



BASIC FINANCIAL STATEMENTS

**Suffolk Tobacco Asset Securitization Corporation
Year Ended December 31, 2010
With Report of Independent Auditors**

Ernst & Young LLP

 **ERNST & YOUNG**

Suffolk Tobacco Asset Securitization Corporation

Basic Financial Statements

Year Ended December 31, 2010

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Report of Independent Auditors

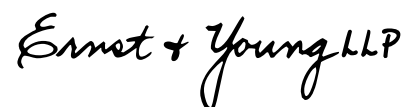
The Board of Directors
Suffolk Tobacco Asset Securitization Corporation
Hauppauge, New York

We have audited the accompanying financial statements of the governmental activities and each major fund of the Suffolk Tobacco Asset Securitization Corporation, (the "Corporation"), a component unit of the County of Suffolk, New York as of and for the year ended December 31, 2010, which collectively comprise the Corporation's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Corporation's internal control over financial reporting. Our audit included 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 the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and 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 respective financial position of the governmental activities and each major fund of the Corporation, as of December 31, 2010, and the respective changes in financial position for the year ended December 31, 2010 in conformity with U.S. generally accepted accounting principles.

Management's discussion and analysis, on pages 2 to 8, are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding methods of measurement and presentation of this required supplementary information. However, we did not audit the information and express no opinion on it.

A handwritten signature in black ink that reads 'Ernst & Young LLP'.

March 15, 2011

Required Supplemental Information

Suffolk Tobacco Asset Securitization Corporation

Management's Discussion and Analysis

Year Ended December 31, 2010

The following is a discussion and analysis of the Suffolk Tobacco Asset Securitization Corporation's (the "Corporation") financial performance, providing an overview of the Corporation's financial activities for the year ended December 31, 2010. Please read this in conjunction with the Corporation's financial statements, which immediately follow this section.

Financial Highlights

- The Corporation's liabilities exceeded its assets by \$27,164,295 (total net deficit) for the current year ended. This amount includes restricted net assets of \$19,263,992 and is net of an unrestricted deficit of \$(46,428,287).
- The Corporation's total net deficit increased by \$11,914,886.
- The Corporation's governmental funds reported total ending fund balance of \$217,580,646, and unreserved, undesignated fund balance of \$125,725 for the year ended December 31, 2010.
- At the end of the current year, unreserved fund balance for the General Fund was \$125,725 or 155.6% of total General Fund expenditures.
- The Corporation's total long-term liabilities increased by \$8,274,895 or 3.49% during the current year. The key factor in this increase is the accretion of interest on outstanding bonds.

Overview of the Financial Statements

The Corporation's annual report is presented in two parts, management's discussion and analysis (this section), and the basic financial statements.

The basic financial statements include government-wide financial statements, fund financial statements, and notes that provide more detailed information to supplement the basic financial statements.

Reporting on the Corporation as a Whole

The government-wide financial statements are designed to present an overall picture of the financial position of the Corporation and start on page 9. These statements consist of the statement of net deficit and the statement of activities, which are prepared using the economic resources measurement focus and the accrual basis of accounting. This means that all the current year's revenues and expenses, with the exception of Tobacco Settlement Revenues ("TSRs") (see notes to the financial statements for additional information) are included regardless of when cash is received or paid, producing a view of financial position similar to that presented by most private-sector companies.

The statement of net deficit combines and consolidates the Corporation's current financial resources with noncurrent assets and long-term obligations. This statement includes all of the Corporation's assets and liabilities.

Net deficit is the difference between the Corporation's assets and liabilities, and represents one measure of the Corporation's financial health. Net deficit is reported as one of two categories: restricted net assets and or unrestricted net deficit. Over time, increases or decreases in the Corporation's net deficit are one indicator of whether its financial health is improving or deteriorating. The reader may wish to consider other nonfinancial factors to assess the overall health of the Corporation.

The statement of activities focuses on both the gross and net cost of various activities; these costs are paid by the Corporation's revenues. This statement summarizes the cost of providing specific government services, and includes all current year revenues and expenses.

Reporting on the Corporation's Most Significant Funds

The fund financial statements begin on page 11 and provide detailed information about the most significant funds – not the Corporation as a whole. The Board of Directors (the "Board") established funds to help it control and manage money for particular purposes or to show that it is meeting legal responsibilities for using certain money.

- *Governmental funds* – The Corporation's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund statements provide a detailed short-term view of the Corporation's general government operations. We describe the relationship (or differences) between governmental activities (reported in the statement of net deficit and the statement of activities) and governmental funds in reconciliations on pages 11 and 13.

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 beginning with page 14.

Financial Analysis of the Corporation as a Whole

Our analysis below focuses on the net deficit and changes in net deficit of the Corporation as a whole.

