

**S**ENECA TOBACCO ASSET  
SECURITIZATION CORPORATION

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*FINANCIAL STATEMENTS*

December 31, 2011

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Dermody, Burke & Brown, CPAs, LLC

## INDEPENDENT AUDITORS' REPORT

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### DIRECTORS

### SENECA TOBACCO ASSET SECURITIZATION CORPORATION

We have audited the accompanying statement of net assets of **SENECA TOBACCO ASSET SECURITIZATION CORPORATION** (the Corporation), a component unit of the County of Seneca, New York as of December 31, 2011 and the related statements of revenue, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 financial position of Seneca Tobacco Asset Securitization Corporation as of December 31, 2011, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 to 6 is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

*Dermody, Burke & Brown*

**DERMODY, BURKE & BROWN, CPAs, LLC**

Auburn, NY

February 22, 2012

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# **SENECA TOBACCO ASSET SECURITIZATION CORPORATION**

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## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

Year Ended December 31, 2011

Our discussion and analysis of **SENECA TOBACCO ASSET SECURITIZATION CORPORATION'S** (the Corporation) financial performance provides an overview of the Corporation's financial activities during 2011. It should be read in conjunction with the financial statements and their associated notes that follow this section to properly evaluate the Corporation's financial position. The financial statements present only the information for the year ended December 31, 2011.

### **Financial Highlight**

As discussed further in the notes to the financial statements, the Corporation was formed to acquire from the County of Seneca all future right, title and interest in the Tobacco Settlement Revenues (TSRs) under the Master Settlement Agreement (MSA) with respect to tobacco related litigation among various states and participating manufacturers. The Corporation is a component unit of Seneca County based on the guidance provided in Technical Bulletin No. 2004-01 and is included as part of the County's financial reporting entity as a blended component unit as of December 31, 2011.

### **Using This Annual Report**

Because the Corporation is treated as a proprietary fund for auditing purposes, it has in the past and will continue to use the accrual basis of accounting. The accrual basis of accounting provides both short-term and long-term information about the Corporation's overall financial status.

The financial statements also include notes that explain some of the information in the statements and provide more detailed data.

The remainder of this overview section of MD&A highlights the structure and contents of the statements.

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**SENECA TOBACCO ASSET SECURITIZATION CORPORATION**

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**MANAGEMENT'S DISCUSSION AND ANALYSIS**

Year Ended December 31, 2011

**Using This Annual Report – Continued**

Summary of Statement of Net Assets

	<b>ASSETS</b>	
	<b>2011</b>	<b>2010</b>
Cash	\$ 226,818	\$ 200,208
Deposits Held with Trustee:		
Debt Service Account	2,346	1,605
Liquidity Reserve Account	511,292	511,292
Collection Account	613	692
	<hr/>	<hr/>
Total Deposits Held with Trustee	514,251	513,589
Prepaid Insurance	0	5,856
Tobacco Settlement Rights Receivable	54,067	487,663
Bond Issuance Costs, Net of Accumulated Amortization	211,682	218,499
Bond Discount, Net of Accumulated Amortization	81,054,584	82,772,369
	<hr/>	<hr/>
<b>TOTAL ASSETS</b>	<b>\$ 82,061,402</b>	<b>\$ 84,198,184</b>
	<hr/>	<hr/>
	<b>LIABILITIES AND NET DEFICIT</b>	
<b>LIABILITIES</b>		
Accrued Interest Payable	\$ 0	\$ 27,418
Bonds Payable, Due Within One Year	45,000	40,000
Bonds Payable, Due After One Year	99,295,000	99,405,000
	<hr/>	<hr/>
Total Liabilities	99,340,000	99,472,418
UNRESTRICTED NET DEFICIT	(17,278,598)	(15,274,234)
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<b>TOTAL LIABILITIES AND NET DEFICIT</b>	<b>\$ 82,061,402</b>	<b>\$ 84,198,184</b>
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The Corporation's assets decreased by approximately \$2.1 million. The bond discount decreased by approximately \$1.7 million due to current year amortization. In addition, the tobacco settlement rights receivable decreased by approximately \$400,000 upon the receipt of tobacco monies in 2011. The bonds payable decreased by \$105,000 which represents the principal payments made in 2011. The recognition of the bond payable liability in 2000 and 2005 created a deficit in the Corporation's net assets. This deficit is expected to be satisfied over time as the tobacco settlement proceeds are received and the debt is paid.

