

**STEUBEN TOBACCO ASSET  
SECURITIZATION CORPORATION  
(A Blended Component Unit of  
the County of Steuben, New York)**

**Basic Financial Statements as of  
December 31, 2011 and 2010  
Together with  
Independent Auditors' Report**

**STEUBEN TOBACCO ASSET SECURITIZATION CORPORATION**  
**(A Blended Component Unit of the County of Steuben, New York)**

**TABLE OF CONTENTS**

---

	<u>Page</u>
Independent Auditors' Report	1 - 2
Management's Discussion and Analysis (Unaudited)	3 - 7
Basic Financial Statements:	
Statements of Net Deficit	8
Statements of Activities and Change in Net Deficit	9
Governmental Fund Balance Sheets	10
Statements of Governmental Fund Revenues, Expenditures and Change in Fund Balance	11
Notes to Basic Financial Statements	12 - 20
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	21 - 22

## INDEPENDENT AUDITORS' REPORT

March 15, 2012

To the Board of Directors of the  
Steuben Tobacco Asset Securitization Corporation:

We have audited the accompanying financial statements of the governmental activities and major fund of the Steuben Tobacco Asset Securitization Corporation (the Corporation), a blended component unit of the County of Steuben, New York, as of and for the years ended December 31, 2011 and 2010, which collectively comprise the Corporation's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States 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 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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and major fund of the Steuben Tobacco Asset Securitization Corporation as of December 31, 2011 and 2010, and the respective changes in financial position thereof for the years then ended in conformity with accounting principles generally accepted in the United States.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 15, 2012, on our consideration of the Steuben Tobacco Asset Securitization Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is 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 considered in assessing the results of our audit.

171 Sully's Trail  
Pittsford, NY 14534  
p (585) 381-1000  
f (585) 381-3131

ROCHESTER • BUFFALO  
ALBANY • SYRACUSE  
PERRY • GENEVA

www.bonadio.com

## **INDEPENDENT AUDITORS' REPORT**

(Continued)

Accounting principles generally accepted in the United States require that the management's discussion and analysis on pages 3 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

**STEBEN TOBACCO ASSET SECURITIZATION CORPORATION  
(A Blended Component Unit of the County of Steuben, New York)**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**

**DECEMBER 31, 2011 and 2010**

**(In thousands)**

---

The following Management's Discussion and Analysis (MD&A) provides a comprehensive overview of the Steuben Tobacco Asset Securitization Corporation's (the Corporation) financial position as of December 31, 2011 and 2010 and its changes in financial position for the years then ended. This MD&A should be read in conjunction with the financial statements and related footnotes of the Corporation, which directly follow the MD&A.

**General Overview**

The Corporation is a special purpose, bankruptcy remote local development corporation organized under the Not-For-Profit Corporation Laws of the State of New York (the State). The Corporation was established on October 3, 2000; however, there were no substantive operations until October 15, 2000. The Corporation is an instrumentality of, but separate and apart from the County of Steuben, New York (the County). Pursuant to a Purchase and Sale Agreement with the County, the County sold to the Corporation all of its future rights, 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 provided 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 County a share of the TSRs under the MSA. The future rights, title and interest of the County's share were sold to the Corporation and were financed by the issuance of bonds.

**Overview of the Financial Statements**

The financial statements of the Corporation have been prepared in accordance with accounting principles generally accepted in the United States as prescribed by the Governmental Accounting Standards Board (GASB). The financial statement presentation consists of the following four basic financial statements:

- Statement of Net Deficit
- Statement of Activities and Change in Net Deficit
- Governmental Fund Balance Sheet
- Statement of Governmental Fund Revenues, Expenditures and Change in Fund Balance

The Statement of Net Deficit and the Statement of Activities and Change in Net Deficit are prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues, expenses, assets and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place. Revenues, expenses, assets and liabilities resulting from non-exchange transactions are recognized when the amounts to be received are measurable and collection is probable. The Governmental Fund Balance Sheet and the Statement of Governmental Fund Revenues, Expenditures and Change in Fund Balance are presented using the current financial resources measurement focus and the modified accrual basis of accounting. These policies are more fully described in the accompanying notes to the basic financial statements.

### Overview of the Financial Statements (Continued)

The Statement of Net Deficit presents all of the Corporation's asset and liability information, with the difference between the two reported as net assets. Fluctuations in net assets can be a useful indicator of the Corporation's financial position. Restricted net assets are those that are restricted based on externally imposed conditions and consist of funds in the debt service and liquidity reserve accounts. These accounts were established to provide for debt service payments for at least one year in the event of insufficient revenues. All other net assets are considered unrestricted.

The Statement of Activities and Change in Net Deficit presents all of the Corporation's revenues, both program and general, expenses, and transfers.

The Governmental Fund Balance Sheet presents the Corporation's assets, liabilities and fund balance. This statement uses the debt service fund, a governmental fund type, to report its financial position.

The Statement of Governmental Fund Revenues, Expenditures, and Change in Fund Balance presents the changes in financial position of the debt service fund.

### Financial Highlights

The Corporation reported a net deficit (i.e., liabilities in excess of assets) of \$29,643 as of December 31, 2011, an increase in the net deficit of \$652 from the prior year.

