

BASIC FINANCIAL STATEMENTS

Suffolk Tobacco Asset Securitization Corporation
Year Ended December 31, 2013
With Report of Independent Auditors

Ernst & Young LLP



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BASIC FINANCIAL STATEMENTS

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Report of Independent Auditors

Management and the Board of Directors
Suffolk Tobacco Asset Securitization Corporation
Hauppauge, New York

Report on the Financial Statements

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, 2013, and the related notes to the financial statements, which collectively comprise the Corporation’s basic financial statements as listed in the table of contents.

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor’s Responsibility

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 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

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 each major fund of the Corporation as of December 31, 2013, and the respective changes in financial position thereof for the year then ended in conformity with U.S. generally accepted accounting principles.

Adoption of GASB Statement No. 65, “Items Previously Reported as Assets and Liabilities”

As discussed in Note B6 to the financial statements, the Agency restated its financial statements as a result of the adoption of Governmental Accounting Standards Board (“GASB”) Statement No. 65, “Items Previously Reported as Assets and Liabilities” effective January 1, 2013. Our opinion is not modified with respect to this matter.

Required Supplementary Information

U.S. generally accepted accounting principles require that management’s discussion and analysis on pages 3 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board which 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we also have issued our report dated March 21, 2014 on our consideration of the 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* in considering the Corporation’s internal control over financial reporting and compliance.

Ernst + Young LLP

March 21, 2014

REQUIRED SUPPLEMENTARY INFORMATION
Management's Discussion and Analysis

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
Year Ended December 31, 2013

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, 2013. 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 and deferred outflows of resources by \$(66,475,107) (total net position (deficit)) for the current year ended. This amount includes restricted net position of \$20,932,375 and is net of an unrestricted deficit of \$(87,407,482).
- The Corporation has implemented GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* ("GASB No. 65"), during the year ended December 31, 2013. As a result, the beginning net position was reduced by \$2,674,312. This amount is the unamortized bond issue cost as of January 1, 2013 that is to be expensed in the year incurred under GASB No. 65. These amounts were previously recorded as deferred charges and amortized.
- The Corporation's total net position (deficit) increased by \$(9,261,699), of this amount, \$(2,674,312) was a result of the implementation of GASB No. 65, which reduced the beginning net position.
- The Corporation's governmental funds reported total ending fund balance of \$237,594,151, and unassigned fund balance of \$164,500 for the year ended December 31, 2013.
- At the end of the current year, unassigned fund balance for the general fund was \$164,500 or approximately 200% of total general fund expenditures.
- The Corporation's total bonds payable increased by \$334,150 or .11% during the current year.
- The Corporation withdrew \$921,726 from the 2008 liquidity reserve account to meet interest payment obligation during the current year.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Corporation's annual report is presented in two parts, management's discussion and analysis (this section), and the basic financial statements.

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 8. These statements consist of the statement of net position 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 position reports all assets, liabilities, deferred outflows/inflows of resources and net position (deficit). The net position (deficit) is displayed as one of two categories: restricted and unrestricted. Over time, changes in the Corporation's net position (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 primarily funded by the Corporation's revenues. This statement summarizes the cost of providing specific government services, and includes all current year revenues and expenses.

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
 Year Ended December 31, 2013

OVERVIEW OF THE FINANCIAL STATEMENTS (continued)

Reporting on the Corporation's Most Significant Funds

The fund financial statements begin on page 10 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 position and the statement of activities) and governmental funds in reconciliations on pages 11 and 13.

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 14.

FINANCIAL ANALYSIS OF THE CORPORATION AS A WHOLE

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

Net Position (Deficit)

Condensed Statement of Net Position (Deficit)
 Governmental Activities
 As of December 31,

| | 2013 | 2012 |
|---|-----------------|-----------------|
| Assets | | |
| Current and other assets | \$ 21,115,124 | \$ 22,040,041 |
| Deferred charges, net | | 224,586,876 |
| Total Assets | 21,115,124 | 246,626,917 |
| Deferred Outflows of Resources | | |
| Purchase of future tobacco settlement revenue | 216,565,983 | -0- |
| Liabilities | | |
| Current liabilities | 2,796,197 | 2,659,458 |
| Non-current liabilities | 301,360,017 | 301,180,867 |
| Total Liabilities | 304,156,214 | 303,840,325 |
| Net Position (Deficit) | | |
| Restricted | 20,932,375 | 21,863,649 |
| Unrestricted | (87,407,482) | (79,077,057) |
| Total Net Position (Deficit) | \$ (66,475,107) | \$ (57,213,408) |

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
Year Ended December 31, 2013

FINANCIAL ANALYSIS OF THE CORPORATION AS A WHOLE (continued)

Net Position (Deficit) (continued)

As of December 31, 2013, total assets and deferred outflows of resources of the Corporation were \$237,681,107, a decrease of \$8,945,810 or 3.63% from the prior year. The decrease is attributable to the amortization of the deferred outflows of resources on the purchase of TSRs, the use of restricted reserves to pay debt interest, and a decrease to beginning net position of \$2,674,312 as a result of implementing GASB No. 65.

