# WARREN TOBACCO ASSET SECURITIZATION CORPORATION

**(A Discretely Presented Component Unit of the County of Warren, New York)**

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

Bonadio & Co., LLP
Certified Public Accountants

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Bonadio & Co., LLP
Certified Public Accountants

**INDEPENDENT AUDITORS' REPORT**

March 16, 2012

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

We have audited the accompanying financial statements of the governmental activities and the major fund of the Warren Tobacco Asset Securitization Corporation (a discretely presented component unit of Warren County) 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 opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our 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 the major fund of the Warren Tobacco Asset Securitization Corporation as of December 31, 2011, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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(Continued)

**INDEPENDENT AUDITORS' REPORT (Continued)**

In accordance with *Government Auditing Standards*, we have also issued our report dated March 16, 2012, on our consideration of Warren 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 5 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 of America, 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.

Bonadio & Co., LLP

# WARREN TOBACCO ASSET SECURITIZATION CORPORATION

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
## DECEMBER 31, 2011

Our discussion and analysis of the Warren Tobacco Asset Securitization Corporation's (WTASC or Corporation) financial performance provides an overview of the Corporation's financial activities for the year ended December 31, 2011. This document should be read in conjunction with the Corporation's financial statements.

The Corporation is a component unit of the County of Warren and is discretely presented in the County's financial statements.

**Financial Highlights**

- The Corporation's net assets decreased $254,108 as a result of this year's activity, which is illustrated in the Statement of Activities.
- The Corporation repaid $120,000 of bonds.
- Tobacco settlement revenue was approximately $678,000.

**Using This Annual Report**

This annual report consists of a set of financial statements. The Statement of Net Assets and the Statement of Activities provide information about the activities of the Corporation as a whole and present a long-term view of the Corporation's finances. For governmental activities, these statements tell how these services were financed in the short-term, as well as what remains for future spending. Fund financial statements also report the Corporation's operations in more detail than the government-wide statements by providing information about the Corporation's major funds.

**Reporting the Corporation as a Whole**

One of the most important questions asked about the Corporation's finances is, "Is the Corporation, as a whole, better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Activities report information about the Corporation as a whole and about its activities in a manner that helps answer this question. These statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenue and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Corporation's net assets and changes in them. You can think of the Corporation's net assets – the difference between assets and liabilities – as one way to measure the Corporation's financial health, or financial position. Over time, increases or decreases in the Corporation's net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the financial capability of the participating cigarette manufacturers to pay and the future cigarette consumption which impacts the tobacco settlement revenue payments, to assess the overall health of the Corporation.

**Overview of the Financial Statements**

WTASC's financial statements consist of two parts: Management's Discussion and Analysis, and basic financial statements. The basic financial statements include government-wide presentation, governmental fund presentation, and notes.

The government-wide financial statements, which include the Statement of Net Assets and the Statement of Activities, are presented to display information about WTASC as a whole and are prepared using the accrual basis; similar to the accounting used by most private-sector companies.

The Statement of Net Assets answers the question, "How is our financial health at the end of the year?" This statement includes all assets and liabilities. Over time, changes in net assets may serve as a useful indicator as to whether the financial position of WTASC is improving or deteriorating.

The Statement of Activities accounts for all revenue and expenses. This statement measures the success of WTASC's operations over the past year and can be used to determine if WTASC has successfully recovered all of its costs through revenue sources. This statement helps to answer the question, "Is WTASC, as a whole, better off or worse off as a result of the year's activities?"

The notes to the financial statements provide additional information essential to understanding the data provided in the basic financial statements.

**Condensed Statement of Net Assets (Rounded)**

| | 2011 | 2010 |
|---|---|---|
| Cash and investments | $ 480,000 | $ 507,000 |
| Accounts receivable | 700,000 | 800,000 |
| Bond discount and issuance costs | 101,000 | 109,000 |
| Total assets | 1,281,000 | 1,416,000 |
| Total liabilities | 6,878,000 | 6,759,000 |
| Net assets: | | |
| Reserved for debt | 480,000 | 417,000 |
| Unreserved | (6,077,000) | (5,760,000) |
| Total net assets (deficit) | $ (5,597,000) | $ (5,343,000) |

Net assets for the year decreased by $254,108. It should be noted that the large unreserved deficit is because generally accepted accounting principles do not allow WTASC to record an asset for the present value of the future tobacco settlement revenue stream, but require the recording of the debt that will be repaid with these future revenues.

