

# Nassau County Tobacco Settlement Corporation

Financial Statements as of and for the  
Year Ended December 31, 2011, and  
Independent Auditors' Reports

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## INDEPENDENT AUDITORS' REPORT

To the Board of Directors  
Nassau County Tobacco Settlement Corporation:

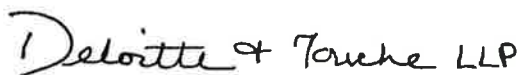
We have audited the accompanying financial statements of the governmental activities and each major fund of the Nassau County Tobacco Settlement Corporation (NCTSC), as of December 31, 2011, and for the year then ended, which collectively comprise NCTSC's basic financial statements as listed in the foregoing table of contents. These financial statements are the responsibility of the management of NCTSC. 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 and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of NCTSC's internal control over financial reporting. Accordingly, we express no such opinion. 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 the governmental activities and each major fund of NCTSC, as of December 31, 2011, and the respective changes in financial position 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 through 6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the NCTSC's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 27, 2012, on our consideration of NCTSC's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.



September 27, 2012

**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (in thousands)**  
Year Ended December 31, 2011

The following is a discussion and analysis of the Nassau County Tobacco Settlement Corporation's (NCTSC) financial performance, which provides an overview of NCTSC's financial activities for the year ended December 31, 2011. Please read this in conjunction with the financial statements, which immediately follow this section.

**FINANCIAL HIGHLIGHTS**

- NCTSC's liabilities exceeded its assets by \$74,600 (total net deficit) for the year ended. This amount includes restricted net assets of \$23,600 and is net of an unrestricted deficit of \$(98,200).
- NCTSC's total net deficit increased by \$18,760.
- NCTSC's governmental funds reported total ending fund balance of \$23,822, and an unassigned fund balance of \$210 for the year ended December 31, 2011.
- At the end of the current year, unassigned fund balance for the General Fund was \$210 or 225% of total General Fund expenditures.
- NCTSC's total bonds payable increased by \$5,406 or 1.2% during the current year. The reason for this increase is due to the accretion of interest on outstanding bonds.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

NCTSC's annual report is presented in three parts, management's discussion and analysis (this section), the basic financial statements, and required supplemental information.

The basic financial statements include government-wide financial statements, fund financial statements, and notes that provide more detailed information to supplement the basic financial statements.

**Reporting on NCTSC as a Whole**

The government-wide financial statements are designed to present an overall picture of the financial position of NCTSC and start on page 7. These statements consist of the statement of net deficit and the statement of activities, which are prepared using the economic resources measurement focus and the accrual basis of accounting. This means that all the current year's revenues and expenses, with the exception of Tobacco Settlement Revenues ("TSRs") (see notes to the financial statements for additional information) are included regardless of when cash is received or paid, producing a view of financial position similar to that presented by most private-sector companies.

The statement of net deficit combines and consolidates NCTSC's current financial resources with noncurrent assets and long-term obligations. This statement includes all of NCTSC's assets and liabilities.

The net deficit is the difference between NCTSC's assets and liabilities, and represents one measure of NCTSC's financial health. The net deficit is reported as one of two categories: restricted net assets and unrestricted net deficit. Over time, changes in NCTSC's net deficit are one indicator of whether its financial health is improving or deteriorating. The reader should consider other nonfinancial factors, such as regulatory changes and tobacco consumption, to assess the overall health of the Corporation.

The statement of activities focuses on both the gross and net cost of various activities; these costs are paid by NCTSC's revenues. This statement summarizes the cost of providing specific government services, and includes all current year revenues and expenses.

**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (in thousands)**  
Year Ended December 31, 2011

**OVERVIEW OF THE FINANCIAL STATEMENTS (continued)**

**Reporting on NCTSC's Most Significant Funds**

The fund financial statements begin on page 9 and provide detailed information about the most significant funds. The Board of Directors (the "Board"), per the Indenture, established funds to help it control and manage money for particular purposes and to demonstrate that it is meeting legal responsibilities for using certain money.

- *Governmental funds* - NCTSC's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund statements provide a detailed short-term view of NCTSC's general government operations. We describe the relationship (or differences) between governmental activities (reported in the statement of net deficit and the statement of activities) and governmental funds in reconciliations on pages 10 and 12.

**Notes to the Financial Statements**

The notes provide additional information that is essential to a full understanding of the information provided in the government-wide and fund financial statements. The notes to the basic financial statements can be found beginning with page 13.

**FINANCIAL ANALYSIS OF NCTSC AS A WHOLE**

Our analysis below focuses on the net deficit and changes in net deficit of NCTSC as a whole.

**Net Deficit**

Condensed Statement of Net Deficit  
Governmental Activities  
As of December 31,

	2011	2010
<b>Assets</b>		
Current and other assets	\$ 23,822	\$ 24,372
Deferred charges, net	354,977	367,974
<b>Total Assets</b>	<b>378,799</b>	<b>392,346</b>
<b>Liabilities</b>		
Current liabilities	1,611	3,414
Non-current liabilities	451,788	444,772
<b>Total Liabilities</b>	<b>453,399</b>	<b>448,186</b>
<b>Net Deficit</b>		
Restricted	23,600	24,009
Unrestricted	(98,200)	(79,849)
<b>Total Net Deficit</b>	<b>\$ (74,600)</b>	<b>\$ (55,840)</b>

As of December 31, 2011, total assets of NCTSC were \$378,799, a decrease of \$13,547 or 3.57% over the prior year. The decrease is mostly attributable to the amortization of the deferred charge on the purchase of TSRs. Total liabilities increased \$5,213 or 1.16% to \$453,399. The major reason for the increase is the accretion of interest on outstanding bonds of \$5,406, less the change in the interest accrual. The overall net deficit increased over the prior year by \$18,760 to a current deficit of \$(74,600). Of this net deficit for governmental activities, \$23,600 was restricted by statute or other specific purposes and unrestricted net deficit totaled \$(98,200).

