

**CHEMUNG TOBACCO ASSET SECURITIZATION  
CORPORATION**

**FINANCIAL STATEMENTS**

**DECEMBER 31, 2012**

**CHEMUNG TOBACCO ASSET SECURITIZATION CORPORATION**

**TABLE OF CONTENTS**

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<b><u>AUDITED FINANCIAL STATEMENTS</u></b>	<b><u>PAGE</u></b>
INDEPENDENT AUDITORS' REPORT	1 - 2
STATEMENTS OF FINANCIAL POSITION	3
STATEMENTS OF ACTIVITIES	4
STATEMENTS OF CASH FLOWS	5
NOTES TO FINANCIAL STATEMENTS	6 - 8
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	9 - 10



## INDEPENDENT AUDITORS' REPORT

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

### **Report on the Financial Statements**

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, 2012 and 2011, and the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

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

### **Auditors' Responsibility**

Our responsibility is to express an opinion on these financial statements based on our 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 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.

## **Opinion**

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, 2012 and 2011, and the changes in its net deficit and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated March 11, 2013, 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 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 Chemung Tobacco Asset Securitization Corporation's internal control over financial reporting and compliance.

*EFP Rotenberg, LLP*

EFP Rotenberg, LLP  
Rochester, New York  
March 11, 2013

**CHEMUNG TOBACCO ASSET SECURITIZATION CORPORATION**  
**Statements of Financial Position**  
**December 31, 2012 and 2011**

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	<u>2012</u>	<u>2011</u>
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 132,828	\$ 103,254
Tobacco settlement proceeds receivable	737,590	728,841
Total current assets	<u>870,418</u>	<u>832,095</u>
<b>Restricted Cash - Liquidity Reserve</b>	648,255	648,254
<b>Unamortized Bond Issuance Costs - Net</b>	<u>138,898</u>	<u>148,249</u>
<b>Total Assets</b>	<u>\$ 1,657,571</u>	<u>\$ 1,628,598</u>
<b>LIABILITIES AND NET DEFICIT</b>		
<b>Liabilities</b>		
Bonds payable - net	\$ 5,861,028	\$ 6,012,109
<b>Net Deficit</b>		
Unrestricted net deficit	<u>(4,203,457)</u>	<u>(4,383,511)</u>
<b>Total Liabilities and Net Deficit</b>	<u>\$ 1,657,571</u>	<u>\$ 1,628,598</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, 2012 and 2011**

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	<u>2012</u>	%	<u>2011</u>	%
<b>Revenues</b>				
Tobacco settlement proceeds	\$ 603,866	99.9	\$ 592,896	99.9
Interest and investment income	<u>108</u>	<u>0.1</u>	<u>105</u>	<u>0.1</u>
Total revenues	<u><u>603,974</u></u>	<u><u>100.0</u></u>	<u><u>593,001</u></u>	<u><u>100.0</u></u>
<b>Expenses</b>				
Administrative fees	63	-	10,000	1.7
Amortization expense	9,351	1.5	10,176	1.7
Insurance expense	5,545	0.9	5,020	0.8
Interest expense	393,051	65.1	402,084	67.8
Investment fees	9,560	1.6	12,390	2.1
Professional fees	<u>6,350</u>	<u>1.1</u>	<u>6,250</u>	<u>1.1</u>
Total expenses	<u><u>423,920</u></u>	<u><u>70.2</u></u>	<u><u>445,920</u></u>	<u><u>75.2</u></u>
<b>Change in Net Deficit</b>	<b>180,054</b>	<b>29.8</b>	<b>147,081</b>	<b>24.8</b>
<b>Net Deficit - Beginning</b>	<b>(4,383,511)</b>		<b>(4,530,592)</b>	
<b>Net Deficit - Ending</b>	<b>\$ (4,203,457)</b>		<b>\$ (4,383,511)</b>	

