

Nassau County Tobacco Settlement Corporation

Financial Statements as of and for the
Year Ended December 31, 2010, and
Independent Auditors' Reports

NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Nassau County Tobacco Settlement Corporation:

We have audited the accompanying financial statements of the governmental activities and each major fund of the Nassau County Tobacco Settlement Corporation (NCTSC), as of December 31, 2010, and for the year then ended, which collectively comprise NCTSC's basic financial statements as listed in the foregoing table of contents. These financial statements are the responsibility of the management of NCTSC. Our responsibility is to express an opinion on these financial statements based on our audit.

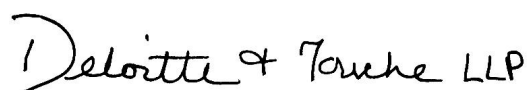
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of NCTSC's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities and each major fund of NCTSC, as of December 31, 2010, and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 through 3 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the NCTSC's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 27, 2011, on our consideration of NCTSC's internal control over financial reporting and 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 read in conjunction with this report in considering the results of our audit.

As discussed in Note 7, the 2009 net assets (deficit) has been restated.



June 27, 2011

NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS (in thousands)

OVERVIEW OF THE FINANCIAL STATEMENTS

The annual financial statements consist of three parts: (1) management's discussion and analysis (this section); (2) the entity-wide financial statements; and (3) the governmental funds financial statements and the notes to the financial statements.

The entity-wide financial statements of NCTSC, which include the statement of net assets (deficit) and the statement of activities, are presented to display information about the reporting entity as a whole, in accordance with Governmental Accounting Standards Board (GASB) Statement No. 34 - *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended by GASB Statement No. 37 and by GASB Statement No. 38, *Certain Financial Statement Disclosures*. The statement of net assets (deficit) and the statement of activities are prepared using the economic resources measurement focus and the accrual basis of accounting. All revenues and expenses are taken into account regardless of when cash is paid or received.

NCTSC's governmental funds financial statements are presented using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized when it becomes susceptible to accrual, which is when it becomes both measurable and available to finance expenditures in the current fiscal period.

The reconciliations of the statement of revenues, expenditures and changes in fund balances and the balance sheet of governmental funds to the Statement of Activities and the statement of net assets are presented to assist the reader in understanding the differences between the governmental funds and the entity-wide financial statements.

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS

ENTITY-WIDE FINANCIAL STATEMENTS

On November 23, 1999, NCTSC entered into a Purchase and Sale Agreement (Agreement) dated as of October 1, 1999, with Nassau County (County) pursuant to which NCTSC acquired from the County, among other things, all of the County's right, title, and interest under the Master Settlement Agreement (MSA) and the Consent Decree, as such terms are defined in the Agreement, and which are referred to herein as Tobacco Settlement Revenues (TSRs). The consideration paid by NCTSC to the County for such acquisition consisted of \$247,500 in cash (of which \$77,500 was paid into escrow for the benefit of the County) and the sole beneficial interest in NCTSC Residual Trust (Residual Trust), a Delaware business trust to which NCTSC has conveyed a residual interest in all the TSRs. The NCTSC funded such consideration from the proceeds of its Tobacco Settlement Asset-Backed Bonds, Series A, which are referred to herein as the 1999 Bonds. NCTSC's right to receive TSRs is its most significant asset and is expected to produce funding for its obligations to the extent of the receipt of TSR's.

On April 5, 2006, NCTSC issued \$431,034 of Tobacco Settlement Asset-Backed Bonds, Series 2006 (Series 2006 Bonds) pursuant to an *Amended and Restated Indenture* dated as of March 1, 2006 (Indenture), to refund all of the 1999 Bonds outstanding in the aggregate principal amount of \$272,125. The Series 2006 Bonds consist of the \$42,645 *Series 2006A-1 Taxable Senior Current Interest Bonds*, \$37,905 *Series 2006A-2 Senior Convertible Bonds*, \$291,540 *Series 2006A-3 Senior Current Interest Bonds*, and \$58,944 *Series 2006B-E Subordinate CABs*. Unless otherwise indicated, defined terms have the meanings ascribed to them in the Offerings Circular dated March 31, 2006, for the Series 2006 Bonds.