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**SENECA TOBACCO ASSET SECURITIZATION CORPORATION**

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**MANAGEMENT'S DISCUSSION AND ANALYSIS**

Year Ended December 31, 2011

**Using This Annual Report – Continued**Summary of Revenue and Expenses

	2011	2010
OPERATING REVENUE		
Administrative Fee Income	\$ 41,228	\$ 39,745
Interest Income	<u>281</u>	<u>9,393</u>
Total Operating Revenue	41,509	49,138
OPERATING EXPENSES		
Payments to Seneca County	0	338,000
Interest Expense	290,927	325,251
Administrative Agent Fee	9,655	14,682
Liability Insurance	10,139	10,000
Professional Fees	10,550	10,525
Amortization	<u>1,724,602</u>	<u>1,724,602</u>
Total Operating Expenses	<u>2,045,873</u>	<u>2,423,060</u>
CHANGE IN UNRESTRICTED NET ASSETS (DEFICIT)	<u>\$ (2,004,364)</u>	<u>\$ (2,373,922)</u>

The Corporation showed a decrease in net assets in 2011 and 2010. This decrease results from interest earnings, which does not provide enough revenue to meet the Corporation's current expense for bond interest payments and amortization expense.

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## SENECA TOBACCO ASSET SECURITIZATION CORPORATION

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### MANAGEMENT'S DISCUSSION AND ANALYSIS

Year Ended December 31, 2011

#### Using This Annual Report – Continued

##### Analysis of Overall Financial Position

Overall, the Corporation continues to show a decrease in net assets, which meets expectations. Cash received on the tobacco settlement rights receivable has been sufficient to meet the Corporation's current expenditure demands. However, interest expense on debt continues to exceed interest revenue generated on deposits. As the debt is paid down, the interest expense is scheduled to decline.

##### Long-Term Debt Activity

The Corporation issued debt to fund its purchases of the future right, title, and interest in the Tobacco Settlement Revenues. Debt is amortized through 2042 for the 2000 Series Bonds and 2060 for the 2005 Series Bonds.

Serial bond principal payments are due annually and interest semiannually for the 2000 Series Bonds. At December 31, 2011, the Corporation had \$4,865,000 in 2000 serial bonds outstanding. This was a 2% decrease from the previous year due to scheduled principal payments.

The Corporation is required to make annual debt service payments beginning June 2038 for the 2005 Series Bonds. These bonds are Capital Appreciation Bonds and pay interest at maturity, not every year. The series 2005 Bonds are subordinate to the 2000 bonds. In December 2009, \$1,055,000 of the Series 1 Bonds was retired with the monies held in the trapping fund.

More detailed information about the Corporation's long-term liabilities is presented in Note 6 to the financial statements.

##### Budget

GASB 34 requires an analysis of significant variations between the original budget and final budget amounts and between final budget amounts and actual budget results. Management has prepared a budget for its operating expenses only, and there were no changes or amendments to the operating budget. Because the budget is not a complete budget, comparison to current operations could be misleading. As such, it has not been presented in this report.

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## SENECA TOBACCO ASSET SECURITIZATION CORPORATION

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### MANAGEMENT'S DISCUSSION AND ANALYSIS

Year Ended December 31, 2011

#### Using This Annual Report – Continued

##### Other Known Facts

##### Consumption Decline Trapping Event

As defined in Exhibit A of the Indenture, a Consumption Decline Trapping Event means that shipments of cigarettes in or to the 50 United States, the District of Columbia and Puerto Rico as measured under the MSA, are less in any year preceding a Deposit Date than the amount opposite such year under the "Consumption Decline Trapping Event" definition, which number is 305,664,161,271.

According to the MSA Report, the amount shown as relevant shipments for the year 2010 was less than the shipment amount specified above and therefore, a Consumption Decline Trapping Event has occurred.

##### **Contacting the Corporation's Financial Management**

This financial report is designed to provide to the readers of these financial statements an overview of the Corporation's finances and to show the Corporation's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Corporation's Treasurer, Nicholas Sciotti at 1 DiPronio Drive, Waterloo, NY 13165.