Total liabilities increased \$315,889, or .10% to \$304,156,214. The increase is attributable to the accretion of interest on outstanding bonds. The overall net position (deficit) increased over the prior year by \$(9,261,699) to a current net position (deficit) of \$(66,475,107). Of this net position (deficit), \$20,932,375 was restricted by statute or other specific purposes for long-term bond liabilities and interest payments and unrestricted net position (deficit) totaled \$(87,407,482).

Changes in Net Position (Deficit)

Condensed Statement of Activities
Governmental Activities

| | Year ended December 31, 2013 | Year ended December 31, 2012 |
|--|---------------------------------|---------------------------------|
| General Revenues | | |
| Interest on investments | \$ 862,171 | \$ 865,597 |
| Tobacco settlement revenue | 18,747,148 | 18,758,798 |
| Total General Revenues | 19,609,319 | 19,624,395 |
| Expenses | | |
| General government support | 87,346 | 84,244 |
| Transfer to residual trust | 1,858,998 | 12,005,631 |
| Amortization of deferred outflows of resources | 5,346,580 | 5,281,594 |
| Interest on debt | 18,903,782 | 18,081,243 |
| Total Expenses | 26,196,706 | 35,452,712 |
| Increase in Net Deficit | (6,587,387) | (15,828,317) |
| Net Position (Deficit) at Beginning of Year | (57,213,408) | (41,385,091) |
| Cumulative Effect of Change in Accounting Principle | (2,674,312) | -0- |
| Net Position (Deficit) at End of Year | \$ (66,475,107) | \$ (57,213,408) |

For the year ended December 31, 2013, general revenues were \$19,609,319, a decrease of \$15,076, which is directly attributable to TSRs received in 2013 which totaled \$18,747,148. For the year ended December 31, 2013, expenses totaled \$26,196,706, a decrease from the prior year of \$9,256,006. This decrease is mainly the combination of an increase in interest accretion on outstanding bonds and a decrease in transfer to the Suffolk County Residual Trust (the "Residual Trust"). The negative cumulative effect of change in accounting principle of \$2,674,312 was the result of the implementation of GASB No. 65. As a result of expenses exceeding revenues, and the negative cumulative effect of change in accounting principle, the net position (deficit) for the year ended December 31, 2013 was \$(66,475,107), an increase in the deficit of \$9,261,699 over the prior year.

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
Year Ended December 31, 2013

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, 2013, the Corporation's governmental funds reported combined ending fund balances of \$237,594,151, a decrease of \$6,256,406 in comparison with prior year. Of this total, \$164,500 constitutes unassigned fund balance, which is available for spending at the Corporation's discretion. The remainder of fund balance is nonspendable 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, 2013, unassigned fund balance of the general fund was \$164,500. The fund balance of the Corporation's general fund increased by \$17,662 for the year ended December 31, 2013.

Debt Service Fund

The debt service fund is used to account for and report financial resources that are restricted for payment of general long-term bond principal and interest. This fund also includes the 2008 Liquidity Reserve Account and 2012 Liquidity Reserve Account. The 2008 Liquidity Reserve Account and 2012 Liquidity Reserve Account are required to be funded at \$18,760,231 and \$3,025,163; respectively. These levels are required to be maintained per the 2008 Indenture and 2012 Indenture Agreements. More information on the 2008 Liquidity Reserve Account and 2012 Liquidity Reserve Account can be found in note C.1.

Prior to an Event of Default, amounts on deposit in the 2008 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. As of the end of current year, 2008 Liquidity Reserve Account was underfunded by \$921,726. This amount was withdrawn in December, 2013 to meet the required bond interest payment.

Prior to an Event of Default, amounts on deposit in the 2012 Liquidity Reserve Account will be available to pay principal and interest of the Series 2012A Bonds and Series 2012B Bonds when due to the extent pledged revenues are insufficient for such purpose.

At December 31, 2013, total fund balance was \$20,863,668 and is restricted to pay future debt service. The fund balance of the Corporation's debt service fund decreased by \$924,242 for the year ended December 31, 2013. This decrease is due to the withdrawal of \$921,726 from 2008 Liquidity Reserve Account in December of 2013 to meet the required bond interest payment. Revenues consisted solely of interest earned on investments. Other financing sources consisted of amounts transferred in from the collection fund during 2013. Expenditures include payments of principal and interest on the Corporation's outstanding bonds.

