State of Iowa.

**Tobacco Settlement Authority
(A Component Unit of the State of Iowa)**

**Management's Discussion and Analysis
Year Ended June 30, 2021**

Overview of the Financial Statements

This Discussion and Analysis is intended to serve as an introduction to the Authority's basic financial statements. The Authority's basic financial statements are comprised of three components:

1) government-wide financial statements, 2) fund financial statements and 3) notes to financial statements.

Government-wide financial statements: The government-wide financial statements are designed to provide readers with a broad overview of the Authority's finances, in a manner similar to a private-sector business.

The Statement of Net Position presents information on all of the Authority's assets and deferred outflows of resources and liabilities with the difference between these reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Authority is improving or deteriorating.

The Statement of Activities presents information showing how the Authority's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

Fund financial statements: A fund is a grouping of related accounts used to maintain control over resources segregated for specific activities or objectives. Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the Authority's near-term financial requirements.

Because the focus of governmental funds is narrower than the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Authority's near-term financing decisions. Both the governmental fund Balance Sheet and the governmental fund Statement of Revenues, Expenditures and Changes in Fund Balance provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

Notes to financial statements: The notes provide additional information essential to a full understanding of the data provided in the government-wide and the fund financial statements.

Government-Wide Financial Analysis

The Authority has total deficit net position as of June 30, 2021 and 2020. This indicates the Authority's liabilities, primarily the bonds, exceed the Authority's ability to pay those liabilities without additional funding. This is expected since debt service on the bonds is to be paid from future Tobacco Settlement Revenues.

**Tobacco Settlement Authority
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**Management's Discussion and Analysis
Year Ended June 30, 2021**

Table 1 reflects total net position of \$(619,564,810) as of June 30, 2021, which represents a decrease of \$46,998,382 from June 30, 2020. The Authority's total assets decreased \$91,113,472, primarily due to paying down the advance to the State and removal of the Guaranteed Insurance Contract (GIC) required for the 2005 Bonds but not required for the 2021 Bonds. Total liabilities decreased \$35,063,488, primarily due to the favorable pricing on the 2021 Bonds.

Table 1 - Authority's Net Position

	Governmental Activities	
	June 30,	
	2021	2020
Assets		
Current assets	\$ 48,957,926	\$ 89,717,150
Noncurrent assets	26,251,986	76,606,234
Total assets	75,209,912	166,323,384
Deferred outflows of resources	21,594,825	12,543,223
Liabilities		
Current liabilities	35,800,256	74,902,973
Long-term liabilities	680,569,291	676,530,062
Total liabilities	716,369,547	751,433,035
Net Position (Deficit)		
Restricted for debt service	26,251,986	17,407,318
Unrestricted	(645,816,796)	(589,973,746)
Total net position (deficit)	\$ (619,564,810)	\$ (572,566,428)

**Tobacco Settlement Authority
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**Management's Discussion and Analysis
Year Ended June 30, 2021**

Table 2 highlights the Authority's revenues and expenses for the years ended June 30, 2021 and 2020. This table utilizes the full accrual method of accounting.

Table 2 - Authority's Changes in Net Position

	Governmental Activities	
	Years Ended June 30,	
	2021	2020
General revenues, investment income	\$ 2,041,325	\$ 2,882,887
Expenses:		
Current:		
Administrative	72,677	69,502
Enforcement	465,506	541,960
Cost of issuance	4,904,179	-
Debt service, interest	43,597,345	46,352,367
Total expenses	49,039,707	46,963,829
Decrease in net position (deficit)	(46,998,382)	(44,080,942)
Net position (deficit), beginning of year	(572,566,428)	(528,485,486)
Net position (deficit), end of year	\$ (619,564,810)	\$ (572,566,428)

Financial Analysis of the Governmental Activities

As noted earlier, the Authority uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The fiscal year 2021 ending fund balance of the Authority's governmental fund decreased \$46,998,382 from fiscal year 2020. The decrease is due primarily to the principal and interest payments made in the current year and due secondarily to the cost of issuing the 2021 Bonds. The ending fund balance is restricted for debt service.

Debt Administration

As of June 30, 2021 and 2020, the Authority had \$715,009,291 and \$735,591,839, respectively, of outstanding revenue bonds, as shown in Table 3. In the current year, the Authority paid \$90,786,992 of principal and incurred \$43,597,345 of interest on outstanding debt.

Additional information about the Authority's long-term debt can be found in Note 3 to the financial statements.

