



BASIC FINANCIAL STATEMENTS

**Suffolk Tobacco Asset Securitization Corporation
Year Ended December 31, 2011
With Report of Independent Auditors**

Ernst & Young LLP

 **ERNST & YOUNG**

Suffolk Tobacco Asset Securitization Corporation

Basic Financial Statements

Year Ended December 31, 2011

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Report of Independent Auditors

The Board of Directors
Suffolk Tobacco Asset Securitization Corporation
Hauppauge, New York

We have audited the accompanying financial statements of the governmental activities and each major fund of the Suffolk Tobacco Asset Securitization Corporation, (the “Corporation”), a component unit of the County of Suffolk, New York as of and for the year ended December 31, 2011, 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 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Corporation’s internal control over financial reporting. Our audit included 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 the Corporation’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and 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 respective financial position of the governmental activities and each major fund of the Corporation, as of December 31, 2011, and the respective changes in financial position for the year ended December 31, 2011 in conformity with U.S. generally accepted accounting principles.

As discussed in Note B, the Corporation adopted Government Accounting Standards Board Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* as of January 1, 2011.

Accounting principles generally accepted in the United States require that accompanying required supplementary information, such as management’s discussion and analysis on pages 3 through 9 and the budgetary comparison schedule – general fund on page 31, 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.

Ernst + Young LLP

March 27, 2012

Required Supplemental Information

Suffolk Tobacco Asset Securitization Corporation

Management's Discussion and Analysis

Year Ended December 31, 2011

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

FINANCIAL HIGHLIGHTS

- The Corporation's liabilities exceeded its assets by \$41,385,091 (total net deficit) for the current year ended. This amount includes restricted net assets of \$18,832,725 and is net of an unrestricted deficit of \$(60,217,816).
- The Corporation's total net deficit increased by \$14,220,796.
- The Corporation's governmental funds reported total ending fund balance of \$211,964,831, and unassigned fund balance of \$224,992 for the year ended December 31, 2011.
- At the end of the current year, unassigned fund balance for the General Fund was \$224,992 or 223.35% of total General Fund expenditures.
- The Corporation's total bonds payable increased by \$8,529,001 or 3.46% during the current year. The key factor in this increase is the accretion of interest on outstanding bonds.
- The Corporation received sufficient Tobacco Settlement Revenues (the "TSRs") to make the required debt service payments of \$7,446,509 and a Turbo Principal Payment of \$85,000 against its Series 2008 Bonds during 2011.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Corporation'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 the Corporation as a Whole

The government-wide financial statements are designed to present an overall picture of the financial position of the Corporation and start on page 10. 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 the Corporation's current financial resources with noncurrent assets and long-term obligations. This statement includes all of the Corporation's assets and liabilities.

Net deficit is the difference between the Corporation's assets and liabilities, and represents one measure of the Corporation's financial health. Net deficit is reported as one of two categories: restricted net assets and unrestricted net deficit. Over time, changes in the Corporation'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 the Corporation's revenues. This statement summarizes the cost of providing specific government services, and includes all current year revenues and expenses.

Reporting on the Corporation's Most Significant Funds

The fund financial statements begin on page 12 and provide detailed information about the most significant funds – not the Corporation as a whole. The Board of Directors (the "Board") 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* – The Corporation'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 the Corporation'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 13 and 15.

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 16.

Financial Analysis of the Corporation As A Whole

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

Net Deficit

Condensed Statement of Net Deficit – Governmental Activities

	December 31	
	2011	2010
Assets		
Current and other assets	\$ 19,074,744	\$ 19,227,827
Deferred charges, net	195,081,562	200,627,423
Total assets	214,156,306	219,855,250
Liabilities		
Current liabilities	1,803,102	1,955,251
Noncurrent liabilities	253,738,295	245,064,294
Total liabilities	255,541,397	247,019,545
Net deficit		
Restricted	18,832,725	19,263,992
Unrestricted	(60,217,816)	(46,428,287)
Total net deficit	\$ (41,385,091)	\$ (27,164,295)

As of December 31, 2011, total assets of the Corporation were \$214,156,306, a decrease of \$5,698,944 or 2.59% over the prior year. The decrease is mostly attributable to the amortization of the deferred charge on the purchase of TSRs. Total liabilities increased \$8,521,852 or 3.45% to \$255,541,397. The major reason for the increase is the accretion of interest on outstanding bonds of \$9,773,306, less principal payments and amortization of deferred discounts of \$1,244,305. The overall net deficit increased over the prior year by \$14,220,796 to a current deficit of \$(41,385,091). Of this net deficit for governmental activities, \$18,832,725 was restricted by statute or other specific purposes and unrestricted net deficit totaled \$(60,217,816).

