

**OSWEGO TOBACCO ASSET
SECURITIZATION CORPORATION**

*(A Component Unit of the County of Oswego, New York)
Basic Financial Statements and Required
Supplementary Information for the
Year Ended December 31, 2014
And Independent Auditors' Reports*

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

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Certified Public Accountants

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Oswego Tobacco Asset Securitization Corporation

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and each major fund of the Oswego Tobacco Asset Securitization Corporation (the "OTASC"), a component unit of the County of Oswego, New York, as of and for the year ended December 31, 2014, and the related notes to the financial statements, which collectively comprise the OTASC's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

OTASC's 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.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States 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 auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, and each major fund of OTASC, as of December 31, 2014, and the respective changes in its financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 2 to the financial statements, OTASC has restated its General Fund fund balance as of December 31, 2013. 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 the Management's Discussion and Analysis, as listed in the table of contents, 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 23, 2015 on our consideration of OTASC'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 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 OTASC's internal control over financial reporting and compliance.



March 23, 2015

OSWEGO TOBACCO ASSET SECURITIZATION CORPORATION
(A Component Unit of the County of Oswego, New York)
Management's Discussion and Analysis
Year Ended December 31, 2014

As management of the Oswego Tobacco Asset Securitization Corporation ("OTASC"), a blended component unit of the County of Oswego (the "County"), we offer readers of OTASC's financial statements this narrative overview and analysis of the financial activities of OTASC for the fiscal year ended December 31, 2014. For comparative purposes, certain items relating to the December 31, 2013 presentation have been reclassified. This document should be read in conjunction with additional information that we have furnished in OTASC's financial statements, which follow this narrative.

Financial Highlights

- ◆ Total government-wide liabilities of OTASC exceeded government-wide assets by \$9,005,734 at December 31, 2014. This compares to total government-wide liabilities of OTASC exceeding government-wide assets by \$10,250,583 at December 31, 2013.
- ◆ OTASC's net position increased by \$1,244,849 for the year ended December 31, 2014. This increase in OTASC's net position was largely due to tobacco settlement revenue outpacing expense requirements during the year.
- ◆ At the close of the current year, OTASC's governmental funds reported combined fund balances of \$1,705,958, a decrease of \$27,928 in comparison with the prior year, as restated. Approximately 3.1% of this amount, \$52,531, is available for spending at OTASC's discretion (unassigned fund balance).
- ◆ OTASC's total bonds payable decreased by \$1,145,000 during the year ended December 31, 2014 as a result of principal payments made during the year.

Overview of the Financial Statements

This discussion and analysis are intended to serve as an introduction to the OTASC's basic financial statements. OTASC's basic financial statements comprise of three components: 1) government-wide financial statements, 2) fund financial statements and 3) notes to the financial statements.

Government-wide financial statements—The *government-wide financial statements* are designed to provide readers with a broad overview of OTASC's finances, in a manner similar to a private-sector business.

The *statement of net position* presents information on all OTASC's assets, liabilities, and deferred inflows/outflows of resources, with the difference reported as *net position*. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of OTASC is improving or deteriorating.

The *statement of activities* presents information showing how OTASC'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.

The government-wide financial statements can be found on pages 8-9 of this report.

Fund financial statements—A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. OTASC, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Both of OTASC’s funds are classified as governmental funds.

Governmental funds—*Governmental funds* are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating a government’s near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government’s near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

OTASC maintains two individual governmental funds, the General Fund and the Debt Service Fund. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balance for the both funds.

The basic governmental fund financial statements can be found on pages 10-13 of this report.

Notes to the financial statements—The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 14-22 of this report.

Government-Wide Overall Financial Analysis

As noted earlier, net position may serve over time as a useful indicator of a government’s financial position. In the case of OTASC, liabilities exceeded assets by \$9,005,734 at December 31, 2014, as compared to \$10,250,583 at December 31, 2013. Table 1, shown on the following page, presents the condensed statements of net position (deficit) for OTASC at December 31, 2014 and December 31, 2013.

Table 1—Condensed Statements of Net Position

	December 31,	
	2014	2013
Current assets	\$ 3,626,321	\$ 3,472,208
Total assets	<u>3,626,321</u>	<u>3,472,208</u>
Current liabilities	64,975	69,296
Noncurrent liabilities	<u>12,567,080</u>	<u>13,653,495</u>
Total liabilities	<u>12,632,055</u>	<u>13,722,791</u>
Net position	<u>\$ (9,005,734)</u>	<u>\$ (10,250,583)</u>

A portion of OTASC's net position, \$1,653,427, represents resources that are subject to external restrictions on how they may be used. The resulting deficit net position of \$(10,659,161) is considered to be unrestricted.

