

**CHEMUNG TOBACCO ASSET SECURITIZATION
CORPORATION**

FINANCIAL STATEMENTS

DECEMBER 31, 2011

CHEMUNG TOBACCO ASSET SECURITIZATION CORPORATION

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Chemung Tobacco Asset Securitization Corporation
Elmira, New York

We have audited the accompanying statements of financial position of Chemung Tobacco Asset Securitization Corporation, a blended component unit of the County of Chemung, New York, as of December 31, 2011 and 2010, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 audits 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 audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Chemung Tobacco Asset Securitization Corporation as of December 31, 2011 and 2010, and the changes in its net deficit and its cash flows for the years 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 5, 2012, on our consideration of Chemung Tobacco Asset Securitization 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 should be considered in assessing the results of our audits.

EFP Rotenberg, LLP

EFP Rotenberg, LLP
Corning, New York
March 5, 2012

CHEMUNG TOBACCO ASSET SECURITIZATION CORPORATION
Statements of Financial Position
December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 103,254	\$ 80,991
Tobacco settlement proceeds receivable	<u>728,841</u>	<u>719,497</u>
Total current assets	832,095	800,488
Restricted Cash - Liquidity Reserve	648,254	648,254
Unamortized Bond Issuance Costs - Net	<u>148,249</u>	<u>158,425</u>
Total Assets	<u>\$ 1,628,598</u>	<u>\$ 1,607,167</u>
LIABILITIES AND NET DEFICIT		
Liabilities		
Bonds payable - net	\$ 6,012,109	\$ 6,137,759
Net Deficit		
Unrestricted net deficit	<u>(4,383,511)</u>	<u>(4,530,592)</u>
Total Liabilities and Net Deficit	<u>\$ 1,628,598</u>	<u>\$ 1,607,167</u>

The accompanying notes are an integral part of these financial statements.

CHEMUNG TOBACCO ASSET SECURITIZATION CORPORATION
Statements of Activities
For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>%</u>	<u>2010</u>	<u>%</u>
Revenues				
Tobacco settlement proceeds	\$ 592,896	99.9	\$ 735,207	99.9
Interest and investment income	105	0.1	138	0.1
Total revenues	<u>593,001</u>	<u>100.0</u>	<u>735,345</u>	<u>100.0</u>
Expenses				
Administrative fees	10,000	1.7	5,000	0.7
Amortization expense	10,176	1.7	10,176	1.4
Insurance expense	5,020	0.8	5,029	0.7
Interest expense	402,084	67.8	414,080	56.3
Investment fees	12,390	2.1	6,819	0.9
Miscellaneous	-	-	789	0.1
Professional fees	6,250	1.1	6,650	0.9
Telephone	-	-	146	-
Transfer to Chemung County	-	-	378,249	51.4
Total expenses	<u>445,920</u>	<u>75.2</u>	<u>826,938</u>	<u>112.4</u>
Change in Net Deficit	147,081	<u>24.8</u>	(91,593)	<u>(12.4)</u>
Net Deficit - Beginning	<u>(4,530,592)</u>		<u>(4,438,999)</u>	
Net Deficit - Ending	<u>\$ (4,383,511)</u>		<u>\$ (4,530,592)</u>	

The accompanying notes are an integral part of these financial statements.

CHEMUNG TOBACCO ASSET SECURITIZATION CORPORATION
Statements of Cash Flows
For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash Flows from Operating Activities		
Proceeds of tobacco receipts	\$ 583,552	\$ 725,852
Interest and investment income received	105	138
Payments of operating expenses	(33,660)	(24,513)
Payments of bond interest expense	<u>(397,734)</u>	<u>(409,759)</u>
Net cash flows from operating activities	152,263	291,718
Cash Flows from Financing Activities		
Principal repayment of bonds payable	<u>(130,000)</u>	<u>(265,000)</u>
Net Change in Cash and Cash Equivalents	22,263	26,718
Cash and Cash Equivalents - Beginning	<u>80,991</u>	<u>54,273</u>
Cash and Cash Equivalents - Ending	<u>\$ 103,254</u>	<u>\$ 80,991</u>
Reconciliation of Change in Net Deficit to Net Cash Flows from Operating Activities		
Change in net deficit	\$ 147,081	\$ (91,593)
Adjustments		
Transfer to Chemung County	-	378,249
Amortization	10,176	10,176
Consumption of discount on bonds	4,350	4,321
Changes in assets and liabilities		
Change in tobacco proceeds receivable	(9,344)	(9,355)
Change in accounts payable	<u>-</u>	<u>(80)</u>
Net cash flows from operating activities	<u>\$ 152,263</u>	<u>\$ 291,718</u>

The accompanying notes are an integral part of these financial statements.

