TSASC, Inc.

Financial Statements
(Together with Independent Auditors' Report)

Years Ended June 30, 2008 and 2007

Marks Paneth & Shron LLP
Certified Public Accountants and Consultants

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YEARS ENDED JUNE 30, 2008 AND 2007

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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 year ended June 30, 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 audit. The financial statements of TSASC as of and for the year ended June 30, 2007 were audited by other auditors whose report dated September 26, 2007 expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 audit provides 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, 2008 and the respective changes in financial position thereof for the year 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 23, 2008

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, 2008 and 2007. It should be read in conjunction with TSASC's entity-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 entity-wide financial statements; and (3) the governmental fund financial statements.

The entity-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 entity-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 sheet of the debt service fund to the statement of net assets are presented to assist the reader in understanding the differences between entity-wide and debt service fund financial statements.

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS - ENTITY-WIDE FINANCIAL STATEMENTS

On February 8, 2006, TSASC completed a restructuring of all of its outstanding indebtedness. On that date TSASC issued $1.35 billion of its Series 2006-1 bonds. The proceeds of the Series 2006-1 bonds were used: (1) to fund a legal defeasance escrow account held by the Trustee for holders of all Series 1999-1 and Series 2002-1 bonds then outstanding, (2) to redeem all bonds then outstanding under the Transportation Infrastructure Finance Innovations Act of 1998 Loan Agreement ("TIFIA"), (3) to fund the reserve required under the amended and restated bond indenture dated as of January 1, 2006 ("Indenture") and (4) to cover costs of issuance of the Series 2006-1 bonds. 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. On December 11, 2007 and June 23, 2008 the Trust transferred to the City $419.45 million and $132.56 million, respectively.

As a result of the restructuring, the Series 2006-1 bonds are the only indebtedness of TSASC outstanding as of June 30, 2008 and 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 bonds. The proportion of Collections pledged to the payment of the Series 2006-1 bonds 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 interest and principal on the Series 2006-1 bonds.

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

	2008	2007	2006	Variance 2008/2007	Variance 2007/2006
	(in thousands)			(in thousands)	
Revenues:					
Tobacco settlement revenue	$ 211,937	$ 214,433	$ 229,013	$ (2,496)	$ (14,580)
Interest earnings	14,729	21,728	24,191	(6,999)	(2,463)
Total revenue	226,666	236,161	253,204	(9,495)	(17,043)
Expenses:					
Transfer to Trust	552,018	-	-	552,018	-
Interest expense	67,108	67,932	73,561	(824)	(5,629)
Other	19,240	19,212	28,367	28	(9,155)
Total expenses	638,366	87,144	101,928	551,222	(14,784)
Change in net deficit	(411,700)	149,017	151,276	(560,717)	(2,259)
Net deficit, beginning of year	(610,648)	(759,665)	(910,941)	149,017	151,276
Net deficit, end of year	$(1,022,348)	$ (610,648)	$ (759,665)	$ (411,700)	$ 149,017

The Master Settlement Agreement ("MSA"), dated November 23, 1998, is an industry-wide settlement of litigation between participating cigarette manufacturers and 46 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.

In fiscal year 2008, TSASC received $210.94 million in TSRs compared to $208.43 million in fiscal year 2007. 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. The funds deposited into this account cannot be released until disputes are fully resolved, which may take years.

Of the total TSRs received, 37.40% ("Pledged") are pledged for debt service payments and the operating expenses of TSASC and 62.60% ("Unpledged") are due the TSASC Trust, of which the City is the beneficial owner. In fiscal year 2008, $552.02 million was transferred to the Trust. This transfer represents fiscal year 2008 unpledged TSRs of $132.05 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.