At December 31, 2014, total OTASC assets were \$3,626,321; and, \$3,472,208 at December 31, 2013. The largest asset held by OTASC for both years was tobacco settlement revenues receivable. OTASC had no noncurrent assets at December 31, 2014 and December 31, 2013.

OTASC's liabilities totaled \$12,632,055 at December 31, 2014; and, \$13,722,791 at December 31, 2013. The largest portion of the liabilities is net bonds payable totaling \$12,567,080 and \$13,653,495 at December 31, 2014 and 2013, respectively.

Governmental Activities—During the current year, net position for governmental activities increased \$1,244,849 from the prior fiscal year for an ending deficit balance of \$(9,005,734). The statement of activities presents revenues received and expenses paid by OTASC. Presented as Table 2, is the condensed statement of activities for the years ended December 31, 2014 and 2013.

Table 2—Condensed Statements of Activities

	Year Ended December 31,	
	2014	2013
General revenues	\$ 2,153,410	\$ 1,827,318
Expenses—governmental activities	(903,561)	(950,106)
Transfer to County	<u>(5,000)</u>	<u>(5,000)</u>
Change in net assets	1,244,849	872,212
Net position—beginning	<u>(10,250,583)</u>	<u>(11,122,795)</u>
Net position—ending	<u>\$ (9,005,734)</u>	<u>\$ (10,250,583)</u>

Total revenues for the years ended December 31, 2014 and 2013 were \$2,153,410 and \$1,827,318, respectively. The net increase in revenues of \$326,092 is primarily due to the increase in tobacco settlement revenues in 2014. Revenues for the years ended December 31, 2014 and 2013 consisted of \$2,076,258 (96.4%) and \$1,751,232 (95.8%), respectively, of tobacco settlement revenues, \$77,152 and \$76,086, respectively, of interest and net earnings from investments.

During the fiscal year ended December 31, 2014, OTASC received increased tobacco settlement revenues as a result of the settlement of a lawsuit disputing MSA payments in sales years 2003 through 2012. The lawsuit was brought about by Participating Manufactures (tobacco companies) on the basis that certain settling states, including New York State, did not diligently enforce their respective Qualifying Statutes in each of those years. The Arbitration Panel determined that New York State diligently enforced its Qualifying Statutes during sales year 2003 and therefore is not subject to the NPM Adjustment for 2003 pursuant to the MSA.

A summary of sources of revenues for the years ended December 31, 2014 and December 31, 2013 is presented below in Table 3.

Table 3—Sources of revenues

	Year Ended December 31,		Increase/(Decrease)	
	2014	2013	Dollars	Percent (%)
Tobacco settlement revenues	\$ 2,076,258	\$ 1,751,232	\$ 325,026	18.6 %
Interest and net earnings from investments	77,152	76,086	1,066	1.4 %
Total revenues	<u>\$ 2,153,410</u>	<u>\$ 1,827,318</u>	<u>\$ 326,092</u>	17.8 %

Total expenses for the years ended December 31, 2014 and 2013 were \$903,561 and \$950,106, respectively. Expenses for the years ended December 31, 2014 and 2013 primarily consisted of \$852,726 (94.4%) and \$911,065 (95.9%), respectively, of interest and fiscal charges, and \$50,835 and \$39,041, respectively, of general government support expenses incurred in connection with the operations of OTASC.

A summary of operating expenses for the years ended December 31, 2014 and December 31, 2013 is presented below in Table 4.

Table 4—Operating expenses

	December 31,		Increase/(Decrease)	
	2014	2013	Dollars	Percent (%)
General government support	\$ 50,835	\$ 39,041	\$ 11,794	30.2 %
Interest and fiscal charges	852,726	911,065	(58,339)	(6.4)%
Total operating expenses	<u>\$ 903,561</u>	<u>\$ 950,106</u>	<u>\$ (46,545)</u>	(4.9)%

Financial Analysis of Governmental Funds

As noted earlier, OTASC uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds—The focus of OTASC’s governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing OTASC’s financing requirements. In particular, unassigned fund balance may serve as a useful measure of a government’s net resources available for discretionary use as they represent the portion of fund balance which has not yet been limited to use for a particular purpose by either an external party, OTASC itself, or a group or individual that has been delegated authority to assign resources for use for particular purposes by OTASC’s Board.