Net Deficit

Condensed Statement of Net Deficit – Governmental Activities

	December 31	
	2010	2009
Assets		
Current and other assets	\$ 19,227,827	\$ 19,317,276
Deferred charges, net	200,627,423	204,820,545
Total assets	219,855,250	224,137,821
Liabilities		
Current liabilities	1,955,251	2,597,831
Noncurrent liabilities	245,064,294	236,789,399
Total liabilities	247,019,545	239,387,230
Net assets		
Restricted	19,263,992	19,263,992
Unrestricted	(46,428,287)	(34,513,401)
Total net assets	\$ (27,164,295)	\$ (15,249,409)

As of December 31, 2010, total assets of the Corporation were \$219,855,250, a decrease of \$4,282,571 or 1.91% over the prior year. The decrease is mostly attributable to the amortization of the deferred charge on the purchase of TSRs. Total liabilities increased \$7,632,315 or 3.19% to \$247,019,545. The increase is attributable to the accretion of interest on outstanding bonds of \$9,139,200, less principal payments and amortization of deferred discounts of \$1,494,305. The overall net deficit increased over prior year by \$11,914,886 to a current deficit of \$(27,164,295). Of this net deficit for governmental activities, \$19,263,992 was restricted by statute or other specific purposes and unrestricted net deficit totaled \$(46,428,287).

In the government-wide financial statements, principal and interest payable are recorded when incurred. Currently, per the Indenture Agreement (“Indenture”), the Corporation receives only 36% of the TSRs and uses those monies to fund its operations and debt service payments. The remaining TSRs must be transferred to the Residual Trust. More information on the Residual Trust can be found in note D. In 2013, the Corporation will be able to utilize 75% of the TSRs received for operations and debt services payments. Upon receipt of these additional revenues, the deficit will begin to decrease and eventually be eliminated when all debt requirements are met.

Changes in Net Deficit

Condensed Statement of Activities – Governmental Activities

	Year Ended December 31,	
	2010	2009
General revenues		
Interest on investments	\$ 865,597	\$ 865,597
Tobacco settlement revenue	19,401,559	23,313,551
Total general revenues	<u>20,267,156</u>	<u>24,179,148</u>
Expenses		
General government support	86,798	85,697
Payment to residual trust	12,416,998	15,584,623
Amortization of deferred charge	4,112,326	3,686,698
Interest on debt	15,565,920	15,060,689
Total expenses	<u>32,182,042</u>	<u>34,417,707</u>
Change in net deficit	(11,914,886)	(10,238,559)
Net deficit at beginning of year	(15,249,409)	(5,010,850)
Net deficit at end of year	<u>\$ (27,164,295)</u>	<u>\$ (15,249,409)</u>

For the year ended December 31, 2010, general revenues were \$20,267,156, a decrease of \$3,911,992, which is directly attributable to TSRs received in 2010 totaling \$19,401,559. For the year ended December 31, 2009, expenses totaled \$32,182,042, a decrease over the prior year of \$2,235,665. This decrease is primarily attributable to three main factors: a decrease in transfers to the residual trust of \$3,167,625, offset by an increase in interest on debt of approximately \$505,231 and an increase in amortization of deferred charge on the purchase of TSRs of \$425,628. As a result of expenses exceeding revenues, the net deficit for the year ended December 31, 2010 was \$(27,164,295), an increase in the deficit of \$11,914,886 over last year.

Financial Analysis of the Corporation's Funds

Governmental Funds

The focus of the Corporation's governmental funds is to provide information on short-term inflows, outflows, and balances of expendable resources. Such information is useful in assessing the Corporation's financing requirements.

At December 31, 2010, the Corporation's governmental funds reported combined ending fund balances of \$217,580,646, a decrease of \$4,195,244 in comparison with prior year. Of this total, \$125,725 constitutes unreserved, undesignated fund balance, which is available for spending at the Corporation's discretion. The remainder of fund balance is reserved or designated to indicate that it is not available for new spending because it has already been committed for other purposes.

General Fund

The General Fund is the principal operating fund of the Corporation. At December 31, 2010 and 2009, unreserved, undesignated fund balance of the General Fund was \$125,725 and \$6,507, respectively. The fund balance of the Corporation's General Fund increased by \$119,218 for the year ended December 31, 2010. This increase was primarily due to a transfer from the Collection Fund, offset by operating expenditures incurred throughout the year.

Debt Service Fund

The Debt Service Fund is used to account for the accumulation of resources for payment of general long-term bond principal and interest. This fund also includes the Liquidity Reserve Account. The Liquidity Reserve Account was funded at its required level of \$18,760,231. This level is required to be maintained per the Bond Indenture. More information on the Liquidity Reserve Account can be found in note C.1.

Prior to an Event of Default, amounts on deposit in the Liquidity Reserve Account will be available to pay principal and interest of the Series 2008A Bonds, Series 2008B Bonds and Series 2008C Bonds when due, and pay any other Senior Bonds that are not Capital Appreciation Bonds to the extent Pledged Revenues are insufficient for such purpose. This fund was necessary in order for the Corporation to obtain the desired ratings for the Series 2008 Bonds from the rating agencies.