The Series 2005C Bonds (taxable) were replaced with the Series 2010A Bond (tax-exempt) on June 1, 2010. There were no new debt obligations issued. Required payments were made in 2007 through and including 2011 against bonds issued in 2005 based upon the TSRs received by the Corporation.

### Condensed Statement of Net Deficit (In thousands)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Total assets	\$ <u>3,486</u>	\$ <u>3,554</u>	\$ <u>3,648</u>
Bonds payable, net of bond discount	29,956	29,962	30,034
Other liabilities	<u>3,173</u>	<u>2,583</u>	<u>2,037</u>
Total liabilities	<u>33,129</u>	<u>32,545</u>	<u>32,071</u>
Net deficit	<u>\$ (29,643)</u>	<u>\$ (28,991)</u>	<u>\$ (28,423)</u>

### Total Assets

The total assets decreased \$68 from 2010 to 2011. The decrease in total assets from 2010 to 2011 was primarily due to a decrease in TSR receivable of approximately \$78, offset by an increase in cash of approximately \$10. The decrease in accounts receivable was the result of anticipated 2012 TSRs being less than those that were expected in 2011. The total assets decreased \$94 from 2009 to 2010. The decrease in total assets from 2009 to 2010 was primarily due to a decrease in investments of approximately \$32 and a decrease in TSR receivable of approximately \$73, offset by an increase in cash of approximately \$12. The decrease in investments is primarily due to a reduction in the Debt Service fund balance to meet the interest and principal payment requirements on the Series 2005 Bonds. The decrease in accounts receivable was the result of anticipated 2011 TSRs being less than those that were expected in 2010.

## Financial Highlights (Continued)

### Total Liabilities

The increase in total liabilities from 2010 to 2011 of \$584 reflects the increase in accrued interest payable on outstanding bonds (approximately \$589) and a decrease in bonds payable (approximately \$6). The increase in total liabilities from 2009 to 2010 of \$474 reflects the increase in accrued interest payable on outstanding bonds (approximately \$548) and a decrease in bonds payable (approximately \$72).

### Total Net Assets

The increase in the net deficit from 2010 to 2011 of approximately \$652 was primarily due to the consistency of the interest and amortization expense (approximately \$1,996) and a decrease in TSRs (approximately \$84). The increase in the net deficit from 2009 to 2010 of approximately \$568 was primarily due to the increase in interest and amortization expense (approximately \$1,673), debt issuance costs in 2010 of \$20 and a decrease in TSRs (approximately \$433).

### Condensed Statement of Activities And Change in Net Deficit (In thousands)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Expenses:			
General government -			
Materials and services	\$ 7	\$ 7	\$ 17
Administrative costs	23	23	32
Debt issuance costs	-	20	-
Interest, amortization and fees	<u>1,996</u>	<u>1,976</u>	<u>303</u>
Total expenses	2,026	2,026	352
Program revenues - tobacco settlement	<u>1,374</u>	<u>1,458</u>	<u>1,891</u>
Change in net assets	(652)	(568)	1,539
Net deficit - beginning of year	<u>(28,991)</u>	<u>(28,423)</u>	<u>(29,962)</u>
Net deficit - end of year	<u>\$ (29,643)</u>	<u>\$ (28,991)</u>	<u>\$ (28,423)</u>

### Expenses

Expenses incurred in 2011 were the same as those incurred in 2010. The consistency in the expenses is due to an increase in the amount of interest recorded in 2011, along with no debt issuance costs as they were 2010 expenses only. Expenses incurred in 2010 were more than those incurred in 2009. This increase was due primarily to an increase in the amount of interest recorded in 2010.

### Revenues

Total revenues recorded during 2011 were less than those recorded in 2010. TSRs decreased by \$84 in 2011 compared to 2010. Revenues recorded during 2010 decreased by \$433 over 2009 amounts.

## Financial Analysis of the Corporation's Fund Financial Statements

The Corporation uses fund accounting to ensure and demonstrate compliance with finance related legal requirements.

The focus of the Corporation's governmental fund reporting is to provide information on near-term inflows, outflows and balances of spendable resources. Such information is useful in assessing the Corporation's financing requirements. In particular, unassigned fund balance may serve as a useful measure of the Corporation's net resources available for spending at the end of the year.

In 2011, the Corporation implemented Governmental Accounting Standards Board, No. 54, which required that fund balances be reported different than in prior years.

As of December 31, 2011, the Corporation's debt service fund reported an ending fund balance of \$1,877, an increase of \$9 from the prior year. Approximately \$119 of fund balance is unassigned fund balance and is available for the Corporation's future needs. The remainder of fund balance is restricted, which indicates that it is not available for spending since it has already been committed to pay future debt service and fund future bond issuance costs.

As of December 31, 2010, the Corporation's debt service fund reported an ending balance of \$1,868, a decrease of \$18 from the prior year. Approximately \$110 of fund balance is unassigned fund balance and is available for the Corporation's future needs. The remainder of fund balance is restricted, which indicates that it is not available for spending, since it has already been committed to pay future debt service and fund future bond issuance costs.