In the government-wide financial statements, principal and interest payable are recorded when incurred. Currently, per the Indenture Agreement (“Indenture”), the Corporation receives only 36% of the TSRs and uses those monies to fund its operations and debt service payments. The remaining TSRs must be transferred to the Residual Trust. More information on the Residual

Trust can be found in Note D to the basic financial statements. In 2013, the Corporation will be able to utilize 75% of the TSRs received for operations and debt services payments. Upon receipt of these additional revenues, management anticipates that the deficit will begin to decrease and eventually be eliminated when all debt requirements are met.

Changes in Net Deficit

	Year Ended December 31,	
	2011	2010
General revenues		
Interest on investments	\$ 865,597	\$ 865,597
Tobacco settlement revenue	18,394,272	19,401,559
Total general revenues	19,259,869	20,267,156
Expenses		
General government support	106,722	86,798
Payment to residual trust	11,772,335	12,416,998
Amortization of deferred charge	5,465,066	4,112,326
Interest on debt	16,136,542	15,565,920
Total expenses	33,480,665	32,182,042
Increase in net deficit	(14,220,796)	(11,914,886)
Net deficit at beginning of year	(27,164,295)	(15,249,409)
Net deficit at end of year	\$ (41,385,091)	\$ (27,164,295)

For the year ended December 31, 2011, general revenues were \$19,259,869, a decrease of \$1,007,287, which is directly attributable to TSRs received in 2011 which totaled \$18,394,272. For the year ended December 31, 2010, expenses totaled \$33,480,665, an increase over the prior year of \$1,298,623. This increase is primarily attributable to three main factors: an increase in amortization of deferred charge on the purchase of TSRs of \$1,352,740, a decrease in transfers to the residual trust of \$644,663 and an increase in interest on debt of approximately \$570,622. As a result of expenses exceeding revenues, the net deficit for the year ended December 31, 2011 was \$(41,385,091), an increase in the deficit of \$14,220,796 over the prior year.

Financial Analysis of the Corporation's Funds

Governmental Funds

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

At December 31, 2011, the Corporation's governmental funds reported combined ending fund balances of \$211,964,831, a decrease of \$5,615,815 in comparison with prior year. Of this total, \$224,992 constitutes unassigned fund balance, which is available for spending at the Corporation'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 the Corporation. At December 31, 2011 and 2010, unassigned fund balance of the General Fund was \$224,992 and \$125,725, respectively. The fund balance of the Corporation's General Fund increased by \$99,267 for the year ended December 31, 2011. This increase was primarily due to a transfer from the Collection Fund, offset by operating expenditures incurred throughout the year.

Debt Service Fund

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 Liquidity Reserve Account. The Liquidity Reserve Account was funded at its required level of \$18,760,231. This level is required to be maintained per the Bond Indenture. More information on the Liquidity Reserve Account can be found in Note C.

Prior to an Event of Default, amounts on deposit in the Liquidity Reserve Account will be available to pay principal and interest of the Series 2008A Bonds, Series 2008B Bonds and Series 2008C Bonds when due, and pay any other Senior Bonds that are not Capital Appreciation Bonds to the extent Pledged Revenues are insufficient for such purpose. This fund was necessary in order for the Corporation to obtain the favorable ratings for the Series 2008 Bonds from the rating agencies.