At December 31, 2010, total fund balance was \$19,010,608 and is reserved to pay future debt service. The fund balance of the Corporation's Debt Service Fund decreased by \$181,251 for the year ended December 31, 2010. This decrease is due to excess expenditures over revenue and other financing sources. Revenues consisted solely of interest earned on investments. Financing sources consisted of amounts transferred to the Debt Service Fund from TSRs received in the Collection Fund during 2010. Expenditures include payments of principal and interest on the Corporation's outstanding bonds.

Collection Fund

The Collection Fund is used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes such as funding required debt service obligations and making required transfers to the Suffolk County Residual Trust in accordance with the Indenture.

At December 31, 2010, total fund balance was \$198,444,313, which is designated for future amortization of the consideration paid by the Corporation to the County for the acquisition of future TSRs. The fund balance of the Corporation's Collection Fund decreased by \$4,133,211 for the year ended December 31, 2010, primarily due to the decrease in TSRs and the increase in the amortization of the deferred charge. The Corporation collected \$19,401,559 of total TSRs, of which \$6,784,561 was transferred to the Debt Service Fund to repay a portion of the Corporation's outstanding bonds, \$12,416,998 was transferred to the residual trust, per the Indenture, and \$200,000 was transferred to the General Fund to pay operating expenses.

Cost of Issuance Fund

The Cost of Issuance Fund is used to account for the portion of the Series 2008 Bond proceeds used to pay the cost of issuance per the Indenture. Except for the payment of obligations that existed at December 31, 2009, there was no activity during 2010 in this fund.

The Collection Fund and the Cost of Issuance Fund were established per the requirements of the Indenture.

Debt Administration

Debt

The Corporation's total bonded debt increased by \$7,644,895 or 3.2% during the current year. The key factor in this increase is the accretion of interest on outstanding bonds. More detailed information about the Corporation's long-term liabilities is presented in the notes to the basic financial statements.

The Corporation's bond ratings, as assigned by Fitch Ratings, remained stable for the Series 2008A Current Interest Serial Bonds at BBB+, which are due in multiple increments through 2018. The Corporation's \$40,045,000 Series 2008B Current Interest Turbo Term Bonds, due on June 1, 2028, decreased from BBB+ to BBB, with a negative outlook during 2010. The Corporation's \$62,295,000 Series 2008B Current Interest Turbo Term Bonds, due June 1, 2048, and \$107,671,781 Series 2008C Convertible Capital Appreciation Turbo Term Bonds, due on June 1, 2044, decreased from BBB to BBB- with a negative outlook during 2010. Lastly, the Corporation's \$13,375,082 Series 2008D Convertible Capital Appreciation Turbo Term Bonds, due June 1, 2048, decreased during 2010 from BB+ to BB- with a negative outlook. The decreases in bond ratings were based on the level of stress each class is able to withstand, as indicated by Fitch's new break-even cash flow model of the annual Master Settlement Agreement (MSA) payment.

Future Economic Factors

The amount of TSRs received is dependent on many economic factors, including future domestic cigarette consumption, the financial capability of the Participating Manufacturers (the "PMs"), litigation affecting the MSA and related legislation, enforcement of state legislation related to the MSA and the tobacco industry. Payments by the PMs under the MSA are subject to certain adjustments, which may be material.

Additional Financial Information

This financial report is designed to provide the Corporation's interested parties with an overview of the Corporation's financial operations and financial condition. Should the reader have questions regarding the information included in this report or wish to request additional financial information, please contact the Suffolk Tobacco Asset Securitization Corporation, H. Lee Dennison Building, 12th Floor, 100 Veterans Memorial Highway, P.O. Box 6100, Hauppauge, New York 11788-0099, Attention: Chairperson.

Basic Financial Statements

Suffolk Tobacco Asset Securitization Corporation

Government-Wide Financial Statement
Statement of Net Deficit

December 31, 2010

	Primary Governmental Activities
Assets	
Current assets:	
Cash and cash equivalents	\$ 133,330
Cash and cash equivalents – restricted	250,377
Other receivables – restricted	72,133
Prepays	11,756
Total current assets	<u>467,596</u>
Non-current assets:	
Restricted investments – special reserves	18,760,231
Deferred charges, net	200,627,423
Total non-current assets	<u>219,387,654</u>
Total assets	<u>219,855,250</u>
Liabilities	
Current liabilities:	
Accounts payable and accrued liabilities	7,605
Accrued interest payable	513,341
Bonds payable	1,434,305
Total current liabilities	<u>1,955,251</u>
Non-current liabilities:	
Bonds payable	245,064,294
Total non-current liabilities	<u>245,064,294</u>
Total liabilities	<u>247,019,545</u>
Net deficit	
Restricted:	
Debt service	19,263,992
Unrestricted	(46,428,287)
Total net deficit	<u>\$ (27,164,295)</u>

See accompanying notes.