Accounts receivable declined because as smoking rates decline, Tobacco Settlement Revenue will also decline.

## Overview of the Financial Statements (Continued)

**Condensed Statement of Activities (Rounded)**

| | 2011 | 2010 |
|---|---|---|
| Tobacco settlement revenue | $ 678,000 | $ 670,000 |
| Interest income | 28,000 | 28,000 |
| Total revenue | 706,000 | 698,000 |
| Distribution to County | 444,000 | 410,000 |
| Interest expense and amortization | 495,000 | 277,000 |
| General and administrative costs | 21,000 | 21,000 |
| Total expenses | 960,000 | 708,000 |
| Change in net assets | $ (254,000) | $ (10,000) |

Changes in the WTASC's estimate of tobacco settlement revenue receivables offset by the decrease in actual receipts resulted in a slight increase in tobacco settlement revenue during 2011. Interest expense and amortization rose during the current year due to changes in long-term debt amortization resulting from deferred principal payments. These items were the predominate factor for the $254,108 decline in net assets.

**Major Funds**
WTASC's governmental fund financial statements, which include the Governmental Funds Balance Sheet and the Statement of Revenue, Expenditures, and Changes in Fund Balance, are presented using the modified accrual basis of accounting.

An analysis of the significant balances and transactions in the funds follows:

**Debt Service Fund**
This fund is generally restricted to debt service activities.

For 2011, total fund equity decreased by approximately $27,000. This decrease was due mainly to a decrease in the amount tobacco settlement revenue in 2011. Additionally, an increase in amounts distributed to Warren County were offset by a decline in debt service expenditures.

**Debt Administration**
As of December 31, 2011, WTASC had $40,975,000 (par value) of outstanding bonds payable, netted against $34,238,000 of bond discounts. The WTASC paid $120,000 in principal, and approximately $248,000 in interest during the year. Currently, there are no plans for WTASC to issue additional debt.

**Economic Factors**
Tobacco settlement revenue is the primary revenue source for WTASC. Tobacco settlement revenue is dependent on future tobacco sales, as well as the participating manufacturers' ability to pay. Increases or decreases in tobacco consumption will result in corresponding increases or decreases in tobacco settlement revenue.

**Contacting the Corporation's Financial Management**
This financial report is designed to provide investors and creditors with a general overview of the Corporation's finances and to show the Corporation's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Corporation's Treasurer's Office at 1340 State Route 9, Lake George, NY 12845.

## WARREN TOBACCO ASSET SECURITIZATION CORPORATION
## (A Discretely Presented Component Unit of the County of Warren, New York)

### STATEMENT OF NET ASSETS
### DECEMBER 31, 2011

| | |
|---|---|
| **ASSETS** | |
| CURRENT ASSETS: | |
| Cash - Restricted | $ 42,126 |
| Investments - Restricted | 437,679 |
| Accounts receivable | 700,000 |
| Total current assets | 1,179,805 |
| NON CURRENT ASSETS: Bond issuance cost, net | 101,271 |
| Total assets | 1,281,076 |
| **LIABILITIES** | |
| CURRENT LIABILITIES: | |
| Bonds payable | 200,000 |
| Accrued interest | 20,376 |
| Total current liabilities | 220,376 |
| LONG-TERM LIABILITIES: Bonds payable, net | 6,657,692 |
| Total liabilities | 6,878,068 |
| **NET ASSETS** | |
| Restricted for debt service | 479,805 |
| Unrestricted | (6,076,797) |
| Total net assets (deficit) | $ (5,596,992) |

The accompanying notes are an integral part of these statements.

