TSASC, INC.

A COMPONENT UNIT OF THE CITY OF NEW YORK

Financial Statements
(Together with Independent Auditors' Report)

Years Ended June 30, 2009 and 2008

Marks Paneth & Shron LLP
Certified Public Accountants and Consultants

TSASC, INC.

FINANCIAL STATEMENTS
(Together with Independent Auditors' Report)

YEARS ENDED JUNE 30, 2009 AND 2008

CONTENTS

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
TSASC, Inc.

We have audited the accompanying financial statements of the governmental activities of TSASC, Inc. ("TSASC"), a component unit of The City of New York, as of and for the years ended June 30, 2009 and 2008, as listed in the table of contents. These financial statements are the responsibility of TSASC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the governmental activities of TSASC, Inc. as of June 30, 2009 and 2008 and the respective changes in financial position thereof for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying management's discussion and analysis on pages 2 – 6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Marks Paneth & Shron LLP

New York, New York
September 25, 2009

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is a narrative overview and analysis of the financial activities of TSASC, Inc. ("TSASC") for the fiscal years ended June 30, 2009 and 2008. It should be read in conjunction with TSASC's government-wide financial statements, governmental fund financial statements and the notes to the financial statements.

The annual financial statements consist of three parts: (1) management's discussion and analysis (this section); (2) the government-wide financial statements; and (3) the governmental fund financial statements.

The government-wide financial statements of TSASC, which include the statements of net assets (deficits) and the statements of activities, are presented to display information about the reporting entity as a whole, in accordance with Governmental Accounting Standards Board ("GASB") Statement No. 34 - *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended.

The government-wide financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Accordingly, revenue is recognized when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows.

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

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

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS - GOVERNMENT-WIDE FINANCIAL STATEMENTS

On February 8, 2006, TSASC issued $1.35 billion of Series 2006-1 bonds, the proceeds of which were used to restructure all of TSASC's outstanding indebtedness. After the restructuring of its outstanding debt, TSASC had Tobacco Settlement Revenues ("TSR") available that were deposited into the Unpledged TSR account held by the Trustee for transfer on or after December 6, 2007 (together with the unpledged portions of TSRs received from February 8, 2006 to December 6, 2007) and interest earnings, to the TSASC Tobacco Settlement Trust (the "Trust"), as owner of the Residual Certificate. The City of New York (the "City") is the beneficial owner of the Trust and the funds received by the Trust, net of the Trust's expenses, are transferred to the City. During fiscal year 2009 and 2008 the Trust transferred to the City $145.65 million and $552.02 million, respectively. There was no transfer to the Trust in fiscal year 2007 as the Amended and Restated Indenture dated January 1, 2006 (the "Indenture") did not permit transfers prior to December 6, 2007.

The Indenture provides that a defined portion of the TSRs and other revenues (collectively, "Collections") are applied to the payment of the Series 2006-1 debt service. The proportion of Collections pledged to the payment of the Series 2006-1 debt service is currently 37.40% and is subject to reduction at June 1, 2024, and at each June 1st thereafter, depending on the magnitude of cumulative bond redemptions under the Series 2006-1 bond turbo redemption feature. The turbo redemption feature requires all the pledged Collections, after funding of operating costs, to be applied to payment of principal and interest on the Series 2006-1 bonds.

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

	2009	2008	2007	Variance 2009/2008	Variance 2008/2007
	(in thousands)			(in thousands)	
Revenues:					
Tobacco settlement revenue	$ 233,612	$ 211,937	$ 214,433	$ 21,675	$ (2,496)
Interest earnings	1,687	14,729	21,728	(13,042)	(6,999)
Total revenues	235,299	226,666	236,161	8,633	(9,495)
Expenses:					
Transfer to Trust	145,646	552,018	-	(406,372)	552,018
Interest expense	66,218	67,108	67,932	(890)	(824)
Other	18,856	19,240	19,212	(384)	28
Total expenses	230,720	638,366	87,144	(407,646)	551,222
Change in net deficit	4,579	(411,700)	149,017	416,279	(560,717)
Net deficit, beginning of year	(1,022,348)	(610,648)	(759,665)	(411,700)	149,017
Net deficit, end of year	$(1,017,769)	$(1,022,348)	$ (610,648)	$ 4,579	$ (411,700)

The Master Settlement Agreement ("MSA"), dated November 23, 1998, is an industry-wide settlement of litigation between participating cigarette manufacturers and 46 States (the "Settling States"), including the State of New York (the "State"). The MSA governs the amount of TSRs received by TSASC. The State receives 12.76% of the total TSRs collected of which TSASC receives 26.67% of the State's share or 3.40% of total TSRs paid by the participating cigarette manufacturers.