Total assets were \$392,346 as of December 31, 2010, a decrease of 3.2% from the prior year primarily due to the amortization of deferred charges as a result of the implementation of GASB 48. The components of total assets as of December 31, 2010 were: (1) cash and cash equivalents of \$114; (2) investments of \$24,230; (3) deferred charges of \$339,931; (4) cost of issuance net of amortization of \$28,043; and (5) prepaid expenses of \$28.

Total expenses for the year ended December 31, 2010 were \$37,231, as compared to the \$30,792 for the year ended December 31, 2009. The 2009 financial statements were restated in 2010 resulting in an increase in the fund deficit in the statement of activities by \$21,577 and an increase of the net deficit in the statement of net assets (deficit) by \$21,577 for the year ended December 31, 2009. The adjustment was a result of the increase in bonds payable and related interest expense for accretion of interest on the bonds on the capital appreciation bonds (CAB's).

The increase in expenses in 2010 was primarily due to an increase of bond interest expense of approximately \$6,484 from 2009.

Revenues of \$19,884 for the year ended December 31, 2010 consisted primarily of TSR's as compared with \$23,969 for the year ended December 31, 2009.

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS - GOVERNMENTAL FINANCIAL STATEMENTS

Total assets were \$24,522 as of December 31, 2010. The components of total assets as of December 31, 2010 were: (1) cash and cash equivalents of \$114; (2) investments of \$24,230; (3) prepaid expenses of \$28; and (4) due from General Fund of \$150.

Total expenditures for the year ended December 31, 2010 were \$19,823, as compared to the \$24,327 for the year ended December 31, 2009. In 2010, expenditures decreased 18.5%, primarily due to the decrease in bond principal expense.

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NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION

STATEMENT OF NET ASSETS (DEFICIT) AS OF DECEMBER 31, 2010 (in thousands)

	Governmental Activities
ASSETS	
CASH AND CASH EQUIVALENTS	\$ 114
INVESTMENTS	24,230
DEFERRED CHARGES	339,931
COST OF ISSUANCE — Net of amortization	28,043
PREPAID EXPENSE	<u>28</u>
TOTAL	<u>\$ 392,346</u>
LIABILITIES AND NET ASSETS (DEFICIT)	
ACCRUED INTEREST PAYABLE	\$ 1,804
BONDS PAYABLE:	
Due within one year	1,610
Due in more than one year	<u>444,772</u>
Total liabilities	<u>448,186</u>
NET ASSETS (DEFICIT):	
Restricted — senior liquidity reserve	24,009
Unrestricted	<u>(79,849)</u>
Total net assets (deficit)	<u>(55,840)</u>
TOTAL	<u>\$ 392,346</u>

See notes to financial statements.

NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION

STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED DECEMBER 31, 2010 (in thousands)

	Governmental Activities
REVENUES:	
Tobacco settlement revenues	\$ 19,881
Interest income	<u>3</u>
Total revenues	<u>19,884</u>
EXPENSES:	
General and administrative	76
Bond interest expense	24,748
Amortization expense	<u>12,407</u>
Total expenses	<u>37,231</u>
CHANGE IN NET ASSETS	(17,347)
NET ASSETS (DEFICIT) — Beginning of year, as restated	<u>(38,493)</u>
NET ASSETS (DEFICIT) — End of year	<u><u>\$ (55,840)</u></u>

See notes to financial statements.

NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION

BALANCE SHEET

AS OF DECEMBER 31, 2010 (in thousands)

	Governmental Funds		Total Governmental Funds
	General	Debt Service	
ASSETS			
Cash and cash equivalents	\$ 114	\$ -	\$ 114
Investments		24,230	24,230
Prepaid expense	28		28
Due from general fund		150	150
TOTAL	<u>\$ 142</u>	<u>\$ 24,380</u>	<u>\$ 24,522</u>
LIABILITIES AND FUND BALANCE			
LIABILITIES:			
Accounts payable	\$ -	\$ -	\$ -
Due to debt service fund	<u>150</u>		<u>150</u>
Total liabilities	<u>150</u>	<u>-</u>	<u>150</u>
Restricted fund balance- senior liquidity reserve	-	24,009	24,009
Unrestricted fund balance	<u>(8)</u>	<u>371</u>	<u>363</u>
Total fund balance	<u>(8)</u>	<u>24,380</u>	<u>24,372</u>
TOTAL	<u>\$ 142</u>	<u>\$ 24,380</u>	<u>\$ 24,522</u>

See notes to financial statements.

NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE FOR THE YEAR ENDED DECEMBER 31, 2010 (in thousands)

	Governmental Fund Types		Total
	General	Debt Service	
REVENUES:			
Tobacco settlement revenues	\$ -	\$ 19,881	\$ 19,881
Interest		3	3
Total revenues	<u>-</u>	<u>19,884</u>	<u>19,884</u>
EXPENDITURES:			
Current-			
Professional fees	<u>76</u>		<u>76</u>
Total current	<u>76</u>	<u>-</u>	<u>76</u>
Debt service-			
Principal		403	403
Interest		<u>19,344</u>	<u>19,344</u>
Total debt service	<u>-</u>	<u>19,747</u>	<u>19,747</u>
Total expenditures	<u>76</u>	<u>19,747</u>	<u>19,823</u>
EXCESS (DEFICIT) OF REVENUES OVER EXPENDITURES	<u>(76)</u>	<u>137</u>	<u>61</u>
FUND BALANCE- BEGINNING OF YEAR	<u>68</u>	<u>24,243</u>	<u>24,311</u>
FUND BALANCE- END OF YEAR	<u>\$ (8)</u>	<u>\$ 24,380</u>	<u>\$ 24,372</u>

See notes to financial statements.

NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION

RECONCILIATION OF THE BALANCE SHEET OF GOVERNMENTAL FUNDS TO THE STATEMENT OF NET ASSETS (DEFICIT) AS OF DECEMBER 31, 2010 (in thousands)

TOTAL FUND BALANCES	\$	24,372
AMOUNTS REPORTED FOR GOVERNMENTAL ACTIVITIES IN THE STATEMENT OF NET ASSETS (DEFICIT) ARE DIFFERENT BECAUSE:		
Deferred charges represent the unamortized balance of funds transferred to the County, which are recorded in the governmental funds when the funds are received		339,931
Accrued interest is not due and payable in the current period from currently available financial resources and, are therefore, not reported in the governmental funds financial resources		(1,804)
Long term liabilities are not due and payable in the current period and, therefore, are not reported in the governmental funds		(446,382)
Cost of issuance is expensed in full in the governmental funds, but is capitalized and amortized in the statement of net assets — amortization expense		<u>28,043</u>
CHANGE IN NET ASSETS OF GOVERNMENTAL ACTIVITIES	\$	<u>(55,840)</u>

See notes to financial statements.

NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES FOR THE YEAR ENDED DECEMBER 31, 2010 (in thousands)

NET CHANGE IN FUND BALANCES — Total governmental funds	\$	61
AMOUNTS REPORTED FOR GOVERNMENTAL ACTIVITIES IN THE STATEMENT OF NET ASSETS ARE DIFFERENT BECAUSE:		
Payment of bond principal is reported in the statement of net assets as a reduction of long-term liability, but as an expense in the governmental funds when the outlay of financial resources is required		403
Interest expense is reported in the statement of activities on the accrual basis, but reported as an expenditure in governmental funds when outlay of financial resources is required		(5,404)
Cost of issuance and purchase cost of future TSRs (GASB Statement 48) is expensed in full in the governmental funds, but is capitalized and amortized in the statement of net assets — amortization expense		(12,407)
CHANGE IN NET ASSETS OF GOVERNMENTAL ACTIVITIES	\$	<u>(17,347)</u>

See notes to financial statements.

NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION

NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2010 (IN THOUSANDS)

1. ORGANIZATION

The Nassau County Tobacco Settlement Corporation (NCTSC) is a special-purpose local development corporation organized under the Not-for-Profit Corporation Law of the State of New York and is an instrumentality of, but separate and apart from, Nassau County (“County”). Although legally separate from and independent of the County, NCTSC is considered an affiliated organization under Governmental Accounting Standards Board (GASB) Statement No. 39, *Determining whether Certain Organizations are Component Units*, and reported as a component unit of the County for County financial reporting purposes and, accordingly, is included in the County’s financial statements.

The board of directors of NCTSC has three members, one of which must meet certain requirements of independence: (i) one appointed by a majority vote of the County Legislature, (ii) one who must be the County Treasurer, *ex officio*, designated by the County Executive, and (iii) one selected by (i) and (ii). As of December 31, 2010, one position was vacant.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General — In its accounting and financial reporting in conformity with accounting principles generally accepted in the United States of America (“generally accepted accounting principles”), NCTSC follows the pronouncements of the GASB.

Basis of Accounting and Measurement Focus — NCTSC prepares its financial statements in accordance with GASB Statement No. 34 (as amended by GASB Statement No. 37) *Basic Financial Statements — and Management’s Discussion and Analysis — for State and Local Governments*, and GASB Statement No. 38, *Certain Financial Statement Disclosures*. GASB Statement No. 38 requires certain disclosures to be made in the notes to the financial statements concurrent with the implementation of GASB Statement No. 34.

The entity-wide financial statements of NCTSC, which include the statement of net assets and the statement of activities, are presented to display information about the reporting entity as a whole, in accordance with GASB Statement No. 34. The statement of net assets and the statement of activities are prepared using the economic resources measurement focus and the accrual basis of accounting.

NCTSC uses two governmental funds to report its financial position and results of operations:

General Fund — The General Fund is used to account for all financial resources associated with NCTSC except for those required to be accounted for in another fund. Revenue is recognized when it becomes susceptible to accrual, which is when it becomes both measurable and available to finance expenditures in the current fiscal period.

Debt Service Fund — The Debt Service Fund is used to account for the accumulation of resources, primarily TSRs, for the payment of long-term bond principal, interest, and related costs.

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental funds are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and liabilities generally are included on the balance sheet. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

Governmental funds are accounted for on the modified accrual basis of accounting. Governmental fund revenues are recognized in the accounting period in which they become susceptible to accrual, (i.e., both measurable and available to finance expenditures of the fiscal period). Expenditures are recognized in the accounting period in which the fund liability is incurred, if measurable. Transfers among funds are recognized in the accounting period in which the interfund receivable and payable arise.

Cash and Cash Equivalents — Cash and cash equivalents include amounts in demand deposits, as well as short-term investments with original maturities of three months or less from the date acquired by NCTSC.

Investments — Investments are recorded on the balance sheet at fair value and all investment income, including changes in the fair value of investments, is reported as revenue and expense in the statement of operations.

Expenditures — Expenditures are recorded on a modified accrual basis of accounting. Payments to the County and others are recorded when paid. General administration costs consist of operating expenses for professional services fees and are paid from general fund revenues.

Debt service is recognized when due.

Use of Estimates — The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets 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.

New Accounting Standards — In February 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which should be implemented beginning with fiscal years ending December 31, 2011. NCTSC has not completed the process of evaluating the impact that will result from implementing this statement and is therefore unable to determine the impact that adopting this will have on its financial position and results of operations when such statement is adopted.

In March 2009, GASB issued Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* and Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, which were both effective immediately. Neither of these statements have an impact on the NCTSC's financial statements.