Table 3 - Outstanding Debt, June 30

	Governmental Activities	
	2021	2020
Term bonds	\$ 279,650,000	\$ 484,330,000
Convertible capital appreciation bonds	-	178,010,000
Serial bonds	104,550,000	-
Capital appreciation bonds	1,607,540,000	551,790,000
Less deferred amounts	(1,276,730,709)	(478,538,161)
	\$ 715,009,291	\$ 735,591,839

**Tobacco Settlement Authority
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**Management's Discussion and Analysis
Year Ended June 30, 2021**

Economic Factors

The Authority pledges all surplus collections, if any, to the turbo redemption of the Series 2021 bonds. Tobacco Settlement Revenues, the primary revenue source for the Authority, is dependent on future tobacco product sales. The amount of future revenue recognized by the State of Iowa and by the Tobacco Settlement Authority could, therefore, be adversely impacted by consumption trends within the tobacco industry.

Requests for Information

These financial statements and discussion are designed to provide our citizens, taxpayers, investors and creditors with a complete disclosure of the Authority's finances and to demonstrate a high degree of accountability. If you have questions about this report or need additional information, please contact the State Treasurer's Office, Lucas State Office Building, Des Moines, Iowa 50319.

**Tobacco Settlement Authority
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**Governmental Fund Balance Sheet/Statement of Net Position (Deficit)
June 30, 2021**

	General Fund Balance Sheet	Adjustments	Statement of Net Position (Deficit)
Assets			
Current assets:			
Cash on deposit with Treasurer of State	\$ 5,412,806	\$ -	\$ 5,412,806
Due from the State	43,539,750	-	43,539,750
Interest receivable, restricted	5,370	-	5,370
Total current assets	<u>48,957,926</u>	-	<u>48,957,926</u>
Noncurrent assets:			
Restricted assets, cash and cash equivalents			
Cash and cash equivalents	26,251,986	-	26,251,986
Total assets	<u>75,209,912</u>	-	<u>75,209,912</u>
Deferred Outflow of Resources , deferred charge on refunding	-	21,594,825	21,594,825
Total assets and deferred outflows of resources	<u><u>\$ 75,209,912</u></u>		
Liabilities			
Current liabilities:			
Due to the State	\$ 144,180	-	144,180
Bonds payable, current portion	-	34,440,000	34,440,000
Accrued interest payable	-	1,216,076	1,216,076
Total current liabilities	<u>144,180</u>	<u>35,656,076</u>	<u>35,800,256</u>
Noncurrent liabilities, bonds payable, net	-	680,569,291	680,569,291
Total liabilities	<u>144,180</u>	<u>716,225,367</u>	<u>716,369,547</u>
Fund Balance , restricted for debt service	<u>75,065,732</u>	<u>(75,065,732)</u>	<u>-</u>
Total liabilities and fund balances	<u><u>\$ 75,209,912</u></u>		
Net Position (Deficit)			
Restricted for debt service		26,251,986	26,251,986
Unrestricted (deficit)		<u>(645,816,796)</u>	<u>(645,816,796)</u>
Total net position (deficit)		<u><u>\$ (619,564,810)</u></u>	<u><u>\$ (619,564,810)</u></u>

See notes to financial statements.

**Tobacco Settlement Authority
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**Reconciliation of the Governmental Fund Balance Sheet to the Statement of
Net Position (Deficit)
June 30, 2021**

Amounts reported for governmental activities in the statement of net position (deficit) are different because:

Total fund balance for the governmental fund		\$	75,065,732
<p>Long-term liabilities applicable to governmental activities are not due and payable in the current year and, accordingly, are not reported as fund liabilities. Interest on long-term debt is not accrued in the governmental fund, but rather is recognized as an expenditure when due. All liabilities, both current and long-term, are reported in the statement of net position (deficit).</p>			
Accrued interest on bonds			(1,216,076)
Bonds payable	\$	(1,991,740,000)	
Unamortized appreciation discount		1,332,136,247	
Unamortized bond premium		<u>(55,405,538)</u>	(715,009,291)
Deferred outflow of resources for deferred charge on refunding			<u>21,594,825</u>
Total net position (deficit) of governmental activities			<u><u>\$ (619,564,810)</u></u>

See notes to financial statements.

