

**Sullivan County Tobacco Asset
Securitization Corporation**
(A Blended Component Unit of the
County of Sullivan, New York)

Financial Statements

Year Ended December 31, 2017



Independent Auditors' Report

**The Board of Directors of the Sullivan County
Tobacco Asset Securitization Corporation**

Report on the Financial Statements

We have audited the accompanying financial statements of the Sullivan County Tobacco Asset Securitization Corporation ("STASC"), a blended component unit of the County of Sullivan, New York, as of and for the year ended December 31, 2017, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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 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 from 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 auditors' 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 STASC'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 STASC'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 opinion.

Opinions

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, 2017, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

We draw attention to Note 1 in the notes to financial statements that indicates that these 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, 2017 and the changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

We further draw attention to Note 4 in the notes to financial statements which discusses that 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 turbo redemption payments or even its ability to pay planned structured principal payments as they are due. As a result, actual payments may not conform to either the turbo redemption maturities or the planned structured principal payments schedules. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the 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 financial statements and other knowledge we obtained during our audit of the 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 have also issued our report dated March 15, 2018 on our consideration of the STASC'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 STASC's internal control over financial reporting and compliance.

PKF O'Connor Davies, LLP
PKF O'Connor Davies, LLP
Harrison, New York
March 15, 2018

**Sullivan County Tobacco Asset
Securitization Corporation**
(A Blended Component Unit of the County of Sullivan, New York)
Management's Discussion and Analysis (MD&A)
December 31, 2017

Introduction

As management of the Sullivan County 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, 2017. 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

- ❖ The Governmental Accounting Standards Board ("GASB") issued Technical Bulletin 2004-1, "*Tobacco Settlement Recognition and Financial Reporting Entity Issues*", as amended and/or superseded by GASB Statement No. 48, "*Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*", which clarified certain asset and revenue recognition criteria. Prior to the issuance of this guidance, the STASC had recognized as a receivable/revenue the present value of the future tobacco revenue stream. The new guidance required a reversal of this position, in that it promulgated that Tobacco Settlement Revenues ("TSR") 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 position. Over time, as TSR payments are received and the bonded indebtedness is retired, the deficit will be reduced.
- ❖ On the statement of net position, the liabilities of the STASC exceeded its assets and deferred outflows of resources at the close of the most recent fiscal year, resulting in a deficit of \$15,146,078. The deficit was decreased by \$168,303, due to the amount recognized for TSR's of \$851,806, less operating expenses of \$34,073 and non-operating net interest expense of \$649,430.

Financial Statements

The *statement of net position* presents information on the STASC's assets, deferred outflows of resources and liabilities, with the difference between them reported as *net position*. The *statement of revenues, expenses and changes in net position* presents information showing how the STASC's net position changed during the most recent fiscal year. All changes in net position 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 position and the statement of revenues, expenses and changes in net position. The notes to financial statements are located beginning on page 8 of this report.

Financial Analysis

Net position increased by \$168,303 in 2017, compared with a decrease of \$6,833,101 in 2016, a difference of \$7,001,404. Recognition of tobacco settlement revenues decreased \$483,625. The majority of this decrease was due to a 2016 settlement of a multi-year dispute over the amount to be paid by the participating tobacco manufacturers. Non-operating costs decreased \$7,489,370 as compared to 2016. This decrease is directly related to the refunding in the prior year of the 2001 bond, which generated a payment to the County of Sullivan of \$8,192,100. The refunding also generated a \$934,500 gain on investment in the prior year.

Debt Administration

At the end of the current fiscal year, the STASC had total gross bonded debt for the 2016 Series B and C bonds outstanding of \$16,360,000. STASC made debt service payments during the year of \$325,000.

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 Janet Young, President of the STASC, 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 Position
December 31, 2017

ASSETS

Current assets

Cash and equivalents	\$ 237,764
Tobacco settlement receivable	1,090,714
Prepaid expenses	<u>3,357</u>
Total Current Assets	1,331,835

Noncurrent assets

Restricted cash and equivalents	<u>1,103,852</u>
Total Assets	<u>2,435,687</u>

DEFERRED OUTFLOWS OF RESOURCES

Deferred amounts on refunding bonds	<u>226,569</u>
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LIABILITIES

Current liabilities

Accrued liabilities	57,971
Current maturities of bonds payable	<u>545,000</u>
Total Current Liabilities	602,971

Noncurrent liabilities

Bonds payable, net of current maturities	<u>17,205,363</u>
Total Liabilities	<u>17,808,334</u>

NET POSITION

Unrestricted	<u><u>\$ (15,146,078)</u></u>
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See notes to financial statements.

Sullivan County Tobacco Asset Securitization Corporation
(A Blended Component Unit of the County of Sullivan, New York)

Statement of Revenues, Expenses and Changes in Net Position
Year Ended December 31, 2017

OPERATING REVENUES

Tobacco settlement revenues \$ 851,806

OPERATING EXPENSES

Professional fees 29,837

Insurance expense 4,236

Total Operating Expenses 34,073

Income from Operations 817,733

NON-OPERATING REVENUES (EXPENSES)

Interest income 12,048

Interest expense (661,478)

Total Non-Operating Expenses (649,430)

Change in Net Position 168,303

NET POSITION

Beginning of year (15,314,381)

End of year \$ (15,146,078)

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, 2017

CASH FLOWS FROM OPERATING ACTIVITIES

Cash received from tobacco settlement revenues	\$ 946,321
Cash paid to vendors	<u>(34,073)</u>
Net Cash from Operating Activities	<u>912,248</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Interest income	<u>12,048</u>
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CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES

Repayment of bonds payable	(325,000)
Interest paid	<u>(834,499)</u>
Net Cash from Non-Capital Financing Activities	<u>(1,159,499)</u>