TSRs received in the fiscal year are based upon tobacco sales during the previous calendar year, adjusted by factors such as inflation, volume and disputed amounts deposited by the participating cigarette manufacturers into a disputed payment account. In fiscal year 2009, TSASC earned $233.61 million in TSRs compared to $211.94 million in fiscal year 2008. The increase in TSRs in fiscal year 2009 was primarily due to the release of $540 million from the MSA 2005 disputed payment escrow account, of which TSASC received $18.4 million. The release of these funds from this escrow account to the Settling States in February 2009 was in exchange for the Settling States to agree to submit to arbitration over $1.5 billion in disputed payments from 2003. If the tobacco companies prevail in these disputes, the money released in February 2009 to the Settling States would be repaid through reduced settlement payments in the future. However, the probability and the amount of any such future reduction cannot be estimated at this time.

Of the total TSRs received, 37.40% are pledged for debt service payments and the operating expenses of TSASC and 62.60% are due the TSASC Trust, of which the City is the beneficial owner. In fiscal year 2009, $145.65 million, consisting of TSRs and interest earnings, was transferred to the Trust, compared to $552.02 million transferred in fiscal year 2008. The fiscal year 2008 transfer represented fiscal year 2008 unpledged TSRs of $132.02 million, fiscal year 2007 unpledged TSRs of $128.33 million, fiscal year 2006 unpledged TSRs of $123.13 million and $136.16 million resulting from the restructuring of TSASC's outstanding indebtedness as previously discussed, plus interest income earned on the unpledged TSRs held by TSASC until transferred to the Trust. There was no transfer to the Trust in fiscal year 2007 in accordance with the Indenture.

Interest earnings decreased in fiscal year 2009 due to the low interest rate environment and the transfer to the Trust in fiscal year 2008, as discussed above.

Under the TSASC turbo redemption feature, $23.86 million of Series 2006-1 bonds were redeemed in fiscal year 2009 compared to $19.32 million in fiscal year 2008. The 23% increase in redemptions was primarily due to the additional TSRs received, as discussed above. TSASC had outstanding bonds of $1.27 billion and $1.30 billion as of June 30, 2009 and 2008, respectively.

Other expenses are composed primarily of the amortization of deferred bond refunding costs and the costs of issuance (COI) relating to the fiscal year 2006 restructuring of debt. In fiscal years 2009 and 2008, the amortization expense was $18.35 million and $18.72 million, respectively.

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

	2009	2008	2007	Variance 2009/2008	Variance 2008/2007
	(in thousands)			(in thousands)	
Assets:					
Total assets – non-capital	$ 212,743	$ 212,825	$ 624,220	$ (82)	$ (411,395)
Liabilities:					
Current liabilities	$ 5,323	$ 5,430	$ 5,494	$ (107)	$ (64)
Long-term liabilities:					
Bonds payable	1,273,690	1,297,545	1,316,860	(23,855)	(19,315)
Other	(48,501)	(67,802)	(87,486)	19,301	19,684
Total liabilities	1,230,512	1,235,173	1,234,868	(4,661)	305
Net assets (deficit):					
Restricted	(1,018,568)	(1,023,072)	(1,021,827)	4,504	(1,245)
Unrestricted	799	724	411,179	75	(410,455)
Net deficit, end of year	$ (1,017,769)	$ (1,022,348)	$ (610,648)	$ 4,579	$ (411,700)

Bonds payable decreased $23.86 million in fiscal year 2009 and $19.32 million in fiscal year 2008 due to the turbo redemption of the Series 2006-1 bonds in December and June of fiscal years 2009 and 2008, respectively. Other liabilities are the remaining unamortized bond discount and deferred bond refunding costs related to the issuance of the Series 2006-1 bonds.