At December 31, 2014, OTASC’s governmental funds reported combined fund balances of \$1,705,958, a decrease of \$27,928 in comparison with the prior year, as restated. Approximately 3.1% of this amount, \$52,531, constitutes unassigned fund balance, which is available for spending at OTASC’s discretion. The remainder of the fund balance, \$1,653,427, is restricted to indicate that it is restricted for a particular purpose.

The General Fund is the chief operating fund of OTASC. At the end of the current fiscal year, total fund balance of the General Fund was unassigned fund balance in the amount of \$52,531. As a measure of the General Fund’s liquidity, it may be useful to compare both unassigned fund balance and total fund balance to total General Fund expenditures. Unassigned fund balance and total fund balance both represent approximately 103.3% of total General Fund expenditures.

The Debt Service Fund, the remaining major governmental fund, had an increase in fund balance during the current year of \$27,907 to bring the year end fund balance to \$1,653,427. The increase results from tobacco settlement revenues and interest earnings outpacing the costs of principal payments and interest expense during the year.

Debt Administration

Long-Term Debt—At the end of the current fiscal year, OTASC had Tobacco Settlement Bonds outstanding of \$12,860,000. During the year ended December 31, 2014, OTASC made principal payments of \$1,145,000 on its Tobacco Settlement Bonds.

Request for Information

This financial report is designed to provide a general overview of OTASC’s finances for all those with an interest in OTASC’s finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Oswego Tobacco Asset Securitization Corporation Secretary/Treasurer, 46 East Bridge Street, Oswego, New York, 13126.

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BASIC FINANCIAL STATEMENTS

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OSWEGO TOBACCO ASSET SECURITIZATION CORPORATION
(A Component Unit of the County of Oswego, New York)
Statement of Net Position
December 31, 2014

	<u>Primary Government Governmental Activities</u>
ASSETS	
Current assets:	
Cash and cash equivalents	\$ 106,477
Investments	1,600,825
Interest receivable	64,132
Due from New York State	<u>1,854,887</u>
Total assets	<u>3,626,321</u>
 LIABILITIES	
Current liabilities:	
Accounts payable	1,344
Accrued interest payable	63,631
Noncurrent liabilities:	
Due within one year—net bonds payable	4,621,415
Due in more than one year—net bonds payable	<u>7,945,665</u>
Total liabilities	<u>12,632,055</u>
 NET POSITION	
Restricted for debt service	1,653,427
Unrestricted	<u>(10,659,161)</u>
Total net position	<u>\$ (9,005,734)</u>

The notes to the financial statements are an integral part of this statement.

OSWEGO TOBACCO ASSET SECURITIZATION CORPORATION
(A Component Unit of the County of Oswego, New York)
Statement of Activities
Year Ended December 31, 2014

Functions/Programs	Expenses	Program Revenues	Net (Expenses) and Changes in Net Position
			Primary Governmental Activities
Primary government			
General government support	\$ 50,835	\$ -	\$ (50,835)
Interest and fiscal charges	<u>852,726</u>	<u>-</u>	<u>(852,726)</u>
Total primary government	<u>903,561</u>	<u>-</u>	<u>(903,561)</u>
General revenues:			
Tobacco settlement revenue			2,076,258
Interest earnings			77,152
Transfer to County			<u>(5,000)</u>
Total general revenues and transfer			<u>2,148,410</u>
Change in net position			<u>1,244,849</u>
Net position—beginning			<u>(10,250,583)</u>
Net position—ending			<u>\$ (9,005,734)</u>

The notes to the financial statements are an integral part of this statement.

OSWEGO TOBACCO ASSET SECURITIZATION CORPORATION
(A Component Unit of the County of Oswego, New York)
Balance Sheet—Governmental Funds
December 31, 2014

	General	Debt Service	Total
ASSETS			
Cash and cash equivalents	\$ 53,875	\$ 52,602	\$ 106,477
Investments	-	1,600,825	1,600,825
Total assets	53,875	1,653,427	1,707,302
LIABILITIES			
Accounts payable	\$ 1,344	-	\$ 1,344
Total liabilities	1,344	-	1,344
FUND BALANCES			
Restricted for debt service	-	1,653,427	1,653,427
Unassigned	52,531	-	52,531
Total fund balances	52,531	1,653,427	1,705,958
Total liabilities and fund balances	\$ 53,875	\$ 1,653,427	\$ 1,707,302

The notes to the financial statements are an integral part of this statement.