The TSRs not remitted to the Trust in fiscal year 2006 is the result of the February 2006 restructuring of TSASC's debt. That restructuring, including the establishment of the Unpledged TSR account, which resulted in a reduction of $36.9 million of TSRs payments previously reported as due to the Trust. The estimated payable as of June 30, 2005 was $42.3 million, of which $5.5 million was paid to the Trust during the year ended June 30, 2006 and the balance was retained in the Unpledged TSR account and distributed to the Trust after December 6, 2007, as discussed above.

Interest earnings decreased in fiscal year 2008 due to the December 11, 2007 transfer to the Trust.

TSASC received $78.89 million in Pledged TSRs in fiscal year 2008, of which $65.83 million was used for interest payments on TSASCs bonds. Of the remaining Pledged TSRs and interest earnings, $19.31 million was used for the redemption of Series 2006-1 bonds through the turbo redemption feature which represents funds in excess of the amounts required for the funding of Operating Expenses and for the funding of any deficiencies, if necessary. There were no deficiencies in any of TSASC's accounts and therefore the remaining Pledged TSRs and interest earnings were used for the turbo redemption.

The turbo redemption decreases the total annual interest expense paid by TSASC. Total bonds outstanding as of June 30, 2008 and 2007 are $1.30 billion and $1.32 billion, respectively.

Other expenses are composed primarily of the amortization of deferred bond refunding costs relating to the fiscal year 2006 restructuring of debt and the amortization of the Cost of Issuance (COI) pertaining to the bonds retired as part of the restructuring in fiscal year 2006. In fiscal years 2008 and 2007, the amortization expense was $18.72 million and $18.98 million, respectively.

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

	2008	2007	2006	Variance 2008/2007	Variance 2007/2006
	(in thousands)			(in thousands)	
Assets:					
Total assets – non-capital	$ 212,825	$ 624,220	$ 472,032	$ (411,395)	$ 152,188
Liabilities:					
Current liabilities	$ 5,430	$ 5,494	$ 5,560	$ (64)	$ (66)
Long-term liabilities:					
Bonds payable	1,297,545	1,316,860	1,333,565	(19,315)	(16,705)
Other	(67,802)	(87,486)	(107,428)	19,684	19,942
Total liabilities	1,235,173	1,234,868	1,231,697	305	3,171
Net assets (deficit):					
Restricted	(1,023,072)	(1,021,827)	(1,024,483)	(1,247)	2,656
Unrestricted	724	411,179	264,818	(410,453)	146,361
Net deficit, end of year	$ (1,022,348)	$ (610,648)	$ (759,665)	$ (411,700)	$ 149,017

In fiscal year 2008, total assets decreased 66% due to the remittance to the Trust of $552.02 million, while in fiscal year 2007 there was no remittance to the Trust as the Indenture dated January 1, 2006 did not permit any transfers prior to December 6, 2007.

Bonds payable decreased $19.31 million in fiscal year 2008 and $16.70 million in fiscal year 2007 due to the turbo redemption of the Series 2006-1 bonds in December and June of fiscal year 2008 and fiscal year 2007, respectively.

The net deficits are due to the issuance of Series 2006-1 bonds in fiscal year 2006. The 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,

	2008	2007	2006	Variance 2008/2007	Variance 2007/2006
	(in thousands)			(in thousands)	
Revenues:					
Tobacco settlement revenue	$ 210,937	$ 208,433	$ 199,133	$ 2,504	$ 9,300
Interest earnings	14,729	21,728	24,191	(6,999)	(2,463)
Total revenue	225,666	230,161	223,324	(4,495)	6,837
Expenditures:					
Transfer to Trust	552,018	-	5,445	552,018	(5,445)
Interest expense	65,833	66,637	96,345	(804)	(29,708)
Principal amounts of bonds retired	19,315	16,705	193,540	2,610	(176,835)
Other	517	237	11,724	280	(11,487)
Total expenditures	637,683	83,579	307,054	554,104	(223,475)
Other financing sources, net	-	-	134,833	-	(134,833)
Change in fund balance	(412,017)	146,582	51,103	(558,599)	95,479
Fund balance, beginning of year	530,859	384,277	333,174	146,582	51,103
Fund balance, end of year	$ 118,842	$ 530,859	$ 384,277	$ (412,017)	$ 146,582

The change in fund balance in fiscal year 2008 was due to the transfer of unpledged TSRs to the Trust as previously discussed. The transfer of 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 recognizing of a full year of insurance expense in fiscal year 2008, as the policy was effective May 2007.