### Debt Service

Debt obligations of the Corporation as of December 31, 2011 consist of the remaining balance of the Series 2005 Tobacco Settlement Asset-Backed Bonds and the Series 2010 Tobacco Settlement Asset-Backed Bonds. The proceeds of the Series 2005 Bonds were used to advance refund/defuse the remaining outstanding Series 2000 Bonds (which were originally issued to purchase the rights to the future TSRs due to the County), pay the Trust, and to pay related costs of issuance of the Series 2005 Bonds. The total amount of the Series 2005 Bonds and Series 2010 Bonds outstanding at December 31, 2011 was \$29,956. The 2005 Series Bonds were not rated since they were sold to the New York Counties Tobacco Trust IV and New York Counties Tobacco Trust V, unrelated trusts established by participating local development corporations, including the Corporation. The 2005 Bonds were structured, however, to enable the New York Counties Tobacco Trust IV and V bonds to attain the following ratings:

<u>Bond Series IV</u>	<u>Standard &amp; Poor's</u>	<u>Fitch</u>
2005A	BBB -	BBB
2005B	BBB -	BBB
2005D	Non-rated	BBB -
2005E	Non-rated	BB
2010A	Non-rated	BBB
<u>Bond Series V</u>	<u>Standard &amp; Poor's</u>	<u>Fitch</u>
2005 S4B	Non-rated	Non-rated



### **Debt Service (Continued)**

The Series 2005 Trust IV Bonds are composed of the following:

- \$14,755,000 Tobacco Settlement Asset-Backed Bonds, Series 2005A (Tax Exempt Turbo Bonds), maturity date is June 1, 2042, interest rate of 5.00%.
- \$3,290,000 Tobacco Settlement Asset-Backed Bonds, Series 2005B (Taxable Turbo Bonds), maturity date is June 1, 2027, interest rate of 6.00%.
- \$1,090,190 Tobacco Settlement Asset-Backed Bonds, Series 2005D (Tax Exempt Turbo Capital Appreciation Bonds), maturity date is June 1, 2050, interest rate of 0.00%, with an accreted value at maturity of \$14,565,000.
- \$1,188,760 Tobacco Settlement Asset-Backed Bonds, Series 2005E (Tax Exempt Turbo Capital Appreciation Bonds), maturity date is June 1, 2055, interest rate of 0.00%, with an accreted value at maturity of \$27,005,000.

In 2005, the Corporation entered into a forward purchase contract for the issuance of Tobacco Settlement Asset-Backed Bonds, Series 2010A Bonds (Tax Exempt Turbo Term Bonds) to be in an amount equal to the amount of Series 2005C Bonds outstanding on the date of issuance of the Series 2010A bonds. The Series 2005C Bonds were replaced by the Series 2010A Bonds on June 1, 2010 with a maturity date of June 1, 2041 and an interest rate of 6.25%.

The Series 2010 Bonds are composed of the following:

- \$8,300,000 Tobacco Settlement Asset-Backed Bonds, Series 2010A (Taxable Turbo Bonds), maturity date is June 1, 2041, interest rate of 6.25%.

The Series 2005 Trust V Bonds are composed of the following:

- \$3,323,840 Tobacco Settlement Asset-Backed Bonds, Series 2005 S4B (Tax Exempt Turbo Capital Appreciation Bonds), maturity date is June 1, 2060, with an accreted value at maturity of \$221,000,000.

Turbo bonds are subject to prepayment from Turbo Redemption Payments. Turbo Redemption Payments are made from collections (other than partial and lump sum payments) in excess of the amount needed to pay certain operating expenses. To the extent possible, the Turbo Redemption Payments will amortize the Series 2005 Bonds earlier than their stated maturity dates at their accreted values. Turbo Redemption payments of \$40,000 and \$105,000 were made in 2011 and 2010, respectively, against the Series 2005 Bonds.

Payments on the outstanding capital appreciation bonds are based on the accreted value of the bonds at their stated maturity. The accretion of these capital appreciation bonds over their life results in the recognition of substantial annual costs until the capital appreciation bonds are redeemed. Reference should be made to the Bonds Payable footnote (Note 5) in the financial statements for a summary of the required principal and interest (which includes accretion of the capital appreciation bonds) payments.

### **Contacting the Corporation**

This financial report is designed to provide a general overview of the Corporation's finances and to demonstrate the Corporation's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Treasurer, Steuben Tobacco Asset Securitization Corporation, 3 E. Pulteney Square, Bath, NY 14810.