CHEMUNG TOBACCO ASSET SECURITIZATION CORPORATION
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies and Nature of the Organization

Nature of the Organization - In January 1997, the State of New York filed a lawsuit against the tobacco industry, seeking to recover the costs that the State and local governments had incurred in treating smoking related illnesses. Chemung Tobacco Asset Securitization Corporation (the "Corporation") was established to acquire from Chemung County all or a portion of the rights, title and interest under the Master Settlement Agreement (the "MSA") and the Consent Decree and Final Judgment (the "Decree") as described herein.

The MSA includes New York and 45 other states, 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 four of the largest United States tobacco product manufacturers: Philip Morris Incorporated, R.J. Reynolds Tobacco Company, Brown and Williamson Tobacco Company (B&W), and Lorillard Tobacco Company (collectively, the "Original Participating Manufacturers" or "OPMs"). On January 5, 2004, Reynolds American Inc. was incorporated as a holding company to facilitate the combination of the U.S. assets, liabilities, and operations of B&W with those of Reynolds Tobacco. The agreement was entered into 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.

The Corporation was formed to raise funds by issuing bonds, use those funds to acquire the rights to future proceeds from a settlement agreement with various tobacco companies payable to the County, and remain in existence during the term of the bonds to collect the tobacco settlement proceeds and service the debt.

The Corporation is dependent on future proceeds from the settlement agreement. Proceeds received in excess of the Corporation's operational expenses, debt service and required reserves are transferred to the County, as the beneficial owner of the residual certificate, subject to restrictions imposed by certain trapping events.

During 2003, the Corporation adopted its first amendment to the indenture, dated as of December 1, 2000, between the Corporation and Manufacturers and Traders Trust Company (M&T), as Trustee. The amendment effectively modifies the indenture to be consistent with the official statement concerning downgrade trapping events as being immediate, in the year in which the event occurred.

The Corporation is a local development corporation created in October 2000 under Section 1411 of the New York State Not-for-Profit Corporation Law. In accordance with Governmental Accounting Standards Board (GASB) Statement No. 39, *Determining Whether Certain Organizations are Component Units*, and Technical Bulletin 2004-1, *Tobacco Settlement Recognition and Financial Reporting Entity Issues*, the Corporation is required to be included in the basic financial statements of Chemung County, New York. Accordingly, the Corporation is presented as a blended component unit of the County.

Method of Accounting - The Corporation maintains its books and prepares its financial statements on the accrual basis of accounting.

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

Cash and Cash Equivalents - For purposes of the statements of financial position and statements of cash flows, cash and cash equivalents include deposits and cash in money market funds. The Corporation maintains cash and cash equivalents at financial institutions which periodically may exceed federally insured limits.

Subsequent Events - In accordance with ASC 855-10, the Corporation evaluated subsequent events through March 5, 2012, the date these financial statements were available to be issued.

CHEMUNG TOBACCO ASSET SECURITIZATION CORPORATION
Notes to Financial Statements

Note 2. Tobacco Settlement Proceeds Receivable

This asset represents estimated annual payments to be received from the MSA between various tobacco manufacturers and state and local governments. The MSA resolved cigarette smoking-related litigation between the manufacturers and the states. The right to receive the payments was acquired by the Corporation through a purchase from the County. As of December 31, 2011 and 2010, the tobacco settlement proceeds receivable amounted to \$728,841 and \$719,497, respectively.

Note 3. Bonds Payable

The bonds were issued on December 7, 2000, as part of the New York State Counties Tobacco Trust/Tobacco Settlement Pass-Through Bond Series 2000. Face value of the bonds issued was \$8,090,000. The bonds were sold at a discount of \$116,695, for a net issue price of \$7,973,305. The discount will be amortized over the maturity period of the bonds. The weighted average maturity period of the bonds is 15.914 years with a final maturity date of December 31, 2025. Interest on the bonds ranges from 5.000% to 6.625%. The repayment schedule is based on the flexible amortization payments which accelerates the maturity date. In the event sufficient funds are not available to meet maturities, rated maturity dates will be used to extend the maturity schedule of the bonds.

During the year ended December 31, 2011, sufficient funds were not available to meet maturities, therefore, principal payments only amounted to \$130,000 for the year ended December 31, 2011. Required maturities for the year ended December 31, 2011, called for \$270,000 in principal payments. The unpaid principal of \$140,000 will be added to the required maturities for the year ended December 31, 2012. At December 31, 2011 and 2010, the face value of the bonds was \$6,075,000 and \$6,205,000 with remaining discount of \$62,891 and \$67,241, respectively.