Suffolk Tobacco Asset Securitization Corporation

Government-Wide Financial Statement
Statement of Activities

Year Ended December 31, 2010

	Primary Governmental Activities
Expenses:	
General government support	\$ 86,798
Payment to residual trust	12,416,998
Amortization of deferred charge	4,112,326
Interest on debt	15,565,920
Total expenses	<u>32,182,042</u>
General revenues:	
Interest on investments	865,597
Tobacco settlement revenue	19,401,559
Total general revenues	<u>20,267,156</u>
Change in net deficit	(11,914,886)
Net deficit at beginning of year	<u>(15,249,409)</u>
Net deficit at end of year	<u><u>\$ (27,164,295)</u></u>

See accompanying notes.

Suffolk Tobacco Asset Securitization Corporation

Governmental Funds
Balance Sheet

December 31, 2010

	Major Funds			Total Governmental Funds
	General Fund	Debt Service Fund	Collection Fund	
Assets				
Cash and cash equivalents	\$ 133,330	\$ -	\$ -	\$ 133,330
Cash – restricted	-	250,377	-	250,377
Investments – restricted	-	18,760,231	-	18,760,231
Deferred charges	-	-	198,444,313	198,444,313
Total assets	<u>\$ 133,330</u>	<u>\$ 19,010,608</u>	<u>\$ 198,444,313</u>	<u>\$ 217,588,251</u>
Liabilities				
Accounts payable and accrued liabilities	\$ 7,605	\$ -	\$ -	\$ 7,605
Total liabilities	<u>7,605</u>	<u>-</u>	<u>-</u>	<u>7,605</u>
Fund Balances				
Reserved for:				
Debt service	-	19,010,608	-	19,010,608
Unreserved:				
Designated for future amortization of deferred charges	-	-	198,444,313	198,444,313
Undesignated	125,725	-	-	125,725
Total fund balance	<u>125,725</u>	<u>19,010,608</u>	<u>198,444,313</u>	<u>217,580,646</u>
Total liabilities and fund balance	<u>\$ 133,330</u>	<u>\$ 19,010,608</u>	<u>\$ 198,444,313</u>	<u>\$ 217,588,251</u>

See accompanying notes.

Suffolk Tobacco Asset Securitization Corporation

Reconciliation of the Governmental Funds Balance Sheet to the
Statement of Net Deficit

December 31, 2010

Total fund balance – Governmental Funds	\$ 217,580,646
Amounts reported for governmental activities in the statement of net deficit are different because:	
Unamortized balance of deferred charge for bond issuance costs.	2,183,110
Certain expenditures are considered prepaid to match expenses with the period for which it relates.	11,756
Long-term liabilities applicable to the Corporation’s governmental activities are not due and payable in the current period and accordingly are not reported in the funds. However these liabilities are included in the statement of net assets:	
Bonds payable	(246,498,599)
Interest payable applicable to the Corporation’s governmental activities are not due and payable in the current period and, accordingly, are not reported in the funds. However these liabilities are included in the statement of net assets.	(513,341)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.	72,133
Net deficit of governmental activities	<u>\$ (27,164,295)</u>

See accompanying notes.

Suffolk Tobacco Asset Securitization Corporation

Governmental Funds
Statement of Revenues, Expenditures and Changes in Fund Balances

Year Ended December 31, 2010

	Major Funds			Total Governmental Funds
	General Fund	Debt Service Fund	Collection Fund	
Revenues				
Tobacco settlement revenue	\$ -	\$ -	\$ 19,401,559	\$ 19,401,559
Interest on investments	-	865,597	-	865,597
Total revenues	-	865,597	19,401,559	20,267,156
Expenditures				
General government support	80,782	-	6,038	86,820
Payment to residual trust	-	-	12,416,998	12,416,998
Amortization of deferred charge	-	-	4,112,326	4,112,326
Debt service:	-	-	-	-
Principal	-	1,650,000	-	1,650,000
Interest	-	6,196,256	-	6,196,256
Total expenditures	80,782	7,846,256	16,535,362	24,462,400
Excess (deficiency) of revenues over (under) expenditures	(80,782)	(6,980,659)	2,866,197	(4,195,244)
Other Financing Sources (Uses)				
Transfers in	200,000	6,799,408	-	6,999,408
Transfers out	-	-	(6,999,408)	(6,999,408)
Total other financing sources (uses)	200,000	6,799,408	(6,999,408)	-
Net change in fund balances	119,218	(181,251)	(4,133,211)	(4,195,244)
Fund balances at beginning of year	6,507	19,191,859	202,577,524	221,775,890
Fund balances at end of year	\$ 125,725	\$ 19,010,608	\$ 198,444,313	\$ 217,580,646

See accompanying notes.