At December 31, 2011, total fund balance was \$18,760,592 and is restricted to pay future debt service. The fund balance of the Corporation's Debt Service Fund decreased by \$250,016 for the year ended December 31, 2011. This decrease is due to excess expenditures over revenue and other financing sources. Revenues consisted solely of interest earned on investments. Financing sources consisted of amounts transferred to the Debt Service Fund from TSRs received in the Collection Fund during 2011. Expenditures include payments of principal and interest on the Corporation's outstanding bonds.

Collection Fund

The Collection 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 to the Suffolk County Residual Trust in accordance with the Indenture.

At December 31, 2011, total fund balance was \$192,979,247, which is non-spendable and represents the unamortized consideration paid by the Corporation to the County for the acquisition of future TSRs (Deferred charges). The fund balance of the Corporation's Collection Fund decreased by \$5,465,066 for the year ended December 31, 2011, primarily due to the amortization of the deferred charge. The Corporation collected \$18,394,272 of total TSRs, of which \$6,415,897 was transferred to the Debt Service Fund to repay a portion of the Corporation's outstanding bonds, \$11,772,335 was transferred to the residual trust, per the Indenture, \$200,000 was transferred to the General Fund to pay operating expenses and \$6,040 was used to pay the trust company.

Budgetary Highlights

The General Fund reported an excess of revenues and other financing sources over expenditures and other financing uses this year of \$99,267, increasing fund balance to \$224,992. Total expenditures were less than budgeted by \$99,267, which was due to less cost than anticipated for operating expenses.

Debt Administration

Debt

The Corporation's total bonded debt increased by \$8,529,001 or 3.46% during the current year. The key factor in this increase is the accretion of interest on outstanding bonds. More detailed information about the Corporation'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 taken 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.

The Corporation's bond ratings, as assigned by Fitch Ratings, remained stable for the Series 2008A Current Interest Serial Bonds at BBB+, which are due in multiple increments through 2018. The Corporation's \$40,045,000 Series 2008B Current Interest Turbo Term Bonds, due on June 1, 2028, decreased from BBB to BBB-, with a negative outlook during 2011. The Corporation's \$62,295,000 Series 2008B Current Interest Turbo Term Bonds, due June 1, 2048, and \$107,671,781 Series 2008C Convertible Capital Appreciation Turbo Term Bonds, due on June 1, 2044, decreased from BBB- to BB+ with a negative outlook during 2011. Lastly, the Corporation's \$13,375,082 Series 2008D Convertible Capital Appreciation Turbo Term Bonds, due June 1, 2048, decreased during 2011 from BB- to B+ with a negative outlook.

Future Economic Factors

The amount of TSRs received is dependent on many economic 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.

Additional Financial Information

This financial report is designed to provide the Corporation’s interested parties with an overview of the Corporation’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 Suffolk Tobacco Asset Securitization Corporation, H. Lee Dennison Building, 12th Floor, 100 Veterans Memorial Highway, P.O. Box 6100, Hauppauge, New York 11788-0099, Attention: Chairperson.

Basic Financial Statements

Suffolk Tobacco Asset Securitization Corporation

Government-Wide Financial Statement
Statement of Net Deficit

December 31, 2011

Assets

Current assets:

Cash	\$	230,212
Cash equivalents – restricted		361
Other receivables – restricted		72,133
Prepays		11,807
Total current assets		<u>314,513</u>

Non-current assets:

Restricted investments – special reserves		18,760,231
Deferred charges, net		195,081,562
Total non-current assets		<u>213,841,793</u>
Total assets		<u>214,156,306</u>

Liabilities

Current liabilities:

Accounts payable and accrued liabilities		5,220
Accrued interest payable		508,577
Bonds payable		1,289,305
Total current liabilities		<u>1,803,102</u>

Non-current liabilities:

Bonds payable		<u>253,738,295</u>
Total non-current liabilities		<u>253,738,295</u>
Total liabilities		<u>255,541,397</u>

Net deficit

Restricted:

Debt service		18,832,725
Unrestricted		(60,217,816)
Total net deficit	\$	<u>(41,385,091)</u>

See accompanying notes.