**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (in thousands)**  
Year Ended December 31, 2011

**FINANCIAL ANALYSIS OF NCTSC AS A WHOLE (continued)**

**Changes in Net Deficit**

Condensed Statement of Activities  
Governmental Activities  
Years ended December 31,

	2011	2010
<b>General Revenues</b>		
Tobacco settlement revenues	\$ 18,849	\$ 19,881
Interest on investments	3	3
Miscellaneous income	23	-0-
Total General Revenues	18,875	19,884
<b>Expenses</b>		
General government support	93	76
Amortization of deferred charges	12,407	12,407
Interest on debt	25,135	24,748
Total Expenses	37,635	37,231
Increase in Net Deficit	(18,760)	(17,347)
<b>Net Deficit at Beginning of Year</b>	(55,840)	(38,493)
Net Deficit at End of Year	\$ (74,600)	\$ (55,840)

For the year ended December 31, 2011, general revenues were \$18,875, a decrease of \$1,009, which is directly attributable to a decrease in TSRs received in 2011 which totaled \$18,849. For the year ended December 31, 2010, expenses totaled \$37,635, an increase over the prior year of \$404. This increase is primarily attributable to an increase in interest on debt. As a result of expenses exceeding revenues, the net deficit as of the year ended December 31, 2011 was \$(74,600), an increase in the deficit of \$18,760 over the prior year.

**FINANCIAL ANALYSIS OF NCTSC'S FUNDS**

**Governmental Funds**

The focus of NCTSC's governmental funds is to provide information on short-term inflows, outflows, and balances of expendable resources. Such information is useful in assessing NCTSC's financing requirements.

At December 31, 2011, NCTSC's governmental funds reported combined ending fund balances of \$23,822, a decrease of \$550 in comparison with the prior year. Of this total, \$210 constitutes unassigned fund balance, which is available for spending at NCTSC's discretion. The remainder of fund balance is non-spendable or restricted to indicate that it is not available for new spending.

**General Fund**

The General Fund is the principal operating fund of NCTSC. At December 31, 2011 and 2010, unassigned fund balance(deficit) of the General Fund was \$222 and \$(8), respectively. The fund balance of NCTSC's General Fund increased by \$230 for the year ended December 31, 2011. This increase was primarily due to a transfer from the Debt Service Fund, offset by operating expenditures incurred throughout the year.

**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
MANAGEMENT'S DISCUSSION AND ANALYSIS (in thousands)  
Year Ended December 31, 2011

**FINANCIAL ANALYSIS OF NCTSC'S FUNDS** (continued)

**Governmental Funds** (continued)

**Debt Service Fund**

The Debt Service Fund is used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes such as funding required debt service obligations and making required transfers in accordance with the Indenture.

The Debt Service Fund is used to account for the accumulation of resources for payment of general long-term bond principal and interest. This fund also includes the Senior Liquidity Reserve Account. In accordance with the Indenture, the Senior Liquidity Reserve Account was underfunded at its required level by \$628. As result of insufficient TSRs received in April 2011 amounts were required to be withdrawn from the reserve to pay a portion of the minimum interest payment on the bonds due December 1, 2011.

In accordance with the Indenture, amounts on deposit in the Senior Liquidity Reserve Account will be available to pay principal and interest of the Series 2006 Bonds when due.

At December 31, 2011, total fund balance was \$23,600 and is restricted to pay future debt service. The fund balance of the Debt Service Fund decreased by \$780 for the year ended December 31, 2011. This decrease is due to excess expenditures over revenue and other financing sources. Revenues consisted solely of TSRs and interest earned on investments. Financing uses consisted of amounts transferred to the General Fund from TSRs received. Expenditures include payments of principal and interest on NCTSC's outstanding bonds.

**DEBT ADMINISTRATION**

**Debt**

NCTSC's total bonded debt increased by \$5,406 or 1.2% during the current year. The reason for this increase is due to the accretion of interest on outstanding bonds. More detailed information about NCTSC's long-term liabilities is presented in the notes to the basic financial statements.

For 2011, the aggregate Master Settlement Agreement (MSA) payment was 5% lower than the amount in 2010. This drop was driven by a large decline in tobacco consumption as well as an increase in the disputed payments not being released to the states. As a result, downgrades were reported on a number of turbo and capital appreciation bonds (CABs) which are typically more leveraged and are more negatively impacted by the MSA payment decline. No serial bonds were downgraded.