Suffolk Tobacco Asset Securitization Corporation

Reconciliation of the Governmental Funds Statement of Revenues,
Expenditures and Changes in Fund Balances to the
Statement of Net Deficit

Year Ended December 31, 2010

Net change in fund balances	\$ (4,195,244)
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:	
Repayment of bond principal	1,650,000
Bond interest is recorded as an expenditure on the fund statements when it is paid, and on the statement of activities when it is incurred.	(9,369,664)
Prepaid expenditures are recorded as an expenditure on the fund statements when it is paid, and on the statement of activities when it is incurred.	22
Change in net deficit of Governmental Activities	<u>\$ (11,914,886)</u>

See accompanying notes.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements

December 31, 2010

A. Organization

The Suffolk Tobacco Asset Securitization Corporation (the “Corporation”) is a local development corporation, and is an instrumentality of, but separate and apart from the County of Suffolk (the “County”), New York, incorporated under the provisions of Section 1411 of the New York State Not-For-Profit Corporation Law. Although legally separate from and independent of the County, the Corporation is considered an affiliated organization under Governmental Accounting Standards Board (GASB) Statement No. 39, “Determining whether Certain Organizations are Component Units”. Accordingly, the Corporation is being reported as a blended component unit for financial reporting purposes in the County’s financial statements.

The Board of Directors (the “Board”) of the Corporation has four directors, one director is appointed by the Presiding Officer of the County legislature, three directors are appointed by the County Executive of which one director must meet certain requirements of independence and one director is a non-voting member.

B. Summary of Significant Accounting Policies

The financial statements of the Corporation have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental 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 the government’s accounting policies are described below.

Basis of Presentation

The Corporation’s basic financial statements include both government-wide (reporting on the Corporation as a whole) and fund financial statements (reporting on the Corporation’s most significant funds).

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

B. Summary of Significant Accounting Policies (continued)

Government-Wide Financial Statements

The government-wide financial statements, i.e. the statement of net deficit and the statement of activities, display information about the Corporation as a whole. These statements include the financial activities of the overall government. Eliminations of internal activity have been made in these statements. All of the activities of the Corporation are considered governmental activities.

In the government-wide statement of net deficit, the Corporation's governmental activities are presented on a consolidated basis and are reported on a full accrual, economic resource basis, which recognizes all long-term assets and receivables (except for Tobacco Settlement Revenues) as well as long-term debt and obligations. The Corporation's net deficit is reported in two parts—restricted net assets and unrestricted net deficit.

The government-wide statement of activities reports the gross expenses of each of the Corporation's functional categories which are supported by general revenues.

This government-wide focus is more on the sustainability of the Corporation as an entity and the change in the Corporation's net deficit resulting from the current year's activities.

Fund Financial Statements

Fund financial statements report detailed information about the Corporation. The focus of governmental financial statements is on major funds rather than reporting funds by type. Each major fund is presented in a separate column. Non-major funds are aggregated and presented in a single column. The Corporation has disclosed all funds as major.

The funds of the Corporation are considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

B. Summary of Significant Accounting Policies (continued)

Governmental Funds – Governmental funds are those through which most governmental functions are financed. The acquisition, use and balances of expendable financial resources and the related liabilities are accounted for through governmental funds. The measurement focus of the governmental funds is upon determination of financial position and changes in financial position.

The Corporation reports the following major governmental funds:

General Fund – is the principal operating fund of the Corporation. This fund is used to account for all financial resources except those required to be accounted for in other funds.

Debt Service Fund – is used to account for the accumulation of resources for payment of general long-term bond principal and interest, and also includes the Liquidity Reserve Account. The Liquidity Reserve Account was funded at its required level of \$18,760,231 at December 31, 2010. This level is required to be maintained per the Bond Indenture.

Collection Fund – is used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes, such as funding required debt service obligations and making required payments to the Suffolk County Residual Trust in accordance with the Indenture.

Cost of Issuance Fund – is used to account for the portion of the Series 2008 Bond proceeds used to pay the cost of issuance per the Indenture. There was no 2010 activity in this fund.

Basis of Accounting/Measurement Focus

The financial statements of the Corporation are prepared in accordance with GAAP. The Corporation's reporting entity applies all relevant GASB pronouncements and applicable Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless they conflict with GASB pronouncements. The Corporation's reporting entity does not apply FASB pronouncements or APB opinions issued after November 30, 1989.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

B. Summary of Significant Accounting Policies (continued)

Measurement focus refers to what is being measured, where as the basis of accounting refers to when revenues and expenditures are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurement made, regardless of the measurement focus applied.

In the government-wide statements, governmental activities are presented using the economic resources measurement focus and are presented using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place. Management, however, has elected to recognize TSRs as they are collected due to the unpredictability of the revenues and the difficulty with which to estimate the amount earned.

In the fund financial statements, governmental funds use a current financial resources measurement focus and are accounted for using the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (measurable and available to finance current operations). “Measurable” means the amount of the transaction can be determined and “available” means collectible within the current period or soon enough thereafter to pay liabilities of the current period. The Corporation considers all revenues available if they are collected within 60 days after the year end.