OSWEGO TOBACCO ASSET SECURITIZATION CORPORATION
(A Component Unit of the County of Oswego, New York)
Reconciliation of the Balance Sheet—Governmental Funds
to the Government-wide Statement of Net Position
December 31, 2014

Amounts reported for governmental activities in the statement of net position (page 8) are different because:

Total fund balance—governmental funds (page 10)		\$ 1,705,958
Other long-term assets are not available to pay for current period expenditures and, therefore, are not reported in the funds.		1,919,019
Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the funds. The effects of these items are:		
Accrued interest payable	\$ (63,631)	
Discount on bonds payable	292,920	
Bonds payable	<u>(12,860,000)</u>	<u>(12,630,711)</u>
Net position of governmental activities		<u>\$ (9,005,734)</u>

The notes to the financial statements are an integral part of this statement.

OSWEGO TOBACCO ASSET SECURITIZATION CORPORATION
(A Component Unit of the County of Oswego, New York)
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
Year Ended December 31, 2014

	General	Debt Service	Total
REVENUES			
Tobacco settlement revenue	\$ -	\$ 1,896,371	\$ 1,896,371
Interest earnings	-	76,342	76,342
Total revenues	-	1,972,713	1,972,713
EXPENDITURES			
Current:			
General government	50,835	-	50,835
Debt service:			
Principal	-	1,145,000	1,145,000
Interest	-	799,806	799,806
Total expenditures	50,835	1,944,806	1,995,641
Excess (deficiency) of revenues over expenditures	(50,835)	27,907	(22,928)
OTHER FINANCING USES			
Transfer to County	(5,000)	-	(5,000)
Total other financing uses	(5,000)	-	(5,000)
Net change in fund balances	(55,835)	27,907	(27,928)
Fund balances—beginning, as restated	108,366	1,625,520	1,733,886
Fund balances—ending	\$ 52,531	\$ 1,653,427	\$ 1,705,958

The notes to the financial statements are an integral part of this statement.

OSWEGO TOBACCO ASSET SECURITIZATION CORPORATION
(A Component Unit of the County of Oswego, New York)
Reconciliation of the Statement of Revenues, Expenditures and Changes in
Fund Balances—Governmental Funds to the Government-wide Statement of Activities
Year Ended December 31, 2014

Amounts reported for governmental activities in the statement of activities (page 9) are different because:

Net change in fund balances—total governmental funds (page 12)	\$ (27,928)
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Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.	180,697
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The issuance of long-term debt provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net position. Also, governmental funds report the effect of premiums, discounts and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities. Additionally, in the statement of activities, certain operating expenses are measured by the amounts earned during the year. In the governmental funds, however, expenditures for these items are measured by the amount of financial resources used (essentially, the amounts actually paid). The net effect of these differences in the treatment of long-term debt and the related items is as follows:

	\$ 5,665	
Accrued interest payable	(58,585)	
Discount on bonds payable	1,145,000	1,092,080
Bonds payable		
Change in net position of governmental activities		\$ 1,244,849

The notes to the financial statements are an integral part of this statement.

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OSWEGO TOBACCO ASSET SECURITIZATION CORPORATION
(A Component Unit of the County of Oswego, New York)
Notes to the Financial Statements
December 31, 2014

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basic financial statements of the Oswego Tobacco Asset Securitization Corporation (“OTASC”) have been prepared in conformity with accounting principles generally accepted in the United States of America applied to government units. The Governmental Accounting Standards Board (“GASB”) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The more significant of OTASC’s accounting policies are described below.

Description of Government-Wide Financial Statements

The government-wide financial statements (i.e., statement of net position and the statement of changes in net position) report information on all the nonfiduciary activities of OTASC. All fiduciary activities are reported only in the fund financial statements. *Governmental activities*, which are normally supported by taxes, intergovernmental revenues, and other nonexchange transactions, are reported separately from *business-type activities*, which rely to a significant extent on fees and charges for support. OTASC reports no business-type activities.

Reporting Entity

OTASC is a special purpose, bankruptcy remote, local development corporation organized under the Not-for-Profit Corporation Law of the State of New York. OTASC is an instrumentality of, but separate, and apart from the County of Oswego, New York (the “County”). Although legally separate from the County, OTASC is a component unit of the County. Based on the nature and significance of OTASC’s relationship with the County and the criteria set forth by GASB, OTASC is included within the County basic financial statements as a blended component unit.

The sole Member of OTASC is the Chairman of the Board of Legislators of the County of Oswego, New York. The Member is also a member of the Board of Directors of OTASC. The Board of Directors of OTASC has five members.

The OTASC was incorporated in 2003 for the purpose of issuing Asset Backed Bonds in order to provide funds to purchase from the County certain of the County’s right, title and interest under the Master Settlement Agreement (the “MSA”) and the Consent Decree and Final Judgment (the “Decree”) as described herein.