Collection Fund

The collection fund is used to account for and report financial resources that are restricted, committed, or assigned from 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 2008 Indenture Agreement and 2012 Indenture Agreement.

At December 31, 2013, total fund balance was \$216,565,983. This amount is the unamortized balance of deferred outflows of resources from the purchase of future TSRs from the County and it is nonspendable. The fund balance decreased by \$5,349,826 for the year ended December 31, 2013, primarily due to the amortization of deferred outflows of resources from the acquisition of future TSRs. The Corporation collected \$18,747,148 of total TSRs, of which \$16,782,395 was transferred to the debt service fund to repay a portion of the Corporation's 2008 and 2012 outstanding bonds and interest payments. \$1,858,998 was transferred to the residual trust, per the 2012 Indenture Agreement, \$100,000 was transferred to general fund to pay general support expense and \$9,001 was used to pay the trustee fees.

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
Year Ended December 31, 2013

FINANCIAL ANALYSIS OF THE CORPORATION'S FUNDS (continued)

Governmental Funds (continued)

Cost of Issuance Fund

The cost of issuance fund is used to account for and report financial resources that are restricted, committed, or assigned from the portion of the Series 2012 Bond proceeds used to pay the cost of issuance per the 2012 Indenture. During 2013, the balance of \$3,245 due to collection fund was transferred.

The collection fund and the cost of issuance fund were established per the requirements of the 2008 Indenture and 2012 Indenture Agreements.

DEBT ADMINISTRATION

The Corporation's total bonded debt increased by \$334,150 or .11% during the current year. The key factor in this increase is the accretion of interest. More detailed information about the Corporation's long-term liabilities is presented in the notes to the basic financial statements.

For 2013, the aggregate Master Settlement Agreement ("MSA") payment was .062% less than the amount in 2012. This decrease was primarily due to the decrease in consumption of cigarettes as compared to prior year.

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, were upgraded from BB to BBB- with a negative outlook during 2013. 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, were upgraded from B+ to BB- with a negative outlook during 2013. Lastly, the Corporation's \$13,375,082 Series 2008D Convertible Capital Appreciation Turbo Term Bonds, due June 1, 2048, was affirmed at B rating level with a negative outlook during 2013.

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.

In relation to an on-going dispute involving Non-Participating Manufacturers ("NPM"), during September 2013 the Corporation received a ruling from Arbitration that the State of New York diligently enforced its Qualifying Statute during calendar year 2003 and, therefore, is not subject to a NPM Adjustment. A NPM Adjustment would reduce TSR payments payable to the Corporation under the MSA. As a result, funds that have been held in dispute are scheduled to be released to the State in April 2014, of which a certain amount will be payable to the Corporation. The final amount of the Corporation's allocation is presently unknown.

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 POSITION
December 31, 2013

ASSETS

Current Assets:

| | |
|--|---------------|
| Cash | \$ 167,000 |
| Cash and cash equivalents - restricted | 3,025,163 |
| Other receivables - restricted | 68,707 |
| Prepays | <u>15,749</u> |

Total Current Assets 3,276,619

Non-Current Assets:

| | |
|---|-------------------|
| Restricted investments - special reserves | <u>17,838,505</u> |
|---|-------------------|

Total Non-Current Assets 17,838,505

Total Assets 21,115,124

DEFERRED OUTFLOWS OF RESOURCES

| | |
|---|--------------------|
| Purchase of future tobacco settlement revenue | <u>216,565,983</u> |
|---|--------------------|

Total Deferred Outflows of Resources 216,565,983

LIABILITIES

Current Liabilities:

| | |
|--|------------------|
| Accounts payable and accrued liabilities | 2,500 |
| Accrued interest payable | 1,435,551 |
| Bonds payable | <u>1,358,146</u> |

Total Current Liabilities 2,796,197

Non-Current Liabilities:

| | |
|---------------|--------------------|
| Bonds payable | <u>301,360,017</u> |
|---------------|--------------------|

Total Liabilities 304,156,214

NET POSITION (DEFICIT)

Restricted:

| | |
|--------------|------------|
| Debt service | 20,932,375 |
|--------------|------------|

Unrestricted (87,407,482)

Total Net Position (Deficit) \$ (66,475,107)

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
GOVERNMENT-WIDE FINANCIAL STATEMENT
STATEMENT OF ACTIVITIES
Year Ended December 31, 2013

Expenses:

| | |
|--|-------------------|
| General government support | \$ 87,346 |
| Transfer to residual trust | 1,858,998 |
| Amortization of deferred outflows of resources | 5,346,580 |
| Interest on debt | <u>18,903,782</u> |
| Total Expenses | <u>26,196,706</u> |