Budgetary Comparison

Under GASB Statement No. 34, budgetary comparison information is required to be presented for the general fund and each major special revenue fund with a legally adopted budget. However, the Corporation is not legally required to adopt a budget for any of its funds. Therefore, budget comparison information is not included in the Corporation’s financial statements.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

B. Summary of Significant Accounting Policies (continued)

Assets, Liabilities and Fund Equity

Cash, Cash Equivalents and Investments

The Corporation's cash and cash equivalents consist of demand deposits and money market accounts.

Investments consist of a repurchase agreement and are stated at the contract value. More information on investments can be found in Note C.

Restricted Assets

Certain assets of the Corporation are classified as restricted assets because their use is restricted by contractual agreements and regulations.

Other Receivables

Other receivables include accrued interest income related to the Corporation's investment income. Receivables are recorded and revenues recognized as earned.

Interfund Receivables and Payables

During the course of operations, transactions occur between individual funds that may result in amounts owed between funds. Those transactions are classified as "due to and due from other funds" in the governmental funds financial statements. Interfund receivables and payables between funds within governmental activities are eliminated in the statement of net deficit.

Prepays

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in the government-wide financial statements.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

B. Summary of Significant Accounting Policies (continued)

Deferred Charges

Deferred charges are those where the liability recognition criteria have been met, but which expenditure recognition criteria have not been met. Such amounts include the following:

Issuance Costs:

In the governmental funds financial statements, issuance costs are recognized as expenditures in the period incurred. Issuance costs recorded in the government-wide financial statements are deferred and amortized over the term of the bonds using the bonds-outstanding method, which approximates the effective interest method. Bond discounts are presented as a reduction of the face amount of bonds payable, whereas issuance costs are recorded as deferred charges.

Deferral of Cost from Purchase of Future TSRs:

GASB 48, *Sales and Pledges of Receivables and Future Revenues and Intra-entity Transfers of Assets and Future Revenues*, requires the Corporation to record the transfer of funds made to the County for the purchase of the TSRs to be classified as a deferred charge. The deferred charge on the TSRs is being amortized based on the ratio of resources used to purchase the future TSRs over the estimated total future revenues to be received to the maturity of the related debt, which is then applied to the current revenues recognized during the year.

Long-term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method or a method that approximates effective interest. Bonds payable is reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

B. Summary of Significant Accounting Policies (continued)

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources while discounts on debt issuance are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Equity Classifications

In the government-wide statements, equity is displayed in two components:

- a. Restricted net assets – consists of net assets with constraints placed on the use either by (1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or (2) law through constitutional provisions or enabling legislation. Restricted net assets reported in the statement of net deficit as of December 31, 2010 are not restricted by enabling legislation.
- b. Unrestricted net deficit – all other net assets that do not meet the definition of “restricted”.

When both restricted and unrestricted resources are available for use, it is the Corporation’s policy to use restricted resources first, then unrestricted resources as needed.

In the fund statements, governmental fund equity is classified as fund balance. Fund balance is further classified as reserved and unreserved, with unreserved further split between designated and undesignated. Portions of fund equity are segregated for future use and therefore not available for future appropriation or expenditure. Amounts reserved for debt service represent portions of fund equity which are required to be segregated in accordance with state law or U.S. generally accepted accounting principles. Designations of fund balances in governmental funds for future amortization of deferred charges indicate the utilization of these resources in the subsequent years.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

B. Summary of Significant Accounting Policies (continued)

Revenues and Expenditures

Tobacco Settlement Revenue

Pursuant to a Purchase and Sale Agreement dated as of August 1, 2008, (the “TSR Purchase Agreement”) between Suffolk County (the “County”), as seller, and the Corporation, as purchaser, the County sold to the Corporation all rights, title and interest of the County under the Master Settlement Agreement (the “MSA”) entered into by participating tobacco product manufacturers (the “Manufacturers”), 46 states and six other U.S. jurisdictions in November 1998 in settlement of smoking-related litigation and the related Consent Decree and Final Judgment (the “Consent Decree”), including the County’s right to be paid certain payments referred to as Tobacco Settlement Revenues (the “TSRs”) to be made by the Manufacturers under the MSA. The consideration paid by the Corporation to the County for such acquisition consisted of \$206,243,337 in cash, all of which was paid into escrow for the benefit of the County. The Corporation funded such consideration from the proceeds of its Tobacco Settlement Asset-Backed Bonds Series 2008 (Series 2008 Bonds) issued on August 21, 2008, pursuant to an Indenture agreement (the “Indenture”) dated August 1, 2008.

Per the Purchase and Sale Agreement, receipts shall be transferred directly to the Corporation. Under the MSA, amounts shall be paid by the Manufacturers to the escrow agent on or before April 15th. The escrow agent will then disburse these funds to the Corporation. The Corporation collected \$19,401,559 of TSRs, of which \$6,784,561 was transferred to the Debt Service Fund to repay a portion of the Corporation’s outstanding bonds, \$12,416,998 was transferred to the residual trust, per the Indenture, and \$200,000 was transferred to the General Fund to pay operating expenses.