**WARREN TOBACCO ASSET SECURITIZATION CORPORATION**
**(A Discretely Presented Component Unit of the County of Warren, New York)**

**STATEMENT OF ACTIVITIES AND CHANGE IN NET ASSETS**
**FOR THE YEAR ENDED DECEMBER 31, 2011**

| | Expenses | Net (Expense) Revenue and Changes in Net Assets |
|---|---|---|
| GOVERNMENTAL ACTIVITIES: | | |
| Distribution to Warren County - Residual share | 443,805 | $ (443,805) |
| Amortization - Bond issuance cost | 7,277 | (7,277) |
| Amortization - Bond discount | 240,068 | (240,068) |
| General and administrative costs | 21,256 | (21,256) |
| Debt service - Interest | 247,180 | (247,180) |
| Total governmental activities | $ 959,586 | $ (959,586) |
| GENERAL REVENUE: | | |
| Tobacco settlement revenue | | $ 677,610 |
| Interest income | | 27,868 |
| Total general revenue | | 705,478 |
| CHANGE IN NET ASSETS | | (254,108) |
| NET ASSETS (DEFICIT) - beginning of year | | (5,342,884) |
| NET ASSETS (DEFICIT) - end of year | | $ (5,596,992) |

The accompanying notes are an integral part of these statements.

# WARREN TOBACCO ASSET SECURITIZATION CORPORATION
## (A Discretely Presented Component Unit of the County of Warren, New York)

### BALANCE SHEET - GOVERNMENTAL FUNDS
### DECEMBER 31, 2011

| | Governmental Fund Type |
|---|---|
| | Debt Service |
| **ASSETS** | |
| Cash - Restricted | $ 42,126 |
| Investments - Restricted | 437,679 |
| Accounts Receivable | 700,000 |
| | $ 1,179,805 |
| **LIABILITIES AND FUND EQUITY** | |
| LIABILITIES: | |
| Deferred revenue | $ 700,000 |
| FUND EQUITY | |
| Restricted - debt service reserve | 479,805 |
| | $ 1,179,805 |

The accompanying notes are an integral part of these statements.

## WARREN TOBACCO ASSET SECURITIZATION CORPORATION
## (A Discretely Presented Component Unit of the County of Warren, New York)

### COMBINED STATEMENT OF REVENUE, EXPENDITURES, AND CHANGES IN FUND EQUITY - GOVERNMENTAL FUNDS FOR THE YEAR ENDED DECEMBER 31, 2011

| | Governmental Fund Type |
|---|---|
| | Debt Service |
| REVENUE: | |
| Tobacco settlement revenue | $ 777,610 |
| Investment income | 27,868 |
| Total revenue | 805,478 |
| EXPENDITURES: | |
| Distribution to Warren County. - Residual share | 443,805 |
| General and administrative costs | 21,256 |
| Total expenditures | 465,061 |
| EXCESS OF REVENUE OVER EXPENDITURES | 340,417 |
| OTHER SOURCES AND (USES): | |
| Debt service - Principal | (120,000) |
| Debt service - Interest | (247,713) |
| Total other uses | (367,713) |
| EXCESS OF EXPENDITURES AND OTHER (USES) OVER REVENUE | (27,296) |
| FUND EQUITY - beginning of year | 507,101 |
| FUND EQUITY - end of year | $ 479,805 |

The accompanying notes are an integral part of these statements.

## WARREN TOBACCO ASSET SECURITIZATION CORPORATION
## (A Discretely Presented Component Unit of the County of Warren, New York)

### RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCE TO NET ASSETS OF GOVERNMENTAL ACTIVITIES DECEMBER 31, 2011

| | |
|---|---|
| Fund balance, governmental funds | $ 479,805 |
| Amounts reported for governmental activities in the statement of net assets are different due to the following: | |
| Deferred revenue recognized at fund level is not recognized in government wide statements | 700,000 |
| Bond issuance costs and discount used in governmental activities are not current financial resources and, therefore, are not reported in the funds | 101,271 |
| Interest accrued on long term debt under the accrual basis of accounting | (20,376) |
| Long-term liabilities, including bonds payable and other debt, are not due and payable in the current period and are, therefore, not reported in the funds | (6,857,692) |
| Net assets (deficit) of governmental activities | $ (5,596,992) |

The accompanying notes are an integral part of these statements.