General Revenues:

| | |
|----------------------------|-------------------|
| Interest on investments | 862,171 |
| Tobacco settlement revenue | <u>18,747,148</u> |
| Total General Revenues | <u>19,609,319</u> |

Change in Net Position (Deficit) (6,587,387)

Net Position (Deficit) at Beginning of Year (57,213,408)

Cumulative Effect of Change in Accounting Principle (2,674,312)

Net Position (Deficit) at Beginning of Year, as restated (59,887,720)

Net Position (Deficit) at End of Year \$ (66,475,107)

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
GOVERNMENTAL FUNDS
BALANCE SHEET
 December 31, 2013

| | MAJOR FUNDS | | | | |
|---|-----------------|-------------------------|--------------------|--------------------------------|--|
| | General Fund | Debt Service Fund | Collection Fund | Total Governmental Funds | |
| ASSETS | | | | | |
| Cash | \$ 167,000 | | | \$ 167,000 | |
| Cash and cash equivalents - restricted | \$ 3,025,163 | | | 3,025,163 | |
| Investments - restricted | | 17,838,505 | | 17,838,505 | |
| Total Assets | 167,000 | 20,863,668 | | 21,030,668 | |
| DEFERRED OUTFLOWS OF RESOURCES | | | | | |
| Purchase of future tobacco settlement revenue | | | \$ 216,565,983 | 216,565,983 | |
| Total Deferred Outflows of Resources | | | 216,565,983 | 216,565,983 | |
| Total Assets and Deferred Outflows of Resources | \$ 167,000 | \$ 20,863,668 | \$ 216,565,983 | \$ 237,596,651 | |
| LIABILITIES | | | | | |
| Accounts payable and accrued liabilities | \$ 2,500 | | | \$ 2,500 | |
| Total Liabilities | 2,500 | | | 2,500 | |
| FUND BALANCES | | | | | |
| Non-spendable: | | | | | |
| Deferred outflows of resources | | | \$ 216,565,983 | 216,565,983 | |
| Restricted: | | | | | |
| Debt service | | \$ 20,863,668 | | 20,863,668 | |
| Unassigned | 164,500 | | | 164,500 | |
| Total Fund Balances | 164,500 | 20,863,668 | 216,565,983 | 237,594,151 | |
| Total Liabilities and Fund Balances | \$ 167,000 | \$ 20,863,668 | \$ 216,565,983 | \$ 237,596,651 | |

See accompanying notes.

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET POSITION
December 31, 2013

Total Fund Balances - Governmental Funds \$ 237,594,151

Amounts reported for governmental activities in the statement of net position are different because:

Certain expenditures are considered prepaid to match expenses with the period for which it relates 15,749

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 position:

Bonds payable (302,718,163)

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 position. (1,435,551)

Receivables in the statement of net position that do not provide current financial resources are not reported as receivables in the funds. 68,707

Net Position (Deficit) of Governmental Activities \$ (66,475,107)

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
 GOVERNMENTAL FUNDS
 STATEMENT OF REVENUES, EXPENDITURES
 AND CHANGES IN FUND BALANCES
 Year Ended December 31, 2013

| | MAJOR FUNDS | | | | |
|--|-----------------|-------------------------|--------------------|--------------------------------|----------------|
| | General Fund | Debt Service Fund | Collection Fund | Total Governmental Funds | |
| REVENUES | | | | | |
| Tobacco settlement revenue | | | \$ 18,747,148 | | \$ 18,747,148 |
| Interest on investments | | \$ 865,597 | | | 865,597 |
| Total Revenues | | 865,597 | 18,747,148 | | 19,612,745 |
| EXPENDITURES | | | | | |
| General government support | \$ 82,338 | | 9,001 | | 91,339 |
| Transfer to residual trust | | | 1,858,998 | | 1,858,998 |
| Amortization of deferred outflows of resources | | | 5,346,580 | | 5,346,580 |
| Debt service: | | | | | |
| Principal | | 1,330,000 | | | 1,330,000 |
| Interest | | 17,242,234 | | | 17,242,234 |
| Total Expenditures | 82,338 | 18,572,234 | 7,214,579 | | 25,869,151 |
| Excess (Deficiency) of Revenues Over (Under) Expenditures | (82,338) | (17,706,637) | 11,532,569 | | (6,256,406) |
| OTHER FINANCING SOURCES (USES) | | | | | |
| Transfers in | 100,000 | 16,782,395 | | | 16,882,395 |
| Transfers out | | | (16,882,395) | | (16,882,395) |
| Total Other Financing Sources (Uses) | 100,000 | 16,782,395 | (16,882,395) | | -0- |
| Net Change in Fund Balances | 17,662 | (924,242) | (5,349,826) | | (6,256,406) |
| Fund Balances at Beginning of Year | 146,838 | 21,787,910 | 221,915,809 | | 243,850,557 |
| Fund Balances at End of Year | \$ 164,500 | \$ 20,863,668 | \$ 216,565,983 | | \$ 237,594,151 |