Transfers to Residual Trust

Transfers to residual trust represent portions of the TSRs received that are required to be transferred to the Suffolk County Residual Trust per the Indenture. See note D for more detail.

Interfund Transactions

Interfund transactions have been eliminated from the government-wide financial statements. In the funds statements interfund transactions include payments to the Debt Service Fund to cover various debt obligations.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

B. Summary of Significant Accounting Policies (continued)

Use of 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.

Subsequent Events

Management has evaluated subsequent events through the date of the report, which is the date the financial statements were available to be issued.

C. Detail Notes on All Funds

Cash, Cash Equivalents and Investments

Custodial Credit Risk – Deposits/Investments – Custodial credit risk for investments exist when, in the event of the failure of the counterparty, a government will not be able to recover the value of its investments or collateral securities that are in possession of an outside party.

Governmental Accounting Standards Board Statement No. 40 directs that deposits be disclosed as exposed to custodial credit risk if they are not covered by depository insurance, and the deposits are either:

- Uncollateralized
- Collateralized with securities held by the pledging financial institution, or
- Collateralized with securities held by the pledging financial institution's trust department or agent but not in the Corporation's name

At December 31, 2010, the Corporation's deposit balances were \$383,707. Of these balances, \$133,330 was covered by the Federal Deposit Insurance Corporation. \$250,377 consisted of a temporary investment in Dreyfus Treasury & Agency Cash Management, and is uncollateralized. Dreyfus Treasury & Agency Cash Management invests only in U.S. government or U.S. Treasury securities, and in repurchase agreements.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

C. Detail Notes on All Funds (continued)

The Corporation's Liquidity Reserve Account is invested in a Repurchase Agreement with Bayerische Landesbank. Bayerische Landesbank is authorized to invest in various securities as set forth in the Investment Repurchase Agreement, dated August 21, 2008. The Corporation's share of investments in this repurchase agreement was \$18,760,231 at December 31, 2010, is due to mature on June 1, 2048, and earns interest at 4.614%, annually. The Repurchase Agreement is fully collateralized by debt obligations having fair values that range from 100% to 102% of the deposited amount held by a custodial bank.

Credit Risk – State law limits investments to those authorized by State statutes. The Corporation has a written investment policy.

Interest-Rate Risk – Interest-rate risk arises because potential purchasers of debt securities will not agree to pay face value for those securities if interest rates substantially increase, thereby affording potential purchasers more favorable rates on essentially equivalent securities. Accordingly, such investments would have to be held to maturity to avoid a potential loss.

Concentration of Credit Risk – Credit risk can arise as a result of failure to adequately diversify investments. Concentration risk disclosure is required for positions of 5 percent or more in securities of a single issuer.

At December 31, 2010, the Corporation did not have any investments subject to credit risk, interest-rate risk or concentration of credit risk.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

C. Detail Notes on All Funds (continued)

Deferred Charges

Deferred charges created as a result of the issuance of the 2008 Serial Bonds and the deferral of cost from purchase of the future TSRs as of December 31, 2010 is as follows:

Cost of issuance	\$ 1,401,411
Underwriter's discount	972,243
Total cost of issuance	<u>2,373,654</u>
Less related amortization	(190,544)
Deferred charges, net – cost of issuance	<u>2,183,110</u>
Purchase of TSRs	206,243,337
Less related amortization	(7,799,024)
Deferred charges, net – purchase of TSRs	<u>198,444,313</u>
Total deferred charges – net of amortization	<u><u>\$ 200,627,423</u></u>

Total amortization expense for the cost of issuance and purchase of TSRs for the year ended December 31, 2010 totaled \$80,796 and \$4,112,326, respectively.

Interfund Receivables, Payables and Transfers

For the year ended December 31, 2010, interfund transfer balances represent payments from the Collection Fund to disburse TSRs pursuant to the Indenture. Interfund transfers are stated as follows:

	Transfer In	Transfer Out
General fund	\$ 200,000	\$ –
Debt service fund	6,799,408	–
Collection fund	–	6,999,408
	<u>\$ 6,999,408</u>	<u>\$ 6,999,408</u>

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

C. Detail Notes on All Funds (continued)

Long-term Debt

Bonds – Tobacco Settlement Asset-Backed Bonds Series 2008 (Series 2008 Bonds) issued in 2008 for the purchase of future rights to TSRs are secured by a pledge of revenues to be derived from TSR receipts after the deduction of the amounts necessary to pay all operating charges and to fund the required revenue percentage to the Residual Trust, as required by the Indenture. At December 31, 2010, projected principal and interest to expected maturity date totaled \$780,732,301. These expected maturity dates are based on projected TSRs and are subject to change due to several factors that might affect this revenue. Additional TSRs have been pledged to the period 2048 to ensure that sufficient amounts of revenue will be received to pay the outstanding debt obligation. Principal and interest paid on these bonds in 2010 totaled \$7,846,256.

