

**FINANCIAL STATEMENTS**

**ONONDAGA TOBACCO ASSET  
SECURITIZATION CORPORATION**

**DECEMBER 31, 2009**

# ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION

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## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors  
Onondaga Tobacco Asset Securitization Corporation  
Syracuse, New York

We have audited the accompanying financial statements of the governmental activities and the major fund of the Onondaga Tobacco Asset Securitization Corporation, a blended component unit of the County of Onondaga, New York as of and for the year ended December 31, 2009 as listed in the table of contents. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities and the major fund of the Onondaga Tobacco Asset Securitization Corporation at December 31, 2009, and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 25, 2010, 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* and important for assessing the results of our audit.

The management's discussion and analysis is not required part of the financial statements but is supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion thereon.

*Testone, Marshall & Surcanga, LLP*

March 25, 2010  
Syracuse, New York

## **ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)**

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Our discussion and analysis of Onondaga Tobacco Asset Securitization Corporation's (the "Corporation") financial performance provides an overview of the Corporation's financial activities during 2009. It should be read in conjunction with the financial statements and their associated notes that follow this section to properly evaluate the Corporation's financial position. The financial statements present only the information for the year ended December 31, 2009.

### **FINANCIAL HIGHLIGHTS**

As discussed further in the notes to the financial statements, the Corporation was formed to acquire from the County of Onondaga all future right, title and interest in the Tobacco Settlement Revenues (TSRs) under the Master Settlement Agreement (MSA) with respect to tobacco related litigation among various states and participating manufacturers. The Corporation is a component unit of Onondaga County and, accordingly, is included in the County's financial statements as a blended component unit. The Corporation is classified as a special-purpose government under *GASB Statement No. 14* and consists of one governmental fund. The fund and government-wide financial statements are presented together and include a reconciliation of the individual line items between the two statement types in a separate column.

### **USING THIS ANNUAL REPORT**

This annual report consists of a series of financial statements and notes to those statements. The statement of net assets and statement of activities provide information about the Corporation's activity and present a long-term view of the Corporation's finances. The fund financial statements tell how the governmental activity's services were financed in the short-term as well as what remains for future spending.

### **REPORTING THE CORPORATION AS A WHOLE**

#### **Government-Wide Financial Statements**

The Corporation presents its government-wide financial statements as the statement of net assets and the statement of activities. These include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

**ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)**

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**REPORTING THE CORPORATION AS A WHOLE (CONT'D)**

**Government-Wide Financial Statements (Cont'd)**

These two statements report the Corporation's net assets and changes in them. You can think of the Corporation's net assets - the difference between assets and liabilities - as one way to measure the Corporation's financial health or financial position. Over time, increases or decreases in the Corporation's net assets are one indicator of whether its financial health is improving or deteriorating.

Below is a condensed version of the government-wide financial statements as and for the years ended December 31:

|                       | <b>2009</b>   | <b>2008</b>   |
|-----------------------|---------------|---------------|
| Assets                | \$ 11,952,181 | \$ 15,480,289 |
| Liabilities           | 134,355,834   | 138,077,446   |
| Net Deficit           | (122,403,653) | (122,597,157) |
| Revenues              | 8,313,612     | 9,154,710     |
| Expenses              | 8,120,108     | 8,237,803     |
| Change in Net Deficit | 193,504       | 916,907       |

The Corporation's assets decreased by \$3,528,108. The Corporation's liabilities decreased by \$3,721,612. Net deficit decreased by \$193,504 or .16%.

The most significant variance between years was the payment of \$3.2 million towards the 2005 NYCTTV issue from the funds in the Trapping Account, which was established under the NYCTT II issue. Due to the Turbo redemption structure of NYCTT V, the approximately \$2,876,000 of actual payments redeemed \$19.7 million in bonds. Under the Master Settlement Agreement, the tobacco companies are required to make annual payments to the Corporation. During 2009, approximately \$7.8 million in tobacco revenues were received compared to \$8.4 million in 2008. In 2009, approximately \$8.1 million in expenses were incurred compared to \$8.2 million in 2008.

During the year ended December 31, 2009, no new bonds were issued and no distributions were made to the County. However, during 2009 interest expense of approximately \$2,490,000 was accreted on the Series 2005 bonds, while approximately \$2,850,000 was accreted during 2008.

No residual payments have been made to the County since 2003 due to the trapping events that occurred. Under a trapping event, those monies that would have been paid out to the County are now required to fund a trapping account as required by the Corporation's Indenture. In addition, as a result of the issuance of the 2005 Series Bonds, the County relinquished the right to use these monies for anything other than Corporation debt retirement. The trapping event that was in effect at year-end 2008 has been satisfied and will be further discussed below.

The recognition of the bonds payable liability in 2001 and 2005 has created a deficit in the Corporation's net assets. The deficit is expected to be satisfied over time as the tobacco settlement proceeds are received.