**STEUBEN TOBACCO ASSET SECURITIZATION CORPORATION**  
**(A Blended Component Unit of the County of Steuben, New York)**

**STATEMENTS OF NET DEFICIT**  
**DECEMBER 31, 2011 AND 2010**

	<u>2011</u>	<u>2010</u>
<b>ASSETS</b>		
Cash	\$ 119,796	\$ 110,226
Tobacco settlement revenues receivable	1,607,941	1,685,913
Interest and dividend income receivable	19	19
Restricted cash and cash equivalents	<u>1,758,489</u>	<u>1,758,028</u>
Total assets	<u>3,486,245</u>	<u>3,554,186</u>
<b>LIABILITIES</b>		
<b>CURRENT LIABILITIES:</b>		
Due to County of Steuben	1,252	-
Current portion bonds payable	185,000	40,000
Accrued interest	<u>3,172,206</u>	<u>2,583,302</u>
Total current liabilities	3,358,458	2,623,302
BONDS PAYABLE, net of current portion and bond discount	<u>29,770,786</u>	<u>29,922,180</u>
Total liabilities	<u>33,129,244</u>	<u>32,545,482</u>
<b>NET DEFICIT</b>		
Restricted for debt service	1,758,489	1,758,028
Unrestricted	<u>(31,401,488)</u>	<u>(30,749,324)</u>
Net deficit	<u>\$ (29,642,999)</u>	<u>\$ (28,991,296)</u>

The accompanying notes are an integral part of these statements.

**STEUBEN TOBACCO ASSET SECURITIZATION CORPORATION**  
**(A Blended Component Unit of the County of Steuben, New York)**

**STATEMENTS OF ACTIVITIES AND CHANGE IN NET DEFICIT**  
**FOR YEARS ENDED DECEMBER 31, 2011 AND 2010**

---

	<u>2011</u>	<u>2010</u>
EXPENSES:		
General government -		
Materials and services	\$ 6,789	\$ 6,970
Administrative costs	23,465	43,565
Interest, amortization and fees	<u>1,995,710</u>	<u>1,976,024</u>
Total expenses	2,025,964	2,026,559
PROGRAM REVENUE:		
Tobacco settlement revenues	<u>1,374,026</u>	<u>1,458,148</u>
Net program revenues	(651,938)	(568,411)
GENERAL REVENUES - INVESTMENT INCOME	<u>235</u>	<u>204</u>
CHANGE IN NET DEFICIT	(651,703)	(568,207)
NET DEFICIT - beginning of year	<u>(28,991,296)</u>	<u>(28,423,089)</u>
NET DEFICIT - end of year	<u>\$ (29,642,999)</u>	<u>\$ (28,991,296)</u>

The accompanying notes are an integral part of these statements.

**STEBEN TOBACCO ASSET SECURITIZATION CORPORATION**  
**(A Blended Component Unit of the County of Steuben, New York)**

**GOVERNMENTAL FUND BALANCE SHEETS**  
**DECEMBER 31, 2011 AND 2010**

	<u>2011</u>	<u>2010</u>
<b>ASSETS</b>		
Cash	\$ 119,796	\$ 110,226
Accounts receivable	1,607,941	1,685,913
Accrued interest receivable	19	19
Restricted cash and cash equivalents	<u>1,758,489</u>	<u>1,758,028</u>
 Total assets	 <u>\$ 3,486,245</u>	 <u>\$ 3,554,186</u>
<b>LIABILITIES AND FUND BALANCES</b>		
LIABILITIES:		
Due to Steuben County	\$ 1,252	\$ -
Deferred revenue	<u>1,607,941</u>	<u>1,685,913</u>
 Total liabilities	 <u>1,609,193</u>	 <u>1,685,913</u>
FUND BALANCES:		
Restricted for -		
Debt service	1,758,489	1,758,028
Unassigned	<u>118,563</u>	<u>110,245</u>
 Total fund balances	 <u>1,877,052</u>	 <u>1,868,273</u>
 Total liabilities and fund balances	 <u>\$ 3,486,245</u>	 <u>\$ 3,554,186</u>
Amounts reported for governmental activities in the statement of net assets are different because:		
Total fund balances	\$ 1,877,052	\$ 1,868,273
 Tobacco settlement revenue was not received in the current period and therefore, is not reported as revenues at the fund level	 1,607,941	 1,685,913
 Bonds payable and accrued interest are not due and payable in the current period and therefore, are not reported at the fund level	 <u>(33,127,992)</u>	 <u>(32,545,482)</u>
 Total net deficit	 <u>\$ (29,642,999)</u>	 <u>\$ (28,991,296)</u>

The accompanying notes are an integral part of these statements.

**STEBEN TOBACCO ASSET SECURITIZATION CORPORATION**  
**(A Blended Component Unit of the County of Steuben, New York)**

**STATEMENTS OF GOVERNMENTAL FUND REVENUES, EXPENDITURES AND  
CHANGE IN FUND BALANCE  
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**

	<u>2011</u>	<u>2010</u>
REVENUES:		
Tobacco settlement revenues	\$ 1,451,998	\$ 1,531,511
Interest and dividends	<u>235</u>	<u>204</u>
Total revenues	<u>1,452,233</u>	<u>1,531,715</u>
EXPENDITURES:		
General and administrative	6,789	6,970
Administrative costs	23,465	43,565
Debt service - principal	40,000	105,000
Debt service - interest	<u>1,373,200</u>	<u>1,394,150</u>
Total expenditures	<u>1,443,454</u>	<u>1,549,685</u>
NET CHANGE IN FUND BALANCES	8,779	(17,970)
FUND BALANCES - beginning of year	<u>1,868,273</u>	<u>1,886,243</u>
FUND BALANCES - end of year	<u>\$ 1,877,052</u>	<u>\$ 1,868,273</u>