In fiscal year 2008, total assets decreased 66% due to the remittance of $552.02 million to the Trust, while in fiscal year 2007 there was no remittance to the Trust as the Indenture did not permit transfers prior to December 6, 2007.

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

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS - GOVERNMENTAL FINANCIAL STATEMENTS

The following summarizes the changes in debt service fund balances for the years ended June 30,

	2009	2008	2007	Variance 2009/2008	Variance 2008/2007
	(in thousands)			(in thousands)	
Revenues:					
Tobacco settlement revenue	$ 232,612	$ 210,937	$ 208,433	$ 21,675	$ 2,504
Interest earnings	1,687	14,729	21,728	(13,042)	(6,999)
Total revenues	234,299	225,666	230,161	8,633	(4,495)
Expenditures:					
Transfer to Trust	145,646	552,018	-	(406,372)	552,018
Interest expense	64,972	65,833	66,637	(861)	(804)
Principal amounts of bonds retired	23,855	19,315	16,705	4,540	2,610
Other	506	517	237	(11)	280
Total expenditures	234,979	637,683	83,579	(402,704)	554,104
Change in fund balance	(680)	(412,017)	146,582	411,337	(558,599)
Fund balance, beginning of year	118,842	530,859	384,277	(412,017)	146,582
Fund balance, end of year	$ 118,162	$ 118,842	$ 530,859	$ (680)	$ (412,017)

TSRs increased 10.3% in fiscal year 2009 primarily due to the release of funds from the MSA disputed payment escrow account, as previously discussed.

The change in fund balance in fiscal year 2008 was primarily due to the transfer of unpledged TSRs to the Trust, as previously discussed. The transfer on December 11, 2007 reduced the amount of funds available for investment during fiscal year 2008, thereby causing a 32.21% reduction in interest income. Other expenditures increased due to the recognition of a full year of insurance expense in fiscal year 2008, as the policy was effective May 2007.

The following summarizes the changes in the debt service fund assets, liabilities, and fund balances as of June 30,

	2009	2008	2007	Variance 2009/2008	Variance 2008/2007
	(in thousands)			(in thousands)	
Assets:					
Cash and investments	$ 117,970	$ 118,642	$ 530,663	$ (672)	$ (412,021)
Tobacco settlement revenue receivable	85,000	84,000	83,000	1,000	1,000
Other	192	213	196	(21)	17
Total assets	$ 203,162	$ 202,855	$ 613,859	$ 307	$ (411,004)
Liabilities:					
Deferred tobacco settlement revenue	$ 85,000	$ 84,000	$ 83,000	$ 1,000	$ 1,000
Other	-	13	-	(13)	13
Total liabilities	85,000	84,013	83,000	987	1,013
Fund balance:					
Reserved for debt service	117,363	118,118	119,484	(755)	(1,366)
Unreserved	799	724	411,375	75	(410,651)
Total fund balance	118,162	118,842	530,859	(680)	(412,017)
Total liabilities and fund balance	$ 203,162	$ 202,855	$ 613,859	$ 307	$ (411,004)

TSASC's total assets were comparable for fiscal years 2009 and 2008, while fiscal year 2008 total assets decreased 66% from fiscal year 2007 as the Indenture did not permit any transfers to the Trust prior to December 6, 2007. As of June 30, 2009 and 2008, TSASC's investments were primarily invested in U.S. government-sponsored enterprise discount notes, while as of June 30, 2007, TSASC's investments were primarily in non-asset backed commercial paper.

The growth in the TSRs receivable reflects the increase in TSR revenue, a portion of which is related to estimated cigarette sales which occur prior to the end of the fiscal year but for which manufacturers will make payment in the future. Other assets represent the value of prepaid insurance as of June 30, 2009 and 2008.

The decrease in the unreserved fund balance in fiscal year 2008 was due to the remittance to the Trust, as previously discussed, while no remittances to the Trust was made in fiscal year 2007 in accordance with the Indenture.