(Continued)

**ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)**

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**REPORTING THE CORPORATION AS A WHOLE (CONT'D)**

**Fund Financial Statements**

A governmental entity can have various types of funds such as governmental and proprietary. The Corporation only has one fund, the debt service fund, which is a governmental fund.

- Governmental funds 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 and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the Corporation's programs.

Below is a condensed version of the fund financial statement as of and for the years ended December 31:

|                                                   | <b>2009</b>  | <b>2008</b>   |
|---------------------------------------------------|--------------|---------------|
| Assets                                            | \$ 8,709,195 | \$ 12,148,533 |
| Liabilities                                       | -            | -             |
| Fund Balance                                      | 8,709,195    | 12,148,533    |
| Revenues                                          | 8,313,612    | 9,154,710     |
| Expenditures                                      | 11,752,950   | 8,008,427     |
| Excess (Deficiency) of Revenues over Expenditures | (3,439,338)  | 1,146,283     |

The most significant variance between years was in revenues and expenditures. In 2009, approximately \$7.8 million in tobacco revenues were received compared to \$8.4 million in 2008. Under the Master Settlement Agreement, the tobacco companies are required to make annual payments to the Corporation. Expenditures in 2009 were approximately \$3.7 million higher than the previous year, with \$3.2 million related to the payment of principal and interest from the Trapping Account funds.

The debt service fund has two distinct fund balances: reserved for debt service and unreserved-undesignated. Unreserved-undesignated fund balance is generated from general operations and is not restricted in use. Fund balance reserved for debt service results from monies set aside for future payment of the bond principal and interest.

Unlike the government-wide financial statements, in the fund financial statements, the bond payable is not recognized as a liability as it is long-term in nature. Because of this, there is not the issue of the large fund balance deficit under this methodology that is present in the government-wide presentation.

(Continued)

**ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)**

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**REPORTING THE CORPORATION AS A WHOLE (CONT'D)**

**Long-Term Debt Activity**

The Corporation issued debt, which will be repaid by its purchases from the County of the future right, title and interest in the Tobacco Settlement Revenues. Serial Bonds principal payments are due annually and interest semiannually. At December 31, 2009, the Corporation had \$133,897,575 in bonds outstanding. There was a decrease from the previous year as a result of payments of \$2,480,000 on the 2001 issue and \$2,876,000 on the 2005 issue.

**Analysis of Overall Financial Position**

Under the government-wide methodology, the Corporation showed a decrease to its net deficit. This decrease results from the tobacco settlement proceeds and interest income providing more than enough revenue to meet the Corporation's current expenditure/expense demands. Specifically, the government-wide financial statements show a decrease to the Corporation's net deficit by \$193,504. The Corporation continues to meet expectations and has improved at December 31, 2009 as a result of the Corporation's equity position increase.

**Budget**

GASB 34 requires an analysis of significant variants between the original budget and final budget amounts and between final budget amounts and actual budget results. Management has prepared a budget for its operating expenses only, and there were no changes or amendments to the operating budget. Because the budget is not a complete budget, comparison to current operations could be misleading. As such, it has not been presented in this report.

**Other Known Facts**

Two trapping events have occurred and neither is continuing. The first was a Downgrade Trapping event that occurred in 2003. According to the Master Settlement Agreement (MSA), each of the four original participating manufacturers (OPM) had a market share of 7% or more in 2003. The credit ratings of each were monitored. The rating of R.J. Reynolds Tobacco Holdings, Inc. was below the allowable threshold as described in the Official Statement, therefore a downgrade-trapping event occurred. However, in 2009, the rating of R.J. Reynolds returned to the necessary level and the Downgrade Trapping event is no longer occurring. The second trapping event occurred in 2004 when the non-participating manufacturers' (NPM) market share was greater than 7% in 2003. According to the MSA Report, the NPM Market Share in the year 2005 and subsequently has been less than 7%, and, therefore, the NPM Trapping Event is no longer occurring. Whenever a trapping event exists, the Corporation is required to withhold residual payments to the County until the time that the trapping events have been resolved. Those payments to the County that would have been made on the Residual Certificate would be required to be deposited into a trapping account to the extent required by the Corporation's Indenture.

(Continued)



**ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)**

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**REPORTING THE CORPORATION AS A WHOLE (CONT'D)**

As a result of the issuance of the 2005 Series Bonds, the County relinquished the right to use these monies for anything other than Corporation debt retirement. Since the trapping events were satisfied in 2009, the \$3.6 million in the NYCTT II Trapping account was released and used to make the first payment on the 2005 bonds. Based on the turbo redemption structure of the issue, \$769,000 was used to pay interest and \$2,876,000 was used to redeem \$19,655,000 in principal in 2009.