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, 2013

| | |
|---|-----------------------|
| Net Change in Fund Balances | \$ (6,256,406) |
| Interest receivable is recorded as interest revenue on the statement of activities when it is earned, and on the fund statements when it is received. | (3,426) |
| <p>The issuance of long-term debt (e.g., bonds, leases) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds and it is an expenditure in the governmental funds, but the repayment reduces long-term liability in the statement of net position, not the statement of activities. Also, governmental funds report the effect of long-term debt premiums and discounts when debt is first issued as net of current financial resources, whereas these amounts are reported net of long-term debt and amortized over the terms of debt as interest expense in the statement of activities.</p> | |
| Repayment of bond principal | 1,330,000 |
| Amortization of bond premiums | 28,840 |
| Amortization of bond discounts | (155,694) |
| 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. | (1,534,694) |
| 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. | 3,993 |
| Change in Net Position (Deficit) of Governmental Activities | <u>\$ (6,587,387)</u> |

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2013

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. 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, two directors are appointed by the County Executive and the County Budget Director is a nonvoting ex officio member. One director must meet certain requirements of independence.

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.

1. 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, the statement of net position 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.

In the government-wide statement of net position, 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.2) as well as long-term debt and obligations. The Corporation's net position (deficit) is reported in two parts – restricted net position and unrestricted net position (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.

The government-wide financial statements focus more on the sustainability of the Corporation as an entity and the change in the Corporation's net position (deficit) resulting from the current year's activities.

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2013

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

1. BASIS OF PRESENTATION (continued)

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, deferred outflows of resources, liabilities, deferred inflows of resources, 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 and report all financial resources not accounted for and reported in other funds.

Debt Service Fund – is used to account for and report resources that are restricted for payment of general long-term bond principal and interest, and also includes the Liquidity Reserve Accounts. At December 31, 2013, 2008 Liquidity Reserve Account was underfunded by \$921,726. The required level is \$18,760,231 in accordance with the Indenture Agreements. The 2012 Liquidity Reserve Account was funded at the funded level of \$3,025,163 at December 31, 2013.

Collection Fund – is used to account for and report financial resources that are restricted from 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 2008 Indenture and 2012 Indenture Agreements.

Cost of Issuance Fund – is used to account for and report financial resources that are restricted from the portion of the Series 2012 Bond proceeds used to pay the cost of issuance per the 2012 Indenture. There was no activity during 2013.

2. 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.

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.

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2013

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2. BASIS OF ACCOUNTING/MEASUREMENT FOCUS (continued)

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, deferred outflows of resources, liabilities, and deferred inflows of resources resulting from exchange and exchange-like transactions are recognized when the exchange takes place. Management, however, has elected to recognize TSRs as they are collected due to the unpredictability of the revenues and the difficulty with which to estimate the amount earned.

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

3. ASSETS, DEFERRED OUTFLOWS/INFLOWS OF RESOURCES, LIABILITIES, NET POSITION AND FUND BALANCE

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.1.

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.

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. There was no interfund receivables or payables as of December 31, 2013.

PREPAIDS

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

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2013

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3. ASSETS, DEFERRED OUTFLOWS/INFLOWS OF RESOURCES, LIABILITIES, NET POSITION AND FUND BALANCE (continued)

DEFERRED OUTFLOWS/INFLOWS OF RESOURCES

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period(s). The Corporation currently has one position qualifying for reporting in this category, purchase of future tobacco settlement revenues from Suffolk County. More information on the purchase of future tobacco settlement can be found in note B.4.

Deferred outflows of resources from purchase of future tobacco is 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.

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The Corporation did not have any items qualifying for reporting in this category.

LONG-TERM OBLIGATIONS

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

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.

NET POSITION AND FUND BALANCE CLASSIFICATIONS

In the government-wide statements, equity net position (deficit) is displayed in two components:

- a. Restricted component of net position —consists of restricted assets reduced by liabilities and deferred inflows of resources related to those assets. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported. Net position should be reported as restricted when constraints placed on net position use are either (1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or (2) law through constitutional provisions or enabling legislation. As of December 31, 2013, the balances of investments in the debt service fund are restricted for the future payments of outstanding debt or interest accrued. The balance of restricted net position is \$20,932,375 as of December 31, 2013.

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2013

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3. ASSETS, DEFERRED OUTFLOWS/INFLOWS OF RESOURCES, LIABILITIES, NET POSITION AND FUND BALANCE (continued)

NET POSITION AND FUND BALANCE CLASSIFICATIONS (continued)

- b. Unrestricted component of net position —is the net amount of assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of the restricted component of net position. The balance of unrestricted net position (deficit) is \$(87,407,482) as of December 31, 2013.