**WARREN TOBACCO ASSET SECURITIZATION CORPORATION**
**(A Discretely Presented Component Unit of the County of Warren, New York)**

**RECONCILIATION OF THE STATEMENT OF REVENUE, EXPENDITURES, AND CHANGES IN FUND EQUITY TO THE STATEMENT OF ACTIVITIES**
**FOR THE YEAR ENDED DECEMBER 31, 2011**

| | | |
|---|---|---|
| Net changes in fund balance - Total governmental funds | $ | (27,296) |
| Amortization of bond issuance costs is not recorded as an expenditure in the governmental funds, but is recorded in the statement of activities | | (7,277) |
| Amortization of bond discount is an expenditure in the statement of activities, but not in the governmental fund statements | | (240,068) |
| Accrued revenue recorded in the governmental funds but is not recorded in the statement of net assets | | (100,000) |
| Repayments of long-term debt are recorded as expenditures in the governmental funds, but are recorded as payments of liabilities in the statement of net assets | | 120,000 |
| Accrued interest in the statement of activities does not require the expenditure of current resources and is, therefore, not reported as an expenditure in the governmental funds | | 533 |
| Change in net assets - Governmental activities | $ | (254,108) |

The accompanying notes are an integral part of these statements.

## 1. NATURE OF OPERATIONS

The Warren Tobacco Asset Securitization Corporation (WTASC or Corporation) is a special purpose, bankruptcy remote non-profit, local development corporation organized under Section 1411 of the Not-For-Profit Corporation Law of the State of New York. WTASC was established on July 3, 2001, and became active August 8, 2001.

WTASC was formed to acquire from the County of Warren (County) all future rights, title, and interest in 50% of the Tobacco Settlement Revenue (TSRs) under the Master Settlement Agreement (MSA) with respect to tobacco related litigation among various states and participating manufacturers. The purchase price of 50% of the County's future rights, title, and interest in the TSRs has been financed by the issuance of serial bonds. A residual certificate exists, which represents the entitlement to receive all amounts required to be distributed after payment of debt service, operating expenses, and certain other costs as set forth in the indenture. Payments on the residual certificate from TSRs collections are subordinate to payments on bonds and certain other costs specified in the indenture. Excess TSRs not required by WTASC to pay various expenses, debt service, or required reserves with respect to the bonds are transferred to the Warren Tobacco Asset Securitization WTASC 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.

The future TSR payments are dependent on a variety of factors, some of which are:

- The financial capability of the participating cigarette manufacturers to pay TSRs;
- Future cigarette consumption which impacts the TSR payment;
- Future legal and legislative challenges against the tobacco manufacturers and the MSA that provides for the TSR payments.

## 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.

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.

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

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

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, currently the Corporation's only 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.

### Equity Classifications

Government-Wide Statements

In the Government-wide statements, there are two classes of net assets:

Unrestricted net assets are net assets that are not restricted, but which may be internally designated by the Board of Directors. At December 31, 2011, there were no internally designated net assets.

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

Fund Statements

In the fund basis statements there are five allowable classifications of fund balance:

Non-spendable fund balance – Includes amounts that cannot be spent because they are either not in spendable form or legally or contractually required to be maintained intact. The Corporation has no non-spendable fund balances as of yearend.

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. At December 31, 2011, the Corporation's sole source of restricted fund balance consisted of its Debt service reserve.

Committed fund balance – Includes amounts that can be used for the specific purposes pursuant to constraints imposed by formal action of the Corporation's highest level of decision making authority, i.e., the Board of Trustees. The Corporation has no committed fund balances as of yearend.

Assigned fund balance – 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 yearend.

Unassigned fund balance - Includes all other fund amounts that do not meet the definition of the above four classifications and are deemed to be available for general use by the Corporation. The Corporation has no unassigned fund balances as of yearend.

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

### Equity Classifications (Continued)

Order of Fund Balance Spending Policy

The Corporation's policy is to apply expenditures against non-spendable fund balance, restricted fund balance, committed fund balance, assigned fund balance, and unassigned fund balance at the end of the fiscal year. The non-spendable fund balances are determined first and then restricted fund balances for specific purposes are determined. Any remaining fund balance amounts are classified as assigned fund balance. The remaining amounts are reported as unassigned. Assignments of fund balance cannot cause a negative unassigned fund balance.

### 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. All amounts withdrawn from this account are replenished, as needed, and amounts in excess of the required amount are transferred out.

### Deferred Bond Issuance Costs

The Corporation recognizes bond issuance costs as an asset for the governmental fund and government-wide statements. These costs are amortized over the term of the related bonds. 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.