**Contacting the Corporation's Financial Management**

This financial report is designed to provide to the readers of these financial statements an overview of the Corporation's finances and to show the Corporation's accountability for the money it received. If you have questions about this report or need additional financial information, contact the Corporation's President, James Rowley at 421 Montgomery Street, Syracuse, NY 13202.

**ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION**  
**GOVERNMENTAL FUND BALANCE SHEET/STATEMENT OF NET ASSETS**  
**DECEMBER 31, 2009**

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**ASSETS**

|                                                             | <u>Debt Service<br/>Fund</u> | <u>Adjustments</u>      | <u>Statement of<br/>Net Assets</u> |
|-------------------------------------------------------------|------------------------------|-------------------------|------------------------------------|
| CURRENT ASSETS:                                             |                              |                         |                                    |
| Cash and cash equivalents                                   | \$ 90,558                    | \$ -                    | \$ 90,558                          |
| Investments                                                 | <u>8,618,637</u>             | <u>-</u>                | <u>8,618,637</u>                   |
| Total current assets                                        | 8,709,195                    | -                       | 8,709,195                          |
| <br>BOND ISSUANCE COSTS, net of accumulated<br>amortization | <br>-                        | <br>2,313,514           | <br>2,313,514                      |
| <br>BOND DISCOUNT FEES, net of accumulated<br>amortization  | <br><u>-</u>                 | <br><u>929,472</u>      | <br><u>929,472</u>                 |
| <br>TOTAL                                                   | <br><u>\$ 8,709,195</u>      | <br><u>\$ 3,242,986</u> | <br><u>\$ 11,952,181</u>           |

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## LIABILITIES AND NET ASSETS

|                                     | <u>Debt Service<br/>Fund</u> | <u>Adjustments</u>   | <u>Statement of<br/>Net Assets</u> |
|-------------------------------------|------------------------------|----------------------|------------------------------------|
| <b>CURRENT LIABILITIES:</b>         |                              |                      |                                    |
| Accrued interest payable            | \$ -                         | \$ 458,259           | \$ 458,259                         |
| Bonds payable - due within one year | -                            | <u>685,000</u>       | <u>685,000</u>                     |
| Total current liabilities           | -                            | 1,143,259            | 1,143,259                          |
| <b>LONG-TERM LIABILITIES:</b>       |                              |                      |                                    |
| Bonds payable - due after one year  | -                            | <u>133,212,575</u>   | <u>133,212,575</u>                 |
| Total liabilities                   | -                            | <u>134,355,834</u>   | <u>134,355,834</u>                 |
| <b>FUND BALANCE:</b>                |                              |                      |                                    |
| Reserved for debt service           | 8,618,637                    | (8,618,637)          | -                                  |
| Unreserved - undesignated           | <u>90,558</u>                | <u>(90,558)</u>      | -                                  |
| Total fund balance                  | <u>8,709,195</u>             | <u>(8,709,195)</u>   | -                                  |
| Total liabilities and fund balance  | <u>\$ 8,709,195</u>          |                      |                                    |
| <b>NET DEFICIENCY IN ASSETS:</b>    |                              |                      |                                    |
| Restricted for debt service         |                              | 8,618,637            | 8,618,637                          |
| Unrestricted net deficit            |                              | <u>(131,022,290)</u> | <u>(131,022,290)</u>               |
| Total net deficit                   |                              | <u>(122,403,653)</u> | <u>(122,403,653)</u>               |
| <b>TOTAL</b>                        |                              | <u>\$ 3,242,986</u>  | <u>\$ 11,952,181</u>               |

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See Notes to Financial Statements

**ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION**  
**STATEMENT OF GOVERNMENTAL FUND REVENUES, EXPENDITURES AND CHANGE**  
**IN FUND BALANCE/STATEMENT OF ACTIVITIES**  
**FOR THE YEAR ENDED DECEMBER 31, 2009**