**** END ****

TSASC, INC.
STATEMENTS OF NET ASSETS (DEFICIT)
AS OF JUNE 30, 2009 AND 2008

	2009	2008
	(in thousands)	
ASSETS:		
Restricted cash and cash equivalents	$ 3	$ 1
Unrestricted cash and cash equivalents	71	69
Restricted investments	117,360	118,117
Unrestricted investments	536	455
Tobacco settlement revenue receivable	85,000	84,000
Unamortized bond issuance costs	9,581	9,970
Other	192	213
TOTAL ASSETS	$ 212,743	$ 212,825
LIABILITIES:		
Accrued expenses	$ -	$ 13
Accrued interest payable	5,323	5,417
Bonds payable	1,273,690	1,297,545
Unamortized bond discount	(33,101)	(34,440)
Unamortized deferred bond refunding costs	(15,400)	(33,362)
TOTAL LIABILITIES	1,230,512	1,235,173
NET ASSETS (DEFICIT):		
Restricted for debt service	(1,018,568)	(1,023,072)
Unrestricted	799	724
TOTAL DEFICIT	$ (1,017,769)	$ (1,022,348)

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

TSASC, INC.
STATEMENTS OF ACTIVITIES
FOR THE YEARS ENDED JUNE 30, 2009 AND 2008

	2009	2008
	(in thousands)	
EXPENSES:		
Tobacco settlement revenue transfers to Trust:		
Tobacco settlement revenue - current year	$ 145,646	$ 132,018
Prior year's tobacco settlement revenue, excess funds and interest earnings	-	420,000
Total tobacco settlement revenue transfers to Trust	145,646	552,018
General and administrative expenses	506	517
Interest expense	66,218	67,108
Amortization of bond issuance expense	388	391
Amortization of deferred bond refunding costs	17,962	18,332
TOTAL EXPENSES	230,720	638,366
REVENUES:		
Tobacco settlement revenue:		
Tobacco settlement revenue - pledged	87,371	79,264
Tobacco settlement revenue - unpledged	146,241	132,673
Total tobacco settlement revenue	233,612	211,937
Investment earnings	1,687	14,729
TOTAL REVENUES	235,299	226,666
CHANGE IN DEFICIT	4,579	(411,700)
Deficit - beginning of year	(1,022,348)	(610,648)
DEFICIT - END OF YEAR	$ (1,017,769)	$ (1,022,348)

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

TSASC, INC.
DEBT SERVICE FUND BALANCE SHEETS
AS OF JUNE 30, 2009 AND 2008

	2009	2008
	(in thousands)	
ASSETS:		
Restricted cash and cash equivalents	$ 3	$ 1
Unrestricted cash and cash equivalents	71	524
Restricted investments	117,360	118,117
Unrestricted investments	536	-
Tobacco settlement revenue receivable	85,000	84,000
Other	192	213
TOTAL ASSETS	$ 203,162	$ 202,855
LIABILITIES AND FUND BALANCE		
LIABILITIES:		
Accounts payable	$ -	$ 13
Deferred tobacco settlement revenue	85,000	84,000
TOTAL LIABILITIES	85,000	84,013
FUND BALANCE:		
Reserved for debt service	117,363	118,118
Unreserved	799	724
TOTAL FUND BALANCE	118,162	118,842
TOTAL LIABILITIES AND FUND BALANCE	$ 203,162	$ 202,855

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

TSASC, INC.
RECONCILIATIONS OF THE DEBT SERVICE FUND BALANCE SHEETS
TO THE STATEMENTS OF NET ASSETS (DEFICITS)
AS OF JUNE 30, 2009 AND 2008
(in thousands)

	2009	**2008**
Total fund balances - governmental fund	$ 118,162	$ 118,842
Amounts reported for governmental activities in the statements of net assets (deficits) are different because:		
Costs of debt issuance are expenditures in governmental activities. However, in the statement of net assets, the costs of debt issuance are reported as capitalized assets and amortized over the life of the related asset.	9,581	9,970
Bond discounts are reported as other financing uses in the debt service fund financial statements. However, in the statement of net assets, bond discounts are reported as a component of bonds payable and amortized over the lives of the related debt.	33,101	34,440
Deferred tobacco settlement revenue accrued but not received within two months after year end is deferred in the debt service fund financial statements; however it is recognized as revenue and not deferred in the statement of net assets.	85,000	84,000
Costs of bond refundings are reported as expenditures in the debt service fund financial statements. However, in the statement of net assets, those costs and the related gain or loss are deferred and amortized over the shorter of the remaining life of the old debt or the life of the new debt.	15,400	33,362
Some liabilities are not due and payable in the current period from currently available financial resources and therefore are not reported in the debt services fund financial statements. These liabilities consist of:		
Bonds payable	(1,273,690)	(1,297,545)
Accrued interest on bonds	(5,323)	(5,417)
Net deficit of governmental activities	$ (1,017,769)	$ (1,022,348)