NCTSC's bond ratings, as assigned by Fitch Ratings, for the Series 2006A-1 Senior Bonds, due on June 1, 2021, decreased from BBB+ to BBB, with a negative outlook, Series 2006A-2 Senior Convertible Bonds, due June 1, 2026 decreased from BBB+ to BB+ with a negative outlook, Series 2006A-3 Senior Bonds, due June 1, 2035 decreased from BBB to BB+ with a negative outlook, Series 2006A-3 Senior Bonds, due June 1, 2046 decreased from BBB- to BB+ with a negative outlook, Series 2006B Capital Appreciation Turbo Term Bonds, due June 1, 2046 decreased from BBB- to BB- with a negative outlook, Series 2006C Capital Appreciation Turbo Term Bonds, due June 1, 2046 decreased from BB+ to B+ with a negative outlook and Series 2006D Capital Appreciation Turbo Term Bonds, due June 1, 2060 decreased from BB to B+ with a negative outlook during 2011.

NCTSC's bond ratings, as assigned by Standard and Poor's, for the Series 2006A-1 Senior Bonds, due on June 1, 2021, decreased from BBB to B+, Series 2006A-2 Senior Convertible Bonds, due June 1, 2026 decreased from BBB to B-, Series 2006A-3 Senior Bonds, due June 1, 2035 decreased from BBB- to B-, Series 2006A-3 Senior Bonds, due June 1, 2046 decreased from BB- to B- with a negative outlook, Series 2006B Capital Appreciation Turbo Term Bonds, due June 1, 2046 decreased from BBB- to BB- during 2012.

**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
MANAGEMENT'S DISCUSSION AND ANALYSIS (in thousands)  
Year Ended December 31, 2011

**DEBT ADMINISTRATION** (continued)

**Debt** (continued)

During 2011, NCTSC withdrew \$628 from the Senior Liquidity Reserve Account to pay a portion of the interest payment on the Bonds due December 1, 2011 as a result of insufficient tobacco settlement revenues received in April 2011 under the MSA.

**FUTURE ECONOMIC FACTORS**

Currently for 2012, NCTSC has received sufficient tobacco settlement revenues and was able to release from restricted amounts considered excess to satisfy the minimum debt service requirements and replenish approximately \$175 of the \$628 withdrawn from the Senior Liquidity Reserve Account in 2011.

The amount of TSRs received is dependent on many economic factors, including, but not limited to, future domestic cigarette consumption, the financial capability of the Participating Manufacturers (the "PMs"), litigation affecting the MSA and related legislation, enforcement of state legislation related to the MSA and the tobacco industry. Payments by the PMs under the MSA are subject to certain adjustments, which may be material.

**ADDITIONAL FINANCIAL INFORMATION**

This financial report is designed to provide NCTSC's interested parties with an overview of NCTSC's financial operations and financial condition. Should the reader have questions regarding the information included in this report or wish to request additional financial information, please contact the Nassau County Tobacco Settlement Corporation, 1 West Street, 1<sup>st</sup> Floor, Mineola, New York 11501-4248.



## **BASIC FINANCIAL STATEMENTS**

**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
**GOVERNMENT-WIDE FINANCIAL STATEMENT**  
**STATEMENT OF NET DEFICIT**  
December 31, 2011 (in thousands)

**ASSETS**

**Current Assets:**

Cash and cash equivalents	\$	210
Prepays		12
		222
Total Current Assets		222

**Non-Current Assets:**

Restricted investments - special reserves		23,600
Deferred charges, net		327,973
Cost of Issuance, net		27,004
		378,577
Total Non-Current Assets		378,577

		378,799
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**LIABILITIES**

**Current Liabilities:**

Accrued interest payable		1,611
		1,611
Total Current Liabilities		1,611

**Non-Current Liabilities:**

Bonds payable		451,788
		451,788
Total Non-Current Liabilities		451,788

		453,399
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**NET DEFICIT**

Restricted:

Debt service		23,600
Unrestricted		(98,200)
		(74,600)

	\$	(74,600)
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See notes to the financial statements.

**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
**GOVERNMENT-WIDE FINANCIAL STATEMENT**  
**STATEMENT OF ACTIVITIES**  
Year Ended December 31, 2011 (in thousands)

**Expenses:**

General government support	\$	93
Amortization of deferred charges		12,407
Interest on debt		<u>25,135</u>
Total Expenses		<u>37,635</u>

**General Revenues:**

Tobacco settlement revenues		18,849
Interest on investments		3
Miscellaneous income		<u>23</u>
Total General Revenues		<u>18,875</u>

Change in Net Deficit (18,760)

**Net Deficit at Beginning of Year** (55,840)

Net Deficit at End of Year \$ (74,600)

See notes to the financial statements.

**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
**GOVERNMENTAL FUNDS**  
**BALANCE SHEET (in thousands)**  
**December 31, 2011**

	MAJOR FUNDS		
	General Fund	Debt Service Fund	Total Governmental Funds
<b>ASSETS</b>			
Cash and cash equivalents	\$ 210	\$	210
Investments - restricted	\$	23,600	23,600
Prepays	12		12
	222	23,600	23,822
<b>Total Assets</b>	<b>\$ 222</b>	<b>\$ 23,600</b>	<b>\$ 23,822</b>
<b>FUND BALANCES</b>			
Non-spendable:			
Prepays	\$ 12	\$	12
Restricted:			
Debt service	\$	23,600	23,600
Unassigned	210		210
	222	23,600	23,822
<b>Total Fund Balances</b>	<b>222</b>	<b>23,600</b>	<b>23,822</b>
<b>Total Liabilities and Fund Balances</b>	<b>\$ 222</b>	<b>\$ 23,600</b>	<b>\$ 23,822</b>

See notes to the financial statements.