|                                                              | <u>Debt Service<br/>Fund</u> | <u>Adjustments</u>      | <u>Statement of<br/>Activities</u> |
|--------------------------------------------------------------|------------------------------|-------------------------|------------------------------------|
| <b>OPERATING REVENUES:</b>                                   |                              |                         |                                    |
| Tobacco settlement proceeds                                  | \$ 7,806,998                 | \$ -                    | \$ 7,806,998                       |
| Interest income                                              | 506,614                      | -                       | 506,614                            |
| Total operating revenues                                     | <u>8,313,612</u>             | <u>-</u>                | <u>8,313,612</u>                   |
| <b>OPERATING EXPENSES:</b>                                   |                              |                         |                                    |
| Insurance expense                                            | 4,508                        | -                       | 4,508                              |
| Audit fee                                                    | 5,630                        | -                       | 5,630                              |
| Legal fees                                                   | 3,250                        | -                       | 3,250                              |
| Trustee fee                                                  | 7,557                        | -                       | 7,557                              |
| Administrative agency fee                                    | 29,938                       | -                       | 29,938                             |
| Rating agency fee                                            | 18,251                       | -                       | 18,251                             |
| General and administrative costs                             | 28,126                       | -                       | 28,126                             |
| Amortization expense                                         | -                            | 88,770                  | 88,770                             |
| Principal                                                    | 5,356,706                    | (5,356,706)             | -                                  |
| Interest                                                     | 6,298,984                    | 1,635,094               | 7,934,078                          |
| Total operating expenses                                     | <u>11,752,950</u>            | <u>(3,632,842)</u>      | <u>8,120,108</u>                   |
| <b>EXCESS (DEFICIENCY) OF REVENUES<br/>OVER EXPENDITURES</b> | (3,439,338)                  | 3,632,842               | -                                  |
| <b>DECREASE IN NET DEFICIT</b>                               |                              |                         | 193,504                            |
| <b>FUND BALANCE/NET DEFICIT -<br/>BEGINNING OF YEAR</b>      | <u>12,148,533</u>            | <u>(134,745,690)</u>    | <u>(122,597,157)</u>               |
| <b>FUND BALANCE/NET DEFICIT -<br/>END OF YEAR</b>            | <u>\$ 8,709,195</u>          | <u>\$ (131,112,848)</u> | <u>\$ (122,403,653)</u>            |

See Notes to Financial Statements

**ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2009**

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**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The financial statements of the Onondaga Tobacco Asset Securitization Corporation have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to governmental units. Those principles are prescribed by the Governmental Accounting Standards Board (GASB), which is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

**Reporting Entity**

The Onondaga Tobacco Asset Securitization Corporation (the "Corporation") is a Not-For-Profit Local Development Corporation under Section 1411 of the Not-For-Profit Corporation Law of the State of New York. The Corporation was established on July 3, 2001 and became active August 8, 2001.

The Corporation is primarily dependent on the future proceeds from the Tobacco Settlement Rights to meet future obligations under the indenture agreement. The collections of the Corporation will be comprised of TSRs remaining after payment on prior bonds and earnings on funds held by the trust.

The Corporation was formed to acquire from the County of Onondaga all future rights, title and interest in the Tobacco Settlement Revenues (TSRs) under the Master Settlement Agreement (MSA) with respect to tobacco related litigation among various states and participating manufacturers. The County's future right, title and interest in the TSRs has been pledged to repay the serial bonds issued by the Corporation. The County is the beneficial owner of the Trust and thus the funds received by the Trust will ultimately transfer to the County.

The Corporation is classified as a special purpose government under GASB Statement No. 14. A special purpose government is defined as a legally separate entity that performs only one activity. Although legally separate from the County, the Corporation is a component unit of the County, and accordingly, is included in the County's financial statements as a blended component unit.

**Basis of Presentation**

The Corporation is classified as a single-program special-purpose government. Consistent with Appendix C of GASB No. 34, the fund and government-wide financial statements are presented together and include a reconciliation of the individual line items between the two statement types in a separate column.

**ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2009**

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**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)**

**Basis of Presentation (Cont'd)**

**Government-Wide Statements**

The statement of net assets and statement of activities present financial information about the Corporation's governmental activities. These statements include the financial activities of the Corporation.

**Fund Financial Statements**

The fund financial statements provide information about the Corporation's fund. The emphasis of fund financial statements is on major governmental funds.

The Corporation reports the debt service fund as its major governmental fund. This fund is used to account for and report on the accumulation of resources to be used for redemption of general long-term indebtedness and supports the operations of the Corporation.

**Measurement Focus and Basis of Accounting**

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash transaction takes place.

The fund statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. The Corporation considers all revenues reported in the governmental funds to be available if the revenues are collected within 60 days after the end of the fiscal year. Liabilities expected to be paid in more than twelve months are considered to be long-term liabilities.

Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt which are recognized as expenditures to the extent they have matured. Proceeds of general long-term debt are reported as other financing resources.

**Fund Balance Reserve**

In the fund financial statements, the reserve for debt service is used to account for and report on the accumulation of resources to be used for redemption of general long-term indebtedness and supports the operations of the Corporation.

**ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2009**

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**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)**

**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. Significant estimates made by the Corporation in determination of recorded assets and liabilities include, but are not limited to, allowances for receivables and useful lives. Actual results could differ from these estimates.

**Cash and Cash Equivalents**

The Corporation considers all short-term instruments purchased with original maturities of three months or less to be cash equivalents.

**Income Tax Status**

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

**2. EXPLANATION OF CERTAIN DIFFERENCES BETWEEN FUND STATEMENT AND GOVERNMENT-WIDE STATEMENT**

Due to the differences in the measurement focus and basis of accounting used in the fund statement and the government-wide statement, certain financial transactions are treated differently. The basic financial statements contain a full reconciliation of these items. The differences result primarily from the economic focus on the statement of activities, compared with the current financial resources focus on the statement of governmental fund revenue, expenditures and change in fund balance.

