

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

Financial Report  
June 30, 2022

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## Independent Auditor's Report

RSM US LLP

Board of the Tobacco Settlement Authority

### Report on the Audit of the Financial Statements

#### **Opinions**

We have audited the 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, 2022, and the related notes to the financial statements, which collectively comprise the Tobacco Settlement Authority's basic financial statements as listed in the table of contents.

In our opinion, the accompanying 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, 2022, 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.

#### **Basis for Opinions**

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Tobacco Settlement Authority and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

#### **Responsibilities of Management for the Financial Statements**

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Tobacco Settlement Authority's ability to continue as a going concern for 12 months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

#### **Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinions. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Tobacco Settlement Authority's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Tobacco Settlement Authority's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

***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 GAAS, 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.

***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated November 18, 2022 on our consideration of the 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 solely 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 effectiveness of the Authority's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

***RSM US LLP***

Des Moines, Iowa  
November 18, 2022

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

**Management's Discussion and Analysis  
Year Ended June 30, 2022**

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The Office of the Treasurer of State provides this Management's Discussion and Analysis on behalf of the Tobacco Settlement Authority, a component unit of the State of Iowa (the Authority). This narrative overview and analysis of the financial activities of the Authority is for the fiscal year ended June 30, 2022. We encourage readers to consider this information in conjunction with the Trust's financial statements, which follow this section.

**Overview of the Authority**

On November 20, 1998, 46 states, including Iowa, approved a settlement agreement with the four major tobacco industry manufacturers that comprised 99.4% of the U.S. cigarette market. The manufacturers agreed to a settlement valued at \$206.4 billion to be paid over 25 years to settle tobacco-related lawsuits filed by the states. This Master Settlement Agreement (MSA) covered 39 states that filed lawsuits and seven states that had yet to sue. Since 1998, Iowa has received approximately \$1.4 billion from the MSA.

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.

The following summarizes the refundings and issuances of the bonds since 2001:

- In 2005, the Authority issued approximately \$832 million of Tobacco Settlement Asset-Backed Bonds, which were 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.
- 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 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.

In fiscal year 2022, 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 2021 bonds. During the year, the Authority received \$41,482,831 in pledged Tobacco Settlement Revenues.

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

**Management's Discussion and Analysis  
Year Ended June 30, 2022**

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**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, 2022 and 2021. 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  
(A Component Unit of the State of Iowa)**

**Management's Discussion and Analysis  
Year Ended June 30, 2022**

Table 1 reflects total net position of \$(643,189,804) as of June 30, 2022, which represents a decrease of \$23,624,994 from June 30, 2021. The Authority's total assets decreased \$41,247,083, primarily due to paying down the advance to the State. Total liabilities decreased \$18,488,774, primarily due to principal payments on the 2021 Bonds.

Table 1 - Authority's Net Position

	Governmental Activities	
	June 30,	
	2022	2021
<b>Assets</b>		
Current assets	\$ 7,771,919	\$ 48,957,926
Noncurrent assets	26,190,910	26,251,986
<b>Total assets</b>	<b>33,962,829</b>	<b>75,209,912</b>
<b>Deferred outflows of resources</b>	<b>20,728,140</b>	<b>21,594,825</b>
<b>Liabilities</b>		
Current liabilities	32,018,094	35,800,256
Long-term liabilities	665,862,679	680,569,291
<b>Total liabilities</b>	<b>697,880,773</b>	<b>716,369,547</b>
<b>Net Position (Deficit)</b>		
Restricted for debt service	26,190,910	26,251,986
Unrestricted	(669,380,714)	(645,816,796)
<b>Total net position (deficit)</b>	<b>\$ (643,189,804)</b>	<b>\$ (619,564,810)</b>

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

**Management's Discussion and Analysis  
Year Ended June 30, 2022**

Table 2 highlights the Authority's revenues and expenses for the years ended June 30, 2022 and 2021. This table utilizes the full accrual method of accounting.