The MSA was entered into on November 23, 1998, among the attorneys general of 46 states (including New York), the District of Columbia, the Commonwealth of Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa and the Territory of the Northern Marianas and for the four largest United States tobacco manufacturers: Philip Morris Incorporated, R.J. Reynolds Tobacco Company, Brown and Williamson Tobacco Company and Lorillard Tobacco Company (collectively the “Original Participating Manufacturers” or “OPMs”) in settlement of certain smoking-related litigation and the Decree entered in New York Supreme Court, including the County’s right to receive certain initial and annual payments to be made by the OPMs under the MSA.

Subsequent to the initial sale of the bonds, the County has the right to receive net proceeds of future bond issuances and the revenues of OTASC that are in excess of OTASC's expenses, debt service and contractual obligations, pursuant to the Indenture.

In accordance with the Bond Indenture and to the extent contained in the MSA Report, as of the next distribution date, three trapping events have occurred. One is still occurring, while the others, the NPM Trapping Event and the Downgrade Trapping Event as defined in the Bond Indenture and the Official Statement, respectively, are no longer occurring.

In accordance with the Bond Indenture and to the extent contained in the Master Settlement Agreement ("MSA") Report, a trapping event is occurring. A Consumption Decline Trapping Event occurs when shipments of cigarettes in or to the 50 United States, the District of Columbia and Puerto Rico as measured under the MSA, are less in any year preceding a deposit date than the amount opposite such year under the "Consumption Decline Trapping Event" definition, which number for the year 2013 is 285,975,111,088. According to the MSA Report, the amount shown as relevant shipments for the year 2013 was less than the shipment amount specified above, and therefore, a Consumption Decline Trapping Event has occurred.

Basis of Presentation – Government-Wide Financial Elements

While separate government-wide and fund financial statements are presented, they are interrelated. The governmental activities column incorporates data from governmental funds. Separate financial statements are provided for governmental funds.

Basis of Presentation – Fund Financial Statements

The fund financial statements provide information about OTASC's funds. Separate statements for governmental funds are presented. The emphasis of fund financial statements is on major governmental funds, each displayed in a separate column in the fund financial statements.

OTASC reports the following major governmental funds:

- *General Fund*—The General Fund constitutes the primary operating fund of OTASC and includes all operations not required to be recorded in other funds.
- *Debt Service Fund*—The Debt Service Fund is used to account for the accumulation of resources that are restricted for the payment principal and interest on long-term obligations of governmental funds.

During the course of operations the government has activity between funds for various purposes. Any residual balances outstanding at year end are reported as due from/to other funds and advances to/from other funds. While these balances are reported in fund financial statements, certain eliminations are made in the preparation of the government-wide financial statements. Balances between the funds included in governmental activities are eliminated so that only the net amount is included as internal balances in the governmental activities column.

Further, certain activity occurs during the year involving transfers of resources between funds. In fund financial statements these amounts are reported at gross amounts as transfers in/out. While reported in fund financial statements, certain eliminations are made in the preparation of the government-wide financial statements. Transfers between the funds included in governmental activities are eliminated so that only the net amount is included as transfers in the governmental activities column.

Measurement Focus and Basis of Accounting

The accounting and financial reporting treatment is determined by the applicable measurement focus and basis of accounting. Measurement focus indicates the type of resources being measured such as *current financial resources* or *economic resources*. The basis of accounting indicates the timing of transactions or events for recognition in the financial statements.

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 when a liability is incurred, regardless of the timing of the related cash flows.

Tobacco settlement revenues are exchange transactions, based on the notion that the payments are made to the settling states in exchange for their agreement to release the tobacco companies from present and future litigation. Under the terms of the MSA, the tobacco companies have agreed to make annual payments in perpetuity. The MSA includes a schedule of projected annual base payments, subject to certain adjustments based on future events or circumstances. The most significant factor affecting the annual payments is a *volume adjustment*, which creates a direct relationship between domestic shipments of cigarettes and the annual payments. Based on the MSA, the tobacco companies have no obligation to make settlement payments until cigarettes are shipped.

The event that results in the recognition of an asset and revenue by a settling government is the domestic shipment of cigarettes (sales). Therefore, the OTASC recognizes a receivable and revenue for tobacco settlement revenues when that event occurs. Because annual tobacco settlement revenue payments are based on cigarette sales from the preceding calendar year, the OTASC estimates accrued tobacco settlement revenues that derive from sales from January 1 to their respective fiscal year ends. Under the modified accrual basis of accounting, revenue should be recognized to the extent that the event occurs and resources become *available*.