### 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.

### 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.

## 3. CASH AND INVESTMENTS

**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;
- Commercial Paper;
- Repurchase agreements 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. The term of each agreement shall generally not exceed 180 days. The agreement shall be confirmed in writing by the seller, and each security purchased under the agreement shall be specifically identified; segregated from the assets of the seller and delivered for safekeeping into an account designated and controlled by the Corporation. Also, each seller shall enter into a master Repurchase Agreement with the Corporation which shall specify the rights and obligations of the Corporation and the Seller in all transactions;
- 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.

**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 restricts 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;

## 3. CASH AND INVESTMENTS (Continued)

### Custodial Credit Risk – Deposits (Continued)

Obligations partially insured or guaranteed by any agency of the United States of America;

- Obligations issued or fully insured or guaranteed by the State of New York;
- Obligations issued by a municipal corporation, school district or district corporation of New York State;
- Obligations of any public benefit corporation, which under a specific State statute may be accepted as security for deposit of public monies;
- Obligations issued by states (other than the State of New York) of the United States rated in one of the two highest rating categories by at least one Nationally Recognized Statistical Rating Organization (NRSRO);
- Obligations of Puerto Rico rated in the highest rating category 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 two 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;
- Zero coupon obligations of the United States of America marketed as "treasury strips."

As of December 31, 2011, the carrying amount of the Corporation's cash and cash equivalents was $42,126 and was fully covered by FDIC insurance.

### 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 the Corporation's investments, with maturities of less than one year, were in compliance with the investment and deposit policy as follows:

| | 2011 |
|---|---|
| Money market funds | 437,679 |

### Concentration of Credit Risk

The Corporation places no limit on the amount that may be invested in any one issuer. At December 31, 2011, all cash balances were held in one bank; all investment balances were held in a different bank.

## 4. BOND ISSUANCE COST

During 2005, WTASC issued bonds securitized by TSR revenue purchased from Warren County. Associated with this purchase were bond issuance costs which are being amortized over 20 years on a straight-line basis. As of December 31, 2011, the bond issuance cost as shown on the statement of net assets consisted of the following:

| | |
|---|---|
| Bond issuance costs | 145,539 |
| Less: Accumulated amortization | (44,268) |
| Bond issuance costs, net | $ 101,271 |

## 5. LONG-TERM DEBT

On August 8, 2001, WTASC issued $5,540,000 variable rate bonds. These bonds are part of the $215,220,000 New York Counties Tobacco Trust II, Tobacco Settlement Pass-Through Bonds, and Series 2001. The debt is payable solely from pledged tobacco settlement revenue and investment earnings on amounts on deposit.

According to the terms of the required amortization payments, WTASC is required to make annual debt service payments through 2042, with interest ranging from 5% to 6%.

The WTASC's required amortization payments at December 31, 2011, on the Series 2001 Bonds are as follows:

| | 2001 Series - required amortization | |
|---|---|---|
| | Principal | Interest |
| 2012 | 45,000 | 239,510 |
| 2013 | 45,000 | 237,004 |
| 2014 | 50,000 | 234,497 |
| 2015 | 55,000 | 231,712 |
| 2016 | 60,000 | 228,649 |
| 2017-2021 | - | 1,126,533 |
| 2022-2026 | 330,000 | 1,117,342 |
| 2027-2031 | 885,000 | 936,596 |
| 2032-2036 | 915,000 | 691,237 |
| 2037-2041 | 1,270,000 | 401,597 |
| 2042-2043 | 645,000 | 54,308 |
| Total | $ 4,300,000 | $ 5,498,983 |

## 5. LONG-TERM DEBT (Continued)

Depending on the extent of actual collections from the TSRs' payments and availability of funds, WTASC has covenanted to make principal payments in accordance with a flexible amortization payment schedule that allows for increased payments and a final maturity of June 1, 2025 (Super Sinker Payments). The WTASC's amortization payments at December 31, 2011, on the Super Sinker Payments are as follows:

| | 2001 Series - Super Sinker | |
|---|---|---|
| | Principal | Interest |
| 2012 | $ 200,000 | $ 233,459 |
| 2013 | 200,000 | 222,266 |
| 2014 | 210,000 | 210,675 |
| 2015 | 225,000 | 198,306 |
| 2016 | 230,000 | 185,294 |
| 2017-2021 | 1,575,000 | 686,375 |
| 2022-2025 | 1,660,000 | 175,519 |
| Total | $ 4,300,000 | $ 1,911,894 |

For 2011, WTASC made debt service payments of $85,000 in accordance with the Super Sinker provision of the bond agreement.