Table 2 - Authority's Changes in Net Position

	Governmental Activities	
	Years Ended June 30,	
	2022	2021
General revenues, investment income	\$ 42,925	\$ 2,041,325
Expenses:		
Current:		
Administrative	77,046	72,677
Enforcement	1,113,494	465,506
Cost of issuance	-	4,904,179
Debt service, interest	22,477,379	43,597,345
<b>Total expenses</b>	<b>23,667,919</b>	<b>49,039,707</b>
<b>Decrease in net position (deficit)</b>	<b>(23,624,994)</b>	<b>(46,998,382)</b>
Net position (deficit), beginning of year	(619,564,810)	(572,566,428)
Net position (deficit), end of year	\$ (643,189,804)	\$ (619,564,810)

**Financial Analysis of the Governmental Fund Activities**

As noted earlier, the Authority uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The fiscal year 2022 ending fund balance of the Authority's governmental fund decreased \$41,462,839 from fiscal year 2021. The decrease is due primarily to the principal and interest payments made in the current year. The ending fund balance is restricted for debt service.

**Debt Administration**

As of June 30, 2022 and 2021, the Authority had \$696,342,679 and \$715,009,291, respectively, of outstanding revenue bonds, as shown in Table 3. In the current year, the Authority paid \$25,705,000 of principal and incurred \$14,610,224 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	
	2022	
	2022	2021
Term bonds	\$ 258,100,000	\$ 279,650,000
Serial bonds	100,395,000	104,550,000
Capital appreciation bonds	1,607,540,000	1,607,540,000
Less deferred amounts	(1,269,692,321)	(1,276,730,709)
<b>\$ 696,342,679</b>	<b>\$ 715,009,291</b>	



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

**Management's Discussion and Analysis  
Year Ended June 30, 2022**

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**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  
(A Component Unit of the State of Iowa)**

**Governmental Fund Balance Sheet/Statement of Net Position (Deficit)  
June 30, 2022**

	General Fund Balance Sheet	Adjustments	Statement of Net Position (Deficit)
<b>Assets</b>			
Current assets:			
Cash on deposit with Treasurer of State	\$ 5,708,608	\$ -	\$ 5,708,608
Due from the State	2,056,969	-	2,056,969
Interest receivable, restricted	6,342	-	6,342
<b>Total current assets</b>	<u>7,771,919</u>	-	<u>7,771,919</u>
Noncurrent assets, restricted assets, cash and cash equivalents	<u>26,190,910</u>	-	<u>26,190,910</u>
<b>Total assets</b>	<u>33,962,829</u>	-	<u>33,962,829</u>
<b>Deferred Outflow of Resources</b> , deferred charge on refunding	<u>-</u>	<u>20,728,140</u>	<u>20,728,140</u>
<b>Total assets and deferred outflows of resources</b>	<u><u>\$ 33,962,829</u></u>		
<b>Liabilities</b>			
Current liabilities:			
Due to the State	\$ 359,936	-	359,936
Bonds payable, current portion	-	30,480,000	30,480,000
Accrued interest payable	-	1,178,158	1,178,158
<b>Total current liabilities</b>	<u>359,936</u>	<u>31,658,158</u>	<u>32,018,094</u>
Noncurrent liabilities, bonds payable, net		<u>665,862,679</u>	<u>665,862,679</u>
<b>Total liabilities</b>	<u>359,936</u>	<u>697,520,837</u>	<u>697,880,773</u>
<b>Fund Balance</b> , restricted for debt service	<u>33,602,893</u>	<u>(33,602,893)</u>	<u>-</u>
<b>Total liabilities and fund balances</b>	<u><u>\$ 33,962,829</u></u>		
<b>Net Position (Deficit)</b>			
Restricted for debt service		26,190,910	26,190,910
Unrestricted (deficit)		<u>(669,380,714)</u>	<u>(669,380,714)</u>
<b>Total net position (deficit)</b>		<u><u>\$ (643,189,804)</u></u>	<u><u>\$ (643,189,804)</u></u>

See notes to financial statements.

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

**Reconciliation of the Governmental Fund Balance Sheet to the Statement of  
Net Position (Deficit)  
June 30, 2022**

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

Total fund balance for the governmental fund	\$ 33,602,893
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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).

Accrued interest on bonds	(1,178,158)
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Bonds payable	\$ (1,966,035,000)
Unamortized appreciation discount	1,319,900,188
Unamortized bond premium	<u>(50,207,867)</u>
	(696,342,679)

Deferred outflow of resources for deferred charge on refunding	<u>20,728,140</u>
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<b>Total net position (deficit) of governmental activities</b>	<b><u><u>\$ (643,189,804)</u></u></b>
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See notes to financial statements.