Amounts reported for governmental activities in the statements of activities are different because:

Net change in fund balances	\$ 8,779	\$ (17,970)
-----------------------------	----------	-------------

Tobacco settlement revenues reported in the statement of activities were not received in time to pay current financial obligations and therefore, have not been reported as revenue in the governmental fund	(77,972)	(73,363)
--	----------	----------

Certain expenses reported in the statement of activities (amortization of bond issuance costs and the bond discount) do not require the use of current financial resources and therefore, are not reported as expenditures in the governmental fund	(33,606)	(33,606)
---	----------	----------

The net effect of bond repayments, accretion and interest expense are activities of the governmental fund but not reported in the statement of activities	<u>(548,904)</u>	<u>(443,268)</u>
---	------------------	------------------

Change in net deficit	<u>\$ (651,703)</u>	<u>\$ (568,207)</u>
-----------------------	---------------------	---------------------

The accompanying notes are an integral part of these statements.

**STEUBEN TOBACCO ASSET SECURITIZATION CORPORATION  
(A Blended Component Unit of the County of Steuben, New York)**

**NOTES TO BASIC FINANCIAL STATEMENTS  
DECEMBER 31, 2011 AND 2010**

---

**1. ORGANIZATION**

The Steuben Tobacco Asset Securitization Corporation (the Corporation) is a special purpose, bankruptcy remote local development corporation organized under the Not-For-Profit Corporation Law of the State of New York (the State). The Corporation was established on October 3, 2000. The Corporation is an instrumentality of, but separate and apart from the County of Steuben, New York (the County). The Corporation will have not less than three nor more than five directors, consisting of Ex-Officio Directors during the tenure of their respective offices in the County, and Appointed Directors who will serve 1-year terms. Although legally separate from the County, the Corporation is a component unit of the County and, accordingly, is included in the County's basic financial statements as a blended component unit.

On October 15, 2000, pursuant to a Purchase and Sale Agreement with the County, the County sold to the Corporation all of its future rights, 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 provided 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 into by the Supreme Court of the State, allocated to the County a share of the TSRs under the MSA. The future rights, title and interest of the County's share were sold to the Corporation.

The Corporation's purchase of the County's future rights, title and interest in the TSRs was financed by the original Series 2000 Bond issuance. 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 of the Corporation as set forth in the indenture. Payments on the Residual Certificate from TSR collections are subordinate to payments on the bonds and payment of 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 Steuben TASC Residual Trust (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.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Measurement Focus, Basis of Accounting, and Financial Statement Presentation**

The Corporation's financial statements are prepared in conformity with accounting principles generally accepted in the United States as prescribed by the Governmental Accounting Standards Board (GASB). The Corporation's government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### **Measurement Focus, Basis of Accounting, and Financial Statement Presentation (Continued)**

Private sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both government-wide and proprietary fund financial statements to the extent they do not conflict with or contradict guidance with GASB.

The Corporation's fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Corporation considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures and claims and judgments, are recorded only when payment is due.

The major governmental fund is the Debt Service Fund. The Debt Service Fund accounts for the resources accumulated and payments made for operations and principal debt service on long-term general obligation debt.

### **Net Deficit**

Generally accepted accounting principles require that resources be classified for accounting purposes into applicable net asset categories.

Unrestricted net deficit are net assets that are not restricted, but which may be internally designated by the Board of Directors. At December 31, 2011 and 2010, the amount of unrestricted net deficit was (\$31.4) million and (\$30.7) million, of which none were internally designated.

Net assets are reported as restricted when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, laws or regulations of other governments or imposed by law through constitutional provisions or enabling legislation. Restricted net assets of the Corporation are those net assets that are restricted based on externally imposed conditions and include amounts restricted for debt service and bond issuance costs.

The Corporation has adopted a practice of utilizing its restricted net assets when available, prior to unrestricted net assets.

### **Fund Balance**

In the fund financial statements, fund balance is defined as follows:

- Restricted fund balance – 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.
- Unassigned fund balance – includes all other general fund amounts that do not meet the definition above and are deemed to be available for general use by the Corporation.

Beginning fund balances for the Corporation's fund have been restated to reflect the above classification.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### **Cash and Cash Equivalents**

The Corporation considers bank deposit accounts and all highly liquid debt instruments with remaining maturities, when purchased, of 12 months or less to be cash equivalents and these are stated at fair value. The Corporation maintains a liquidity reserve account, which was initially funded from the Series 2000 Bond proceeds and has been increased by funds from the Series 2005 Bonds. This account must be maintained at a minimum of \$1,725,625 until such time that all bonds, other than subordinated bonds, are paid. All amounts withdrawn from this account are replenished, as needed, and amounts in excess of the required amount are transferred out. This account is included in restricted cash and cash equivalents on the balance sheet. At December 31, 2011 and 2010, the balance in the liquidity reserve account was \$1,725,726 and \$1,725,640, respectively.