Tobacco Settlement Authority
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Statement of Revenues, Expenditures and Changes in Fund
Balance/Statement of Activities
Year Ended June 30, 2021

	General Fund Statement of Revenues, Expenditures and Changes in Fund Balance	Adjustments	Statement of Activities
General revenues, investment income	\$ 2,041,325	\$ -	\$ 2,041,325
Expenditures/expenses:			
Current:			
Administrative	72,677	-	72,677
Enforcement	465,506	-	465,506
Cost of issuance	4,904,179	-	4,904,179
Debt service:			
Principal	90,786,992	(90,786,992)	-
Interest	36,776,829	6,820,516	43,597,345
Total expenditures/expenses	133,006,183	(83,966,476)	49,039,707
Other financing sources (uses):			
Refunding bonds issued	688,805,891	(688,805,891)	-
Premium on refunding bonds	56,499,729	(56,499,729)	-
Payment to escrow for refunding	(705,418,030)	705,418,030	-
Total other financing sources (uses)	39,887,590	(39,887,590)	-
Net change in fund balance/net position (deficit)	(91,077,268)	44,078,886	(46,998,382)
Fund balance/net position (deficit), beginning of year	166,143,000	(738,709,428)	(572,566,428)
Fund balance/net position (deficit), end of year	\$ 75,065,732	\$ (694,630,542)	\$ (619,564,810)

See notes to financial statements.

Tobacco Settlement Authority
(A Component Unit of the State of Iowa)

**Reconciliation of the Statement of Revenues, Expenditures and
Changes in Fund Balance to the Statement of Activities**
Year Ended June 30, 2021

Net change in fund balance		\$ (91,077,268)
Repayment of bond principal is an expenditure in the governmental fund but reduces the liability in the statement of net position (deficit)		90,786,992
<p>Under the modified accrual basis of accounting used for the governmental fund, expenditures are recognized for transactions normally paid with expendable available resources. In the Statement of Activities, however, which is presented on the accrual basis, expenses and liabilities are reported regardless of when financial resources are available. In addition, interest on long-term debt is not recognized under the modified accrual basis of accounting until due rather than when it accrues. This adjustment combines the net changes of three balances, as follows:</p>		
Amortization of bond premium	\$ 1,091,191	
Amortization of bond discount	(578,147)	
Accrued interest on bonds	<u>1,901,513</u>	2,414,557
Amortization of deferred charge on refunding		(9,235,073)
<p>The issuance of long-term debt and payments to escrow to refund previously outstanding bonds provides current financial resources/uses to governmental funds. Neither transaction has any effect on net position. This adjustment is as follows:</p>		
Refunding bond proceeds	\$ (688,805,891)	
Refunding bond premium	(56,499,729)	
Payment to escrow for refunding	<u>705,418,030</u>	<u>(39,887,590)</u>
Net change in net position (deficit) of governmental activities		<u>\$ (46,998,382)</u>

See notes to financial statements.

**Tobacco Settlement Authority
(A Component Unit of the State of Iowa)**

Notes to Financial Statements

Note 1. Nature of Operations, Reporting Entity, Measurement Focus and Basis of Accounting and Significant Accounting Policies

Nature of operations: The Tobacco Settlement Authority (the Authority) was authorized by the provisions of Chapter 12E of the Code of Iowa on May 19, 2000. The purposes of the Authority include: (a) implementing and administering a program plan and establishing a stable source of revenue to be used for purposes designated in Chapter 12.65 of the Code of Iowa, (b) entering into sales agreements, (c) issuing bonds and entering into funding options, including refunding and refinancing its debt and obligations, (d) selling, pledging or assigning as security all or a portion of the State of Iowa's (the State) share to provide for and secure the issuance of its bonds, (e) investing funds available to provide for a source of revenue in accordance with the program plan, (f) entering into agreements with the State for the periodic distribution of amounts due the State under any sales agreement, (g) refunding and refinancing the Authority's debts and obligations and managing its funds, obligations and investments, as necessary, (h) selling, pledging or assigning, as security or consideration, all or a portion of the State's share to implement alternative funding options and (i) implementing the purposes of Chapter 12E of the Code of Iowa.

The Authority's Board of Trustees consists of the Treasurer of State, the Auditor of State and the Director of the Department of Management of the State.

Reporting entity: The Authority is a component unit of the State of Iowa (the State). The basic financial statements of the Authority are included in the State's Comprehensive Annual Financial Report.

The Authority has considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the Authority are such that exclusion would cause the Authority's basic financial statements to be misleading or incomplete. The Governmental Accounting Standards Board (GASB) has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the Authority to impose its will on that organization or (2) the potential for the organization to provide specific benefits to or impose specific financial burdens on the Authority. The Authority has no component units which meet the GASB criteria.