**SENECA TOBACCO ASSET SECURITIZATION CORPORATION**

**AUDITED FINANCIAL STATEMENTS**

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**STATEMENT OF NET ASSETS**

December 31, 2011

**ASSETS**

Cash	\$ 226,818
Deposits Held with Trustee:	
Debt Service Account	2,346
Liquidity Reserve Account	511,292
Collection Account	<u>613</u>
Total Deposits Held with Trustee	514,251
Tobacco Settlement Rights Receivable	54,067
Bond Issuance Costs, Net of Accumulated Amortization	211,682
Bond Discount, Net of Accumulated Amortization	<u>81,054,584</u>
<b>TOTAL ASSETS</b>	<b><u>\$ 82,061,402</u></b>

**LIABILITIES AND NET DEFICIT**

**LIABILITIES**

Bonds Payable, Due Within One Year	\$ 45,000
Bonds Payable, Due After One Year	<u>99,295,000</u>
Total Liabilities	99,340,000
UNRESTRICTED NET DEFICIT	<u>(17,278,598)</u>
<b>TOTAL LIABILITIES AND NET DEFICIT</b>	<b><u>\$ 82,061,402</u></b>

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See notes to financial statements.

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**SENECA TOBACCO ASSET SECURITIZATION CORPORATION**

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**STATEMENT OF REVENUE, EXPENSES AND CHANGES IN NET ASSETS**

Year Ended December 31, 2011

OPERATING REVENUE

Administrative Fee Income	\$ 41,228
Interest Income	281
	<hr/>
Total Operating Revenue	41,509

OPERATING EXPENSES

Interest Expense	290,927
Administrative Agent Fee	9,655
Liability Insurance	10,139
Professional Fees	10,550
Amortization	1,724,602
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Total Operating Expenses 2,045,873

CHANGE IN UNRESTRICTED NET ASSETS (DEFICIT) (2,004,364)

NET DEFICIT

Balance, Beginning of Year (15,274,234)

Balance, End of Year \$ (17,278,598)

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See notes to financial statements.

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**SENECA TOBACCO ASSET SECURITIZATION CORPORATION**

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**STATEMENT OF CASH FLOWS**

Year Ended December 31, 2011

**CASH FLOWS FROM OPERATING ACTIVITIES**

Change in Unrestricted Net Assets (Deficit)	\$ (2,004,364)
Adjustments to Reconcile Change in Unrestricted Net Assets (Deficit) to Net Cash Used In Operating Activities:	
Amortization of Bond Issuance and Bond Discount Costs	1,724,602
(Increase) Decrease in Operating Assets:	
Prepaid Insurance	5,856
Tobacco Settlement Rights Receivable	433,596
Accrued Interest Payable	<u>(27,418)</u>
Net Cash Provided By Operating Activities	132,272

**CASH FLOWS FROM INVESTING ACTIVITIES**

Decrease in Deposits Held with Trustee	<u>(662)</u>
Net Cash Used In Investing Activities	(662)

**CASH FLOWS FROM FINANCING ACTIVITIES**

Principal Payments on Bonds Payable	<u>(105,000)</u>
Net Cash Used In Financing Activities	<u>(105,000)</u>
Net Increase in Cash	26,610
Cash, Beginning of Year	<u>200,208</u>
Cash, End of Year	<u><u>\$ 226,818</u></u>

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See notes to financial statements.

## **SENECA TOBACCO ASSET SECURITIZATION CORPORATION**

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### **NOTES TO FINANCIAL STATEMENTS**

December 31, 2011

#### **NOTE 1 – NATURE OF OPERATIONS**

The Seneca Tobacco Asset Securitization Corporation (the Corporation), is a Non-Profit Local Development Corporation under Section 1411 of the Not-For-Profit Corporation Law of the State of New York.

The Corporation was formed to acquire from the County of Seneca all future right, title and interest in the Tobacco Settlement Revenues (TSRs) under the Master Settlement Agreement (MSA) with respect to tobacco related litigation among various states and participating manufacturers. The purchase price of the County's future right, title and interest in the TSRs has been financed by the issuance of serial bonds. A Residual Certificate exists which represents the entitlement to receive all amounts required to be distributed after payment of debt service, operating expenses and certain other costs as set forth in the indenture. Payments on the Residual Certificate from TSR collections are subordinate to payments on bonds and certain other costs specified in the indenture. Excess TSRs not required by the Corporation to pay various expenses, debt service or required reserves with respect to the bonds are transferred to the Trust, as owner of the Residual Certificate. The County is the beneficial owner of the Trust and thus the funds received by the Trust will ultimately transfer to the County.