Pledged revenues consist of a portion of the TSRs equal to 36% of future annual payments through December 31, 2012, and 75% thereafter and like percentages of any lump sum payment made in lieu of such annual payments. Pledged revenue received in 2010 amounted to \$6,984,561, or 89 percent of total principal and interest payments made during the year.

Payments with respect to the Series 2008 Bonds are dependent upon receipt of TSRs. The Series 2008 Bonds are special obligations of the Corporation payable solely from the pledged revenues, the Liquidity Reserve Account, and other funds and accounts under the Indenture. The Corporation has no other assets available for the payment of the Series 2008 Bonds.

The amount of TSRs received is dependent on many factors, including future domestic cigarette consumption, the financial capability of the Participating Manufacturers (the “PMs”), litigation affecting the MSA and related legislation, enforcement of state legislation related to the MSA and the tobacco industry. Payments by the PMs under the MSA are subject to certain adjustments, which may be material.

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

C. Detail Notes on All Funds (continued)

Bonds outstanding at December 31, 2010, are as follows:

Description	Original Date Issued	Original Amount	Interest Rate	Expected Maturity Date	Maturity Date	Amount Outstanding
2008A	08/21/2008	\$ 9,765,000	4.000% – 5.000%	06/01/2010 – 06/01/2018	06/01/2010 – 06/01/2018	\$ 8,575,000
2008B (2028)	08/21/2008	40,045,000	5.375%	06/01/2026	06/01/2028	37,705,000
2008B (2048)	08/21/2008	62,295,000	6.000%	06/01/2039	06/01/2048	62,295,000
2008C	08/21/2008	107,671,781	6.625%	06/01/2037	06/01/2044	107,671,781
2008D	08/21/2008	13,375,082	8.000%	06/01/2048	06/01/2048	13,375,082
Total						<u>\$ 229,621,863</u>

The following table summarizes the Corporation's estimated future debt service requirements as of December 31, 2010 based on future projected TSRs:

	Principal	Interest	Total Principal and Interest
2011	\$ 1,590,000	\$ 6,126,403	\$ 7,716,403
2012	1,740,000	6,054,981	7,794,981
2013	285,000	15,438,238	15,723,238
2014	445,000	15,422,447	15,867,447
2015	620,000	15,398,338	16,018,338
2016 – 2020	12,875,000	75,724,163	88,599,163
2021 – 2025	27,445,000	70,134,334	97,579,334
2026 – 2030	33,737,789	69,917,940	103,655,729
2031 – 2035	52,498,458	57,794,267	110,292,725
2036 – 2040	87,439,863	46,611,869	134,051,732
2041 – 2045	7,858,574	111,901,426	119,760,000
2046 – 2048	3,087,179	60,586,032	63,673,211
	<u>\$ 229,621,863</u>	<u>\$ 551,110,438</u>	<u>\$ 780,732,301</u>

Suffolk Tobacco Asset Securitization Corporation

Notes to Financial Statements (continued)

C. Detail Notes on All Funds (continued)

A summary of changes in long-term liabilities for the year ended December 31, 2010 is as follows:

Description	Balance, January 1, 2010	Increases	Reductions	Balance, December 31, 2010	Noncurrent Liabilities Due Within One Year	Noncurrent Liabilities
<i>Primary Government:</i>						
Bonds	\$ 231,271,863	\$ –	\$ (1,650,000)	\$ 229,621,863	\$ 1,590,000	\$ 228,031,863
Plus: accreted interest	11,506,991	9,139,200	–	20,646,191	–	20,646,191
Less: unamortized deferred discounts	3,925,150	–	155,695	(3,769,455)	(155,695)	(3,613,760)
Total bonds	\$ 238,853,704	\$ 9,139,200	\$ (1,494,305)	\$ 246,498,599	\$ 1,434,305	\$ 245,064,294

D. Residual Trust

In 2008, pursuant to the TSR Purchase Agreement and the Indenture, the Corporation established the Suffolk County Residual Trust (the “Trust”). Per the Indenture, the Trust will receive the future TSRs, consisting of 64% of TSRs received from the bond delivery date through December 31, 2012, 25% of TSRs received thereafter, and 100% of TSRs representing amounts withheld or deposited in the disputed payments account under the MSA before the delivery date. Total amounts paid to the Trust for the year ended December 31, 2010 was \$12,416,998.

E. New Pronouncements

The Governmental Accounting Standards Board (GASB) has issued Statement No. 54 *Fund Balance Reporting and Governmental Fund Type Definitions*. This statement establishes criteria for classifying fund balances into specifically defined classifications and clarifies definitions for governmental fund types. The requirements of this statement become effective for the Corporation for the year ended December 31, 2011.

The Corporation is currently evaluating the impact of the above pronouncement.

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