**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET**  
**TO THE STATEMENT OF NET DEFICIT (in thousands)**  
December 31, 2011

Total Fund Balances - Governmental Funds	\$	23,822
 Amounts reported for governmental activities in the statement of net deficit are different because:		
 Governmental funds report debt issuance costs and purchase cost of future TSRs as an expenditure when those costs are first incurred because they require the use of current financial resources. However, debt issuance costs and purchase cost of future TSRs must be included as a deferred charge in government-wide financial statements:		
Unamortized balance of deferred charge for bond issuance costs.		27,004
Unamortized balance of deferred charge for purchase of TSRs.		327,973
 Long-term liabilities applicable to NCTSC's governmental activities are not due and payable in the current period and accordingly are not reported in the funds. However these liabilities are included in the statement of net deficit:		
Bonds payable		(451,788)
 Interest payable applicable to NCTSC's governmental activities are not due and payable in the current period and accordingly are not reported in the funds. However these liabilities are included in the statement of net deficit.		
		(1,611)
 Net Deficit of Governmental Activities	 \$	 <u><u>(74,600)</u></u>

See notes to the financial statements.

**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
**GOVERNMENTAL FUNDS**  
**STATEMENT OF REVENUES, EXPENDITURES**  
**AND CHANGES IN FUND BALANCES (in thousands)**  
Year Ended December 31, 2011

	MAJOR FUNDS			
	General Fund	Debt Service Fund	Total Governmental Funds	
<b>REVENUES</b>				
Tobacco settlement revenues	\$	18,849	\$	18,849
Interest on investments		3		3
Miscellaneous local sources	23			23
	23	18,852		18,875
<b>EXPENDITURES</b>				
General government support	93			93
Debt service:				
Interest		19,332		19,332
	93	19,332		19,425
<b>Excess (Deficiency) of Revenues Over (Under) Expenditures</b>	(70)	(480)		(550)
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers in	300			300
Transfers out		(300)		(300)
	300	(300)		(550)
<b>Fund Balance (Deficit) at Beginning of Year</b>	230	(780)		(550)
	(8)	24,380		24,372
<b>Fund Balance (Deficit) at End of Year</b>	222	\$ 23,600		\$ 23,822

See notes to the financial statements.

**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
**RECONCILIATION OF THE GOVERNMENTAL FUNDS**  
**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES**  
**TO THE STATEMENT OF ACTIVITIES (in thousands)**  
Year Ended December 31, 2011

Net Change in Fund Balances	\$	(550)
<p>Governmental funds report debt issuance costs and purchase cost of future TSRs as an expenditure when those costs are first incurred because they require the use of current financial resources. However, debt issuance costs and purchase cost of future TSRs must be included as a deferred charge in government-wide financial statements and amortized in the statement of activities.</p>		
		(12,407)
<p>Bond interest is recorded as an expenditure on the fund statements when it is paid, and on the statement of activities when it is incurred.</p>		
		<u>(5,803)</u>
Change in Net Deficit of Governmental Activities	\$	<u><u>(18,760)</u></u>

See notes to the financial statements.

**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
NOTES TO FINANCIAL STATEMENTS (in thousands)  
December 31, 2011

**A. ORGANIZATION**

The Nassau County Tobacco Settlement Corporation ("NCTSC") is a special-purpose local development corporation, and is an instrumentality of, but separate and apart from Nassau County (the "County"), New York, incorporated under the provisions of the New York State Not-For-Profit Corporation Law. Although legally separate from and independent of the County, the Corporation is considered an affiliated organization under Governmental Accounting Standards Board (GASB) Statement No. 39, "Determining whether Certain Organizations are Component Units". Accordingly, the Corporation is being reported as a blended component unit for financial reporting purposes in the County's financial statements.

The board of directors of NCTSC has three members, one of which must meet certain requirements of independence: (i) one appointed by a majority vote of the County Legislature, (ii) one who must be the County Treasurer, ex officio, designated by the County Executive, and (iii) one selected by (i) and (ii). As of December 31, 2011, one position was vacant.

NCTSC did not receive sufficient TSRs to make the required debt service payment of \$19,332 against its Series 2006 Bonds during 2011. NCTSC withdrew \$628 from the Senior Liquidity Reserve Account to pay a portion of the interest payment on the Bonds due December 1, 2011.

Payments with respect to the Series 2006 Bonds are dependent upon receipt of TSRs. The Series 2006 Bonds are special obligations of NCTSC payable solely from the pledged revenues, the Senior Liquidity Reserve Account, and other funds and accounts as provided in the Indenture. NCTSC has no other assets available for the payment of the Series 2006 Bonds.

Failure to pay when due any interest on Senior Bonds or any Serial Maturity or Turbo Term Bond Maturity for Senior Bonds, among other things, will constitute an event of default.

The amount of TSRs received is dependent on many factors, including future domestic cigarette consumption, the financial capability of the Participating Manufacturers (the "PMs"), litigation affecting the MSA and related legislation, enforcement of state legislation related to the MSA and the tobacco industry. Payments by the PMs under the MSA are subject to certain adjustments, which may be material.

