

**SULLIVAN COUNTY TOBACCO ASSET
SECURITIZATION CORPORATION
(A BLENDED COMPONENT UNIT OF
THE COUNTY OF SULLIVAN, NEW YORK)**

FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2010

AND INDEPENDENT AUDITORS' REPORT

SULLIVAN COUNTY TOBACCO ASSET
SECURITIZATION CORPORATION
(A BLENDED COMPONENT UNIT OF THE
COUNTY OF SULLIVAN, NEW YORK)

FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2010

AND INDEPENDENT AUDITORS' REPORT

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of the
Sullivan County Tobacco Asset Securitization Corporation:

We have audited the accompanying statement of net assets of the Sullivan County Tobacco Asset Securitization Corporation ("STASC"), a blended component unit of the County of Sullivan, New York, as of December 31, 2010 and the related statements of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the STASC's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. These 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the STASC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the STASC as of December 31, 2010 and the changes in its net assets and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis 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.

As discussed in Note 1, the financial statements present only the STASC and do not purport to, and do not present fairly the financial position of the County of Sullivan, New York as of December 31, 2010 and the changes in financial position and cash flows, thereof, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As more fully disclosed in Note 5, the only significant resource of the STASC is the right to receive tobacco revenues. A reduction in these revenues would affect debt service coverage on the bonds. If the reduction were material, it could impair the ability of the STASC to make flexible principal payments or even its ability to pay required maturities as they are due. As a result, actual payments may not conform to either the required maturities or the flexible maturity payments.

O'Connor Davies Munns & Dobbins, LLP

O'Connor Davies Munns & Dobbins, LLP

February 13, 2011

**SULLIVAN COUNTY TOBACCO ASSET
SECURITIZATION CORPORATION
Management's Discussion and Analysis (MD&A)
December 31, 2010**

Introduction

As management of the Sullivan Tobacco Asset Securitization Corporation ("STASC"), we offer readers of the STASC's financial statements this narrative overview and analysis of the financial activities of the STASC for the fiscal year ended December 31, 2010. It should be read in conjunction with the financial statements, which immediately follow this section, to enhance understanding of the STASC's financial performance.

Financial Highlights

- ❖ On the statement of net assets, the liabilities of the STASC exceeded its assets at the close of the most recent fiscal year, resulting in a deficit of \$10,529,419. The deficit was decreased by \$299,942, primarily due to the amount recognized for Tobacco Settlement Revenues ("TSR's") of \$1,106,106 less operating expenses of \$45,932 and non-operating net interest expense of \$760,232.
- ❖ During the current fiscal year, the "Downgrade Trapping Event" and the "Non-Participating Manufacturers Trapping Event", described more fully in Note 4 in the notes to financial statements, ended and monies previously accumulated to satisfy the trapping requirements outlined in the STASC's bond indenture in the amount of approximately \$493,000 were transferred to the operating account.
- ❖ The Governmental Accounting Standards Board ("GASB") issued Technical Bulletin 2004-1, which clarified certain asset and revenue recognition criteria. Prior to the issuance of this bulletin, the STASC had recognized as a receivable/revenue the present value of the future tobacco revenue stream. This bulletin required a reversal of this position, in that it promulgated that TSR's and the related asset only be recognized when the event giving rise to recognition (i.e. the shipment of cigarettes) occurs. Because annual TSR payments are based on cigarette sales from the preceding calendar year, the STASC was prohibited from recognizing this future revenue stream as a receivable. Accordingly, the only revenue recognition allowed was for TSR payments to be received in the immediately succeeding fiscal year, as these payments were based on cigarette shipments in the year under audit. This had the effect of deferring revenue recognition, which results in the deficit position reflected on the statement of net assets. Over time, as TSR payments are received and the bonded indebtedness is retired, the deficit will be reduced.

Financial Statements

The *statement of net assets* presents information on the STASC's assets and liabilities, with the difference between the two reported as *net assets*. The *statement of revenues, expenses and changes in net assets* presents information showing how the STASC's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (for example, accounts receivable and accrued interest payable).

The notes to financial statements provide additional information that is essential to a full understanding of the data provided in the statement of net assets and the statement of revenues, expenses and changes in net assets. The notes to financial statements are located beginning on page 8 of this report.

Financial Analysis

Net assets increased by \$299,942 in 2010, compared with an increase of \$590,502 in 2009, a difference of \$290,560. This decrease from the prior year is primarily attributable to a reduction in the recognition of tobacco settlement revenues of \$267,460 and a decrease in the amount of interest income recognized of \$45,439. These were partially offset by the decrease in the interest expense of \$22,236.