In December 2009, GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which should be implemented beginning with fiscal years ending August 31, 2012. Statement No. 57 provides guidance on two implementation issues related to other postemployment benefits (OPEB). The statement amends Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, to permit an agent employer that has an individual-employer OPEB plan with fewer than 100 total plan members to use the alternative measurement method, at its option, regardless of the number of total plan members in the agent multiple-employer OPEB plan in which it participates. This statement also amends GASB

statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, requirement that a defined benefit OPEB plan obtain an actuarial valuation. The amendment permits the requirement to be satisfied for an agent multiple-employer OPEB plan by reporting an aggregation of results of actuarial valuations of the individual-employer OPEB plans or measurements resulting from use of the alternative measurement method for individual employer OPEB plans that are eligible. Additionally, Statement No. 57 clarifies that when actuarially determined OPEB measures are reported by an agent multiple-employer OPEB plan and its participating employers, those measures should be determined as of a common date and at a minimum frequency to satisfy the agent multiple-employer OPEB plan's financial reporting requirements. There was no impact on NCTSC's financial statements as a result of the implementation of GASB Statement No. 57.

In December 2009, GASB issued Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*. GASB Statement No. 58 is effective for financial statements for periods beginning after June 15, 2009. The objective of this Statement is to provide accounting and financial reporting guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code. There was no impact on NCTSC's financial statements as a result of the implementation of GASB Statement No. 58.

In June 2010, GASB issued Statement No. 59, *Financial Instruments Omnibus*. GASB Statement No. 59 establishes additional guidance and provides an update to improve existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. The requirements of this statement will improve financial reporting by providing more complete information, by improving consistency of measurements, and by providing clarification of existing standards. There was no impact on NCTSC's financial statements as a result of the implementation of GASB Statement No. 59.

NCTSC has not completed the process of evaluating the impact that will result from implementing GASB Statement No. 61, *The Financial Reporting Entity: Omnibus — An Amendment of GASB Statements Nos. 14 and 34*. The requirements of this statement result in financial reporting entity financial statements being more relevant by improving guidance for including, presenting and disclosing information about component units and equity interest transactions of a financial reporting entity. NCTSC is therefore unable to disclose the impact GASB Statement No. 61 will have on its financial position, results of operations, and cash flows when such statement is adopted. This statement is effective for financial statements prepared by state and local governments for periods beginning after December 15, 2011.

NCTSC has not completed the process of evaluating the impact of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 1989 FASB and AICPA Pronouncements*. This statement objective is to incorporate pronouncements that do not contradict or conflict with GASB pronouncements. NCTSC is therefore unable to disclose the impact GASB Statement No. 62 will have on its financial position, results of operations, and cash flows when such statement is adopted. This statement is effective for financial statements for periods beginning after December 15, 2011.

3. CASH AND INVESTMENTS

At December 31, 2010, NCTSC's cash was insured by either the Federal Deposit Insurance Corporation or collateralized by securities held in the pledging bank's trust department in NCTSC's name. NCTSC's indenture provides for eligible investments in, among other things, certain obligations of Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, or the Federal Farm Credit System, demand and time deposit accounts and certificates of deposit, noncallable, fully secured bonds or other obligations of any state of the United States, commercial or finance company paper, repurchase obligations, corporate securities bearing interest or sold at discount, money market funds, investment agreements or guaranteed investment contracts, and other obligations or securities that are noncallable.

At December 31, 2010, NCTSC's cash and cash equivalents and investments consisted of the following:

Description	Fair Value at December 31, 2010
Cash and cash equivalents	\$ <u>114</u>
Investments: Institutional treasury money	\$ <u>24,230</u>

Investments at December 31, 2010 consisted of shares of an investment fund which invests in short-term U.S. Treasury securities paying a fixed, variable or floating interest rate and in repurchase agreements backed by U.S. Treasury securities. The main risks of investing in the fund are money market fund risk, interest rate risk, security selection risk, repurchase agreement risk, counterparty risk and prepayment and extension risk.