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

TSASC, INC.
STATEMENTS OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
DEBT SERVICE FUND
FOR THE YEARS ENDED JUNE 30, 2009 AND 2008

	2009	2008
	(in thousands)	
REVENUES:		
Tobacco settlement revenue:		
Tobacco settlement revenue - pledged	$ 86,997	$ 78,890
Tobacco settlement revenue - unpledged	145,615	132,047
Total tobacco settlement revenue	232,612	210,937
Investment earnings	1,687	14,729
TOTAL REVENUES	234,299	225,666
EXPENDITURES:		
Tobacco settlement revenue transfers to Trust:		
Tobacco settlement revenue - current year	145,646	132,018
Prior years' tobacco settlement revenue, excess funds and investment earnings	-	420,000
Total tobacco settlement revenue transfers to trust	145,646	552,018
Interest expense	64,972	65,833
Principal amount of bonds retired	23,855	19,315
General and adminstrative expenses	506	517
TOTAL EXPENDITURES	234,979	637,683
NET CHANGES IN FUND BALANCES	(680)	(412,017)
Fund Balances - beginning of year	118,842	530,859
FUND BALANCES - END OF YEAR	$ 118,162	$ 118,842

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

TSASC, INC.
RECONCILIATIONS OF THE STATEMENTS OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE DEBT SERVICE FUND TO THE STATEMENTS OF ACTIVITIES
FOR THE YEARS ENDED JUNE 30, 2009 AND 2008
(in thousands)

	2009	2008
Net changes in fund balances - total governmental funds	$ (680)	$ (412,017)
Amounts reported for governmental activities in the statement of activities are different because:		
Tobacco settlement revenue is deferred in debt service fund and included in revenue in the statement of activities.	1,000	1,000
Repayment of bond principal is an expenditure in the debt service fund, but the repayment reduces long-term liabilities in the statement of activities.	23,855	19,315
Debt service fund reports the cost of debt issuance and refunding bond issuance costs as expenditures. However, in the statement of activities, the cost of debt issuance is amortized over the life of the related debt.	(388)	(391)
Debt service fund reports bond discounts as other financing uses. However, in the statement of activities, bond discounts are amortized over the lives of the related debt as interest expense.	(1,339)	(1,352)
Costs of bond refundings are reported as expenditures in the debt service fund financial statements. However, in the statement of net assets, those costs and the related gain or loss are deferred and amortized over the shorter of the remaining life of the old debt or the life of the new debt.	(17,962)	(18,332)
Interest expense is reported in the statement of activities on the accrual basis, but interest is reported as an expenditure in the debt service fund when the outlay of financing resources is required.	93	77
Change in net (deficit) assets of governmental activities	$ 4,579	$ (411,700)

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

NOTE 1 – ORGANIZATION AND NATURE OF ACTIVITIES

TSASC, Inc. ("TSASC") is a special purpose, local development corporation organized under the Not-For-Profit Corporation Law of the State of New York (the "State"). TSASC is an instrumentality of, but separate and apart from, The City of New York (the "City"). TSASC is governed by a Board of five directors, consisting of the following officials of the City: the Director of Management and Budget (who also serves as Chairperson), the Commissioner of Finance, the Corporation Counsel of the City, the Comptroller and the Speaker of the Council. Although legally separate from the City, TSASC is a component unit of the City and, accordingly, included in the City's financial statements as a blended component unit in accordance with Governmental Standards Board ("GASB") Statement No. 14, *The Financial Reporting Entity*, as amended.

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

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

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

The Indenture provides that a specified percentage of Collections are pledged ("Pledged"), and required to be applied to the payment of debt service and operating costs. The Pledged percentage is 37.40% and is subject to reduction at June 1, 2024, and at each June 1st thereafter, depending on the magnitude of cumulative bond redemptions under the turbo redemption feature of the Series 2006-1 bonds. The turbo redemption feature ("Turbo") requires all pledged Collections, after payment of operating costs, to be applied to payment of principal of and interest on the Series 2006-1 bonds.