Suffolk Tobacco Asset Securitization Corporation

Government-Wide Financial Statement
Statement of Activities

Year Ended December 31, 2010

Expenses:	
General government support	\$ 106,722
Payment to residual trust	11,772,335
Amortization of deferred charge	5,465,066
Interest on debt	16,136,542
Total expenses	<u>33,480,665</u>
General revenues:	
Interest on investments	865,597
Tobacco settlement revenue	18,394,272
Total general revenues	<u>19,259,869</u>
Change in net deficit	(14,220,796)
Net deficit at beginning of year	<u>(27,164,295)</u>
Net deficit at end of year	<u>\$ (41,385,091)</u>

See accompanying notes.

Suffolk Tobacco Asset Securitization Corporation

Governmental Funds
Balance Sheet

December 31, 2011

	Major Funds			Total Governmental Funds
	General Fund	Debt Service Fund	Collection Fund	
Assets				
Cash	\$ 230,212	\$ -	\$ -	\$ 230,212
Cash equivalents – restricted	-	361	-	361
Investments – restricted	-	18,760,231	-	18,760,231
Deferred charges	-	-	192,979,247	192,979,247
Total assets	<u>\$ 230,212</u>	<u>\$ 18,760,592</u>	<u>\$ 192,979,247</u>	<u>\$ 211,970,051</u>
Liabilities				
Accounts payable and accrued liabilities	\$ 5,220	\$ -	\$ -	\$ 5,220
Total liabilities	<u>5,220</u>	<u>-</u>	<u>-</u>	<u>5,220</u>
Fund Balances				
Nonspendable:				
Deferred charges	-	-	192,979,247	192,979,247
Restricted:				
Debt service	-	18,760,592	-	18,760,592
Unassigned	224,992	-	-	224,992
Total fund balance	<u>224,992</u>	<u>18,760,592</u>	<u>192,979,247</u>	<u>211,964,831</u>
Total liabilities and fund balance	<u>\$ 230,212</u>	<u>\$ 18,760,592</u>	<u>\$ 192,979,247</u>	<u>\$ 211,970,051</u>

See accompanying notes.

Suffolk Tobacco Asset Securitization Corporation

Reconciliation of the Governmental Funds Balance Sheet to the
Statement of Net Deficit

December 31, 2011

Total fund balance – Governmental Funds	\$ 211,964,831
Amounts reported for governmental activities in the statement of net deficit are different because:	
Unamortized balance of deferred charge for bond issuance costs.	2,102,315
Certain expenditures are considered prepaid to match expenses with the period for which it relates.	11,807
Long-term liabilities applicable to the Corporation’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	(255,027,600)
Interest payable applicable to the Corporation’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.	(508,577)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.	72,133
Net deficit of governmental activities	<u>\$ (41,385,091)</u>

See accompanying notes.

Suffolk Tobacco Asset Securitization Corporation

Governmental Funds
Statement of Revenues, Expenditures and Changes in Fund Balances

Year Ended December 31, 2011

	Major Funds			Total Governmental Funds
	General Fund	Debt Service Fund	Collection Fund	
Revenues				
Tobacco settlement revenue	\$ -	\$ -	\$ 18,394,272	\$ 18,394,272
Interest on investments	-	865,597	-	865,597
Total revenues	-	865,597	18,394,272	19,259,869
Expenditures				
General government support	100,733	-	6,040	106,773
Transfer to residual trust	-	-	11,772,335	11,772,335
Amortization of deferred charge	-	-	5,465,066	5,465,066
Debt service:				-
Principal	-	1,400,000	-	1,400,000
Interest	-	6,131,510	-	6,131,510
Total expenditures	100,733	7,531,510	17,243,441	24,875,684
Excess (deficiency) of revenues over (under) expenditures	(100,733)	(6,665,913)	1,150,831	(5,615,815)
Other Financing Sources (Uses)				
Transfers in	200,000	6,415,897	-	6,615,897
Transfers out	-	-	(6,615,897)	(6,615,897)
Total other financing sources (uses)	200,000	6,415,897	(6,615,897)	-
Net change in fund balances	99,267	(250,016)	(5,465,066)	(5,615,815)
Fund balances at beginning of year	125,725	19,010,608	198,444,313	217,580,646
Fund balances at end of year	\$ 224,992	\$ 18,760,592	\$ 192,979,247	\$ 211,964,831

See accompanying notes.