**Total Fund Balances of the Fund Statement versus Net Assets of Government-Wide Statement**

Total fund balances of the Corporation's fund statement differs from net assets of government-wide statement reported in the statement of net assets. This difference primarily results from the additional long-term economic focus on the statement of net assets versus the solely current financial resources focus on the fund balance sheet.

**ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2009**

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**2. EXPLANATION OF CERTAIN DIFFERENCES BETWEEN FUND STATEMENT AND GOVERNMENT-WIDE STATEMENT (CONT'D)**

Explanation of differences between the Governmental Fund Balance Sheet and the Statement of Net Assets:

|                                  |              |
|----------------------------------|--------------|
| Fund Balance - Governmental Fund | \$ 8,709,195 |
|----------------------------------|--------------|

The costs associated with the Series 2001 and 2005 Bond issues are reported as expenditures in the year they are incurred. This is also the case with the discount on the Series 2001 Bond issue. As a result, these are not recorded as assets on the balance sheet. However, the statement of net assets includes those costs and discount fees among the assets of the Corporation, and their original costs are expensed annually over the life of the related debt. The balances at December 31, 2009 are:

|                                 |                  |
|---------------------------------|------------------|
| Original cost of bond issuances | \$ 2,923,366     |
| Less: Accumulated amortization  | <u>609,852</u>   |
| Net cost of bond issuances      | <u>2,313,514</u> |

|                                    |                |
|------------------------------------|----------------|
| Original cost of bond discount fee | 1,298,952      |
| Less: Accumulated amortization     | <u>369,480</u> |
| Net cost of bond discount fee      | <u>929,472</u> |

|                                                        |           |
|--------------------------------------------------------|-----------|
| Total net cost of bond issuances and bond discount fee | 3,242,986 |
|--------------------------------------------------------|-----------|

|                                                                                                                                                                         |               |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|
| Bonds payable are reported in the statement of net assets, but not in the governmental fund – balance sheet because they are not due and payable in the current period. | (133,897,575) |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|

|                                                                                                                                                                |                  |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------|
| Accrued interest payable is reported in the statement of net assets, but not in the governmental fund because it is not due and payable in the current period. | <u>(458,259)</u> |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------|

|                                           |                                |
|-------------------------------------------|--------------------------------|
| Net deficit of government-wide activities | <u><u>\$ (122,403,653)</u></u> |
|-------------------------------------------|--------------------------------|



**ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2009**

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**2. EXPLANATION OF CERTAIN DIFFERENCES BETWEEN FUND STATEMENT AND GOVERNMENT-WIDE STATEMENT (CONT'D)**

**Statement of Governmental Fund Revenues, Expenditures and Change in Fund Balance Versus Statement of Activities**

Differences between the statement of governmental fund revenues, expenditures and changes in fund balance and the statement of activities fall into one of three broad categories. The amounts shown below represent:

|                                                                                                                                                                                                                                                                                          |                       |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|
| Deficiency of revenues over expenditures                                                                                                                                                                                                                                                 | <u>\$ (3,439,338)</u> |
| The amount charged to amortization expense in the current year for bond issuance costs and bond discount fees are expenses in the statement of activities, whereas in governmental fund financial statements expenditures for the total amounts were recorded in the year when incurred. | (88,770)              |
| Repayment of bond principal is an expenditure in the governmental fund financial statements but it reduces long-term liabilities in the statement of net assets, and does not affect the statement of activities.                                                                        | 5,356,706             |
| In the statement of activities, interest is accrued on outstanding bonds, whereas in governmental fund financial statements interest expenditures are reported when due.                                                                                                                 | <u>(1,635,094)</u>    |
| Total adjustment between statements of governmental fund revenue, expenditures and changes in fund balances and the statement of activities.                                                                                                                                             | <u>3,632,842</u>      |
| Change in net deficit - statement of activities                                                                                                                                                                                                                                          | <u>\$ 193,504</u>     |

**ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2009**

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**3. CASH AND CASH EQUIVALENTS**

At December 31, 2009, the carrying amount and the bank balance on the Corporation's deposits totaled \$90,558. These monies are on deposit with a FDIC-insured commercial bank located within Onondaga County.

**4. INVESTMENTS**

**Investments**

Investments are reported at fair market value. The Corporation's trustee holds investments for the funds included in the financial statements. The Corporation invests in authorized investments as described in the bond resolution such as commercial paper or finance company paper; special time deposit accounts; certificates of deposit and obligations of the United States of America.

All investments are insured, registered or held by the Corporation's trustee in the Corporation's name.

A trustee holds the Corporation's investments in the following accounts:

**Debt Service Account**

This is the account from which payments to bondholders are made with money transferred in from the collection account.