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

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. The government-wide financial statements of TSASC, which include the statement of net assets (deficit) and the statement of activities, are presented to display information about the reporting entity as a whole, in accordance with GASB Statement No. 34, as amended. The government-wide financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting.

   TSASC's debt service (governmental) fund financial statements are presented using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized when it becomes susceptible to accrual, which is when it becomes both measurable and available to finance expenditures in the current fiscal period. Expenditures are recognized when the related liability is incurred, except for interest on bonds payable, which is recognized when due. TSASC's sole governmental fund is the debt service fund, which accounts for the accumulation of resources for payment of principal and interest on debt, as well as for TSASC's general operations. TSASC does not anticipate issuing additional debt.

B. Investments, including accrued interest, are reported at fair value as of the reporting date.

C. TSASC records TSRs receivable at June 30th. The TSRs receivable is expected to be received the following April and is based on an estimate of cigarette sales for the six month period from January 1 to June 30. As it is not received within two months of the fiscal year end, the revenue related to the TSRs receivable is deferred in the debt service fund.

D. Bond premiums, discounts and issuance costs are capitalized and amortized over the life of the related debt using the interest method in the government-wide financial statements. The debt service fund financial statements recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

E. Deferred bond refunding costs represent the accounting loss incurred in advance refunding of outstanding bonds. The deferred bond refunding costs are amortized over the shorter of the remaining life of the old debt or the life of the new debt. In the debt service fund, costs of the bond refundings are reported as expenditures when incurred.

F. Interest expense is recognized on the accrual basis in the government-wide financial statements. Interest expenditures are recognized when due in the debt service fund financial statements.

G. The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires TSASC's management to make estimates and assumptions in determining the reported amounts of assets and liabilities, as of the date of the financial statements and the amounts of revenues and expenditures/expenses during the reporting period. Actual results could differ from those estimates.

H. As a component unit of the City, TSASC implements new GASB standards in the same fiscal year as they are implemented by the City. GASB Statement 48: *Sales and Pledges of Receivables and Future Revenues and Intra-entity Transfers of Assets and Future Revenues* was implemented by TSASC in fiscal year 2008. The implementation had no effect on TSASC's accounting or financial reporting.

I. There are newly adopted standards and standards issued but are not yet effective which will or may impact TSASC.

   In November 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. The Statement established accounting and financial reporting standards for pollution remediation obligations which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanup. GASB 49 was effective for financial statements for periods beginning after December 15, 2007, and was thus implemented by the City for its fiscal year ended June 30, 2009. There was no impact on TSASC's financial statements as a result of implementation of GASB 49.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. The Statement requires all intangible assets not specifically excluded by its scope provisions to be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. The requirements for GASB 51 are effective for financial statements for periods beginning after June 15, 2009. TSASC has not completed the process of evaluating GASB 51 but does not expect GASB 51 to have a material impact on its financial statements.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. The Statement establishes guidance on the recognition, measurement and disclosures related to derivative instruments entered into by governmental entities. GASB 53 requires that most derivative instruments be reported at fair value, and requires governmental entities to determine if derivatives are effective hedges of risks associated with related hedgeable items. Generally, for derivatives that are effective hedges, changes in fair values are deferred whereas for others the changes in fair value are recognized in the current period. The requirements for GASB 53 are effective for financial statements for periods beginning after June 15, 2009. TSASC has not completed the process of evaluating the impact of GASB 53 on its financial statements.

In February 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. The Statement affects the display of fund balances in the financial statements and requires that governments disclose their fund balance classifications, policies and procedures in the Notes. Fund balances will be classified as nonspendable, restricted, committed, assigned, and/or unassigned, depending on the definitions provided in the Statement. Additionally, GASB 54 refines the definitions of each of the governmental fund types, such as debt service and capital projects funds. The requirements for GASB 54 are effective for periods beginning after June 15, 2010. TSASC has not completed the process of evaluating the impact of GASB 54 on its financial statements but TSASC's governmental fund financial statement presentation will be impacted by the implementation of GASB 54.