### **Deferred Bond Original Issue Discount**

The Corporation recognizes original issue discounts fully in the year of issuance for the governmental fund statements. These costs are amortized over the term of the related bonds for the government-wide financial statements as additional interest expense. The Corporation recognizes all interest paid as interest expenditures on the modified accrual basis for the governmental fund statements and all interest incurred as expenses on the full accrual basis for the government-wide financial statements. Bond discount expense was \$33,606 for each of the years ended December 31, 2011 and 2010, respectively. Accumulated amortization on bond discounts was \$201,636 and \$168,030 for the years ended December 31, 2011 and 2010.

### **Accounts Receivable**

The Corporation records a receivable for TSRs and does not accrue interest on unpaid amounts. The Corporation has not recorded an allowance for doubtful accounts related to the TSRs and does not anticipate future write-offs.

### **Deferred Revenue**

Deferred revenue represents amounts earned under the modified accrual basis of accounting used in the Debt Service Fund, but not meeting the definition of available for use.

### **Income Taxes**

The Corporation is a not-for-profit corporation and is exempt from income taxes as an organization qualified under Section 501(c)(3) of the Internal Revenue Code. The Corporation has also been classified by the Internal Revenue Service as an entity that is not a private foundation. The Corporation is also exempt from Federal reporting requirements under Internal Revenue Service Revenue Procedure 95-48, 1995-2 C.B. 418 as a governmental unit or affiliate of a governmental unit described in the procedure.

### **Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

### **Reclassifications**

Certain amounts have been reclassified in the 2010 financial statements to conform to the current year presentation.



### 3. DEPOSITS AND INVESTMENTS

#### **Investment and Deposit Policy**

The Corporation follows an investment and deposit policy as outlined in the bond indenture, the overall objective of which is to adequately safeguard the principal amount of funds invested or deposited; conformance with federal, state and other legal requirements; provide sufficient liquidity of invested funds in order to meet obligations as they become due; and attainment of a market rate of return. Oversight of investment activity is the responsibility of the Treasurer of the Corporation.

#### **Interest Rate Risk**

Interest rate risk is the risk that the fair value of investments will be affected by changing interest rates. The Corporation has a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

#### **Credit Risk**

The Corporation's policy is to minimize the risk of loss due to failure of an issuer or other counterparty to an investment to fulfill its obligations. The Corporation's investment and deposit policy authorizes the reporting entity to purchase the following types of investments:

- Obligations of the United States of America;
- Obligations guaranteed by the United States of America where payment of principal and interest are guaranteed by the United States of America;
- Obligations of the State of New York;
- Special time deposit accounts;
- Certificates of Deposit;
- Obligations of public authorities, public housing authorities, urban renewal agencies, and industrial development agencies where the general State statutes governing such entities or whose specific enabling legislation authorizes such investments;
- Obligations issued pursuant to New York State Local Finance Law Section 24.00 and 25.00 (with approval of the New York State Comptroller) by any municipality, school district or district corporation other than the Corporation; and
- Eligible investments, as defined in the indenture between the Corporation and Manufacturers and Traders Trust Company, as trustee, as amended from time to time.

#### **Custodial Credit Risk - Deposits**

Custodial credit risk - deposits is the risk that in the event of a failure of a depository financial institution, the reporting entity may not recover its deposits. In accordance with the Corporation's investment and deposit policy, all deposits of the Corporation including certificates of deposit and special time deposits, in excess of the amount insured under the provisions of the Federal Deposit Insurance Act (FDIA) shall be secured by a pledge of securities with an aggregate value equal to the aggregate amount of deposits. The Corporation does not have a collateral agreement in place as required by its investment policy but would restrict the securities to the following eligible items:

- Obligations issued, or fully insured or guaranteed as to the payment of principal and interest, by the United States of America, an agency thereof or a United States government sponsored corporation;
- Obligations issued or fully guaranteed by the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, and the African Development Bank;
- Obligations partially insured or guaranteed by any agency of the United States of America at a proportion of the market value of the obligation that represents the amount of insurance or guaranty;

### 3. DEPOSITS AND INVESTMENTS (Continued)

#### Custodial Credit Risk – Deposits (Continued)

- Obligations issued or fully insured or guaranteed by the State of New York, obligations issued by a municipal corporation, a school district or district corporation of such State or obligations of any public benefit corporation which under a specific State statute may be accepted as security for deposit of public moneys;
- Obligations issued by states (other than the State of New York) of the United States rated in one of the three highest rating categories by at least one Nationally Recognized Statistical Rating Organization (NRSRO);
- Obligations of Puerto Rico rated in one of the three highest rating categories by at least one NRSRO;
- Obligations of counties, cities and other governmental entities of a state other than the State of New York having the power to levy taxes that are backed by the full faith and credit of such governmental entity and rated in one of the three highest categories by at least one NRSRO;
- Obligations of domestic corporations rated in one of the two highest rating categories by at least one NRSRO;
- Any mortgage related securities, as defined in the Securities Exchange Act of 1934, as amended, which may be purchased by banks under the limitations established by bank regulatory agencies;
- Commercial paper and bankers' acceptances issued by a bank, other than the Corporation's bank, rated in the highest short term category by at least one NRSRO and having maturities of not longer than 60 days from the date they are pledged; and
- Zero coupon obligations of the United States of America marketed as "treasury strips."