Net Change in Cash and Equivalents	(235,203)
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CASH AND EQUIVALENTS

Beginning of year	<u>1,576,819</u>
End of year	<u>\$ 1,341,616</u>
Cash and equivalents	\$ 237,764
Restricted cash and equivalents	<u>1,103,852</u>
Total Cash and Equivalents	<u>\$ 1,341,616</u>

**RECONCILIATION OF INCOME FROM OPERATIONS TO
NET CASH FROM OPERATING ACTIVITIES**

Income from operations	\$ 817,733
Adjustments to reconcile income from operations to net cash from operating activities	
Changes in assets and liabilities	
Tobacco settlement receivable	<u>94,515</u>
Net Cash from Operating Activities	<u>\$ 912,248</u>

NON-CASH INVESTING ACTIVITIES

Increase in bonds payable from amortization of original issue premium	\$ 57,931
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See notes to financial statements.

Sullivan County Tobacco Asset Securitization Corporation
(A Blended Component Unit of the County of Sullivan, New York)

Notes to Financial Statements
December 31, 2017

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 of Sullivan, New York's ("County") 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 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. During 2016, STASC issued \$16,685,000 of Tobacco Settlement Pass-Through Bonds, Series 2016B Serial/Term Bonds and 2016C Turbo Term Bonds (collectively "Series 2016"), the proceeds of which were used to 1) refund the outstanding Series 2001 bonds, 2) fund the Liquidity Reserve Account at its required level, 3) pay certain costs of issuance related to the Series 2016 bonds and 4) provide the County with funds to pay off the current portion of outstanding Capital Bond Anticipation Notes and for future capital projects. The Series 2016 bonds are payable from and secured solely from pledged Tobacco Settlement Revenues ("TSR's"). 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 ("GASB") Technical Bulletin No. 2004-1, *"Tobacco Settlement Recognition and Financial Reporting Entity Issues"*, as amended and/or superseded by GASB Statement No. 48, *"Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues"*, 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, deferred outflows of resources, liabilities, deferred inflows of resources, net position, 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.

Sullivan County Tobacco Asset Securitization Corporation
(A Blended Component Unit of the County of Sullivan, New York)

Notes to Financial Statements (Continued)
December 31, 2017

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

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 as of December 31, 2017 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.

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

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 for Series 2016B Serial/Term Bonds and interest on 2016C Turbo Term Bonds in the current and any future fiscal year, assuming principal is paid in accordance with the requirements of the indenture.

Deferred Outflows/Inflows of Resources

In addition to assets, the statement of financial 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 and so will not be recognized as an outflow of resources (expense) until then.

In addition to liabilities, the statement of financial 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 and so will not be recognized as an inflow of resources (revenue) until that time.

The STASC has reported deferred outflows of resources of \$226,569 for a deferred loss on refunding bonds in the Statement of Net Position. This amount results from the difference in the carrying value of the refunded debt and its reacquisition price. This amount is deferred and amortized over the shorter of the life of the refunded or refunding debt.

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.

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, deferred outflows of resources, liabilities and deferred inflows of resources 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.

Sullivan County Tobacco Asset Securitization Corporation
(A Blended Component Unit of the County of Sullivan, New York)

Notes to Financial Statements (Continued)
December 31, 2017

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

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 March 15, 2018.

Note 2 - Restricted Cash and Equivalents

Restricted cash and equivalents at December 31, 2017 consisted of the following:

United States Treasury Bills	\$ 1,103,404
Money Market Funds	<u>448</u>
	<u>\$ 1,103,852</u>

Note 3 - Bonds Payable

Bonds payable consisted of the following at December 31, 2017:

Description	Interest Rates	Original Issue Amount	Balance January 1, 2017	Redeemed	Balance December 31, 2017
Series 2016B	3% - 5%	\$ 8,100,000	\$ 8,100,000	\$ -	\$ 8,100,000
Series 2016C	4%	<u>8,585,000</u>	<u>8,585,000</u>	<u>325,000</u>	<u>8,260,000</u>
		<u>\$ 16,685,000</u>	<u>\$ 16,685,000</u>	<u>\$ 325,000</u>	<u>\$ 16,360,000</u>

A payment schedule, based upon planned maturities for the Series 2016B Serial/Term bonds and Turbo Redemption maturities for the Series 2016C Turbo Term bonds, is as follows:

Year Ending December 31,	Principal	Interest	Total
2018	\$ 545,000	\$ 688,500	\$ 1,233,500
2019	455,000	674,374	1,129,374
2020	630,000	657,634	1,287,634
2021	650,000	636,330	1,286,330
2022	675,000	611,415	1,286,415
2023 and thereafter	<u>13,405,000</u>	<u>5,061,883</u>	<u>18,466,883</u>
	16,360,000	<u>\$ 8,330,136</u>	<u>\$ 24,690,136</u>
Unamortized Original Issue Premium	<u>1,390,363</u>		
	<u>\$ 17,750,363</u>		

**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***

Independent Auditors' Report

**The Board of Directors of the Sullivan County
Tobacco Asset Securitization Corporation**

We have audited, in accordance with the 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, the financial statements of the Sullivan County Tobacco Asset Securitization Corporation ("STASC") as of and for the year ended December 31, 2017, and the related notes to the financial statements and have issued our report thereon dated March __, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the STASC'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 STASC's internal control. Accordingly, we do not express an opinion on the effectiveness of the STASC'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 a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the STASC'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 STASC's financial statements are free from 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 results of that testing, and not to provide an opinion on the effectiveness of the STASC'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 STASC's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

PKF O'Connor Davies, LLP
PKF O'Connor Davies, LLP
Harrison, New York
March 15, 2018