NOTE 3 – CASH AND CASH EQUIVALENTS

TSASC's cash and cash equivalents consist of bank deposits, money market funds and short-term U.S. Government guaranteed securities with original maturities of three months or less and are held by TSASC's trustee in the trustee's name and are reported at fair value. As of June 30, 2009 and 2008, total cash and cash equivalents are summarized as follows:

	2009	2008
	(in thousands)	
Restricted cash and cash equivalents:		
Cash – FDIC insured	$ 3	$ 1
Unrestricted cash and cash equivalents:		
Cash – FDIC insured	$ 25	$ 26
Cash equivalents	46	498
Total unrestricted cash and cash equivalents	71	524
Total cash and cash equivalents (see Note 4)	$ 74	$ 525

NOTE 4 – INVESTMENTS

The investments as of June 30, 2009 and 2008, are summarized as follows:

	2009	2008
	(in thousands)	
Restricted investments:		
Federal home loan discount notes	$ 117,360	$ 118,117
Unrestricted investments:		
Money market funds	$ 46	$ 43
Federal home loan discount notes	536	455
Total investments including cash equivalents	117,942	118,615
Less amounts reported as cash equivalents	46	498
Total investments (see Note 3)	$ 117,896	$ 118,117

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

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

Credit risk: TSASC investments are primarily government-sponsored enterprise discount notes.

Interest rate risk: TSASC's investments mature within six months or less thereby limiting its exposure from rising interest rates.

NOTE 5 – BONDS PAYABLE

In accordance with the Indenture, Pledged collections during fiscal years 2009 and 2008 were used to fund operating expenses, then to fund interest payments due on December 1, 2008 and 2007 and June 1, 2009, and 2008, then to fund and make turbo redemption payments. During fiscal years 2009 and 2008, Turbo redemptions were $23.85 million and $19.31 million, respectively.

Outstanding bonds payable bear interest at rates ranging from 4.750% to 5.125%. A summary of changes in outstanding bonds in fiscal years 2008 and 2009 is as follows:

	Balance June 30, 2007	Bonds Issued	Bonds Retired or Defeased	Balance June 30, 2008	Bonds Issued	Bonds Retired or Defeased	Balance June 30, 2009
Series 2006-1	$ 1,316,860	$ -	$ (19,315)	$ 1,297,545	$ -	$ (23,855)	$ 1,273,690

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

NOTE 5 – BONDS PAYABLE (Continued)

Debt service requirements for term bond maturities and anticipated sinking fund principal payments, including principal and interest as of June 30, 2009 are as follows (in thousands):

	Term Bond Maturities			Sinking Fund Principal Payments		
	Principal	Interest	Total	Principal	Interest	Total
Year ended June 30,						
2010	$ -	$ 63,873	$ 63,873	$ -	$ 63,873	$ 63,873
2011	-	63,873	63,873	-	63,873	63,873
2012	-	63,873	63,873	-	63,873	63,873
2013	-	63,873	63,873	-	63,873	63,873
2014	-	63,873	63,873	15,100	63,873	78,973
2015 to 2019	-	319,363	319,363	102,400	307,482	409,882
2020 to 2024	204,250	299,960	504,210	152,140	277,639	429,779
2025 to 2029	137,765	250,189	387,954	195,380	235,944	431,324
2930 to 2034	372,650	236,413	609,063	249,645	181,893	431,538
2035 to 2039	-	143,250	143,250	321,655	111,946	433,601
2040 to 2042	559,025	85,950	644,975	237,370	24,741	262,111
	$1,273,690	$1,654,490	$2,928,180	$ 1,273,690	$ 1,459,010	$ 2,732,700

As of June 30, 2009 and 2008, TSASC has funded its debt service according to the Indenture requirements. As of June 30, 2009 and 2008, debt service accounts totaled $31.94 million and $32.56 million, respectively.

As of June 30, 2009 and 2008, the TSASC Liquidity Reserve Account's balance was $85.42 million and $85.56 million, respectively. As required by the Indenture, $85.40 million must be maintained as a Liquidity Reserve.

TSASC, on February 8, 2006, refunded, with Defeasance Collateral, bonds totaling $1.11 billion of which $1.06 billion are still to be paid from the Defeasance Collateral held in the escrow account on deposit with TSASC's escrow trustee.