Debt Administration

At the end of the current fiscal year, the STASC had total gross bonded debt outstanding of \$14,090,000. STASC was able to make its flexible maturities payment of \$435,000, and to date has made principal payments of \$2,875,000.

Additional information on the STASC's long-term debt can be found in Note 3 in the notes to financial statements.

Economic Factors

The bonds are payable only from the assets of the STASC. STASC's only source of funds for payments on the bonds is the collections of TSR's and amounts on deposit in pledged accounts (i.e. liquidity and debt service reserve accounts) pursuant to the indenture. If a participating manufacturer becomes a debtor in a bankruptcy case and defaults in making payments or cigarette consumption declines, funds available to STASC to pay bondholders may be reduced or eliminated.

Requests for Information

This financial report is designed to provide a general overview of the STASC's finances for all those with an interest in those finances. Questions and comments concerning any of the information provided in this report should be addressed to Joshua Potosek, Deputy County Manager, Sullivan County, 100 North Street, Monticello, New York 12701.

SULLIVAN COUNTY TOBACCO ASSET SECURITIZATION CORPORATION
(A BLENDED COMPONENT UNIT OF THE
COUNTY OF SULLIVAN, NEW YORK)

STATEMENT OF NET ASSETS
December 31, 2010

ASSETS

Current Assets:

Cash and equivalents	\$ 760,897
Accounts receivable	1,219,737
Prepaid expenses	<u>3,658</u>

Total Current Assets	<u>1,984,292</u>
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Noncurrent Assets:

Restricted cash and equivalents	110
Restricted investments	1,242,547
Costs of issuance, net of accumulated amortization of \$155,277	<u>274,092</u>

Total Noncurrent Assets	<u>1,516,749</u>
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Total Assets	<u><u>\$ 3,501,041</u></u>
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LIABILITIES

Current Liabilities:

Accrued liabilities	\$ 66,459
Current portion of bonds payable	<u>480,000</u>

Total Current Liabilities	546,459
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Noncurrent Liabilities -

Bonds payable, net of current maturities	<u>13,484,001</u>
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Total Liabilities	<u>14,030,460</u>
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NET ASSETS

Deficit	<u><u>\$ (10,529,419)</u></u>
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See notes to financial statements.

SULLIVAN COUNTY TOBACCO ASSET SECURITIZATION CORPORATION
(A BLENDED COMPONENT UNIT OF THE
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STATEMENT OF REVENUES, EXPENSES AND CHANGES
IN NET ASSETS
YEAR ENDED DECEMBER 31, 2010

Operating Revenues - Tobacco settlement revenues	<u>\$ 1,106,106</u>
Operating Expenses:	
Professional fees	24,929
Insurance expense	4,489
Amortization	<u>16,514</u>
Total Operating Expenses	<u>45,932</u>
Income from Operations	<u>1,060,174</u>
Non-Operating Revenues (Expenses):	
Interest income	54,491
Interest expense	<u>(814,723)</u>
Total Non-Operating Expenses	<u>(760,232)</u>
Change in Net Assets	299,942
Deficit - Beginning of Year	<u>(10,829,361)</u>
Deficit - End of Year	<u><u>\$ (10,529,419)</u></u>

See notes to financial statements.

SULLIVAN COUNTY TOBACCO ASSET SECURITIZATION CORPORATION
(A BLENDED COMPONENT UNIT OF THE
COUNTY OF SULLIVAN, NEW YORK)

STATEMENT OF CASH FLOWS
YEAR ENDED DECEMBER 31, 2010

Cash Flows from Operating Activities:	
Cash received from tobacco settlement revenues	\$ 1,125,044
Cash paid to vendors	<u>(29,319)</u>
Net Cash Provided by Operating Activities	<u>1,095,725</u>
Cash Flows from Investing Activities:	
Decrease in restricted cash and equivalents	580,930
Purchase of restricted investments	(1,242,547)
Sale of restricted investments	1,274,964
Interest income	<u>54,491</u>
Net Cash Provided by Investing Activities	<u>667,838</u>
Cash Flows from Non-Capital Financing Activities:	
Repayment of bonds payable	(435,000)
Interest paid	<u>(809,056)</u>
Net Cash Used in Non-Capital Financing Activities	<u>(1,244,056)</u>
Net Increase in Cash and Equivalents	519,507
Cash and Equivalents - Beginning of Year	<u>241,390</u>
Cash and Equivalents - End of Year	<u>\$ 760,897</u>
Reconciliation of income from operations to net cash provided by operating activities:	
Income from operations	\$ 1,060,174
Adjustments to reconcile income from operations to net cash provided by operating activities -	
Amortization	16,514
Changes in Assets and Liabilities:	
Accounts receivable	18,938
Prepaid expenses	<u>99</u>
Net Cash Provided by Operating Activities	<u>\$ 1,095,725</u>
Noncash Investing Activities -	
Increase in bonds payable from amortization of original issue and underwriters discounts	\$ 7,592

See notes to financial statements.