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

In the Corporation's fund financial statements there are three classifications of fund balance:

Nonspendable – Includes amounts that cannot be spent because they are either not in spendable form, not available within a year, or legally or contractually required to be maintained intact. Non-spendable fund balance includes deferred outflows of resources recorded in the collection fund of \$216,565,983.

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, totaling \$20,863,668.

Unassigned - Includes all other general fund net position that does not meet the definition of the other classifications and is deemed to be available for general use by the Corporation. The balance of unassigned fund balance in the general fund is \$164,500 as of December 31, 2013.

Order of Use of Restricted and Unrestricted Funds

In circumstances where 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 unassigned fund balance.

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2013

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4. REVENUES AND EXPENDITURES

TOBACCO SETTLEMENT REVENUE

Pursuant to a 2008 Purchase and Sale Agreement dated as of August 1, 2008, (the "2008 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.

The Series 2008 Bonds are secured by and payable from a portion of the TSRs equal to 36% of the TSRs received by the Corporation through December 31, 2012, and 75% thereafter, and like percentages of any lump sum payments, if any, received as a payment from a Participating Manufacturer ("PM") that results in, or is due to, a release of that PM from all of its future obligations under the MSA or from any portion of its future obligations under the MSA (such pledged TSRs, the "Previously Pledged TSRs"). The Previously Pledged TSRs do not include (i) 64% of TSRs received by the Corporation through December 31, 2012, (ii) 25% of TSRs received thereafter, (iii) 100% of TSRs representing amounts withheld or deposited in the Disputed Payments Account under the MSA before August 21, 2008, regardless of when such amounts are received, and (iv) 100% of all TSRs paid to Corporation after all amounts due under the 2008 Indenture have been paid or otherwise provided for, each of which constitute "Pledged TSRs" and are transferred to the owner of the security (the "2008 Residual Certificate") issued by the Corporation under the 2008 Indenture, which entitles the owner to the Pledged TSRs.

Pursuant to a 2012 Purchase and Sale Agreement dated as of March 1, 2012 (the "2012 TSR Purchase Agreement") between the County, as seller, and the Corporation, as purchaser, the County sold to the Corporation on the Closing Date 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 (the "2008 Ownership Interest"), 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. The consideration paid by the Corporation to the County for such acquisition consisted of \$34,214,911 in cash, all of which was paid into the Residual Trust for the benefit of the County. The Corporation funded such consideration from the proceeds of its Tobacco Settlement Asset-Backed Bonds, Series 2012 ("Series 2012 Bonds") pursuant to the 2012 Indenture, dated as of March 1, 2012.

Per the 2008 TSR Purchase Agreement and 2012 TSR Purchase Agreement, receipts shall be transferred directly to the Corporation. Under the MSA, amounts shall be paid by the Participating Manufacturers to the escrow agent on or before April 15th of each year. The escrow agent will then disburse these funds to the Corporation. In 2013, the Corporation collected \$18,747,148 of total TSRs, of which \$16,782,395 was transferred to the debt service fund to repay a portion of the Corporation's outstanding bonds and interest, \$1,858,998 was transferred to the residual trust, per the 2008 Indenture and 2012 Indenture, \$9,001 was used to pay the trustee fees and \$100,000 was transferred to general fund for general support expense.

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2013

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4. REVENUES AND EXPENDITURES (continued)

TRANSFERS TO RESIDUAL TRUST

Transfers to the Residual Trust represent portions of the TSRs received that are required to be transferred to the Suffolk County Residual Trust per the 2008 Indenture and 2012 Indenture. See note D for more detail.

INTERFUND TRANSACTIONS

Interfund transactions have been eliminated from the government-wide financial statements. In the fund statements, interfund transactions include transfers from the collection fund to the debt service fund to cover various debt obligations and to the general fund to cover general government support expense.

5. USE OF ESTIMATES

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

6. NEW PRONOUNCEMENT

Effective for the financial statements for the year ended December 31, 2013, the Corporation implemented GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, for the year ended December 31, 2013. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. As of December 31, 2013, the Corporation recognized deferred outflows of resources that resulted from purchase of TSRs from Suffolk County, which were previously recorded as deferred charges. There is no item qualifying as deferred inflows of resources.

In addition, the balance of unamortized bond issuance cost as of December 31, 2012 was fully expensed upon adoption of GASB Statement No. 65 and reduced the beginning net position for fiscal year ended December 31, 2013 by \$2,674,312.