**B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The financial statements of NCTSC have been prepared in conformity with accounting principles generally accepted in the United States of America (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 more significant of NCTSC's accounting policies are described below.

**1. BASIS OF PRESENTATION**

NCTSC's basic financial statements include both government-wide (reporting on NCTSC as a whole) and fund financial statements (reporting on NCTSC's most significant funds).

**Government-Wide Financial Statements**

The government-wide financial statements, i.e. the statement of net deficit and the statement of activities, display information about NCTSC as a whole. These statements include the financial activities of the overall government. Eliminations of internal activity have been made in these statements. All of the activities of NCTSC are considered governmental activities.



**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
NOTES TO FINANCIAL STATEMENTS (in thousands)  
December 31, 2011

**B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (continued)

**1. BASIS OF PRESENTATION** (continued)

**Government-Wide Financial Statements** (continued)

In the government-wide statement of net deficit, NCTSC's governmental activities are presented on a consolidated basis and are reported on a full accrual, economic resource basis, which recognizes all long-term assets and receivables (except for TSRs as discussed in note B.2) as well as long-term debt and obligations. NCTSC's net deficit is reported in two parts – restricted net assets and unrestricted net deficit.

The government-wide statement of activities reports the gross expenses of each of the NCTSC's functional categories which are supported by general revenues.

This government-wide focus is more on the sustainability of NCTSC as an entity and the change in NCTSC's net deficit resulting from the current year's activities.

**Fund Financial Statements**

Fund financial statements report detailed information about NCTSC. The focus of governmental financial statements is on major funds rather than reporting funds by type. Each major fund is presented in a separate column. Non-major funds are aggregated and presented in a single column. NCTSC has presented all funds as major funds.

The funds of NCTSC are considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations.

**Governmental Funds** – Governmental funds are those through which most governmental functions are financed. The acquisition, use and balances of expendable financial resources and the related liabilities are accounted for through governmental funds. The measurement focus of the governmental funds is upon determination of financial position and changes in financial position.

NCTSC reports the following major governmental funds:

General Fund – is the principal operating fund of NCTSC. This fund is used to account for all financial resources except those required to be accounted for in other funds.

Debt Service Fund – is used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes, such as funding the required payment of general long-term bond principal and interest, and also includes the Senior Liquidity Reserve Account. In accordance with the Indenture, the Senior Liquidity Reserve Account was underfunded by \$628 from its required level of \$24,009 in 2011.

**2. BASIS OF ACCOUNTING/MEASUREMENT FOCUS**

The basic financial statements of NCTSC have been prepared in conformity with accounting principles generally accepted in the United States of America ("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.

**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
NOTES TO FINANCIAL STATEMENTS (in thousands)  
December 31, 2011

**B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2. BASIS OF ACCOUNTING/MEASUREMENT FOCUS (continued)**

Measurement focus refers to what is being measured, whereas the basis of accounting refers to when revenues and expenditures are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurement made, regardless of the measurement focus applied.

In the government-wide statements, governmental activities are presented using the economic resources measurement focus and are presented using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place. Management, however, has elected to recognize TSRs as they are collected due to the unpredictability of the revenues and the difficulty with which to estimate the amount earned.

In the fund financial statements, governmental funds use a current financial resources measurement focus and are accounted for using the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (measurable and available to finance current operations). "Measurable" means the amount of the transaction can be determined and "available" means collectible within the current period or soon enough thereafter to pay liabilities of the current period. NCTSC considers all revenues available if they are collected within 60 days after the year end.

**3. ASSETS, LIABILITIES AND FUND EQUITY**

**CASH, CASH EQUIVALENTS AND INVESTMENTS**

NCTSC's cash and cash equivalents consist of demand deposits.

Investments consist of shares in an investment fund which invests in short-term U.S. treasury securities and in repurchase agreements backed by U.S. treasury securities and are stated at the fair value.

**RESTRICTED ASSETS**

Certain assets of NCTSC are classified as restricted assets because their use is restricted by contractual agreements and regulations.

**PREPAIDS**

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items.

**DEFERRED CHARGES**

Deferred charges are those where the liability recognition criteria have been met, but which expenditure recognition criteria have not been met. Such amounts include the following:

Issuance Costs

Issuance costs related to the issuance of long term debt are deferred, amortized on a straight-line basis over the life of the issue, and are presented net of accumulated amortization, in the government-wide financial statements. In the fund financial statements bond issuance costs are recognized, during the current period, as debt service expenditures in the funds.

**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
NOTES TO FINANCIAL STATEMENTS (in thousands)  
December 31, 2011

**B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**3. ASSETS, LIABILITIES AND FUND EQUITY (continued)**

**DEFERRED CHARGES (continued)**

Deferral of Cost from Purchase of Future TSRs

GASB 48, Sales and Pledges of Receivables and Future Revenues and Intra-entity Transfers of Assets and Future Revenues requires NCTSC to record the transfer of funds made to the County for the purchase of the TSRs to be classified as a deferred charge. The deferred charge on the TSRs is being amortized based on the ratio of the estimated TSR revenues to be received over the resources used to purchase the future TSRs which is then applied to the resources used to purchase the future TSRs.

**LONG-TERM OBLIGATIONS**

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities.