TSR revenue increased in fiscal year 2007 compared to fiscal year 2006, as previously discussed. Bond interest expenditures on outstanding bonds were lower for fiscal year 2007 than for fiscal 2006, because the fiscal year 2006 interest payments represented approximately 16 months of bond interest compared to the 12 months of interest paid during fiscal year 2007. The additional interest in fiscal year 2006 resulted from the final interest payment on the defeased bonds as well as the change in interest payment dates for the newly issued Series 2006-1 bonds. The principal amount of bonds retired in fiscal year 2006 was higher than in fiscal year 2007 because of the restructuring in that year, as previously discussed. Other financing sources, net in fiscal year 2006 is higher than in fiscal year 2007 because the fiscal year 2006 amount reflects refunding bond proceeds in excess of the amount used to fund the refunding escrow; those funds were used to retire TIFIA bonds, as previously discussed, and to fund costs of issuing the refunding bonds.

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

	2008	2007	2006	Variance 2008/2007	Variance 2007/2006
	(in thousands)			(in thousands)	
Assets:					
Cash and investments	$ 118,642	$ 530,663	$ 384,277	$ (412,021)	$ 146,386
Tobacco settlement revenue receivable	84,000	83,000	77,000	1,000	6,000
Other	213	196	-	17	196
Total assets	$ 202,855	$ 613,859	$ 461,277	$ (411,004)	$ 152,582
Liabilities:					
Deferred tobacco settlement revenue	$ 84,000	$ 83,000	$ 77,000	$ 1,000	$ 6,000
Other	13	-	-	13	-
Total liabilities	84,013	83,000	77,000	1,013	6,000
Fund balance:					
Reserved for debt service	118,118	119,484	119,459	(1,368)	25
Unreserved	724	411,375	264,818	(410,649)	146,557
Total fund balance	118,842	530,859	384,277	(412,017)	146,582
Total liabilities and fund balance	$ 202,855	$ 613,859	$ 461,277	$ (411,004)	$ 152,582

Cash and investments decreased in fiscal year 2008 due to the transfer to the Trust, as discussed previously. As of June 30, 2008, TSASC's investments were primarily in U.S. Government agency securities, while as of June 30, 2007, TSASC's investments were primarily in non-asset backed commercial paper.

In fiscal year 2007, cash and investments increased over fiscal year 2006 due to an increase in the amount of Unpledged TSRs held by TSASC until remitted to the Trust after December 6, 2007, as discussed previously. The growth in the TSRs receivable reflects the increase in TSR revenue, also discussed above, as a portion of the revenue 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, 2008 and 2007.

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, 2008 AND 2007

	2008	2007
	(in thousands)	
ASSETS:		
Restricted cash and cash equivalents	$ 1	$ 3
Unrestricted cash and cash equivalents	524	1,532
Restricted investments	118,117	119,481
Unrestricted investments	-	409,647
Tobacco settlement revenue receivable	84,000	83,000
Unamortized bond issuance costs	9,970	10,361
Other	213	196
TOTAL ASSETS	$ 212,825	$ 624,220
LIABILITIES:		
Accrued expenses	$ 13	$ -
Accrued interest payable	5,417	5,494
Bonds payable	1,297,545	1,316,860
Unamortized bond discount	(34,440)	(35,791)
Unamortized deferred bond refunding costs	(33,362)	(51,695)
TOTAL LIABILITIES	$ 1,235,173	$ 1,234,868
NET ASSETS (DEFICIT)		
Restricted for debt service	(1,023,072)	(1,021,827)
Unrestricted	724	411,179
TOTAL DEFICIT	$ (1,022,348)	$ (610,648)