**Liquidity Reserve Account**

This reserve has been established pursuant to the Corporation's indenture and was initially funded in an amount equal to the maximum annual debt service on the Series 2001 Bonds. Amounts exceeding the reserve requirement will be transferred to the debt service account and will be available to make flexible amortization bond payments.

**Collection Account**

This account has been established to receive the Tobacco Settlement Revenues under the MSA agreement. The monies received in this account will be transferred to the debt service account to pay the Corporation's bondholders.

**ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS**  
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**4. INVESTMENTS (CONT'D)**

At December 31, 2009, investments are stated at fair value, which approximate cost, and consist of the following:

|                             |                     |
|-----------------------------|---------------------|
| Cash and Money Market Funds | \$ 239,049          |
| Commercial Paper            | <u>8,379,588</u>    |
| Total                       | <u>\$ 8,618,637</u> |

**5. BOND ISSUANCE COSTS AND DISCOUNT FEES**

The Corporation has incurred issuance costs and discount fees associated with the Series 2005 and Series 2001 Bond issues. As is stated previously in the notes to the financial statements, these costs are expensed as incurred in the Corporation's fund financial statements. Such costs and discount fees are deferred and amortized over the life of related debt in the government-wide statements. Balances at December 31, 2009 are as follows:

|                                   | <b>2005 Series</b>    | <b>2001 Series</b>    |                      |
|-----------------------------------|-----------------------|-----------------------|----------------------|
|                                   | <u>Issuance Costs</u> | <u>Issuance Costs</u> | <u>Discount Fees</u> |
| Cost                              | \$ 836,558            | \$ 2,086,808          | \$ 1,298,952         |
| Less: Accumulated<br>Amortization | <u>16,270</u>         | <u>593,582</u>        | <u>369,480</u>       |
| Net                               | <u>\$ 820,288</u>     | <u>\$ 1,493,226</u>   | <u>\$ 929,472</u>    |

Amortization charged to expense in 2009 for bond issuance costs and discount fees was \$60,955 and \$27,815, respectively.

**6. LONG-TERM LIABILITIES**

On August 8, 2001, the Corporation along with six other counties created a trust known as New York Counties Tobacco Trust II (NYCTT II). The trust issued \$215,220,000 in aggregate principal Tobacco Settlement Pass-Through Bonds Series 2001. The Corporation issued \$111,470,000 in variable rate bonds bearing interest rates ranging from 5%-6%. The debt is payable solely from and secured by pledged Tobacco Settlement Rights and investment earnings on amounts on deposit.

(Continued)

**ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2009**

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**6. LONG-TERM LIABILITIES (CONT'D)**

On November 29, 2005 the Corporation along with twenty-three other counties created a New York Counties Tobacco Trust V(NXCTT V) to issue \$199,375,348 in aggregate principal Tobacco Settlement Pass-Through Bond-Series 2005. Series 2005 NYCTT Bonds represent a direct, pass-through interest in corresponding TASC bonds held by the trust and are subordinate to the 2001 Series bonds. The debt is payable from pledged Tobacco Settlement Rights and investment earnings on amounts on deposit. The Series 2005 Bonds are also payable from certain amounts released from Liquidity Reserve Accounts upon retirement of the prior bonds and amounts released from the Trapping Account. The Corporation's share of these capital appreciation bonds are \$700,630,000 variable rate bonds with a face value of \$700,630,000, bond issuance costs of \$836,558 and a distribution to the County of \$30,565,586. The bonds bear interest at rates ranging from 6.00% to 7.15%. During 2009, interest of \$2,490,579 accreted and interest of \$768,745 was remitted on these bonds. There are no scheduled principal or interest payments on the Series 2005 bonds outside of their final maturity dates. The bonds are subject to potential redemption prior to maturity through turbo redemption payments made from surplus collections on deposit with the Corporation. Redemption will take place in order of maturity date at their accreted value.

In 2009 the R.J. Reynolds bonds, which served as backing on the 2005 series bonds, rose to above investment grade. On December 31, 2009 because the Corporation had securitized residuals, a payment was triggered from the Trapping Account in the amount of \$3,645,451. This payment was allocated to principal in the amount of \$2,876,706 and \$768,745 in interest. The payment resulted in a reduction in par value of \$19,655,000.