Measurement focus and basis of accounting: The Authority-wide basic 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 when a liability is incurred, regardless of the timing of related cash flows.

Governmental fund basic financial statements 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 year or soon enough thereafter to pay liabilities of the current year. For this purpose, the Authority considers revenues to be available if they are collected within 60 days after the end of the current fiscal year. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures are recorded only when payment is due.

Authority-wide and fund basic financial statements: The basic financial statements combine both an Authority-wide perspective and a governmental fund perspective.

**Tobacco Settlement Authority
(A Component Unit of the State of Iowa)**

Notes to Financial Statements

Note 1. Nature of Operations, Reporting Entity, Measurement Focus and Basis of Accounting and Significant Accounting Policies (Continued)

The Authority-wide basic financial statements, the statement of net position (deficit) and the statement of activities, report information on all of the activities of the Authority. Governmental activities generally are those normally financed through taxes, intergovernmental revenues and other nonexchange revenues.

Master Settlement Agreement: On November 23, 1998, a Master Settlement Agreement (the MSA) was entered into between 46 states (including the State of Iowa) and the four major tobacco industry manufacturers. The MSA represents the resolution of a large potential financial liability of the tobacco industry manufacturers for smoking-related injuries. The 46 states agreed to settle all past, present and future smoking-related claims against the tobacco industry manufacturers in exchange for agreements and undertakings by the tobacco industry manufacturers concerning a number of issues.

The MSA sets forth the schedule and calculation of payments to be made by the tobacco industry manufacturers to the states. These payments are subject to various adjustments and offsets. Payments to be received under the MSA include:

- Five initial payments, the last of which was paid in January 2003,
- Annual payments which are required to be made on April 15 of each year and will continue in perpetuity, and
- Ten strategic contribution fund payments which were required to be made annually on April 15, from April 15, 2008 through April 15, 2017.

Program Plan: Chapter 12E.10 of the Code of Iowa directs the Authority to establish a Tobacco Settlement Program Plan (Program Plan) to provide the State with a secure and stable source of revenue for the purposes designated in Chapter 12.65 of the Code of Iowa. These purposes relate to health care, substance abuse treatment and enforcement, tobacco use prevention and control and other purposes related to the needs of children, adults and families in the State and to create a savings account for healthy Iowans to be invested to provide an ongoing source of investment earnings.

The Program Plan was submitted to the Legislature and the Executive Council of the State. Implementation of the Program Plan was authorized by a constitutional majority of each house of the General Assembly and approved by the Governor of the State.

Sales Agreement: Upon approval of the Program Plan, the State and the Authority entered into a sales agreement in which the State agreed to sell the Authority all of its right, title and interest in certain amounts payable to the State under the MSA. In return, the Authority agreed to issue tobacco settlement bonds and remit the net bond proceeds and any unpledged moneys to the State.

Tobacco Settlement Asset-Backed Bonds, Series 2005: The Authority issued Tobacco Settlement Asset-Backed Bonds, Series 2005 (Series 2005 Bonds), dated November 30, 2005, in the amount of \$831,962,030.

These bonds were refunded in 2021 by the Series 2021 bonds.

**Tobacco Settlement Authority
(A Component Unit of the State of Iowa)**

Notes to Financial Statements

Note 1. Nature of Operations, Reporting Entity, Measurement Focus and Basis of Accounting and Significant Accounting Policies (Continued)

Tobacco Settlement Asset-Backed Bonds, Series 2021 Senior Bonds: The Authority issued Tobacco Settlement Asset-Backed Bonds, Series 2021 Senior Bonds (Series 2021 Bonds), dated April 13, 2021, in the amount of \$688,805,891.

The Series 2021 Bonds contain turbo redemption features which require all tobacco revenue collections in excess of operating expenditures and scheduled debt service be applied to the redemption of the bonds. The turbo redemptions are not scheduled amortization payments and are to be made only from surplus collections, if any. Failure to make a turbo redemption payment will not constitute default.

Significant accounting policies: The basic financial statements of the Authority have been prepared in conformity with U.S. generally accepted accounting principles, as applied to governmental units. The more significant of the Authority's accounting policies are described below.

Cash equivalents: The cash balances of the Authority are pooled and invested by the Treasurer of State. All highly liquid investments with a maturity of three months or less when purchased are considered to be cash equivalents.

Due from the State: The receivable consists primarily of the amount the State of Iowa has committed from the future amounts to be received by the State under the MSA. Due from the State represents amounts expected to be received by the Authority under the MSA. The Authority received \$41,285,035 from the State of Iowa under the MSA for the year ended June 30, 2021.