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2013

C. DETAIL NOTES ON ALL FUNDS

1. CASH, CASH EQUIVALENTS AND INVESTMENTS

Custodial Credit Risk – Deposits/Investments – Custodial credit risk for investments exists 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.

Deposits are required to 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, 2013, the Corporation's deposit balances were \$3,192,163. Of these balances, \$167,000 was covered by the Federal Deposit Insurance Corporation, and \$3,025,163 consisted of an uncollateralized temporary investment in the Dreyfus Treasury & Agency Cash Management Fund. The entire amount invested in the Dreyfus Treasury & Agency Cash Management Fund consists of the 2012 Liquidity Reserve Account. The Dreyfus Treasury & Agency Cash Management Fund invests only in U.S. government or U.S. Treasury securities, and in repurchase agreements.

The Corporation's 2008 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, between the Corporation and Bayerische Landesbank, dated August 21, 2008. The Corporation's share of investments in this repurchase agreement was \$17,838,505 at December 31, 2013, 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.

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, 2013, the Corporation did not have any investments subject to credit risk, interest-rate risk or concentration of credit risk.

2. DEFERRED OUTFLOWS OF RESOURCES

Deferred outflows of resources created from the purchase of the future TSRs as of December 31, 2013 is as follows:

| | |
|----------------------------|-----------------------|
| Purchase of TSRs | \$ 240,458,248 |
| Less: related amortization | <u>(23,892,265)</u> |
| | <u>\$ 216,565,983</u> |

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
NOTES TO FINANCIAL STATEMENTS
 December 31, 2013

C. DETAIL NOTES ON ALL FUNDS (continued)

3. INTERFUND RECEIVABLES, PAYABLES AND TRANSFERS

For the year ended December 31, 2013, interfund transfers represent payments from the collection fund to the debt service fund to pay outstanding bond and interest payments and to the general fund to pay operating costs. Interfund transfers are stated as follows:

| | Transfer In | Transfer Out |
|-------------------|----------------|-----------------|
| General Fund | \$ 100,000 | |
| Debt Service Fund | 16,782,395 | |
| Collection Fund | | \$ 16,882,395 |
| | \$ 16,882,395 | \$ 16,882,395 |

4. LONG-TERM DEBT

Bonds - Tobacco Settlement Asset-Backed Bonds issued in 2008 and 2012 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. Principal and interest paid on these bonds in 2013 totaled \$18,572,234. Interest on select Series 2008 Bonds and Series 2012 Bonds is excluded from the gross income of the bondholders for federal income tax purposes pursuant to Section 103 of the Internal Revenue Code.

Any additional pledged revenues received above the required debt service payments for the Series 2008 Bonds are used to turbo redeem the outstanding bonds. Any additional pledged revenues received above the required debt service payments for the Series 2012 Bonds are transferred to the 2012 Residual Trust.

For the Series 2008 Bonds, pledged revenues consist of a portion of the TSRs equal to 36% of the annual payments received by the Corporation through December 31, 2012, and 75% thereafter and like percentages of any lump sum payment made in lieu of such annual payments. Pledged revenue does not include 100% of TSRs representing amounts withheld or deposited in the Disputed Payments Account under the MSA before August 21, 2008, regardless of when such amounts are received. Pledged revenue received in 2013 amounted to \$14,060,361 or 89.3% of total principal and interest payments made on the 2008 Series Bonds during the year. The Corporation withdrew \$921,726 from the 2008 Senior Liquidity Reserve to pay a portion of the interest payment on the Bonds due on December 1, 2013.

For the Series 2012 Bonds, pledged revenues consist of a portion of the TSRs equal to 64% of TSRs received by the Corporation 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 August 21, 2008, regardless of when such amounts are received. Pledged revenue received in 2013 amounted to \$4,686,787, of this amount, \$2,828,034 was used to pay 2012 bond principal and interest and \$1,858,998 was transferred to the residual trust.

Payments with respect to the Series 2008 Bonds and Series 2012 Bonds are dependent upon receipt of TSRs. The Series 2008 Bonds are special obligations of the Corporation payable solely from the pledged revenues, the 2008 Liquidity Reserve Account, and other funds and accounts under the 2008 Indenture. The Series 2012 Bonds are special obligations of the Corporation payable solely from the pledged revenues, the 2012 Liquidity Reserve Account, and other funds and accounts under the 2012 Indenture. The Corporation has no other assets available for the payment of the Series 2008 Bonds and Series 2012 Bonds.