Suffolk Tobacco Asset Securitization Corporation

Reconciliation of the Governmental Funds Statement of Revenues,
Expenditures and Changes in Fund Balances to the
Statement of Activities

Year Ended December 31, 2011

Net change in fund balances	\$ (5,615,815)
The issuance of long-term debt provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources:	
Repayment of bond principal	1,400,000
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.	(10,005,032)
Prepaid expenditures are recorded as an expenditure on the fund statements when it is paid, and on the statement of activities when it is incurred.	51
Change in net deficit of Governmental Activities	<u>\$ (14,220,796)</u>

See accompanying notes.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements

December 31, 2011

A. Organization

The Suffolk Tobacco Asset Securitization Corporation (the “Corporation”) is a local development corporation, and is an instrumentality of, but separate and apart from, the County of Suffolk (the “County”), New York, incorporated under the provisions of Section 1411 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 (the “Board”) of the Corporation has four directors, one director is appointed by the Presiding Officer of the County legislature, three directors are appointed by the County Executive of which one director must meet certain requirements of independence and one director is a non-voting member.

B. Summary of Significant Accounting Policies

The financial statements of the Corporation 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 the Corporation’s accounting policies are described below.

Basis of Presentation

The Corporation’s basic financial statements include both government-wide (reporting on the Corporation as a whole) and fund financial statements (reporting on the Corporation’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 the Corporation 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 the Corporation are considered governmental activities.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

B. Summary of Significant Accounting Policies (continued)

In the government-wide statement of net deficit, the Corporation'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) as well as long-term debt and obligations. The Corporation'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 Corporation's functional categories which are supported by general revenues.

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

Fund Financial Statements

Fund financial statements report detailed information about the Corporation. 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. The Corporation has presented all funds as major funds.

The funds of the Corporation 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.

The Corporation reports the following major governmental funds:

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

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

B. Summary of Significant Accounting Policies (continued)

Debt Service Fund – is used to account for the accumulation of resources for payment of general long-term bond principal and interest, and also includes the Liquidity Reserve Account. The Liquidity Reserve Account was funded at its required level of \$18,760,231 in 2011. This level is required to be maintained per the Indenture Agreement.

Collection 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 to the Suffolk County Residual Trust in accordance with the Indenture Agreement.

Basis of Accounting/Measurement Focus

The financial statements of the Corporation are prepared in accordance with GAAP. The Corporation's reporting entity applies all relevant GASB pronouncements and applicable Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless they conflict with GASB pronouncements. The Corporation's reporting entity does not apply FASB pronouncements or APB opinions issued after November 30, 1989.

Measurement focus refers to what is being measured, where as 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

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

B. Summary of Significant Accounting Policies (continued)

(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. The Corporation considers all revenues available if they are collected within 60 days after the year end.

Budgetary Comparison

Under GASB Statement No. 34, budgetary comparison information is required to be presented for the General Fund and each major special revenue fund with a legally adopted budget.

The Corporation prepares an annual budget for the General Fund, which is approved by the Board. The budget is not subject to referendum. Any revisions to the annual budget are adopted by resolution of the Board of Directors.

Assets, Liabilities and Fund Equity

Cash, Cash Equivalents and Investments

The Corporation’s cash and cash equivalents consist of demand deposits and money market accounts.

Investments consist of a repurchase agreement and are stated at the contract value. More information on investments can be found in Note C.

Restricted Assets

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

Other Receivables

Other receivables include accrued interest income related to the Corporation’s investment income. Receivables are recorded and revenues recognized as earned.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

B. Summary of Significant Accounting Policies (continued)

Interfund Receivables and Payables

During the course of operations, transactions occur between individual funds that may result in amounts owed between funds. Those transactions are classified as “due to and due from other funds” in the governmental funds financial statements. Interfund receivables and payables between funds within governmental activities are eliminated in the statement of net deficit.

Prepays

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in the government-wide financial statements.