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, 2012 and 2011**

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	<u>2012</u>	<u>2011</u>
<b>Cash Flows from Operating Activities</b>		
Proceeds of tobacco receipts	\$ 595,116	\$ 583,552
Interest and investment income received	108	105
Payments of operating expenses	(21,518)	(33,660)
Payments of bond interest expense	<u>(389,132)</u>	<u>(397,734)</u>
Net cash flows from operating activities	184,574	152,263
<b>Cash Flows from Financing Activities</b>		
Principal repayment of bonds payable	<u>(155,000)</u>	<u>(130,000)</u>
<b>Net Change in Cash and Cash Equivalents</b>	29,574	22,263
<b>Cash and Cash Equivalents - Beginning</b>	<u>103,254</u>	<u>80,991</u>
<b>Cash and Cash Equivalents - Ending</b>	<u>\$ 132,828</u>	<u>\$ 103,254</u>
<b>Reconciliation of Change in Net Deficit to Net Cash Flows from Operating Activities</b>		
Change in net deficit	\$ 180,054	\$ 147,081
Adjustments		
Amortization	9,351	10,176
Consumption of discount on bonds	3,918	4,350
Changes in assets and liabilities		
Change in tobacco proceeds receivable	<u>(8,749)</u>	<u>(9,344)</u>
Net cash flows from operating activities	<u>\$ 184,574</u>	<u>\$ 152,263</u>

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

**CHEMUNG TOBACCO ASSET SECURITIZATION CORPORATION**  
**Notes to Financial Statements**

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**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.

**CHEMUNG TOBACCO ASSET SECURITIZATION CORPORATION**  
**Notes to Financial Statements**

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**Subsequent Events** - In accordance with ASC 855-10, the Corporation evaluated subsequent events through March 11, 2013, the date these financial statements were available to be issued.

**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, 2012 and 2011, the tobacco settlement proceeds receivable amounted to \$737,590 and \$728,841, 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, 2012, sufficient funds were not available to meet maturities, therefore, principal payments amounted to \$155,000 for the year ended December 31, 2012. The terms of the agreement allows the Corporation to alter the payment schedule should sufficient funds not be available. Required maturities for the year ended December 31, 2012, called for \$425,000 in principal payments. The unpaid principal of \$270,000 will be added to the required maturities for the year ended December 31, 2013. At December 31, 2012 and 2011, the face value of the bonds was \$5,920,000 and \$6,075,000 with remaining discount of \$58,972 and \$62,891, respectively.

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2013	\$ 570,000	\$ 366,709	\$ 936,709
2014	315,000	338,971	653,971
2015	325,000	318,624	643,624
2016	355,000	296,849	651,849
2017	370,000	273,466	643,466
2018 - 1904	2,640,000	900,290	3,540,290
1905 - 1902	<u>1,345,000</u>	<u>95,897</u>	<u>1,440,897</u>
	<u>\$ 5,920,000</u>	<u>\$ 2,590,806</u>	<u>\$ 8,510,806</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>2012</u>	<u>2011</u>
Bond issuance cost	\$ 275,016	\$ 275,016
Accumulated amortization	(136,118)	(126,767)
Unamortized bond issuance costs	<u>\$ 138,898</u>	<u>\$ 148,249</u>

This bond shall not be a debt of either the State or the County of Chemung, New York, and neither the State nor the County shall be liable hereon, nor shall it be payable out of any funds other than those of the Corporation pledged therefore.

**CHEMUNG TOBACCO ASSET SECURITIZATION CORPORATION**  
**Notes to Financial Statements**

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**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 \$648,255 and \$648,254 for the years ended December 31, 2012 and 2011, respectively.

**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, 2012 and 2011, 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**

**INDEPENDENT AUDITORS' REPORT**

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

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 Chemung Tobacco Asset Securitization Corporation as of and for the year ended December 31, 2012, which collectively comprise Chemung Tobacco Asset Securitization Corporation's basic financial statements, and the related notes to the financial statements, and have issued our report thereon dated March 11, 2013.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered Chemung Tobacco Asset Securitization Corporation'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 Chemung Tobacco Asset Securitization Corporation's internal control. Accordingly, we do not express an opinion on the effectiveness of Chemung Tobacco Asset Securitization Corporation'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 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 disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

## **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the 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.

*EFP Rotenberg, LLP*

EFP Rotenberg, LLP  
Rochester, New York  
March 11, 2013