The following is a summary of the Corporation's bonds payable for the year ended December 31, 2009:

|                                              | Issue<br>Date | Final<br>Maturity | Interest<br>Rate | Balance<br>December 31, 2009 |
|----------------------------------------------|---------------|-------------------|------------------|------------------------------|
| Tobacco Settlement Pass - through Bonds 2001 | 8/01          | 6/43              | 5.0 - 6.0%       | <u>\$ 96,835,000</u>         |
| Tobacco Settlement Pass - through Bonds 2005 | 11/05         | 6/60              | 6.0 - 7.15%      | 28,525,438                   |
| Add: interest accretion                      |               |                   |                  | <u>8,537,137</u>             |
| Carrying Value of Series 2005 Bonds          |               |                   |                  | <u>\$ 37,062,575</u>         |

**ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2009**

**6. LONG-TERM LIABILITIES (CONT'D)**

Long-term liability balances and activity for the year are summarized below:

|                                              | Beginning<br>Balance | Issued              | Redeemed             | Ending<br>Balance    | Amounts Due<br>Within One Year |
|----------------------------------------------|----------------------|---------------------|----------------------|----------------------|--------------------------------|
| Bonds payable 2001                           | \$ 99,315,000        | \$ -                | \$(2,480,000)        | \$ 96,835,000        | \$ 685,000                     |
| Bonds payable 2005                           | <u>31,402,144</u>    | <u>-</u>            | <u>(2,876,706)</u>   | <u>28,525,438</u>    | <u>-</u>                       |
| Subtotal                                     | 130,717,144          | -                   | (5,356,706)          | 125,360,438          | 685,000                        |
| Add: Accreted interest                       | <u>6,890,611</u>     | <u>2,415,271</u>    | <u>(768,745)</u>     | <u>8,537,137</u>     | <u>-</u>                       |
| Total bonds payable<br>and accreted interest | <u>\$137,607,755</u> | <u>\$ 2,415,271</u> | <u>\$(6,125,451)</u> | <u>\$133,897,575</u> | <u>\$ 685,000</u>              |

The Corporation's required principal and interest payments at December 31, 2009, on the Series 2001 bonds are as follows:

|           | <b>Series 2001</b>   |                      |                      |
|-----------|----------------------|----------------------|----------------------|
|           | Principal            | Interest             | Total                |
| 2010      | \$ 685,000           | \$ 6,127,744         | \$ 6,812,744         |
| 2011      | 770,000              | 6,087,731            | 6,857,731            |
| 2012      | 860,000              | 6,041,831            | 6,901,831            |
| 2013      | 945,000              | 5,989,938            | 6,934,938            |
| 2014      | 1,005,000            | 5,933,875            | 6,938,875            |
| 2015-2019 | 8,640,000            | 28,529,919           | 37,169,919           |
| 2020-2024 | 15,365,000           | 25,236,014           | 40,601,014           |
| 2025-2029 | 17,365,000           | 20,793,658           | 38,158,658           |
| 2030-2034 | 17,420,000           | 15,859,438           | 33,279,438           |
| 2035-2039 | 22,215,000           | 10,431,137           | 32,646,137           |
| 2040-2043 | <u>11,565,000</u>    | <u>2,175,944</u>     | <u>13,740,944</u>    |
| Total     | <u>\$ 96,835,000</u> | <u>\$133,207,229</u> | <u>\$230,042,229</u> |

Depending on the extent of actual collections from TSR payments and availability of funds, the Corporation has agreed to make principal payments in accordance with a Super Sinker payment schedule that allows for increased payments and a final maturity of December 31, 2028 on the Series 2001 Bonds.

**ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2009**

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**6. LONG-TERM LIABILITIES (CONT'D)**

Under the Super Sinker payment schedule, the Corporation's payments at December 31, 2009, on the Bonds are as follows:

|           | <b>Series 2001</b>   |                     |                      |
|-----------|----------------------|---------------------|----------------------|
|           | <b>Principal</b>     | <b>Interest</b>     | <b>Total</b>         |
| 2010      | \$ 2,645,000         | \$ 5,395,631        | \$ 8,040,631         |
| 2011      | 2,900,000            | 5,248,256           | 8,148,256            |
| 2012      | 3,100,000            | 5,087,644           | 8,187,644            |
| 2013      | 3,295,000            | 4,915,263           | 8,210,263            |
| 2014      | 3,525,000            | 4,731,363           | 8,256,363            |
| 2015-2019 | 22,165,000           | 20,313,098          | 42,478,098           |
| 2020-2024 | 32,375,000           | 12,548,301          | 44,923,301           |
| 2025-2028 | <u>26,830,000</u>    | <u>2,689,275</u>    | <u>29,519,275</u>    |
| Total     | <u>\$ 96,835,000</u> | <u>\$60,928,831</u> | <u>\$157,763,831</u> |

The Series 2005 Bonds are capital appreciation bonds, upon which the investment return on the investment principal is reinvested at a compounded rate until maturity. There are no scheduled principal and interest payments on these bonds other than their respective maturity dates, at which time a single payment is made representing principal and investment return. Such payments are as follows:

|                                              | <b>Principal</b>     | <b>Interest</b>      | <b>Total</b>         |
|----------------------------------------------|----------------------|----------------------|----------------------|
| Series 2005 S1 payable in full June 1, 2038  | \$ 6,127,360         | \$ 34,716,541        | \$ 40,843,901        |
| Series 2005 S2 payable in full June 1, 2050  | 9,604,046            | 126,233,419          | 135,837,465          |
| Series 2005 S3 payable in full June 1, 2055  | 4,963,972            | 130,489,928          | 135,453,900          |
| Series 2005 S4A payable in full June 1, 2060 | <u>7,830,060</u>     | <u>342,240,767</u>   | <u>350,070,827</u>   |
| Total                                        | <u>\$ 28,525,438</u> | <u>\$633,680,655</u> | <u>\$662,206,093</u> |

Depending on the extent of actual collections from TSR payments available after payment on the Series 2001 Bonds, the Corporation has agreed to make principal payments in accordance with a turbo redemption payment schedule that allows for increased payments and a final maturity of June 1, 2033 on the Series 2005 Bonds.

**ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2009**

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**6. LONG-TERM LIABILITIES (CONT'D)**

The following is a summary of the amount of accretion on the series 2005 capital appreciation bonds assuming the projected debt service amortization:

|                                                | Amount of<br>Yearly<br>Accretion |
|------------------------------------------------|----------------------------------|
| 2010                                           | \$ 2,451,138                     |
| 2011                                           | 2,614,218                        |
| 2012                                           | 2,788,213                        |
| 2013                                           | 2,976,859                        |
| 2014                                           | 3,168,940                        |
| 2015-2019                                      | 19,328,081                       |
| 2020-2024                                      | 26,700,782                       |
| 2025-2029                                      | 36,907,476                       |
| 2030-2034                                      | 51,045,772                       |
| 2035-2039                                      | 65,512,456                       |
| 2040-2044                                      | 82,006,090                       |
| 2044-2049                                      | 114,268,702                      |
| 2050-2054                                      | 111,705,512                      |
| 2055-2060                                      | <u>103,669,279</u>               |
| Future Total Accretion                         | 625,143,518                      |
| Cumulative Accreted Interest December 31, 2009 | 8,537,137                        |
| Principal                                      | <u>28,525,438</u>                |
| Estimated Total Debt Service                   | <u>\$662,206,093</u>             |

**7. CONCENTRATION OF CREDIT RISK**

During 2001, the Corporation purchased the rights to receive TSRs from the County of Onondaga. There are a number of risks associated with receipts of such TSRs, including litigation affecting participating manufacturers and possible bankruptcy as a result thereof, and future adjustments to the calculation of the TSRs. The Corporation's financial existence is contingent upon receiving TSR from the tobacco manufacturers.

**8. RECLASSIFICATION**

Certain amounts reported at December 31, 2008 have been reclassified to conform with the current year presentation. This reclassification had no effect on the net assets/fund balance or change in net assets/fund balance as originally reported.



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**INDEPENDENT AUDITOR'S 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***

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To the Board of Directors  
Onondaga Tobacco Asset Securitization Corporation  
Syracuse, New York

We have audited the financial statements of the Onondaga Tobacco Asset Securitization Corporation as of and for the year ended December 31, 2009 and have issued our report thereon dated March 25, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Onondaga Tobacco Asset Securitization Corporation's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and responses we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.



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 entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described as finding 09-1 in the accompanying schedule of findings and responses to be a material weakness.

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.

#### 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*.

This report is intended solely for the information and use of the Corporation's board of directors and management and is not intended to be and should not be used by anyone other than these specified parties.

*Testone, Marshall + Sucena, LLP*

March 25, 2010  
Syracuse, New York

**ONONDAGA TOBACCO ASSET SECURITIZATION CORPORATION**  
**SCHEDULE OF FINDINGS AND RESPONSES**  
**FOR THE YEAR ENDED DECEMBER 31, 2009**

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**Reference Number:** 09-01

**Criteria:**

Adequate controls over accounting and financial reporting

**Cause/Condition:**

Management does not have a thorough understanding of certain disclosures required by U.S. Generally Accepted Accounting Principles (GAAP).

**Effect:**

The financial statements, as presented by management, may not be in accordance with U.S. GAAP.

**Recommendation:**

Management should explore what resources are available to them to provide the proper training necessary to prepare the financial statements in accordance with U.S. GAAP.

**Management Response:**

Statement on Auditing Standards No. 115 requires significantly stricter comments on internal control matters related to audits of financial statements for periods ending on or after December 15, 2009. Generally speaking, the major emphasis of this new standard requires all internally generated financial statements be presented in accordance with GAAP. OTASC, not unlike many special purpose corporations, has not traditionally presented internal statements in accordance with GAAP. Management recognizes this practice can no longer continue. Prior to this year, we relied on our external auditors to compile statements at year-end in accordance with GAAP. The 2008 audit, performed by a different audit firm, did not identify any deficiencies in internal control over financial reporting that were considered a material weakness. We were unaware of the new standard that applies for 2009. Accordingly, management took no action to present internal financial statements for 2009 in accordance with GAAP. We will work with the current audit firm to determine the best option available to us to insure our financial statements are prepared in accordance with U.S. GAAP.