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

**Statement of Revenues, Expenditures and Changes in Fund**  
**Balance/Statement of Activities**  
**Year Ended June 30, 2022**

	General Fund Statement of Revenues, Expenditures and Changes in Fund Balance	Adjustments	Statement of Activities
General revenues, investment income	\$ 42,925	\$ -	\$ 42,925
Expenditures/expenses:			
Current:			
Administrative	77,046	-	77,046
Enforcement	1,113,494	-	1,113,494
Debt service:			
Principal	25,705,000	(25,705,000)	-
Interest	14,610,224	7,867,155	22,477,379
<b>Total expenditures/expenses</b>	<b>41,505,764</b>	<b>(17,837,845)</b>	<b>23,667,919</b>
<b>Net change in fund balance/net position (deficit)</b>	<b>(41,462,839)</b>	<b>17,837,845</b>	<b>(23,624,994)</b>
Fund balance/net position (deficit), beginning of year	75,065,732	(694,630,542)	(619,564,810)
Fund balance/net position (deficit), end of year	<u>\$ 33,602,893</u>	<u>\$ (676,792,697)</u>	<u>\$ (643,189,804)</u>

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, 2022**

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Net change in fund balance		\$ (41,462,839)
Repayment of bond principal is an expenditure in the governmental fund but reduces the liability in the statement of net position (deficit)		25,705,000
<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 two balances, as follows:</p>		
Amortization of bond premium	\$ 5,197,671	
Capital appreciation	(12,236,059)	
Accrued interest on bonds	<u>37,918</u>	(7,000,470)
Amortization of deferred charge on refunding		<u>(866,685)</u>
<b>Net change in net position (deficit) of governmental activities</b>		<b><u>\$ (23,624,994)</u></b>

See notes to financial statements.

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

**Notes to Financial Statements**

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**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**

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**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**

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**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. There were no failed payments for the year ending June 30, 2022.

**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 \$41,482,781 from the State of Iowa under the MSA for the year ended June 30, 2022.

**Bonds payable:** In the Authority-wide financial statements, the Authority reports bonds payable at face value, net of premiums and accretion of capital appreciation on the statement of net position. Bond premiums 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 (uses). 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**

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**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 \$26,190,910 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, 2022 included the cash balance of \$5,708,608 held by the Treasurer of State in pooled money funds and cash equivalents of \$26,190,910 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 Annual Comprehensive 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.

**Tobacco Settlement Authority  
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**Notes to Financial Statements**

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**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, 2022, 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.

**Interest rate risk:** Interest rate risk is the risk that the changes in interest rates will adversely affect the fair value of an investment. Interest rate risk may be mitigated by investing operating funds primarily in shorter term securities, money market funds or similar investment pools and limiting the average maturity of the portfolio.

The Authority has no formal investment policy, but the Authority has historically only invested in investments with maturities less than one year. The Authority also attempts to match its investments with anticipated cash flow requirements. The Authority's money market investment has a weighted average to maturity of 13 days.

**Tobacco Settlement Authority  
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**Notes to Financial Statements**

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**Note 2. Deposits and Investments (Continued)**

**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 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. The Authority had no concentration risk as of June 30, 2022.

**Custodial credit risk:** Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in possession of an outside party. 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.

**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. The original reacquisition price exceeded the net carrying amount of the old debt by \$21,667,049 and as of June 30, 2022, had a carrying value of \$20,728,140. 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 with a final original maturity obligation of \$1,607,540,000. These bonds will not be paid currently but will accrete in value, compounded semi-annually commencing June 1, 2021 at a rate of 4.050%, from the initial principal amount to maturity or earlier redemption. The 2021B bonds are subject to redemption at the option of the Authority at a redemption price equal to 100% of the accreted value being redeemed on the redemption date, in whole or in part at any time, but only in an amount that may not exceed the amount of the projected turbo redemption schedule. For the year ended June 30, 2022, the Authority made \$12,236,059 in redemptions

The bonds bear interest at rates ranging from 0.513% to 5.000% per annum and mature in varying annual amounts ranging from \$2,560,000 to \$287,639,812, with the final term and capital appreciation maturities due in the year ending June 30, 2049. The balance outstanding on June 30, 2022 was \$696,342,679, consists of net debt of \$1,966,035, unamortized bond premiums of \$50,207,867, and capital appreciation discount of \$(1,319,900,188).