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:

a) 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.

b) 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 the Corporation 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 resources used to purchase the future TSRs over the estimated total future revenues to be received to the maturity of the related debt, which is then applied to the current revenues recognized during the year.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

B. Summary of Significant Accounting Policies (continued)

Long-term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities. Bond premiums and discounts are deferred and amortized over the life of the bonds on a straight-line basis. Bonds payable are reported net of applicable bond premium or discount.

In the fund financial statements, governmental fund types recognize bond premiums and discounts during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses.

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 the Company’s policy 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 represents the unamortized consideration paid by the Corporation to the County for the acquisition of future TSRs (Deferred charges) recorded in the collection fund of \$192,979,247.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

B. Summary of Significant Accounting Policies (continued)

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 Corporation's highest level of decision-making authority before the end of the fiscal year, and that require the same level of formal action to remove the constraint. Only the action that constitutes the most binding constraint should be considered a commitment. Commitment requires some level of due process and should be a level of constraint that cannot be undone in a simple manner. The Corporation has no committed fund balances as of December 31, 2011.

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

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 the Corporation.

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, the Board will assess the current financial condition of the Corporation and then determine the order of application of expenditures to which fund balance classification will be charged. It is the intention of the Board that the expenditure is to be spent first from the restricted fund balance to the extent appropriated by either budget or board approved budget revision 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 an commitment, to assigned fund balance to the extent that there is an assignment, and then to the unassigned fund balance.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

B. Summary of Significant Accounting Policies (continued)

Revenues and Expenditures

Tobacco Settlement Revenue

Pursuant to a Purchase and Sale Agreement dated as of August 1, 2008, (the “TSR Purchase Agreement”) between Suffolk County (the “County”), as seller, and the Corporation, as purchaser, the County sold to the Corporation all rights, title and interest of the County under the Master Settlement Agreement (the “MSA”) entered into by participating tobacco product manufacturers (the “Manufacturers”), 46 states and 6 other U.S. jurisdictions in November 1998 in settlement of smoking-related litigation and the related Consent Decree and Final Judgment (the “Consent Decree”), including the County’s right to be paid certain payments referred to as TSRs to be made by the Manufacturers under the MSA. The consideration paid by the Corporation to the County for such acquisition consisted of \$206,243,337 in cash, all of which was paid into escrow for the benefit of the County. The Corporation funded such consideration from the proceeds of its Tobacco Settlement Asset-Backed Bonds Series 2008 (Series 2008 Bonds) issued on August 21, 2008, pursuant to the Indenture Agreement dated August 1, 2008.

Per the Purchase and Sale Agreement, receipts shall be transferred directly to the Corporation. Under the MSA, amounts shall be paid by the Manufacturers to the escrow agent on or before April 15th. The escrow agent will then disburse these funds to the Corporation. The Corporation collected \$18,394,272 of TSRs, of which \$6,415,897 was transferred to the Debt Service Fund to repay a portion of the Corporation’s outstanding bonds, \$11,772,335 was transferred to the residual trust, per the Indenture, \$200,000 was transferred to the General Fund to pay operating expenses and \$6,040 was used to pay the trust company.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

B. Summary of Significant Accounting Policies (continued)

Transfers to Residual Trust

Transfers to residual trust represent portions of the TSRs received that are required to be transferred to the Suffolk County Residual Trust per the Indenture. See Note D for more detail.

Interfund Transactions

Interfund transactions have been eliminated from the government-wide financial statements. In the funds statements interfund transactions include payments to the Debt Service Fund to cover various debt obligations.

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.

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.

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.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

C. Detail Notes on All Funds

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 Corporation's name

At December 31, 2011, the Corporation's deposit balances were \$230,573. Of these balances, \$230,212 was covered by the Federal Deposit Insurance Corporation. \$361 consisted of a temporary investment in Dreyfus Treasury & Agency Cash Management, and is uncollateralized. Dreyfus Treasury & Agency Cash Management invests only in U.S. government or U.S. Treasury securities, and in repurchase agreements.