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

TSASC, INC.
STATEMENTS OF ACTIVITIES
FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
	(in thousands)	
EXPENSES:		
Tobacco settlement revenue transfers to Trust:		
Tobacco settlement revenue - 2008	$ 132,018	$ -
Prior year's tobacco settlement revenue, excess funds and interest earnings	420,000	-
Total tobacco settlement revenue transfers to Trust	552,018	-
General and administrative expenses	517	237
Interest expense	67,108	67,932
Amortization of bond issuance expense	391	394
Amortization of deferred bond refunding costs	18,332	18,581
TOTAL EXPENSES	638,366	87,144
REVENUES:		
Tobacco settlement revenue:		
Tobacco settlement revenue - pledged	79,264	80,198
Tobacco settlement revenue - unpledged	132,673	134,235
Total tobacco settlement revenue	211,937	214,433
Investment earnings	14,729	21,728
TOTAL REVENUES	226,666	236,161
CHANGE IN DEFICIT	(411,700)	149,017
Deficit - beginning of year	(610,648)	(759,665)
DEFICIT - END OF YEAR	$ (1,022,348)	$ (610,648)

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

TSASC, INC.
DEBT SERVICE FUND BALANCE SHEETS
AS OF JUNE 30, 2008 AND 2007

	2008	2007
	(in thousands)	
ASSETS:		
Restricted cash and cash equivalents	$ 1	$ 3
Unrestricted cash and cash equivalents	524	1,532
Restricted investments	118,117	119,481
Unrestricted investments	-	409,647
Tobacco settlement revenue receivable	84,000	83,000
Other	213	196
TOTAL ASSETS	$ 202,855	$ 613,859
LIABILITIES AND FUND BALANCE		
LIABILITIES:		
Accounts payable	$ 13	$ -
Deferred tobacco settlement revenue	84,000	83,000
TOTAL LIABILITIES	84,013	83,000
FUND BALANCE:		
Restricted for debt service	118,118	119,484
Unrestricted	724	411,375
TOTAL FUND BALANCE	118,842	530,859
TOTAL LIABILITIES AND FUND BALANCE	$ 202,855	$ 613,859

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, 2008 AND 2007

	2008	2007
	(in thousands)	
REVENUES:		
Tobacco settlement revenue:		
Tobacco settlement revenue - pledged	$ 78,890	$ 77,954
Tobacco settlement revenue - unpledged	132,047	130,479
Total tobacco settlement revenue	210,937	208,433
Investment earnings	14,729	21,728
TOTAL REVENUES	225,666	230,161
EXPENDITURES:		
Tobacco settlement revenue transfers to Trust:		
Tobacco settlement revenue	132,018	-
Prior years' tobacco settlement revenue, excess funds and investment earnings	420,000	-
Total tobacco settlement revenue transfers to trust	552,018	-
Interest expense	65,833	66,637
Principal amount of bonds retired	19,315	16,705
General and adminstrative expenses	517	237
TOTAL EXPENDITURES	637,683	83,579
NET CHANGES IN FUND BALANCES	(412,017)	146,582
Fund Balances- beginning of year	530,859	384,277
FUND BALANCES - END OF YEAR	$ 118,842	$ 530,859

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, 2008 AND 2007

	2008	2007
Total fund balances- governmental fund	$ 118,842	$ 530,859
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.	9,970	10,361
Bond discounts are reported as other financing uses in the debt service fund financial statements. However, in the statements of net assets, bond discounts are reported as a component of bonds payable and amortized over the lives of the related debt.	34,440	35,791
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.	84,000	83,000
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.	33,362	51,695
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	(1,297,545)	(1,316,860)
Accrued interest on bonds	(5,417)	(5,494)
Net deficit of governmental activities	$ (1,022,348)	$ (610,648)

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, 2008 AND 2007

	2008	2007
Net changes in fund balances- total governmental funds	$ (412,017)	$ 146,582
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	6,000
Repayment of bond principal is an expenditure in the debt service fund, but the repayment reduces long-term liabilities in the statement of activities.	19,315	16,705
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.	(391)	(394)
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.	(1,352)	(1,361)
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.	(18,332)	(18,581)
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.	77	66
Change in net (deficit) assets of governmental activities	$ (411,700)	$ 149,017

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.