The Corporation is classified as a special-purpose government under GASB Statement No. 14. A special-purpose government is defined as a legally separate entity that performs only one activity. Although legally separate from the County, the Corporation is a component unit of the County, and accordingly, is included in the County's financial statements as a blended component unit.

The Corporation is primarily dependent on the future proceeds from the Tobacco Settlement Rights to meet future obligations under the indenture agreement.

## SENECA TOBACCO ASSET SECURITIZATION CORPORATION

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### NOTES TO FINANCIAL STATEMENTS

December 31, 2011

#### NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES

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##### **Basis of Presentation**

The financial statements of the Corporation have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The Corporation has adopted GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting" and GASB Statement No. 29, "The Use of Not-for-Profit Accounting and Financial Accounting Principles by Governmental Entities." In 2004, the Corporation was required and has implemented GASB Statement No. 34 "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments."

##### **Basis of Accounting**

The financial statements have been prepared on the accrual basis of accounting, whereby revenues are recognized when earned and expenses are recognized when incurred.

##### **Cash and Cash Equivalents**

For purposes of the statement of cash flows, the Corporation uses the indirect method of reporting net cash flows from operating activities, and considers all short-term investments with an original maturity of three months or less to be cash equivalents. At December 31, 2011, there were no cash equivalents.

##### **Income Taxes**

The Seneca Tobacco Asset Securitization Corporation is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code.

**SENECA TOBACCO ASSET SECURITIZATION CORPORATION**

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**NOTES TO FINANCIAL STATEMENTS**

December 31, 2011

**NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES – Continued**

**Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**Subsequent Events**

Management has evaluated subsequent events through February 22, 2012, which is the date the financial statements were available to be issued.

**NOTE 3 – TOBACCO SETTLEMENT RIGHTS RECEIVABLE**

The tobacco settlement rights receivable represents estimated future payments to be received from the MSA. The receivable was recorded at the cost of the purchase price from the County of \$5,600,904. As the payments are received under the MSA, the receivable is reduced. The receivable balance at December 31, 2011 was \$54,067.

**NOTE 4 – DEPOSITS HELD WITH TRUSTEE**

Deposits held with trustee include the following:

**Liquidity Reserve Account** – This reserve has been established pursuant to the Corporation's indenture and was initially funded in the amount equal to the maximum annual debt service on the Series 2000 Bonds. At December 31, 2011, these deposits consisted primarily of money market funds.

**Debt Service Account** – This is the account from which payments to bondholders are made with money transferred in from the collection account. At December 31, 2011, these deposits consisted primarily of money market funds.

**Collection Account** – This account has been established to receive the Tobacco Settlement payments under the MSA agreement. The monies received in this account are transferred to the debt service account to pay the Corporation's bondholders. At December 31, 2011, these deposits consisted primarily of money market funds.

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**SENECA TOBACCO ASSET SECURITIZATION CORPORATION**

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**NOTES TO FINANCIAL STATEMENTS**

December 31, 2011

**NOTE 5 – BOND ISSUANCE COSTS AND DISCOUNT FEES**

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The Corporation has incurred issuance costs and discount fees associated with the Series 2005 and 2000 Bond issues. Such costs and discount fees are deferred and amortized over the life of related debt. Balances at December 31, 2011 are as follows:

	<b>Issuance Costs</b>	<b>Discount Fees</b>
Cost	\$ 269,390	\$ 91,727,104
Less: Accumulated Amortization	<u>57,708</u>	<u>10,672,520</u>
Net	<u>\$ 211,682</u>	<u>\$ 81,054,584</u>

Amortization charged to expense in 2011 for bond issuance costs and discount fees was \$6,817 and \$1,717,785, respectively.

**NOTE 6 – LONG-TERM DEBT**

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On December 7, 2000, the Corporation issued \$6,450,000 in variable rate bonds. These bonds were part of the \$227,130,000 New York Counties Tobacco Trust I, Tobacco Settlement Pass-Through Bonds, Series 2000. The debt is payable solely from pledged Tobacco Settlement Rights and investment earnings on amounts on deposit. According to the terms of the required amortization payments, the Corporation is required to make annual debt service payments through 2042 with interest ranging from 5% to 6.3%.

Depending on the extent of actual collections from TSR payments and availability of funds, the Corporation has agreed to make principal payments in accordance with a flexible amortization payment schedule that allows for increased payments and a final maturity of June 1, 2024 on the Series 2001 Bonds.