4. LONG-TERM DEBT

In 1999, the NCTSC issued \$294,500 of the 1999 Bonds. On April 5, 2006, NCTSC issued \$431,034 of Tobacco Settlement Asset-Backed Bonds, Series 2006 ("Series 2006 Bonds") pursuant to an Amended and Restated Indenture dated as of March 1, 2006 ("Indenture"). The Series 2006 Bonds consist of the Series 2006A-1 Taxable Senior Current Interest Bonds of \$42,645, the Series 2006A-2 Senior Convertible Bonds of \$37,906, the Series 2006A-3 Senior Current Interest Bonds of \$291,540, and the Series 2006B-E Subordinate CABs of \$58,944. Unless otherwise indicated, defined terms have the meanings ascribed to them in the Offering Circular for the Series 2006 Bonds dated March 31, 2006.

Interest on the Series 2006A-1 Taxable Senior Current Interest Bonds and the Series 2006A-3 Senior Current Interest Bonds accrues from their dated date, which interest is payable currently on each Distribution Date, commencing with the first Distribution Date after their issuance through and including the Maturity Date or earlier redemption date of such Bonds. Interest on the Series 2006A-1 Taxable Senior Current Interest Bonds and the Series 2006A-3 Senior Current Interest Bonds is computed on the basis of a 360-day year consisting of twelve 30-day months. Failure to pay the full amount of interest due on the 2006A-1 Taxable Senior Current Interest Bonds or the Series 2006A-3 Senior Current Interest Bonds on any Distribution Date is an Event of Default.

The Series 2006A-2 Senior Convertible Bonds accrue interest from their dated date, which interest is compounded on each Distribution Date, commencing with the first Distribution Date after their issuance through and excluding the Conversion Date, or earlier redemption date of such Bond. Prior to the Conversion Date, interest is not payable on a current basis. After the applicable Conversion Date, such Convertible Bond will become a Current Interest Bond with a principal amount equal to the Accreted Value at such Conversion Date as set forth in a Series Supplement, the interest on which will be payable currently on each Distribution Date after the Conversion Date until the Maturity Date or earlier redemption date of such Bond as provide in the Indenture. Interest on the Convertible Bonds is computed on the basis of a 360-day year consisting of twelve 30-day months. Failure to pay the full amount of interest due on any Distribution Date after the Conversion Date is an Event of Default.

Interest on the Series 2006B First Subordinate CABs, the Series 2006C Second Subordinate CABs, the Series 2006D Third Subordinate CABs and the Series 2006E Fourth Subordinate CABs accretes from the dated date thereof and is compounded on each Distribution Date, commencing with the first Distribution Date after their issuance through and including the Maturity Date or earlier redemption date of such Bond.

NCTSC used the proceeds from the Series 2006 Bonds, along with other funds, to: (i) refund all of the 1999 Bonds then-currently outstanding in the aggregate principal amount of \$272,125; (ii) fund a Senior Liquidity Reserve for the Series 2006 Senior Bonds of \$24,009; (iii) pay the costs of issuance of the Series 2006 Bonds; (iv) fund certain projected requirements for the Operating Account; (v) fund interest on the Series 2006 Bonds through the December 1, 2007 payment; and (vi) pay certain amounts to the NCTSC Residual Trust as registered owner of the Residual Certificate. Pursuant to the Indenture, TSRs paid on or after April 1, 2009, are subject to the lien of the Indenture. The Series 2006 Bonds shall accrete interest from its issuance date (as set forth on such bonds) and interest shall be compounded on each distribution date, commencing with the first distribution date after its issuance through and including the maturity date or redemption date of such bond, whichever is earlier.

The payment of the Series 2006 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 Participating Manufacturers. Such bonds are secured by and payable solely from TSRs and other collateral pledged under the Indenture.

Failure to pay when due any interest on Senior Bonds or any Serial Maturity or Turbo Term Bond Maturity for Senior Bonds, among other things, will constitute an event of default.