**SULLIVAN COUNTY TOBACCO ASSET
SECURITIZATION CORPORATION
(A BLENDED COMPONENT UNIT
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NOTES TO FINANCIAL STATEMENTS

Note 1 - Nature of Business and Summary of Significant Accounting Principles

Nature of Business

The Sullivan County Tobacco Asset Securitization Corporation ("STASC") is a special purpose, bankruptcy-remote local development corporation. STASC was organized under the provisions of Section 1411 of the New York State Not-For-Profit Corporation Law and pursuant to the Public Authorities Law of the State of New York. The Board of Directors of STASC consists of five members; the County Manager, the County's Commissioner of Financial Management, the Chairman of the County's Board of Legislators, the Majority Leader of the County's Board of Legislators and the Minority Leader of the County's Board of Legislators.

An agreement among the attorneys general of 46 states and various territories ("Settling States") and the four largest United States tobacco manufacturers was entered into on November 23, 1998. The agreement, known as the Master Settlement Agreement ("MSA"), resolved cigarette smoking-related litigation between the Settling States and U.S. Tobacco manufacturers. Pursuant to the MSA, the Settling States and the participating manufacturers agreed to settle all past, present and future smoking related claims in exchange for an agreement by the participating manufacturers to make certain payments. Under the MSA, the State of New York is entitled to receive approximately 12.76% of the initial and annual payments. The New York Consent Decree, which was entered into in the Supreme Court of the State of New York for the County of New York in December 1998, allocated 0.155% of this State-wide share of the initial and annual payments to the County of Sullivan, New York ("County") and the remainder among the State, the City of New York and all other counties within the State.

During 2001, the County sold all of its future rights, title and interest to receive payments under the MSA and the Consent Decree to STASC for \$15,047,000. The debt issued by STASC to securitize these revenues is not considered debt of the County and is secured only by future tobacco settlement payments.

Entity Definition

Based on the guidance provided by Governmental Accounting Standards Board Technical Bulletin No. 2004-1, *Tobacco Settlement Recognition and Financial Reporting Entity Issues*, the STASC is reported as a blended component unit of the County in its financial statements.

Basis of Presentation

A fund is an independent fiscal and accounting entity with a self-balancing set of accounts which comprise its assets, liabilities, net assets, revenues and expenses. The accounts of the STASC are maintained on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The STASC applies all applicable Financial Accounting Standards Board pronouncements in accounting for and reporting on its operations.

The accompanying financial statements present only the activities of the STASC and do not purport to, and do not, present fairly the financial position of the County of Sullivan, New York as of December 31, 2010 and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

**SULLIVAN COUNTY TOBACCO ASSET
SECURITIZATION CORPORATION
(A BLENDED COMPONENT UNIT
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NOTES TO FINANCIAL STATEMENTS (Continued)

Note 1 - Nature of Business and Summary of Significant Accounting Principles (Continued)

Use of Estimates

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

Cash and Equivalents

Cash and equivalents consist of demand deposit accounts, time deposit accounts, money market accounts and certificates of deposit with original maturities of three months or less.

Restricted Cash and Equivalents and Investments

The terms of the bond indenture provide for the establishment of a liquidity reserve. The reserve has been established at the maximum annual debt service requirements in the current and any future fiscal year, assuming principal is paid in accordance with the requirements of the indenture.

The terms of the bond indenture also provide for the establishment of a trapping account. Following the occurrence of a trapping event (see Note 4), amounts that otherwise would have been paid on the residual certificate to the County will be deposited in the trapping account and will be restricted to pay interest, required amortization payments and flexible amortization payments, in such order, to the extent collections or other available amounts are insufficient for such purposes.

Costs of Issuance

The costs of issuance of the bonds are being amortized over the flexible maturities of the bonds, which is twenty six years.

Tax Status

The STASC is exempt from federal income tax under Section 501 (a) of the Internal Revenue Code as a 501(c)(3) organization.