**Tobacco Settlement Authority  
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**Notes to Financial Statements**

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**Note 3. Bonds Payable (Continued)**

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.
- (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 \$26,190,910 as of June 30, 2022.
- (e) The debt service reserve account was funded from bond proceeds. 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.

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**Notes to Financial Statements**

**Note 3. Bonds Payable (Continued)**

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
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	2,560,000	2.0440	52,326	1,875,000	5.000	817,750
2028-2032	-	-	-	14,480,000	-	1,470,750
2033-2037	-	-	-	-	-	-
2038-2042	-	-	-	-	-	-
2043-2047	-	-	-	-	-	-
2048-2049	-	-	-	-	-	-
	<u>\$ 19,535,000</u>		<u>\$ 827,341</u>	<u>\$ 16,355,000</u>		<u>\$ 5,559,500</u>

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
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	-	4.0 - 5.0	2,747,150	-	4.000	3,330,200
2028-2032	10,865,000	4.0 - 5.0	13,470,500	-	4.000	16,651,000
2033-2037	31,600,000	4.0 - 5.0	8,355,700	-	4.000	16,651,000
2038-2042	22,040,000	4.0 - 5.0	1,785,400	16,135,000	4.000	16,334,400
2043-2047	-	-	-	46,095,000	4.000	9,875,800
2048-2049	-	-	-	21,025,000	4.000	1,269,400
	<u>\$ 64,505,000</u>		<u>\$ 37,347,350</u>	<u>\$ 83,255,000</u>		<u>\$ 77,432,600</u>

**Tobacco Settlement Authority  
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**Notes to Financial Statements**

**Note 3. Bonds Payable (Continued)**

Year Ending June 30	Turbo Term Bonds			Series 2021 B-2 Capital Appreciation Bonds		
	Principal	Interest Rate	Interest	Principal	Accretion Rate	Annual Accretion
2023	\$ 26,305,000	4.000%	\$ 6,993,800	\$ -	4.050%	\$ -
2024	26,745,000	4.000	5,941,600	-	4.050	-
2025	27,575,000	4.000	4,871,800	-	4.050	-
2026	28,540,000	4.000	3,768,800	-	4.050	-
2027	29,645,000	4.000	2,627,200	-	4.050	-
2028-2032	36,035,000	4.000	1,790,800	-	4.050	-
2033-2037	-		-	-	4.050	-
2038-2042	-		-	-	4.050	-
2043-2047	-		-	-	4.050	-
2048-2049	-		-	-	4.050	-
2050 and there:	-		-	287,639,812	4.050	1,319,900,188
	<u>\$ 174,845,000</u>		<u>\$ 25,994,000</u>	<u>\$ 287,639,812</u>		<u>\$ 1,319,900,188</u>

Year Ending June 30	Total	
	Principal	Interest & Accretion
2023	\$ 30,480,000	\$ 14,137,901
2024	30,960,000	13,058,020
2025	31,835,000	11,948,684
2026	32,865,000	10,786,810
2027	34,080,000	9,574,626
2028-2032	61,380,000	33,383,050
2033-2037	31,600,000	25,006,700
2038-2042	38,175,000	18,119,800
2043-2047	46,095,000	9,875,800
2048-2049	21,025,000	1,269,400
2050 and thereafter	287,639,812	1,319,900,188
	<u>\$ 646,134,812</u>	<u>\$ 1,467,060,979</u>

**Tobacco Settlement Authority  
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**Notes to Financial Statements**

**Note 3. Bonds Payable (Continued)**

The following summarizes the bond payable activity for the Authority for the year ended June 30, 2022:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Bonds payable:					
Term bonds	\$ 279,650,000	\$ -	\$ (21,550,000)	\$ 258,100,000	\$ 26,305,000
Issuance premiums	29,418,588	-	(2,846,321)	26,572,267	-
Serial Bonds	104,550,000	-	(4,155,000)	100,395,000	4,175,000
Issuance premiums	25,986,950	-	(2,351,350)	23,635,600	
Capital appreciation bonds	1,607,540,000	-	-	1,607,540,000	-
Less, capital appreciation discount	(1,332,136,247)	12,236,059	-	(1,319,900,188)	-
Total bonds payable, net	<u>\$ 715,009,291</u>	<u>\$ 12,236,059</u>	<u>\$ (30,902,671)</u>	<u>\$ 696,342,679</u>	<u>\$ 30,480,000</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.

**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.