Bonds payable: In the Authority-wide financial statements, the Authority reports bonds payable at face value, net of discounts and accretion of capital appreciation on the statement of net position. Bond discounts are deferred and amortized using the effective interest method over the life of the related debt. Issuance costs are reported as an expense in the year costs are incurred. Interest expense is recognized on the accrual basis.

In the governmental fund financial statements, bond discounts and bond premiums are recognized as other financing sources. Principal payments, interest expense, and bond issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures when paid or when due and payable.

Deferred outflows of resources: In addition to assets, the statement of net position (deficit) sometimes reports deferred outflows of resources. This financial statement element, deferred outflows of resources, represents a consumption of net position that applies to future period(s) and so will not be recognized as an outflow of resources (expense/expenditure) until that time. The Authority has one item which qualifies for reporting in this category, the deferred charge on refunding resulting from the difference in the carrying value of refunded debt along with any unamortized bond discount/premium amounts, and its reacquisition price. This amount is deferred and amortized over the shorter of the life of the refunded debt or the refunding debt.

Fund balance: In the governmental fund financial statements, the fund balance is classified as restricted. Amounts are restricted to specific purposes when constraints placed on the use of the resources are either externally imposed by creditors, grantors or state or federal laws or imposed by law through constitutional provisions or enabling legislation.

**Tobacco Settlement Authority
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Notes to Financial Statements

Note 1. Nature of Operations, Reporting Entity, Measurement Focus and Basis of Accounting and Significant Accounting Policies (Continued)

Net position (deficit): Net position (deficit) represents the difference between assets plus deferred outflows of resources and liabilities. Net position is reported as restricted when there are limitations imposed on their use through enabling legislation or through external restrictions imposed by creditors, grantors or laws or regulations of other governments. The Authority has a restricted net position of \$26,251,986 for debt service by the sales agreement. The Authority first applies restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net position are available.

Use of estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Budget: The Authority does not, and is not required to, have an appropriation budget.

Note 2. Deposits and Investments

Cash and cash equivalents as of June 30, 2021 included the cash balance of \$5,412,806 held by the Treasurer of State in pooled money funds and cash equivalents of \$26,251,986 invested in open-ended money market funds.

The Authority participates in the Treasurer of State's investment pool but does not own the underlying investments of the pool. For more information in regard to the credit risk, interest rate risk and concentration of credit risk of the Treasurer of State's investment pool, see the State of Iowa Comprehensive Annual Financial Statement.

Investment policy: The Amended and Restated Trust Indenture entered into as of April 1, 2021, by the Authority defines "Eligible Investments" for the accounts held by the Authority.

Authorized investments: The Authority is authorized to invest TSA accounts in obligations of the United States government, its agencies and instrumentalities; certificates of deposits in Iowa financial institutions; prime bankers' acceptances, commercial paper or other short-term corporate debt; repurchase agreements; money market mutual funds organized in trust form; and other investments as permitted under the Indenture and Section 12B.10 of the Code of Iowa.

Fair value measurements: The Authority uses the fair value hierarchy established by generally accepted accounting principles based on the valuation inputs used to measure the fair value of the asset. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Generally accepted accounting principles provide a hierarchy that prioritizes the inputs to fair value measurements based on the extent inputs to valuation techniques are observable in the marketplace. The hierarchy assigns a higher priority to observable inputs that would reflect the State's assumptions about how market participants would value an asset or liability based on the best information available. Fair value measurements should maximize the use of observable inputs and minimize the use of unobservable inputs.

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Notes to Financial Statements

Note 2. Deposits and Investments (Continued)

The three levels of the fair value hierarchy are as follows:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities that are available at the measurement date.

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for an asset or liability, either directly or indirectly.

Level 3 – Unobservable inputs for an asset or liability that are used to measure fair value when observable inputs are not available. These inputs are developed based upon the best information available in such circumstances.

The categorization of fair value measurements by level of the hierarchy is based upon the lowest level input that is significant to the overall fair value measurement for a given asset or liability. The assessment of the significance of particular inputs to these fair value measurements requires judgement and considers factors specific to each asset or liability.

In the event that changes in the inputs used in the fair value measurement of an asset or liability result in a transfer into a different level, such transfers are recognized at the end of the reporting period.

At June 30, 2021, the Authority's investments in money market equities are classified as Level 1 investments.