The governmental fund statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, OTASC considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures are recorded only when the payment is due. Issuance of long-term debt and acquisitions under capital leases are reported as other financing sources.

Interest associated with the current fiscal period is considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Entitlements are recorded as revenues when all eligibility requirements are met, including any time requirements, and the amount is received during the period or within the availability period for this revenue source (within 60 days of year-end). Expenditure-driven grants are recognized as revenue when the qualifying expenditures have been incurred and all other eligibility requirements are met and the amount is received during the period or within the availability period for this revenue source (within 60 days of year-end). All other revenue items are considered to be measurable and available only when cash is received by the OTASC.

Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position/Fund Balance

Cash, cash equivalents and Investments—Cash and cash equivalents consist of cash on hand, demand deposits, time deposits and short-term investments with original maturities of three months or less from the date acquired by OTASC. Investments for OTASC are reported at cost plus interest.

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, *deferred outflows of resources*, represents a consumption of net position that applies to a future period(s) and so will *not* be recognized as an outflow of resources (expense/expenditure) 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, *deferred inflows of resources*, represents an acquisition of net position that applies to a future period(s) and so will *not* be recognized as an inflow of resources (revenue) until that time.

OTASC does not have any deferred outflows or inflows of resources at December 31, 2014.

Net position flow assumption—Sometimes OTASC will fund outlays for a particular purpose from both restricted (e.g., restricted bond proceeds) and unrestricted resources. In order to calculate the amounts to report as restricted – net position and unrestricted – net position in the government-wide financial statements, a flow assumption must be made about the order in which the resources are considered to be applied. It is OTASC’s policy to consider restricted – net position to have been depleted before unrestricted – net position is applied.

Fund balance flow assumption—Sometimes OTASC will fund outlays for a particular purpose from both restricted and unrestricted resources (the total of committed, assigned, and unassigned fund balance). In order to calculate the amounts to report as restricted, committed, assigned, and unassigned fund balance in the governmental fund financial statements a flow assumption must be made about the order in which the resources are considered to be applied. If OTASC must use funds for emergency expenditures it shall expend funds first from funds classified under GASB as nonspendable (if funds become available) then restricted funds. The use of committed and assigned funds as classified by GASB will occur after the exhaustion of available restricted funds. Finally, if no other fund balances are available OTASC will use unassigned fund balance.

Fund balance policies—Fund balance of governmental funds is reported in various categories based on the nature of any limitations requiring the use of resources for specific purposes. OTASC itself can establish limitations on the use of resources through either a commitment (committed fund balance) or an assignment (assigned fund balance).

The committed fund balance classification includes amounts that can be used only for the specific purposes determined by a formal action of OTASC’s highest level of decision-making authority (OTASC Board). The governing board is the highest level of decision-making authority for the government that can, by adoption of an ordinance prior to the end of the fiscal year, commit fund balance. Once adopted, the limitation imposed by the ordinance remains in place until a similar action is taken (the adoption of another ordinance) to remove or revise the limitation.

Amounts in the assigned fund balance classification are intended to be used by the government for specific purposes but do not meet the criteria to be classified as committed. The governing board (OTASC Board) has by resolution authorized the sole Member to assign fund balance. The Board may also assign fund balance as it does when appropriating fund balance to cover a gap between

estimated revenue and appropriations in the subsequent year's appropriated budget. Unlike commitments, assignments generally only exist temporarily. In other words, an additional action does not normally have to be taken for the removal of an assignment. Conversely, as discussed above, an additional action is essential to either remove or revise a commitment.

Revenues and Expenditures/Expenses

Program Revenues—Amounts reported as *program revenues* include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions (including special assessments) that are restricted to meeting the operational or capital requirements of a particular function or segment. Items not properly included among program revenues are reported instead as *general revenues*.

Tobacco Settlement Revenues—During the fiscal year ended December 31, 2014, OTASC received increased tobacco settlement revenues as a result of the settlement of a lawsuit disputing MSA payments in sales years 2003 through 2012. The lawsuit was brought about by Participating Manufactures (tobacco companies) on the basis that certain settling states, including New York State, did not diligently enforce their respective Qualifying Statutes in each of those years. The Arbitration Panel determined that New York State diligently enforced its Qualifying Statutes during sales year 2003 and therefore is not subject to the NPM Adjustment for 2003 pursuant to the MSA.

Expenditures/Expenses—Expenditures are recorded on a modified accrual basis of accounting. Payments to the County are recorded when the obligation is incurred. General administration costs consist of operating expenses for professional service fees and are paid from General Fund revenues. *Direct expenses* are those that are clearly identifiable with a specific function. Indirect expenses have been included as part of the program expenses reported for the various functional activities.