As described in the Offering Circular, the Series 2006 Bonds were issued with various schedules for, among other things, the payment of interest, principal, sinking fund installments and/or Turbo Redemptions. NCTSC's projected Sinking Fund Installments and interest payments are as follows:

Periods Ending December 31	Principal	Interest	Debt Service
2011	\$ 1,610	\$ 19,217	\$ 20,827
2012	1,965	19,095	21,060
2013	2,340	18,948	21,288
2014	2,695	18,776	21,471
2015	2,770	18,649	21,419
2016-2020	24,120	90,019	114,139
2021-2025	37,005	85,243	122,248
2026-2030	46,455	67,792	114,247
Thereafter	327,422	1,079,668	1,407,090
	<u>\$ 446,382</u>	<u>\$ 1,417,407</u>	<u>\$ 1,863,789</u>

5. DEFERRED CHARGES

Deferred charges for the cost of issuance from the defeasance of the 1999 Bonds and sale of the Series 2006 Bonds are as follows:

Description	Amount
Cost of issuance	\$ 1,519
Original issue discount	9,011
Underwriter's discount	3,836
Loss on defeasance	<u>18,869</u>
Total	33,235
Less accumulated amortization	<u>5,192</u>
Cost of Issuance — net of amortization	<u>\$ 28,043</u>

Such costs are amortized over the life of the bonds.

Total deferred charges as a result of the implementation of GASB Statement No. 48 in 2007:

Total deferred charges	\$ 387,765
Less accumulated amortization	<u>47,834</u>
Deferred charges — net of amortization	<u>\$ 339,931</u>

6. RESIDUAL TRUST

Approximately \$140 million of the proceeds of the Series 2006 Bonds and unpledged TSR's were deposited into the NCTSC Residual Trust ("Residual Trust"), a Delaware statutory trust, on behalf of the County as the beneficial owner of the Residual Certificate. Such proceeds are held to provide monies to the County in accordance with the tax certificates executed in connection with the Series 2006 Bonds.

The original 1999 purchase price paid by the NCTSC to the County under the Purchase and Sale Agreement ("Agreement") consisted of: (i) the net proceeds of the sale of the 1999 Bonds and (ii) a 100% beneficial ownership interest in the Trust. The Agreement was amended and restated as of March 1, 2006. Under the amended Agreement, TSRs received from April 5, 2006 to March 31, 2009, were not pledged to the holders of the Series 2006 Bonds and, therefore, all TSRs received during that time were to be transferred to the Trust on behalf of the County. The County has and is expected to continue to appropriate such Series 2006 Bond proceeds to finance various capital projects or designated operating expenses of the County or the Nassau Health Care Corporation.

7. RESTATEMENT

Subsequent to the issuance of the 2009 financial statements, NCTSC's management determined it had understated the December 31, 2009 end of year net deficit in the statement of activities, and the net deficit and bonds payable in the statement of net assets (deficit) as of December 31, 2009 by \$21,577. The adjustment was a result of an error related to not recording the accretion of certain amounts to Bonds Payable in prior years. Accordingly, NCTSC has restated the beginning of year Net Assets (Deficit) in the accompanying statement of activities to correct this error. The adjustment resulted in the originally reported Net Assets (Deficit) as of December 31, 2009 increasing from (\$16,916) to (\$38,493) with a resulting increase in Bonds Payable from the originally reported amount of \$419,261 to \$440,838 as of December 31, 2009.

This change has no effect on the cash flow or liquidity of NCTSC.

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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 of
Nassau County Tobacco Settlement Corporation:

We have audited the financial statements of Nassau County Tobacco Settlement Corporation (the NCTSC), as of December 31, 2010, and for the year then ended, and have issued our report thereon dated June 27, 2011, which contained an emphasis of a matter paragraph relating to a restatement of the 2009 net assets (deficit) and bonds payable. 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 the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. However, we identified a deficiency in internal control that we consider to be a significant deficiency as it relates to the restatement of prior year fund balance and net assets.

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 combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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. We consider the error in the prior year net assets (deficit) and bonds payable to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, 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 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, management, and the Office of the New York State Comptroller and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

June 27, 2011