Money market equities: Mutual funds are reported at fair value based on quoted market prices obtained from exchanges and also reported at fair value based on evaluation using market sources and integrating relative credit information, observed market movements, and sector news into the evaluated pricing applications and models.

Credit risk: Credit risk is the risk an issuer or other counterparty to an investment will not fulfill its obligation to the Authority. Under bond resolutions of the Official Statement of the Tobacco Settlement Asset-Backed Bonds, Series 2021, the Authority is authorized to invest in defeasance collateral, noncallable senior debt obligations of U.S. government-sponsored agencies that are not backed by the full faith and credit of the U.S. government, demand and time deposits in or certificates of, or banker's acceptances issued by, any bank or trust company, savings and loan association or savings bank, municipal obligations of any state of the United States or the State or any political subdivision thereof, commercial or finance company paper, repurchase obligations, securities bearing interest or sold at a discount issued by any corporation incorporated under the laws of the United States or any state, municipality or political subdivision thereof, units of taxable money market funds, investment agreements, forward delivery agreements, or guaranteed investment contracts rated, or with any financial institution or corporation, and other obligations, securities, agreements or contracts that are noncallable and are acceptable to each nationally recognized rating service agency.

Concentration of credit risk: Concentration of credit risk is the risk of loss that may be attributed to the magnitude of the Authority's investment in a single issuer. The Authority places no limit on the amount that may be invested in any one issuer. The Authority's investment in the mutual fund is rated AAA.

Custodial credit risk: Custodial credit risk for deposits is the risk the Authority's deposits may not be returned to it in the event of a bank failure. The Authority's deposits in financial institutions were covered by the Federal Deposit Insurance Corporation or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa.

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Notes to Financial Statements

Note 3. Bonds Payable

On April 13, 2021, the Authority issued \$688,805,891 of Tobacco Settlement Asset-Backed Series 2021 Bonds, to refund Tobacco Settlement Asset-Backed Series 2005 bonds which had carrying value of \$743,782,892 as of this date. The Authority will reduce its total debt service payments over the next 44 years by approximately \$881,490,000 and obtain an economic gain (difference between the present values of debt services payments on the old and new debt) of approximately \$167,803,000. The original reacquisition price exceeded the net carrying amount of the old debt by \$21,667,049 and as of June 30, 2021, had a carrying value of \$21,594,825. This amount is recorded as deferred outflow and amortized over the life of the refunded debt.

The Tobacco Settlement Asset-Backed Series 2021 Bonds were issued in four series: the Series 2021 A-1 Bonds in the principal amount of \$25,750,000, which are federally taxable serial bonds, the Series 2021 A-2 Bonds in the principal amount of \$164,115,000, which are federally tax-exempt serial and term bonds, the Series 2021 B-1 Bonds in the principal amount of \$225,000,000, which are federally tax-exempt turbo term bonds, the Series 2021 B-2 Bonds in the principal amount of \$273,940,891, which are federally tax-exempt capital appreciation turbo bonds.

The bonds bear interest at rates ranging from 0.375% to 5.000% per annum and mature in varying annual amounts ranging from \$2,560,000 to \$97,826,417, with the final term and capital appreciation maturities due in the year ending June 30, 2049. The balance outstanding on June 30, 2021 was \$715,009,291 \$1,991,740,000 net of unamortized bond premiums and deferred amounts of \$(1,276,730,709).

The bond documents include the following provisions:

- (a) The Series 2021 Bonds are special revenue obligations of the Authority secured by, and payable solely and only out of, the monies, assets or revenues pledged by the Authority pursuant to the Indenture. The bonds are not a general obligation or general indebtedness of the Authority and do not constitute an obligation or indebtedness of the State or any political subdivision of the State. The Authority may not pledge the credit or taxing power of the State or any political subdivision of the State or create a debt or obligation of the State. The Authority has no taxing power. The Series 2021 Bonds constitute neither a general, legal or moral obligation of the State or any of its political subdivisions and the State has no obligation or intention to satisfy any deficiency or default of any payment of the bonds.
- (b) The Series 2021 bonds are secured by and are payable solely from (i) 78% of the future amounts to be received by the State of Iowa under the MSA, (ii) investment earnings on certain accounts pledged under the bond indenture, (iii) amounts held in the debt service reserve account established under the bond indenture, (iv) amounts held in other accounts established under the Bond indenture and (v) certain rights of the Authority as specified in the sales agreement.
- (c) The proceeds of the Series 2021 Bonds, except as deposited in the debt service reserve account, are not pledged to the payment of, and therefore are not available to the holders of, the Series 2021 A-1, A-2, B-1, B-2 bonds.