Other

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 revenues and expenses during the reporting period and the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

Adoption of New Accounting Pronouncements—During the year ended December 31, 2014, OTASC implemented GASB Statement No. 67, *Financial Reporting for Pension Plans—an amendment of GASB Statement No. 25*, GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*, and GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. The objective of GASB Statement No. 67 is to improve financial reporting by state and local governmental pension plans. This Statement replaces GASB Statement No. 25 and Statement No. 50. The objective of GASB Statement No. 69 is to standardize accounting and financial reporting related to government combinations and disposals of government operations. The objective of GASB Statement No. 70 is to improve financial reporting by state and local governments that extend and receive nonexchange financial guarantees. GASB Statement Nos. 67, 69, and 70 did not have a material impact on OTASC's financial position or results from operations.

Future Impacts of Accounting Pronouncements—OTASC has not completed the process of evaluating the impact that will result from adopting GASB Statements No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*; No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date—and amendment of GASB Statement No. 68*, effective for the year ending December 31, 2015; and No. 72, *Fair Value Measurement and Application*, effective for the year ending December 31, 2016. OTASC is, therefore, unable to disclose the impact that adopting GASB Statement Nos. 68, 71 and 72 will have on its financial position and results of operations.

2. RESTATEMENT

Tobacco settlement payments to be received by the County during the year ending December 31, 2015 are based on tobacco sales made during the year ended December 31, 2014. While they are not considered receivable under the modified basis of accounting as discussed in Note 1, they are considered receivable within the governmental activities during the current year. Previously, OTASC recognized tobacco settlement revenues within the governmental funds. Fund balance of the General Fund at December 31, 2013 has been restated to remove \$1,675,000 of tobacco settlement revenues within the General Fund fund balance.

The effect of this restatement is as follows:

General Fund—fund balance, December 31, 2013, as previously stated	\$ 1,783,366
Removal of Tobacco Settlement Revenue	<u>(1,675,000)</u>
General Fund—fund balance, December 31, 2013, as restated	<u>\$ 108,366</u>

3. CASH AND CASH EQUIVALENTS

OTASC’s investment policies are governed by New York State statutes. All deposits are carried at fair value. Collateral is required for demand deposit accounts, time deposit accounts and certificates of deposit not covered by Federal deposit insurance. OTASC has entered into custodial agreements with the various banks which hold their deposits. These agreements authorize the obligation that may be pledged as collateral. Obligations that may be pledged as collateral are outlined in Chapter 623 of the laws of the State of New York.

Cash and cash equivalents at December 31, 2014, are as follows:

	General Fund	Debt Service Fund	Total
Deposits	<u>\$ 53,875</u>	<u>\$ 52,602</u>	<u>\$ 106,477</u>

Deposits—All deposits are carried at fair value and are classified by custodial credit risk at December 31, 2014 as follows:

	Carrying Amount	Bank Balance
FDIC insured	<u>\$ 106,477</u>	<u>\$ 106,477</u>

Investments— OTASC’s investment policy provides for eligible investments in defeasance collateral, obligations of FHLMC, FNMA, or the Federal Farm Credit System, demand and time deposit accounts and certificates of deposit, general obligations of states and guaranteed state obligations, commercial or finance company paper, repurchase obligations, corporate securities bearing interest or sold at discount, taxable money market funds, investment agreements or guaranteed investment contracts, and other obligations or securities that are non-callable.

Investments include discount notes, which mature at par value of \$1,677,000, and are carried at cost plus interest. Investments at December 31, 2014 are as follows:

	Carrying Amount
Discount Notes	<u>\$ 1,600,825</u>

Custodial Credit Risk – Deposits – Custodial credit risk is the risk that in the event of a bank failure, OTASC’s deposits may not be returned to it. As noted above, by New York State statute all deposits in excess of FDIC insurance coverage must be collateralized. As of December 31, 2014, OTASC’s deposits were fully FDIC insured.

Custodial Credit Risk—Investments—For investments, this is the risk that, in the event of the failure of the counterparty, OTASC will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. For deposits, this is the risk that in the event of a bank failure, OTASC’s deposits may not be returned to it.

4. RECEIVABLES

Due from New York State—Represents amounts owed to OTASC for tobacco settlement revenue earned in 2014. OTASC has accrued \$1,854,887 within governmental activities only, as it is not recognized on the modified accrual basis of accounting.