As of December 31, 2011 and 2010, the carrying amount of the Corporation's cash and cash equivalents was \$119,796 and \$110,226, respectively, were fully insured under the FDIA.

#### Custodial Credit Risk - Investments

Custodial credit risk - investments is the risk that an entity will not be able to recover the value of an investment or collateral securities that are in the possession of an outside party if the counterparty to the transaction fails. The Corporation's investment and deposit policy requires that all custodial investments be registered or insured in the Corporation's name and held in the custody of the bank or the bank's trust department. The Corporation requires that all repurchase agreements be limited to obligations of the United States of America or obligations whose principal and interest are fully guaranteed, or insured by the United States of America. As of December 31, 2011 and 2010, the Corporation's investments, with maturities of less than one year, were in compliance with the investment and deposit policy as follows:

<u>Investment Type</u>	<u>2011</u>	<u>2010</u>
Money market fund (U.S. Treasuries)	<u>\$ 1,758,489</u>	<u>\$ 1,758,028</u>

### 3. DEPOSITS AND INVESTMENTS (Continued)

#### Concentration of Credit Risk

The Corporation places no limit on the amount that may be invested in any one issuer. At December 31, 2011 and 2010, all amounts were held by one bank.

The Corporation had the following reserve funds as of December 31:

<u>Investments</u>	<u>2011</u>	<u>2010</u>
Liquidity reserve	\$ 1,725,726	\$ 1,725,640
Collection account	454	-
Debt service reserve	1,263	3,250
Turbo redemption account	4,559	2,655
Bond issuance and rebate cost reserve	<u>26,487</u>	<u>26,483</u>
Total	<u>\$ 1,758,489</u>	<u>\$ 1,758,028</u>

### 4. BONDS PAYABLE

The Corporation issued \$28,623,950 of Series 2005 Trust IV Tobacco Asset-Backed Bonds in August 2005 and \$3,323,840 in Series 2005 Trust V Tobacco Asset-Backed Bonds in November 2005. All Series 2005 Bonds are secured by a perfected security interest in, and pledge of, the Trust Estate, as defined in the Indenture, which includes, among other things, the TSRs and all investment earnings on amounts on deposit in the accounts established under the Indenture (collectively, the Collections). Among the accounts so established are the Liquidity Reserve Account and the Debt Service Account. The Corporation retains TSRs in an amount sufficient to service its debt and pay its operating expenses.

The Series 2005 Bonds are payable solely from and secured solely by the future right, title and interest of the Corporation in the collection of TSRs previously purchased by the Corporation from the County. This series consists of subordinate turbo capital appreciation bonds that provide long-dated financing for the Corporation and take advantage of current market conditions where interest rates are low, investors have a favorable view of litigation events and where institutional investors are looking for high yield investments. The Corporation is required to covenant not to issue additional bonds or refunding bonds that would extend the term of the capital appreciation bonds or other outstanding bonds.

The Series 2005 Trust IV Bonds are composed of the following:

- \$14,755,000 Tobacco Settlement Asset-Backed Bonds, Series 2005A (Tax Exempt Turbo Bonds), maturity date is June 1, 2042, interest rate of 5.00%.
- \$3,290,000 Tobacco Settlement Asset-Backed Bonds, Series 2005B (Taxable Turbo Bonds), maturity date is June 1, 2027, interest rate of 6.00%.
- \$1,090,190 Tobacco Settlement Asset-Backed Bonds, Series 2005D (Tax Exempt Turbo Capital Appreciation Bonds), maturity date is June 1, 2050, interest rate of 0.00%, with an accreted value at maturity of \$14,565,000.
- \$1,188,760 Tobacco Settlement Asset-Backed Bonds, Series 2005E (Tax Exempt Turbo Capital Appreciation Bonds), maturity date is June 1, 2055, interest rate of 0.00%, with an accreted value at maturity of \$27,005,000.

#### 4. BONDS PAYABLE (Continued)

The Series 2005 Trust V Bonds are composed of the following:

- \$3,323,840 Tobacco Settlement Asset-Backed Bonds, Series 2005 S4B (Tax Exempt Turbo Capital Appreciation Bonds), maturity date is June 1, 2060, with an accreted value at maturity of \$221,000,000.

In 2005, the Corporation entered into a forward purchase contract for the issuance of Tobacco Settlement Asset-Backed Bonds, Series 2010A Bonds (Tax Exempt Turbo Term Bonds) to be in an amount equal to the amount of Series 2005C Bonds outstanding on the date of issuance of the Series 2010A Bonds. The Series 2005C Bonds were replaced by the Series 2010A Bonds on June 1, 2010 with a maturity date of June 1, 2041 and an interest rate of 6.25%.

The Series 2010 Bonds are composed of the following:

- \$8,300,000 Tobacco Settlement Asset-Backed Bonds, Series 2010A (Taxable Turbo Bonds), maturity date is June 1, 2041, interest rate of 6.25%.