**EQUITY CLASSIFICATIONS**

In the government-wide statements, equity is displayed in two components:

- a. Restricted net assets — consists of net assets with constraints placed on the use either by (1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or (2) law through constitutional provisions or enabling legislation. Restricted net assets reported in the statement of net deficit as of December 31, 2011 are not restricted by enabling legislation.
- b. Unrestricted net deficit — all other net assets that do not meet the definition of “restricted.”

When both restricted and unrestricted resources are available for use, it is NCTSC's practice to use restricted resources first, then unrestricted resources as needed.

In the fund financial statements there are five classifications of fund balance:

**Non-spendable** – Includes amounts that cannot be spent because they are either not in spendable form, not available within a year, or legally or contractually required to be maintained intact. Non-spendable fund balance includes prepaid expenses recorded in the General Fund.

**Restricted** – Includes amounts with constraints placed on the use of resources either externally imposed by creditors, grantors, contributors or laws or regulations of other governments; or imposed by law through constitutional provisions or enabling legislation. Restricted fund balance includes all amounts reported in the Debt Service Fund per the requirements of the indenture agreement.

**Committed** – Includes amounts that are subject to a purpose constraint imposed by a formal action of the NCTSC's highest level of decision-making authority. NCTSC is not empowered to establish law; accordingly NCTSC will not have committed fund balances.

**Assigned** – Includes amounts that are constrained by NCTSC's intent to be used for specific purposes, but are neither restricted nor committed. NCTSC has no assigned fund balances as of December 31, 2011.

**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
NOTES TO FINANCIAL STATEMENTS (in thousands)  
December 31, 2011

**B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**3. ASSETS, LIABILITIES AND FUND EQUITY (continued)**

**EQUITY CLASSIFICATIONS (continued)**

**Unassigned** - Includes all other General Fund net assets that do not meet the definition of the above four classifications and are deemed to be available for general use by NCTSC. It is also used to report negative fund balances in other governmental funds.

**Order of Use of Restricted and Unrestricted Funds**

In circumstances where an expenditure is incurred for a purpose for which amounts are available in multiple fund balance classifications, management will assess the current financial condition of NCTSC and then determine the order of application of expenditures to which fund balance classification will be charged. It is the intention of the NCTSC that the expenditure is to be spent first from the restricted fund balance to the extent appropriated by budget and then from the unrestricted fund balance. Expenditures incurred in the unrestricted fund balances shall be applied first to the committed fund balance to the extent that there is a commitment, to assigned fund balance to the extent that there is an assignment, and then to the unassigned fund balance.

**4. REVENUES AND EXPENDITURES**

**TOBACCO SETTLEMENT REVENUES**

On November 23, 1999, NCTSC entered into a Purchase and Sale Agreement (Agreement) dated as of October 1, 1999, with the County pursuant to which NCTSC acquired from the County, among other things, all of the County's right, title, and interest under the MSA and the Consent Decree, as such terms are defined in the Agreement, and which are referred to herein as TSRs. The consideration paid by NCTSC to the County for such acquisition consisted of \$247,500 in cash (of which \$77,500 was paid into escrow for the benefit of the County) and the sole beneficial interest in NCTSC Residual Trust (Residual Trust), a Delaware business trust to which NCTSC has conveyed a residual interest in all the TSRs. The NCTSC funded such consideration from the proceeds of its Tobacco Settlement Asset-Backed Bonds, Series A, which are referred to herein as the 1999 Bonds. NCTSC's right to receive TSRs is its most significant asset and is expected to produce funding for its obligations to the extent of the receipt of TSRs.

Per the Agreement, TSRs shall be transferred directly to NCTSC. Under the MSA, amounts shall be paid by the participating manufacturers to the escrow agent on or before April 15<sup>th</sup>. The escrow agent will then disburse these funds to NCTSC's Indenture Trustee. NCTSC collected \$18,849 of TSRs, of which \$300 was transferred to the General Fund to pay operating expenses and the balance was used to pay the debt service requirements.

**INTERFUND TRANSACTIONS**

Interfund transactions have been eliminated from the government-wide financial statements. In the funds statements interfund transactions include payments to the General Fund to cover various operating costs.

**5. USE OF ESTIMATES**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
NOTES TO FINANCIAL STATEMENTS (in thousands)  
December 31, 2011

**B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (continued)

**6. SUBSEQUENT EVENTS**

Management has evaluated subsequent events through the date of the report, which is the date the financial statements were available to be issued.

**7. NEW PRONOUNCEMENT**

The corporation has adopted all of the current statements of the GASB that are applicable. Effective with the financial report for the year ended December 31, 2011, the corporation has adopted GASB Statement No. 54, "Fund Balance Reporting and Governmental Fund Type Definitions." This statement establishes criteria for classifying fund balances into specifically defined classifications and clarifies definitions for governmental fund types.

**C. DETAIL NOTES ON ALL FUNDS**

**1. CASH, CASH EQUIVALENTS AND INVESTMENTS**

Custodial Credit Risk – Deposits/Investments – Custodial credit risk for investments exist when, in the event of the failure of the counterparty, a government will not be able to recover the value of its investments or collateral securities that are in possession of an outside party.

Governmental Accounting Standards Board Statement No. 40 directs that deposits be disclosed as exposed to custodial credit risk if they are not covered by depository insurance, and the deposits are either:

- Uncollateralized
- Collateralized with securities held by the pledging financial institution, or
- Collateralized with securities held by the pledging financial institution's trust department or agent but not in the NCTSC's name

At December 31, 2011, NCTSC's deposit balances were \$210. Of these balances, \$210 was covered by the Federal Deposit Insurance Corporation.