The Corporation's Liquidity Reserve Account is invested in a Repurchase Agreement with Bayerische Landesbank. Bayerische Landesbank is authorized to invest in various securities as set forth in the Investment Repurchase Agreement, dated August 21, 2008. The Corporation's share of investments in this repurchase agreement was \$18,760,231 at December 31, 2011, is due to mature on June 1, 2048, and earns interest at 4.614%, annually. The Repurchase Agreement is fully collateralized by debt obligations having fair values that range from 100% to 102% of the deposited amount held by a custodial bank.

Credit Risk – State law limits investments to those authorized by State statutes. The Corporation has a written investment policy.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

C. Detail Notes on All Funds (continued)

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, the Corporation did not have any investments subject to credit risk, interest-rate risk or concentration of credit risk.

Deferred Charges

Deferred charges created as a result of the issuance of the 2008 Serial Bonds and the deferral of cost from purchase of the future TSRs as of December 31, 2011 is as follows:

Cost of issuance	\$ 1,401,411
Underwriter's discount	972,243
Total cost of issuance	<u>2,373,654</u>
Less related amortization	<u>(271,339)</u>
Deferred charges, net – cost of issuance	2,102,315
Purchase of TSRs	206,243,337
Less related amortization	<u>(13,264,090)</u>
Deferred charges, net – purchase of TSRs	<u>192,979,247</u>
Total deferred charges – net of amortization	<u>\$ 195,081,562</u>

Total amortization expense for the cost of issuance and purchase of TSRs for the year ended December 31, 2011 totaled \$80,795 and \$5,465,066, respectively.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

C. Detail Notes on all Funds (continued)

Interfund Transfers

For the year ended December 31, 2011, interfund transfer balances represent payments from the Collection Fund to disburse TSRs pursuant to the Indenture. Interfund transfers are stated as follows:

	<u>Transfer In</u>	<u>Transfer Out</u>
General fund	\$ 200,000	\$ –
Debt service fund	6,415,897	–
Collection fund	–	6,615,897
	<u>\$ 6,615,897</u>	<u>\$ 6,615,897</u>

Long-term Debt

Bonds – Tobacco Settlement Asset-Backed Bonds Series 2008 (Series 2008 Bonds) issued in 2008 for the purchase of future rights to TSRs are secured by a pledge of revenues to be derived from TSR receipts after the deduction of the amounts necessary to pay all operating charges and to fund the required revenue percentage to the Residual Trust, as required by the Indenture. Principal and interest paid on these bonds in 2011 totaled \$7,531,510. Interest on the Series 2008 Bonds is excluded from gross income for federal income tax purposes pursuant to Section 103 of the Internal Revenue Code.

Any additional revenues received above the required debt service payments are used to turbo redeem the outstanding bonds. The Corporation received sufficient TSRs to make the required debt service payment of \$7,446,509 and a Turbo Principal Payment of \$85,000 against its Series 2008 Bonds during 2011.

Pledged revenues consist of a portion of the TSRs equal to 36% of future annual payments through December 31, 2012, and 75% thereafter and like percentages of any lump sum payment made in lieu of such annual payments. Pledged revenue received in 2011 amounted to \$6,615,815, or 88% of total principal and interest payments made during the year.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

C. Detail Notes on all Funds (continued)

Payments with respect to the Series 2008 Bonds are dependent upon receipt of TSRs. The Series 2008 Bonds are special obligations of the Corporation payable solely from the pledged revenues, the Liquidity Reserve Account, and other funds and accounts under the Indenture. The Corporation has no other assets available for the payment of the Series 2008 Bonds.

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.

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

Description	Original Date Issued	Original Amount	Interest Rate	Maturity Date	Amount Outstanding
				06/01/2012 –	
2008A	08/21/2008	\$ 9,765,000	4.000% – 5.000%	06/01/2018	\$ 7,260,000
2008B (2028)	08/21/2008	40,045,000	5.375%	06/01/2028	37,620,000
2008B (2048)	08/21/2008	62,295,000	6.000%	06/01/2048	62,295,000
2008C	08/21/2008	107,671,781	6.625%	06/01/2044	107,671,781
2008D	08/21/2008	13,375,082	8.000%	06/01/2048	13,375,082
Total					<u>\$ 228,221,863</u>

The following table summarizes the Corporation’s minimum future debt service requirements as of December 31, 2011:

	Principal	Interest	Total Principal and Interest
2012	\$ 1,445,000	\$ 6,073,122	\$ 7,518,122
2013	285,000	15,464,306	15,749,306
2014	445,000	15,448,516	15,893,516
2015	610,000	15,424,675	16,034,675
2016	815,000	15,390,194	16,205,194
2017 – 2021	3,660,000	76,166,594	79,826,594
2022 – 2026	–	75,934,094	75,934,094
2027 – 2031	37,620,000	68,856,831	106,476,831
2032 – 2036	–	65,823,719	65,823,719
2037 – 2041	–	65,823,719	65,823,719
2042 – 2046	107,671,781	76,879,329	184,551,110
2047 – 2048	75,670,082	295,240,728	370,910,810
	<u>\$ 228,221,863</u>	<u>\$ 792,525,827</u>	<u>\$ 1,020,747,690</u>

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

C. Detail Notes on all Funds (continued)

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

Description	Balance, January 1, 2011	Increases	Reductions	Balance, December 31, 2011	Noncurrent Liabilities Due Within One Year	Noncurrent Liabilities
<i>Primary Government:</i>						
Bonds	\$ 229,621,863	\$ -	\$ (1,400,000)	\$ 228,221,863	\$ 1,445,000	\$ 226,776,863
Plus: accreted interest	20,646,191	9,773,306	-	30,419,497	-	30,419,497
Less: unamortized deferred discounts	(3,769,455)	-	155,695	(3,613,760)	(155,695)	(3,458,065)
Total bonds	<u>\$ 246,498,599</u>	<u>\$ 9,773,306</u>	<u>\$ (1,244,305)</u>	<u>\$ 255,027,600</u>	<u>\$ 1,289,305</u>	<u>\$ 253,738,295</u>

D. Residual Trust

In 2008, pursuant to the TSR Purchase Agreement and the Indenture, the Corporation established the Suffolk County Residual Trust (the "Trust"). Per the Indenture, the Trust will receive the future TSRs, consisting of 64% of TSRs received from the bond delivery date through December 31, 2012, 25% of TSRs received thereafter, and 100% of TSRs representing amounts withheld or deposited in the disputed payments account under the MSA before the delivery date. Total amounts transferred to the Trust for the year ended December 31, 2011 was \$11,772,335.

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 will become effective for the Corporation for the year ending December 31, 2013.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

E. New Pronouncements (continued)

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 will become effective for the Corporation for the year ending December 31, 2012.

The Corporation is currently evaluating the impact of the above pronouncements.

F. Subsequent Events

Pursuant to a purchase and sale agreement dated as of March 1, 2012 between the County, as seller, and the STASC, as purchaser, the County will sell to the STASC all of the right, title and interest of the County in the Pledged TSRs paid or payable to the County under the MSA and the Consent Decree, including the County's right to be paid certain Annual Payments to be made by cigarette manufacturers under the MSA, which amounts are no longer subject to the lien of the 2008 Indenture and are held by the County, as beneficial owner of the 2008 Residual Certificate. In order to complete this purchase, bonds in an amount not to exceed \$45 million, were authorized to be issued by STASC. It is anticipated that the bonds will be issued in April 2012.

Suffolk Tobacco Asset Securitization Corporation

Governmental Fund – Schedule of Revenues, Expenditures and
Changes in Fund Balance Budget and Actual

Year Ended December 31, 2011

	<u>Budget Amounts</u>			Variance Positive
	Original	Final	Actual	
Expenditures				
General government support	\$ 200,000	\$ 200,000	\$ 100,733	\$ 99,267
Total expenditures	<u>200,000</u>	<u>200,000</u>	<u>100,733</u>	<u>99,267</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(200,000)</u>	<u>(200,000)</u>	<u>(100,733)</u>	<u>99,267</u>
Other financing sources				
Transfers in	200,00	200,000	200,000	–
Net change in fund balance	<u>\$ –</u>	<u>\$ –</u>	<u>99,267</u>	<u>\$ 99,267</u>
Fund balance at beginning of year			<u>125,725</u>	
Fund balance at end of year			<u>\$ 244,992</u>	

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