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Notes to Financial Statements

Note 3. Bonds Payable (Continued)

- (d) A bond fund is established with the bond indenture trustee and money will be deposited in the fund as provided in the bond indenture. The money will be held in trust and, except as otherwise provided in the bond indenture, will be applied solely to the payment of debt service. The bond fund includes the debt service account, the debt service reserve account, the extraordinary prepayment account and such other accounts as deemed necessary. The amount in the required debt service account is \$18,861,792 as of June 30, 2021.
- (e) The debt service reserve account was funded from bond proceeds in an aggregate amount of \$18,861,792. The account will be available to pay (i) the principal and interest on the Series 2021A and the Series 2021B-1 Bonds to the extent collections under the MSA are insufficient and (ii) after an event of default, extraordinary prepayments. Amounts on deposit in the subaccounts of debt service reserve account are not available for turbo redemption and do not secure the Series 2021B-2 Bonds.
- (f) If an event of default has occurred, collections remaining after the payment of certain expenses and all current and past due interest on bonds will be deposited in the extraordinary prepayment account and will be applied, together with amounts in the debt service account, the debt service reserve account, the extraordinary prepayments account and the partial lump sum payment account, to the extraordinary prepayments of the bonds for principal or, in the case of capital appreciation bonds, the accreted value of outstanding bonds will be paid, in whole or in part, on each succeeding distribution date. The accreted value of capital appreciation bonds and any interest that has accrued will be payable only after all other bonds have been fully paid.

The Authority is subject to certain nonfinancial covenants related to the Series 2021 Bonds. The Authority is in compliance with these covenants.

Annual debt service requirements to maturity for the bonds are as follows:

Year Ending June 30	Series 2021 A-1 Serial Taxable			Series 2021 A-2 Serial Tax Exempt		
	Principal	Interest Rate	Interest	Principal	Interest Rate	Interest
2022	\$ 4,155,000	0.5630%	\$ 272,393	\$ -	5.000%	\$ 817,750
2023	4,175,000	0.6630	249,001	-	5.000	817,750
2024	4,215,000	0.9380	221,320	-	5.000	817,750
2025	4,260,000	1.3820	181,784	-	5.000	817,750
2026	4,325,000	1.6320	122,910	-	5.000	817,750
2027-2031	2,560,000	2.0440	52,326	16,355,000	5.000	2,288,500
2032-2036	-		-	-		-
2037-2041	-		-	-		-
2042-2046	-		-	-		-
2047-2049	-		-	-		-
	<u>\$ 23,690,000</u>		<u>\$ 1,099,734</u>	<u>\$ 16,355,000</u>		<u>\$ 6,377,250</u>

**Tobacco Settlement Authority
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Notes to Financial Statements

Note 3. Bonds Payable (Continued)

Year Ending June 30	Series 2021 A-2 Serial Tax Exempt			Series 2021 A-2 Term Bonds		
	Principal	Interest Rate	Interest	Principal	Interest Rate	Interest
2022	\$ -	4.0 - 5.0%	\$ 2,747,150	\$ -	4.000%	\$ 3,330,200
2023	-	4.0 - 5.0	2,747,150	-	4.000	3,330,200
2024	-	4.0 - 5.0	2,747,150	-	4.000	3,330,200
2025	-	4.0 - 5.0	2,747,150	-	4.000	3,330,200
2026	-	4.0 - 5.0	2,747,150	-	4.000	3,330,200
2027-2031	-	4.0 - 5.0	10,988,600	-	4.000	13,320,800
2032-2036	29,095,000	4.0 - 5.0	11,014,350	-	4.000	16,651,000
2037-2041	35,410,000	4.0 - 5.0	4,355,800	-	4.000	16,651,000
2042-2046	-	-	-	42,740,000	4.000	13,360,800
2047-2049	-	-	-	40,515,000	4.000	4,128,200
	<u>\$ 64,505,000</u>		<u>\$ 40,094,500</u>	<u>\$ 83,255,000</u>		<u>\$ 80,762,800</u>