At December 31, 2011, NCTSC's investments were \$23,600. Investments consisted of shares of an investment fund which invests in short-term U.S. Treasury securities paying a fixed, variable or floating interest rate and in repurchase agreements backed by U.S. Treasury securities.

Credit Risk – State law limits investments to those authorized by State statutes. Investments are governed by the Indenture.

Interest-Rate Risk – Interest-rate risk arises because potential purchasers of debt securities will not agree to pay face value for those securities if interest rates substantially increase, thereby affording potential purchasers more favorable rates on essentially equivalent securities. Accordingly, such investments would have to be held to maturity to avoid a potential loss.

Concentration of Credit Risk – Credit risk can arise as a result of failure to adequately diversify investments. Concentration risk disclosure is required for positions of 5 percent or more in securities of a single issuer.

At December 31, 2011, NCTSC did not have any investments subject to credit risk, interest-rate risk or concentration of credit risk.

**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
NOTES TO FINANCIAL STATEMENTS (in thousands)  
December 31, 2011

**C. DETAIL NOTES ON ALL FUNDS (continued)**

**2. DEFERRED CHARGES**

Deferred charges created as a result of the issuance of the 2006 Serial Bonds and the deferral of cost from purchase of the future TSRs as of December 31, 2011 is as follows:

Cost of issuance	\$	1,519
Original issue discount		9,011
Underwriter's discount		3,836
Loss on defeasance		<u>18,869</u>
Total cost of issuance		33,235
Less: related amortization		<u>(6,231)</u>
Deferred charges, net - cost of issuance	\$	<u>27,004</u>
Purchase of TSRs	\$	387,765
Less: related amortization		<u>(59,792)</u>
Deferred charges, net - purchase of TSRs	\$	<u>327,973</u>

Total amortization expense for the cost of issuance and purchase of TSRs for the year ended December 31, 2011 totaled \$1,039 and \$11,958, respectively.

**3. INTERFUND TRANSFERS**

For the year ended December 31, 2011, interfund transfer balances represent payments from the collection account in the Debt Service Fund to the General Fund to pay operating costs per the Indenture. Interfund transfers are stated as follows:

	Transfer In	Transfer Out
General Fund	\$ 300	
Debt Service Fund		\$ 300
	<u>\$ 300</u>	<u>\$ 300</u>

**4. LONG-TERM DEBT**

Bonds - In 1999, the NCTSC issued \$294,500 of the 1999 Bonds. On April 5, 2006, NCTSC issued \$431,034 of Tobacco Settlement Asset-Backed Bonds, Series 2006 ("Series 2006 Bonds") pursuant to an Amended and Restated Indenture dated as of March 1, 2006 ("Indenture"). The Series 2006 Bonds consisted of the Series 2006A-1 Taxable Senior Current Interest Bonds of \$42,645, the Series 2006A-2 Senior Convertible Bonds of \$37,906, the Series 2006A-3 Senior Current Interest Bonds of \$291,540, and the Series 2006B-E Subordinate CABs of \$58,944. Unless otherwise indicated, defined terms have the meanings ascribed to them in the Offering Circular for the Series 2006 Bonds dated March 31, 2006.

**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (in thousands)**  
December 31, 2011

**C. DETAIL NOTES ON ALL FUNDS (continued)**

**4. LONG-TERM DEBT (continued)**

NCTSC used the proceeds from the Series 2006 Bonds, along with other funds, to: (i) refund all of the 1999 Bonds then-currently outstanding in the aggregate principal amount of \$272,125; (ii) fund a Senior Liquidity Reserve for the Series 2006 Senior Bonds of \$24,009; (iii) pay the costs of issuance of the Series 2006 Bonds; (iv) fund certain projected requirements for the Operating Account; (v) fund interest on the Series 2006 Bonds through the December 1, 2007 payment; and (vi) pay certain amounts to the NCTSC Residual Trust as registered owner of the Residual Certificate. Pursuant to the Indenture, TSRs paid on or after April 1, 2008, are subject to the lien of the Indenture. Interest paid on these bonds in 2011 totaled \$19,332.

Any additional revenues received above the required debt service payments are required to fund sinking fund installments and/or Turbo Redemptions. NCTSC did not receive sufficient TSRs to make the required debt service payment of \$19,332 against its Series 2006 Bonds during 2011. NCTSC withdrew \$628 from the Senior Liquidity Reserve Account to pay a portion of the interest payment on the Bonds due December 1, 2011.

Payments with respect to the Series 2006 Bonds are dependent upon receipt of TSRs. The Series 2006 Bonds are special obligations of NCTSC payable solely from the pledged revenues, the Senior Liquidity Reserve Account, and other funds and accounts as provided in the Indenture. NCTSC has no other assets available for the payment of the Series 2006 Bonds.

Failure to pay when due any interest on Senior Bonds or any Serial Maturity or Turbo Term Bond Maturity for Senior Bonds, among other things, will constitute an event of default.

The amount of TSRs received is dependent on many factors, including future domestic cigarette consumption, the financial capability of the Participating Manufacturers (the "PMs"), litigation affecting the MSA and related legislation, enforcement of state legislation related to the MSA and the tobacco industry. Payments by the PMs under the MSA are subject to certain adjustments, which may be material.