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.

On February 8, 2006, TSASC restructured all outstanding indebtedness by issuing the Series 2006-1 bonds in the amount of $1.35 billion. This restructuring relieved TSASC of its obligation under the original bond indenture to deposit a portion of all amounts in excess of specified percentages of TSRs and other revenues (collectively, "Collections") into a trapping account.

Under the Amended and Restated Indenture dated January 1, 2006 (the "Indenture"), the Residual Certificate represents the entitlement to receive 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, and required to be applied to the payment of debt service and operating costs. That 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 (which 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 entity-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 Statement No. 34 of the Governmental Accounting Standards Board, as amended. The entity-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 generals operations. TSASC does not anticipate issuing additional debt for capital projects.

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

C. TSASC records a receivable for TSRs at June 30th. The TSRs are expected to be received the following April and are based on an estimate of cigarette sales for the six month period from January 1 to June 30.

D. Bond premiums, discounts and issuance costs are capitalized and amortized over the life of the related debt using the interest method in the entity-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.

F. Interest expense is recognized on the accrual basis in the entity-wide financial statements. Interest expenditures are recognized when due in the individual 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, disclosure of contingent assets and liabilities as of the date of the financial statements and the reported 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.

NOTE 3 – CASH AND CASH EQUIVALENTS

TSASC's cash and cash equivalents consist of bank deposits, commercial paper and short-term U.S. Government guaranteed securities with original maturities of three months or less and are held by TSASC's trustee in TSASC's name and are reported at fair value. The commercial paper was rated A1+ by Standard & Poor's Rating Services and P1 by Moody's Investor Services. As of June 30, 2008 and 2007, total cash and cash equivalents are summarized as follows:

	2008	2007
	(in thousands)	
Restricted cash and cash equivalents:		
Cash	$ 1	$ 3
Unrestricted cash and cash equivalents:		
Cash	$ 69	$ 87
Commercial paper	-	1,026
U.S. government agencies	455	419
Total	$ 524	$ 1,532

NOTE 4 – INVESTMENTS

As of June 30, 2008 and 2007, investments were held by TSASC's trustee in TSASC's name. The commercial paper was rated A1+ by Standard & Poor's Rating Services and P1 by Moody's Investor Services. The investments as of June 30, 2008 and 2007, are summarized as follows:

	2008	2007
	(in thousands)	
Restricted investments:		
Commercial paper	$ -	$ 118,876
U.S. government agencies	118,117	605
	$ 118,117	$ 119,481
Unrestricted investments:		
Commercial paper	$ -	$ 409,147
U.S. government agencies	-	500
Total	$ -	$ 409,647

NOTE 5 – BONDS PAYABLE

On February 8, 2006, TSASC issued $1.35 billion of Fiscal Series 2006-1 bonds to restructure all of its outstanding indebtedness. The restructuring advance refunded all bonds outstanding in Series 1999-1 and Series 2002-1 and fully paid all of the bonds issued to TIFIA. This refunding resulted in a legal defeasance of the refunded bonds. In a legal defeasance, the proceeds, net of costs of issuance, are invested in Defeasance Collateral (as defined in TSASC's original Indenture) consisting of U.S. Treasury Securities—State and Local Government Series ("SLGS") and are deposited in an escrow account with the TSASC's Trustee to provide for all future debt service on the legally defeased bonds. This advance refunding resulted in an accounting loss of $97.7 million, which was recorded on the statement of net assets as deferred bond refunding costs, net of accumulated amortization. The advance refunding relieved TSASC of its obligations under the original bond indenture, including the requirement to deposit a portion of the Collections into a trapping account.