On November 29, 2005, WTASC issued $37,750,000 capital appreciation bonds. These bonds are part of the $199,375,348 New York Counties Tobacco Trust V, Tobacco Settlement Pass-Through Bonds, and Series 2005. The debt is payable solely from pledged tobacco settlement revenue and investment earnings on amounts on deposit.

According to the terms of the required amortization payments, WTASC is required to make debt service payments at maturity which ranges from 2038 to 2060, with interest ranging from 6.00% to 7.15%. The debt has been recorded at its par value with an offsetting bond discount bringing the net value to present value.

On December 1, 2009 a principal payment of $174,900 was applied to the capital appreciation bonds as a result of termination of the trapping event which had occurred in previous years. The maturity value of the $174,900 principal paid was $1,195,000; therefore the maturity value of the 2005 bonds due is now $36,555,000.

## 5. LONG-TERM DEBT (Continued)

WTASC's required amortization payments at December 31, 2011, on the Series 2005 Bonds are as follows:

| | Present Value of Principal | Bond Discount | Face Value of Bond |
|---|---|---|---|
| 2038 | $ 813,001 | $ 2,758,417 | $ 3,571,418 |
| 2050 | 673,247 | 6,095,943 | 6,769,190 |
| 2055 | 440,128 | 7,743,362 | 8,183,490 |
| 2060 | 631,316 | 17,399,586 | 18,030,902 |
| Total | $ 2,557,692 | $ 33,997,308 | $ 36,555,000 |

Depending on the extent of actual collections from the TSRs' payments and availability of funds, WTASC has covenanted to make principal payments in accordance with a flexible amortization payment schedule that allows for increased payments and a final maturity of June 1, 2031 (Turbo Redemption Payments).

The WTASC's amortization payments at December 31, 2011, on the Turbo Redemption Payments are as follows:

| | Present Value of Principal | Interest | Total |
|---|---|---|---|
| 2015-2019 | $ 426,824 | $ 212,145 | $ 638,969 |
| 2020-2024 | 672,938 | 599,477 | 1,272,415 |
| 2025-2029 | 1,167,115 | 2,050,170 | 3,217,285 |
| 2030-2031 | 290,815 | 797,471 | 1,088,286 |
| Total | $ 2,557,692 | $ 3,659,263 | $ 6,216,955 |

## 6. CHANGES IN LONG-TERM DEBT

A summary statement of changes in long-term debt is as follows:

| | |
|---|---|
| Balance, beginning of fiscal year | $ 6,737,624 |
| Current year changes: | |
| Payments on long term debt | (120,000) |
| Amortization of bond discount | 240,068 |
| Balance, end of fiscal year | $ 6,857,692 |

## 7. RELATED PARTY

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

## 8. ECONOMIC DEPENDENCY

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

## 9. CONTINGENCY

Future TSRs in accordance with the MSA are subject to adjustment based upon tobacco consumption, inflation, and other factors. These adjustments could affect the amount of funds available to pay the future scheduled debt service payments.

Bonadio & Co., LLP
Certified Public Accountants

**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 16, 2012

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

We have audited the financial statements of the governmental activities and the major fund of the Warren Tobacco Asset Securitization Corporation as of and for the year ended December 31, 2011, which collectively comprise Warren Tobacco Asset Securitization Corporation's basic financial statements and have issued our report thereon dated March 16, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**
Management of the Warren Tobacco Securitization Corporation is responsible for establishing and maintaining effective internal control over financial reporting.
In planning and performing our audit, we considered Warren Tobacco Asset Securitization 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 Warren Tobacco Asset Securitization Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Warren Tobacco Asset Securitization 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.

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(Continued)

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND 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 Warren Tobacco Asset Securitization 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 the audit committee, management, board of directors, and federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

Bonadio & Co., LLP