On November 29, 2005, the Corporation issued variable rate bonds with a face value of \$95,530,000, discount fees totaling \$92,436,115, and bond issuance costs of \$197,730. The bonds bear interest at rates ranging from 6% to 7.85%. These bonds were part of the \$199,375,348 (net of discount) New York Counties Tobacco Trust V., Settlement Pass-Through Bonds, Series 2005. The debt is payable from pledged Tobacco Settlement Rights and investment earnings on deposit. The Corporation is required to make annual debt service payments beginning June 2038 through June 2060. These bonds are Capital Appreciation Bonds and pay interest at maturity, not every year. The series 2005 Bonds are subordinate to the 2000 bonds. In December 2009, Series 1 Bonds with a face value of \$1,055,000 were retired.

**SENECA TOBACCO ASSET SECURITIZATION CORPORATION**

**NOTES TO FINANCIAL STATEMENTS**

December 31, 2011

**NOTE 6 – LONG-TERM DEBT – Continued**

The Corporation's required amortization payments at December 31, 2011 on the above bonds are as follows:

	<b>Series 2000 Principal</b>	<b>Interest</b>	<b>Series 2005 Principal</b>	<b>Interest</b>
2012	\$ 45,000	\$ 394,264	\$ 0	\$ 0
2013	50,000	391,544	0	0
2014	60,000	388,344	0	0
2015	65,000	384,672	0	0
2016	70,000	380,558	0	0
Thereafter	<u>4,575,000</u>	<u>5,684,309</u>	<u>94,475,000</u>	<u>11,381,526</u>
<b>Total</b>	<b><u>\$ 4,865,000</u></b>	<b><u>\$ 7,623,691</u></b>	<b><u>\$ 94,475,000</u></b>	<b><u>\$ 11,381,526</u></b>

The Corporation's flexible amortization payments at December 31, 2011 on the Series 2000 bonds are as follows:

	<b>Series 2000 Principal</b>	<b>Interest</b>
2012	\$ 450,000	\$ 294,556
2013	245,000	279,643
2014	270,000	254,771
2015	275,000	246,040
2016	285,000	228,114
Thereafter	<u>3,340,000</u>	<u>914,943</u>
<b>Total</b>	<b><u>\$ 4,865,000</u></b>	<b><u>\$ 2,218,067</u></b>

Cash paid for interest in 2011 was \$290,927.

Changes in long-term liabilities are as follows:

	<b>Balance at December 31, 2010</b>	<b>Additions</b>	<b>Reductions</b>	<b>Balance at December 31, 2011</b>
Serial Bonds	<u>\$ 99,445,000</u>	<u>\$ 0</u>	<u>\$ 105,000</u>	<u>\$ 99,340,000</u>



## **SENECA TOBACCO ASSET SECURITIZATION CORPORATION**

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### **NOTES TO FINANCIAL STATEMENTS**

December 31, 2011

#### **NOTE 7 – RELATED PARTY**

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The Corporation is a special-purpose local development corporation and is considered by legal counsel to be bankruptcy-remote from the County of Seneca. However, the Corporation's board of directors is comprised of a majority of elected or appointed officials of the County of Seneca and one independent director.

#### **NOTE 8 – CONTINGENCY AND CONCENTRATION OF CREDIT RISK**

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During 2000, the Corporation purchased the rights to receive TSRs (Tobacco Settlement Revenues) from the County of Seneca. There are a number of risks associated with receipts of such TSRs, including litigation affecting participating manufacturers and possible bankruptcy as a result thereof, and future adjustments to the calculation of the TSR's. The Corporation's financial existence is contingent upon receiving these TSRs from the tobacco manufacturers. While the risk is considered remote, being of a material nature, it must be disclosed.

#### **NOTE 9 – FINANCIAL INSTRUMENTS**

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The Corporation maintains its cash accounts with a local financial institution and thus all cash held in excess of the FDIC insurable limit is subject to the solvency of this financial institution. The FDIC insurable limit for interest bearing accounts is \$250,000 per depositor per institution. As of December 31, 2010, the insurable limit for non-interest bearing accounts has been changed to unlimited coverage through December 31, 2012. From time to time throughout the year the bank balances exceeded insurance limits and management considered these circumstances to be a normal business risk.

#### **NOTE 10 – NET ASSET DEFICIT**

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The Corporation has a net deficit of \$17,278,598 at December 31, 2011. This deficit results from operating costs exceeding revenue since the initial period of operation. This deficit will be eliminated through subsequent interest earnings.