Year Ending June 30	Series 2021 B-1 Turbo Term Bonds			Series 2021 B-1 Turbo Term Bonds		
	Principal	Interest Rate	Interest	Principal	Interest Rate	Interest
2022	\$ 11,395,000	0.375%	\$ 42,730	\$ 18,890,000	4.000%	\$ 7,400,000
2023	-	-	-	26,305,000	4.000	6,644,400
2024	-	-	-	26,745,000	4.000	5,592,200
2025	-	-	-	27,575,000	4.000	4,522,400
2026	-	-	-	28,540,000	4.000	3,419,400
2027-2031	-	-	-	56,945,000	4.000	3,369,800
2032-2036	-	-	-	-	-	-
2037-2041	-	-	-	-	-	-
2042-2046	-	-	-	-	-	-
2047-2049	-	-	-	-	-	-
	<u>\$ 11,395,000</u>		<u>\$ 42,730</u>	<u>\$ 185,000,000</u>		<u>\$ 30,948,200</u>

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Notes to Financial Statements

Note 3. Bonds Payable (Continued)

Year Ending June 30	Series 2021 B-2 Capital Appreciation Bonds			Total	
	Principal	Accretion Rate	Accretion	Principal	Interest & Accretion
2022	\$ -	4.050%	\$ -	\$ 34,440,000	\$ 14,610,223
2023	-	4.050	-	30,480,000	13,788,501
2024	-	4.050	-	30,960,000	12,708,620
2025	-	4.050	-	31,835,000	11,599,284
2026	-	4.050	-	32,865,000	10,437,410
2027-2031	-	4.050	-	75,860,000	30,020,026
2032-2036	-	4.050	-	29,095,000	27,665,350
2037-2041	-	4.050	-	35,410,000	21,006,800
2042-2046	-	4.050	-	42,740,000	13,360,800
2047-2049	-	4.050	-	40,515,000	4,128,200
2050 and thereafter	275,403,753	4.050	1,332,136,247	275,403,753	1,332,136,247
	<u>\$ 275,403,753</u>		<u>\$ 1,332,136,247</u>	<u>\$659,603,753</u>	<u>\$ 1,491,461,461</u>

The following summarizes the bond payable activity for the Authority for the year ended June 30, 2021:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Bonds payable:					
Term bonds	\$ 484,330,000	\$ 308,255,000	\$ (512,935,000)	\$ 279,650,000	\$ 34,440,000
Issuance premiums	-	30,018,829	(600,241)	29,418,588	-
Convertible capital appreciation bonds	178,010,000	-	(178,010,000)	-	-
Serial Bonds	-	106,610,000	(2,060,000)	104,550,000	-
Issuance premiums	-	26,480,900	(493,950)	25,986,950	-
Capital appreciation bonds	551,790,000	1,607,540,000	(551,790,000)	1,607,540,000	-
Less:					
Issuance discounts	(11,194,896)	-	11,194,896	-	-
Capital appreciation discount	(454,800,042)	(1,333,599,108)	456,262,903	(1,332,136,247)	-
Total bonds payable, net	<u>\$ 748,135,062</u>	<u>\$ 745,305,621</u>	<u>\$ (778,431,392)</u>	<u>\$ 715,009,291</u>	<u>\$ 34,440,000</u>

Note 4. Deficit Net Position Balance

The deficit net position balance will be paid with future MSA revenues and investment income. The payments to be received by the State under the MSA represent a share of anticipated future sales of tobacco products. Although the Authority expects to receive certain amounts from the State, the collections are not assured.

Note 5. Tobacco Litigation Risk

The amount of revenue recognized by the State and provided to the Authority could be adversely impacted by certain third-party litigation involving tobacco companies and others.

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Notes to Financial Statements

Note 6. Risk Management

The Authority has not purchased commercial insurance for risks of losses to which it is exposed. Instead, the Authority manages its risks internally and pays claim settlements directly. There have been no claims in any of the past three fiscal years against the Authority.

Note 7. Contingency

On January 30, 2020, the World Health Organization declared the coronavirus outbreak (COVID-19) a “Public Health Emergency of International Concern” and on March 11, 2020, declared it to be a pandemic. Actions taken around the world to help mitigate the spread of the coronavirus include restrictions on travel, and quarantines in certain areas, and forced closures for certain types of public places and businesses. The coronavirus and actions taken to mitigate the spread of it have had and are expected to continue to have an adverse impact on the economies and financial markets of many countries and their political subdivision.

It is unknown how long the adverse conditions associated with the coronavirus will last and what the complete financial effect will be to the Authority. The extent to which COVID-19 may affect the Authority’s results will depend on future developments, which are highly uncertain and cannot be predicted, including new information, which may emerge concerning the severity of COVID-19 and actions taken to contain COVID-19 or its impact, among others.

Additionally, it is reasonably possible that estimates made in the financial statements have been, or will be, materially and adversely impacted in the near term as a result of these conditions.