A summary of changes in long-term liabilities for the year ended December 31, 2011 is as follows:

	Balance 1/1/11	Increases	Reductions	Balance 12/31/11	Non-current Liabilities due within one year	Non-current Liabilities
<i>Primary Government:</i>						
Bonds	\$ 420,129		\$ -0-	\$ 420,129	\$ -0-	\$ 420,129
Plus: accreted interest	26,253	\$ 5,406		31,659		31,659
Total bonds	<u>\$ 446,382</u>	<u>\$ 5,406</u>	<u>\$ -0-</u>	<u>\$ 451,788</u>	<u>\$ -0-</u>	<u>\$ 451,788</u>

**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (in thousands)**  
December 31, 2011

**C. DETAIL NOTES ON ALL FUNDS (continued)**

**4. LONG-TERM DEBT (continued)**

Bonds outstanding at December 31, 2011, are as follows:

Description	Original Date Issued	Original Amount	Interest Rate	Maturity Date	Amount Outstanding	Amount Outstanding Including Acc. Interest
2006A1	04/05/06	\$ 42,645	6.830%	6/1/2021	\$ 31,740	\$ 31,740
2006A2	04/05/06	37,906	5.250%	6/1/2026	37,906	44,640
2006A3(2035)	04/05/06	97,005	5.000%	6/1/2035	97,005	97,005
2006A3(2046)	04/05/06	194,535	5.125%	6/1/2046	194,535	194,535
2006B	04/05/06	10,670	5.800%	6/1/2046	10,670	14,815
2006C	04/05/06	9,867	6.000%	6/1/2046	9,867	13,854
2006D	04/05/06	37,604	6.400%	6/1/2060	37,604	53,985
2006E	04/05/06	802	7.350%	6/1/2060	802	1,214
					<u>\$ 420,129</u>	<u>\$ 451,788</u>

The following table summarizes NCTSC's minimum future debt service requirements as of December 31, 2011:

	Principal	Interest	Total Principal and Interest
2012	\$ 0	\$ 19,332	\$ 19,332
2013	0	19,332	19,332
2014	0	19,331	19,331
2015	0	19,332	19,332
2016	0	19,332	19,332
2017-2021	31,739	95,574	127,313
2022-2026	37,906	91,381	129,287
2027-2031	0	74,101	74,101
2032-2036	97,005	66,825	163,830
2037-2041	0	49,850	49,850
2042-2046	215,072	236,292	451,364
2047-2051	0	0	0
2052-2056	0	0	0
2057-2060	38,407	1,141,808	1,180,215
	<u>\$ 420,129</u>	<u>\$ 1,852,490</u>	<u>\$ 2,272,619</u>

**D. RESIDUAL TRUST**

Approximately \$140 million of the proceeds of the Series 2006 Bonds and unpledged TSR's were deposited into the Residual Trust, a Delaware statutory trust, on behalf of the County as the beneficial owner of the Residual Certificate. Such proceeds are held to provide monies to the County in accordance with the tax certificates executed in connection with the Series 2006 Bonds. The original 1999 purchase price paid by NCTSC to the County under the Agreement consisted of: (i) the net proceeds of the sale of the 1999 Bonds and (ii) a 100% beneficial ownership interest in the Trust. This Agreement was amended and restated as of March 1, 2006. Under the amended Agreement, TSRs received from April 5, 2006 to March 31, 2008, were not pledged to the holders of the Series 2006 Bonds and, therefore, all TSRs received during that time were transferred to the Trust on behalf of the County.



**NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION**  
NOTES TO FINANCIAL STATEMENTS (in thousands)  
December 31, 2011

**E. NEW PRONOUNCEMENTS**

The Governmental Accounting Standards Board (GASB) has issued Statement No. 61, "The Financial Reporting Entity: Omnibus-an amendment of GASB Statements No. 14 and No. 34". This statement amends the requirements of GASB Statement No. 14, "The Financial Reporting Entity" and GASB Statement No. 34, "Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments" to better meet user needs and to address reporting entity issues that have arisen since the issuance of those statements. The requirements of this statement become effective for NCTSC for the year ended December 31, 2013.

The Governmental Accounting Standards Board (GASB) has issued GASB Statement No. 62, "Codification of accounting and Financial Reporting Guidance Contained in Pre-November 1989 FASB and AICPA Pronouncements" The Statement objective is to incorporate pronouncements that do not contradict or conflict with GASB pronouncements. The requirements of this statement become effective for NCTSC for the year ended December 31, 2012.

The Governmental Accounting Standards Board (GASB) has issued Statement No. 63, "Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position." This statement will improve financial reporting by standardizing the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government's net position. The requirements of this statement become effective for NCTSC for the year ended December 31, 2012.

NCTSC is currently evaluating the impact of the above pronouncements.



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## **INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Board of Directors of  
Nassau County Tobacco Settlement Corporation:

We have audited the financial statements of Nassau County Tobacco Settlement Corporation (the NCTSC), as of December 31, 2011, and for the year then ended, and have issued our report thereon dated September 27, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

### **Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Directors, management, and the Office of the New York State Comptroller and is not intended to be and should not be used by anyone other than these specified parties.

*Deloitte & Touche LLP*

September 27, 2012