NOTE 5 – BONDS PAYABLE (Continued)

The Amended and Restated Indenture dated January 1, 2006 (the "Indenture") provides that a specified percentage of Collections are pledged and required to be applied to the payment of debt and operating costs. That percentage is 37.40% and is subject to reduction at June 1, 2024, and at each June 1st thereafter, depending upon attainment of pre-defined levels of cumulative bond redemptions under the turbo redemption feature of the Series 2006-1 bonds (which requires all pledged Collections to be applied, after funding of operating costs, to the payment of interest and principal on the Series 2006-1 bonds.)

Under the Indenture, the Residual Certificate represents the entitlement to receive all amounts in excess of specified percentages of Collections pledged and required to be applied to fund debt service and operating costs of TSASC. The Collections in excess of the specified percentages are transferred to 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.

In accordance with the Indenture, Pledged Collections during fiscal year 2008 were used to fund operating expenses, then to fund interest payments due on December 1, 2007 and June 2, 2008, then to fund and make turbo redemption payments of $3.81 million on December 1, 2007 and of $15.50 million on June 2, 2008.

The Pledged TSRs retained in April 2007 were used to fund operating expenses first, then to fund the interest payments due on June 1, 2007 and December 1, 2007. The remaining Pledged TSRs were then used to fund and make turbo redemption payments of $3.34 million on December 1, 2006 and of $13.36 million on June 1, 2007.

Outstanding bonds payable bear interest at rates ranging from 4.750% to 5.125%. A summary of changes in outstanding bonds in fiscal years 2007 and 2008 is as follows:

	Balance June 30, 2006	Bonds Issued	Bonds Retired or Defeased	Balance June 30, 2007	Bonds Issued	Bonds Retired or Defeased	Balance June 30, 2008
Series 2006-1	$ 1,333,565	$ -	$ (16,705)	$ 1,316,860	$ -	$ (19,315)	$ 1,297,545

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, 2008 are as follows (in thousands):

	Term Bond Maturities			Sinking Fund Principal Payments		
	Principal	Interest	Total	Principal	Interest	Total
Year ended June 30,						
2009	$ -	$ 65,006	$ 65,006	$ -	$ 65,006	$ 65,006
2010	-	65,006	65,006	-	65,006	65,006
2011	-	65,006	65,006	-	65,006	65,006
2012	-	65,006	65,006	9,890	65,006	74,896
2013	-	65,006	65,006	13,305	64,536	77,841
2014 to 2018	-	325,029	325,029	91,865	311,845	403,710
2019 to 2023	228,105	314,194	542,299	144,925	284,603	429,528
2024 to 2028	137,765	257,077	394,842	185,780	245,233	431,013
2929 to 2033	-	236,413	236,413	237,850	193,786	431,636
2034 to 2038	372,650	161,883	534,533	305,565	127,537	433,102
2039 to 2042	559,025	114,600	673,625	308,365	40,545	348,910
	$1,297,545	$1,734,226	$3,031,771	$ 1,297,545	$ 1,528,109	$ 2,825,654

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.

As of June 30, 2008 and 2007, TSASC has funded its debt service according to the Indenture requirements. As of June 30, 2008 and 2007, debt service accounts totaled $32.50 million and $32.96 million, respectively.

As of June 30, 2008 and 2007, TSASC has also funded its required liquidity reserves of $85.40 million and $85.40 million, respectively.

TSASC, on February 8, 2006, refunded, with Defeasance Collateral, bonds totaling $1.11 billion of which $1.08 billion is still to be paid from the Defeasance Collateral held in the escrow account on deposit with TSASC's escrow trustee.