Long-term indebtedness for the Corporation's bonds payable consisted of the following:

	<u>2011</u>	<u>2010</u>
Balance - beginning of year	\$ 30,622,790	\$ 30,727,790
Repayments of bonds	<u>(40,000)</u>	<u>(105,000)</u>
Balance - end of year	<u>\$ 30,582,790</u>	<u>\$ 30,622,790</u>
Required payments due within one year	<u>\$ 185,000</u>	<u>\$ 40,000</u>

Principal and interest payments (including accretion on capital appreciation bonds) based upon the required maturities are as follows for the years ended December 31:

	<u>Principal</u>	<u>Interest/ Accretion</u>	<u>Total</u>
2012	\$ 185,000	\$ 2,032,653	\$ 2,217,653
2013	195,000	2,068,685	2,263,685
2014	215,000	2,104,652	2,319,652
2015	220,000	2,046,012	2,266,012
2016	220,000	2,189,972	2,409,972
2017 – 2021	890,000	11,749,597	12,639,597
2022 – 2026	2,500,000	13,569,346	16,069,346
2027 – 2031	3,400,000	15,871,506	19,271,506
2032 – 2036	4,725,000	19,307,339	24,032,339
2037 – 2041	6,255,000	24,704,456	30,959,456
2042 – 2046	6,175,000	32,861,487	39,036,487
2047 – 2051	1,090,190	45,212,170	46,302,361
2052 – 2056	1,188,760	59,262,646	60,451,406
2057 – 2060	<u>3,323,840</u>	<u>52,209,040</u>	<u>55,532,880</u>
	<u>\$ 30,582,790</u>	<u>\$ 285,189,560</u>	<u>\$ 315,772,350</u>

#### 4. BONDS PAYABLE (Continued)

Bonds payable as recorded on the Statement of Net Assets consist of the following as of December 31, 2011:

	<u>Bond Principal</u>	<u>Bond Discount</u>	<u>Total</u>
Beginning balance, 1/1/11	\$ 30,622,790	\$ (660,610)	\$ 29,962,180
Principal payment	(40,000)	-	(40,000)
Amortization	<u>-</u>	<u>33,606</u>	<u>33,606</u>
Ending balance, 12/31/11	<u>\$ 30,582,790</u>	<u>\$ (627,004)</u>	<u>\$ 29,955,786</u>

Bonds payable as recorded on the Statement of Net Assets consist of the following as of December 31, 2010:

	<u>Bond Principal</u>	<u>Bond Discount</u>	<u>Total</u>
Beginning balance, 1/1/10	\$ 30,727,790	\$ (694,216)	\$ 30,033,574
Principal payment	(105,000)	-	(105,000)
Amortization	<u>-</u>	<u>33,606</u>	<u>33,606</u>
Ending balance, 12/31/10	<u>\$ 30,622,790</u>	<u>\$ (660,610)</u>	<u>\$ 29,962,180</u>

Required maturities for the Series 2005 Bonds represent the minimum amount of principal that the Corporation must pay as of the specific distribution dates in order to avoid a default. Turbo (accelerated) amortization payments are required to be made against outstanding principal providing that the Corporation receives sufficient TSRs to make the Turbo payments. The interest payment requirements shown are based on the required principal maturity schedule and include the accreted value portion of capital appreciation bonds in the year in which they are required to be redeemed.

Under the terms of the Indenture, the Corporation is required to maintain certain deposits to fund debt service payments, if needed. Such deposits are included in investments in the basic financial statements. In addition, the Corporation is subject to various debt covenants, including limitations on expenses/expenditures, and compliance with Indenture agreement requirements. The Corporation was in compliance with all covenants and Indenture agreement requirements at December 31, 2011 and 2010.

Principal payments of \$40,000 and \$105,000 were made during 2011 and 2010, respectively, in accordance with the Series 2005 Bonds.

#### **Interest**

Interest expense on bonds payable was \$1,962,104 and \$1,942,418 in 2011 and 2010, respectively. In 2011 and 2010, cash paid for interest was \$1,373,200 and \$1,394,150, respectively.

**5. NET ASSET DEFICIT**

The Corporation has a deficit in net assets as a result of the outstanding bonds. As these bonds are repaid, this will help to reduce the deficit, along with the future revenue streams.

**6. CONTINGENCIES**

Future TSRs are subject to adjustment based upon tobacco consumption, inflation and other factors. Pursuant to the Indenture, these adjustments and other events could trigger additional debt service reserve requirements.

**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**

March 15, 2012

To the Board of Directors of the  
Steuben Tobacco Asset Securitization Corporation:

We have audited the financial statements of the governmental activities and the major fund of Steuben Tobacco Asset Securitization Corporation (the Corporation) as of and for the year ended December 31, 2011, which collectively comprise the Corporation's basic financial statements and have issued our report thereon dated March 15, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States 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**

Management of the Corporation is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audits, we considered the Corporation's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Corporation'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 entity's 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.

171 Sully's Trail  
Pittsford, NY 14534  
p (585) 381-1000  
f (585) 381-3131

ROCHESTER • BUFFALO  
ALBANY • SYRACUSE  
PERRY • GENEVA

www.bonadio.com

(Continued)

**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***

(Continued)

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the Board of Directors and others within the entity and is not intended to be and should not be used by anyone other than these specified parties.