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 425,000	\$ 380,696	\$ 805,696
2013	300,000	358,271	658,271
2014	315,000	338,971	653,971
2015	325,000	318,624	643,624
2016	355,000	296,849	651,849
2017 - 2021	2,415,000	1,064,940	3,479,940
2022 - 2025	<u>1,940,000</u>	<u>204,713</u>	<u>2,144,713</u>
	<u>\$ 6,075,000</u>	<u>\$ 2,963,064</u>	<u>\$ 9,038,064</u>

The cost of issuing the bonds has been capitalized and is reported on the statements of financial position as unamortized bond issuance costs. Amortization of the costs, using the effective interest method, is as follows as of December 31:

	<u>2011</u>	<u>2010</u>
Bond issuance cost	\$ 275,016	\$ 275,016
Accumulated amortization	<u>(126,767)</u>	<u>(116,591)</u>
Unamortized bond issuance costs	<u>\$ 148,249</u>	<u>\$ 158,425</u>

Note 4. Restricted Cash - Liquidity Reserve

The Corporation is required to place a portion of the bond proceeds in trust as a reserve to partially secure payments to the bond holders. The restriction on these funds will be released as the bonds mature and are paid. The restricted cash - liquidity reserve amounted to \$648,254 for both December 31, 2011 and 2010.

CHEMUNG TOBACCO ASSET SECURITIZATION CORPORATION
Notes to Financial Statements

Note 5. Restricted Cash - Trapping Reserve

The Corporation is required to place a portion of the bond proceeds in excess of debt service and operational expenses in this account when a "trapping" event occurs. The trapping events include "consumption decline," "downgrade," "lump sum" and "NPM" trapping requirements. During 2003, a downgrade trapping event occurred whereby an Original Participating Manufacturer, with a market share of 7% or more, received a credit rating below "Baa3" by Moody's or "BBB" by Standard and Poors. The downgrade event requires that an amount equal to 25% of the outstanding bond principal be trapped until one year after the end of the downgrade trapping condition. Insufficient available assets to fully satisfy the 25% trapping requirement occurred as of December 31, 2008. Therefore, future payments of residual certificates were suspended, and available monies trapped, until the 25% trapping requirement was satisfied or the downgrade condition was removed.

In August 2008, the trapping event ended and during 2010 the balance in the trapping account amounting to \$378,249 was transferred to the County, the holder of the residual certificate.

Note 6. Residual Receivable/Payable to Chemung County

The Corporation receives 100% of the County's tobacco settlement proceeds, although only 40% are applicable to the Corporation. The residual 60% is refundable to the County. As of December 31, 2011 and 2010, none of the residual assets due to the County were held by the Corporation.

Note 7. Related Party

The Corporation is a special purpose local development corporation, and is considered by legal counsel to be bankruptcy-remote from the County. However, the Corporation's Board of Directors is comprised of four elected or appointed officials of the County, and one independent director. For financial statement purposes, the Corporation is considered to be a blended component unit of the County.

Note 8. Net Deficit

The net deficit is due to various expenses associated with the bonds. The future cash receipts from the Master Settlement Agreement (MSA) are expected to offset this deficit. The largest payments provided for in the MSA are called initial payments and annual payments. Both are subject to certain adjustments, reductions and offsets, which are described in the following paragraphs.

Initial payments to New York State were made in the first five years of the agreement, starting with \$2.4 billion in 1999; the last four of these were subject to the volume adjustments, the non-settling states reduction, and the offset for miscalculated or disputed payments.

Annual payments to the State commenced on April 15, 2000, starting at \$2.5 billion in 2000 and continuing into perpetuity at a cap of \$9 billion to be reached in 2018. The annual payments are subject to inflation adjustment, the volume adjustment, the previously settled states reduction, the non-settling states reduction, the non-participating manufacturers adjustment, the offset for miscalculated or disputed payments, the federal tobacco legislation offset, the litigating parties offset, and the offsets for claims. The Corporation started receiving the County's portion of the annual payments on April 15, 2001.



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
Chemung Tobacco Asset Securitization Corporation
Elmira, New York

We have audited the financial statements of Chemung Tobacco Asset Securitization Corporation, a blended component unit of the County of Chemung New York, as of and for the year ended December 31, 2011, and have issued our report thereon dated March 5, 2012. 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 Chemung 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 Chemung Tobacco Asset Securitization Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Chemung Tobacco Asset Securitization Corporation's internal control over financial reporting.

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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Chemung Tobacco Asset Securitization 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 disclose 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 Board of Directors and management of Chemung Tobacco Asset Securitization Corporation and is not intended to be and should not be used by anyone other than these specified parties.

EFP Rotenberg, LLP

EFP Rotenberg, LLP
Corning, New York
March 5, 2012