Subsequent Events Evaluation by Management

Management has evaluated subsequent events for disclosure and/or recognition in the financial statements through the date that the financial statements were available to be issued, which date is February 13, 2011.

Note 2 - Restricted Investments

Restricted investments at December 31, 2010 consisted of the following:

Commercial paper, at cost, which approximates fair value, due in June 2011, interest at .68%	<u>\$ 1,242,547</u>
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**SULLIVAN COUNTY TOBACCO ASSET
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NOTES TO FINANCIAL STATEMENTS (Concluded)

Note 3 - Bonds Payable

STASC issued bonds on August 8, 2001 to finance the purchase of the tobacco rights from the County and the related costs of issuance. The bonds were issued for \$16,767,617, net of original issue discount of \$197,383, and bear interest at rates ranging from 5.00% to 6.00%, depending on maturity. A payment schedule, based upon flexible maturities, is as follows:

<u>Year Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 480,000	\$ 784,756	\$ 1,264,756
2012	505,000	758,425	1,263,425
2013	540,000	730,306	1,270,306
2014	565,000	700,119	1,265,119
2015	575,000	667,988	1,242,988
2016 and thereafter	<u>11,425,000</u>	<u>4,296,572</u>	<u>15,721,572</u>
	14,090,000	<u>\$ 7,938,166</u>	<u>\$ 22,028,166</u>
Unamortized Original Issue Discount	<u>(125,999)</u>		
	<u>\$ 13,964,001</u>		

The required principal payments are as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
2011	\$ 120,000
2012	130,000
2013	145,000
2014	155,000
2015	165,000
2016 and thereafter	<u>13,375,000</u>
	<u>\$ 14,090,000</u>

Note 4 - Trapping Events

In accordance with the terms of the bond indenture, a "Downgrade Trapping Event" occurs when any of the four largest United States tobacco manufacturers with a market share of 7% or more has a credit rating that falls below "Baa3" by Moody's or "BBB" by Standard & Poors. During 2003, the credit rating for one of these manufacturers, R.J. Reynolds Tobacco Holdings Inc., had fallen below these allowable thresholds and accordingly, a downgrade trapping event occurred. The indenture requires that, upon the occurrence of this event, 25% of the principal amount outstanding on the bonds be accumulated in a special account until one year after the end of the downgrade trapping event.

The terms of the bond indenture further provide for a "Non-Participating Manufacturer ("NPM") Trapping Event", which occurs when the aggregate market share of the NPM's exceeds 7%. During 2004, the aggregate market share of the NPM's exceeded 7% and accordingly, an NPM trapping event occurred.

**SULLIVAN COUNTY TOBACCO ASSET
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NOTES TO FINANCIAL STATEMENTS (Concluded)

Note 4 - Trapping Events (Continued)

The indenture requires that, upon the occurrence of this event, that the lesser of 1) 6% of the principal amount of outstanding senior bonds for each full percentage point by which the aggregate NPM market share exceeds 7% or 2) 65% of such principal amount; which amount, as calculated immediately prior to the NPM trapping event ceasing to be in effect, shall remain the same for one year and thereafter be zero.

Both trapping events have ended and the accumulated funds previously held in the restricted trapping account in the amount of \$493,235 have been transferred to the STASC's operating account.

Note 5 - Significant Contingencies

The enforceability of the rights and remedies of the State (and thus the bondholders) and of the obligations of a participating manufacturer under the MSA are subject to the Bankruptcy Code and the other applicable insolvency, moratorium or similar laws relating to or affecting the enforcement of creditors' rights. Some of the risks include risks of delay in or reduction of amounts of payment or of non-payment under the MSA and the risk that the State (and thus the County and/or STASC) may be stayed for an extended time from enforcing any rights under the MSA and the Consent Decree or with respect to the payments owed by the bankrupt participating manufacturer or from commencing legal proceedings against the bankrupt participating manufacturer. As a result, if a participating manufacturer becomes a debtor in a bankruptcy case and defaults in making payment, funds available to STASC to pay bondholders may be reduced or eliminated.

The bonds are payable only from the assets of STASC. The bonds are neither legal nor moral obligations of the County or the State of New York, and no recourse may be had thereto for payment of amounts owing on the bonds. STASC's only source of funds for payments on the bonds is the collections and amounts on deposit in pledged accounts pursuant to the indenture. STASC has no taxing power and no significant assets other than the rights to receive tobacco settlement revenues.