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
NOTES TO FINANCIAL STATEMENTS
 December 31, 2013

C. DETAIL NOTES ON ALL FUNDS (continued)

4. LONG-TERM DEBT (continued)

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, 2013, are as follows:

| Description | Original Date Issued | Original Amount | Interest Rate | Maturity Date | Amount Outstanding | Amount Outstanding Including Accreted Interest |
|----------------------------|----------------------|-----------------|----------------|---------------|--------------------|--|
| 2008A | 08/21/08 | \$ 9,765,000 | 4.000 - 5.000% | 6/1/12-6/1/18 | \$ 5,530,000 | \$ 5,530,000 |
| 2008B (2028) | 08/21/08 | 40,045,000 | 5.375% | 6/1/2028 | 37,525,000 | 37,525,000 |
| 2008B (2048) | 08/21/08 | 62,295,000 | 6.000% | 6/1/2048 | 62,295,000 | 62,295,000 |
| 2008C | 08/21/08 | 107,671,781 | 6.625% | 6/1/2044 | 107,671,781 | 142,295,000 |
| 2008D | 08/21/08 | 13,375,082 | 8.000% | 6/1/2048 | 13,375,082 | 20,370,183 |
| 2012A | 03/29/12 | 3,740,000 | 1.830 - 3.320% | 6/1/13-6/1/16 | 2,695,000 | 2,695,000 |
| 2012B | 03/29/12 | 34,635,000 | 4.000 - 5.000% | 6/1/16-6/1/37 | 34,635,000 | 34,635,000 |
| Unamortized Bond Discounts | | | | | | (3,302,371) |
| Unamortized Bond Premiums | | | | | | 675,351 |
| | | | | | | \$ 302,718,163 |

The following table summarizes the Corporation's minimum future debt service requirements as of December 31, 2013:

| | Principal | Interest | Total Principal and Interest |
|-----------|----------------|----------------|------------------------------|
| 2014 | \$ 1,485,000 | \$ 17,204,766 | \$ 18,689,766 |
| 2015 | 1,650,000 | 17,153,729 | 18,803,729 |
| 2016 | 1,865,000 | 17,085,259 | 18,950,259 |
| 2017 | 1,910,000 | 17,003,575 | 18,913,575 |
| 2018 | 4,235,000 | 16,862,375 | 21,097,375 |
| 2019-2023 | 7,715,000 | 82,900,601 | 90,615,601 |
| 2024-2028 | 46,325,000 | 79,889,828 | 126,214,828 |
| 2029-2033 | 8,430,000 | 68,666,575 | 77,096,575 |
| 2034-2038 | 6,770,000 | 66,538,507 | 73,308,507 |
| 2039-2043 | 0 | 65,823,719 | 65,823,719 |
| 2044-2048 | 183,341,863 | 345,790,569 | 529,132,432 |
| | \$ 263,726,863 | \$ 794,919,503 | \$ 1,058,646,366 |

SUFFOLK TOBACCO ASSET SECURITIZATION CORPORATION
NOTES TO FINANCIAL STATEMENTS
 December 31, 2013

C. DETAIL NOTES ON ALL FUNDS (continued)

4. LONG-TERM DEBT (continued)

A summary of changes in long-term liabilities for the year ended December 31, 2013 is as follows:

| | Balance 1/1/13 | Increases | Reductions | Balance 12/31/13 | Due within one year | Due more than One year |
|-----------------------------|-----------------------|---------------------|-----------------------|-----------------------|------------------------|---------------------------|
| Bonds | \$ 265,056,863 | | \$ (1,330,000) | \$ 263,726,863 | \$ 1,485,000 | \$ 262,241,863 |
| Plus: accreted interest | 40,081,024 | \$ 1,537,296 | | 41,618,320 | | 41,618,320 |
| Plus: unamortized premiums | 704,191 | | (28,840) | 675,351 | 28,840 | 646,511 |
| Less: unamortized discounts | (3,458,065) | 155,694 | | (3,302,371) | (155,694) | (3,146,677) |
| Total bonds | <u>\$ 302,384,013</u> | <u>\$ 1,692,990</u> | <u>\$ (1,358,840)</u> | <u>\$ 302,718,163</u> | <u>\$ 1,358,146</u> | <u>\$ 301,360,017</u> |

D. RESIDUAL TRUST

Per the 2012 Indenture, the 2012 Residual Trust will receive the future TSRs, consisting of any additional pledged revenues received above the required debt service payments for the Series 2012 Bonds. Total amounts transferred to the 2012 Residual Trust for the year ended December 31, 2013 was \$1,858,998.



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Report of Independent Auditors 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*

Management and the Board of Directors
Suffolk Tobacco Asset Securitization Corporation
Hauppauge, New York

We have audited, in accordance with the auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the 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, 2013, and the related notes to the financial statements, which collectively comprise the Corporation’s basic financial statements, and have issued our report thereon dated March 21, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Corporation’s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Corporation’s internal control. Accordingly, we do not express an opinion on the effectiveness of the Corporation’s internal control.

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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst + Young LLP

March 21, 2014

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