5. LONG-TERM DEBT

In 2003, OTASC issued \$22,150,000 of Tobacco Settlement Asset Backed Bonds, Series 2003. The net proceeds of Series A Bonds were used to purchase from the County all of the County’s right, title and interest, under the MSA and the Decree, including the Tobacco Settlement Revenues (“TSR”). The bonds mature in 2019 and carry an interest rate of 5.64 percent.

The payment of the Series 2003 Bonds is dependent on the receipt of TSRs. The amount of TSRs actually collected is dependent on many factors including cigarette consumption and the continued operations of the OPMs. Such bonds are secured by and payable solely from TSRs and investment earnings pledged under the Indenture and amounts established and held in accordance with the Indenture. OTASC has no financial assets other than the collections and reserves and amounts held in the other funds and accounts established under the Indenture.

Changes in bonds payable, Tobacco Settlement Bonds, Series 2003, for the year ended December 31, 2014 are as follows:

Description	Beginning Balance 1/1/2014	Additions	Deletions	Ending Balance 12/31/2014	Amount Due Within One Year
Tobacco Settlement Bonds:					
Series 2003	\$ 14,005,000	\$ -	\$ 1,145,000	\$ 12,860,000	\$ 4,680,000
Less:					
Bond discount	(351,505)	-	(58,585)	(292,920)	(58,585)
Net bonds payable	<u>\$ 13,653,495</u>	<u>\$ -</u>	<u>\$ 1,086,415</u>	<u>\$ 12,567,080</u>	<u>\$ 4,621,415</u>

OTASC debt service requirements based upon planned principal payments for Tobacco Settlement Bonds, Series A are as follows:

Year ended December 31,	Principal	Interest	Total
2015	\$ 4,680,000	\$ 628,844	\$ 5,308,844
2016	1,855,000	435,150	2,290,150
2017	2,005,000	319,350	2,324,350
2018	2,450,000	185,700	2,635,700
2019	1,870,000	56,100	1,926,100
	<u>\$ 12,860,000</u>	<u>\$ 1,625,144</u>	<u>\$ 14,485,144</u>

6. NET POSITION AND FUND BALANCE

The government-wide financial statements utilize a net position presentation. Net position is categorized as restricted and unrestricted components.

- ◆ **Restricted for Debt Service**—This category restricts a portion of net position for payment of the debt service obligations of OTASC. At December 31, 2014, the balance of this restriction was \$1,653,427.
- ◆ **Unrestricted Component of Net Position**—This component represents net position of OTASC not restricted for any other purpose.

In the fund financial statements, restricted fund balances are amounts constrained to specific purposes (such as grantors, bondholders, and higher levels of government) through constitutional provisions or by enabling legislation. At December 31, 2014, OTASC reported \$1,653,427 of fund balance restricted for debt service that must be used toward the future repayment of bonded debt.

As of December 31, 2014, OTASC reported no nonspendable, committed, or assigned fund balances.

7. CONTINGENCIES

The ability of OTASC to meet debt service payments of bonds is contingent upon the receipt of TSRs. TSRs are principally dependent upon future levels of domestic consumption. A significant decline in the overall consumption of cigarettes could have a material adverse effect on the payments by the OPMs under the MSA and the amounts available to OTASC to make payments of principal and interest on their bonds.

Certain smokers, smokers' rights organizations, consumer groups, cigarette importers, cigarette distributors, cigarette manufacturers, Native American tribes, taxpayers, taxpayers' groups and other parties have filed actions against some, and in certain cases all, of the signatories to the MSA. In the event of an adverse court ruling in such types of litigation, Bondholders could incur a complete loss of their investment.

Additionally, the OPM's are also exposed to liability from various lawsuits including individual lawsuits, class action lawsuits and health care cost recovery litigation. Ultimately, the outcome of these and any other pending or future lawsuits is uncertain. One or more adverse judgment could result in delays in, or reductions of amounts available for, payments on the bonds.

8. SUBSEQUENT EVENTS

Management has evaluated subsequent events through March 23, 2015, which is the date the financial statements are available for issuance, and have determined there are no subsequent events that require disclosure under generally accepted accounting principles.

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**INDEPENDENT AUDITORS' 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**

To the Board of Directors
Oswego 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 governmental activities and each major fund of Oswego Tobacco Asset Securitization Corporation ("OTASC") as of and for the year ended December 31, 2014, and the related notes to the financial statements, which collectively comprise OTASC's basic financial statements, and have issued our report thereon dated March 23, 2015 (which report contains an emphasis of matter paragraph relating to the restatement of beginning fund balance).

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered OTASC'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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of OTASC's internal control. Accordingly, we do not express an opinion on the effectiveness of the OTASC'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 entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether OTASC'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 result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



March 23, 2015