

**SULLIVAN TOBACCO ASSET
SECURITIZATION CORPORATION
(A BLENDED COMPONENT UNIT OF
THE COUNTY OF SULLIVAN, NEW YORK)**

FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2007

AND INDEPENDENT AUDITORS' REPORT

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

FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2007

AND INDEPENDENT AUDITORS' REPORT

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O'Connor Davies Munns & Dobbins, llp
ACCOUNTANTS AND CONSULTANTS

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of the
Sullivan Tobacco Asset Securitization Corporation:

We have audited the accompanying statement of net assets of the Sullivan Tobacco Asset Securitization Corporation ("STASC"), a blended component unit of the County of Sullivan, New York, as of December 31, 2007 and the related statements of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the STASC'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 of America. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 the STASC'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, 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 STASC as of December 31, 2007 and the changes in its net assets and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, the financial statements present only the STASC and do not purport to, and do not present fairly the financial position of the County of Sullivan, New York as of December 31, 2007 and the changes in financial position and cash flows, thereof, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As more fully disclosed in Note 5, the only significant resource of the STASC is the right to receive tobacco revenues. A reduction in these revenues would affect debt service coverage on the bonds. If the reduction were material, it could impair the ability of the STASC to make flexible principal payments or even its ability to pay required maturities as they are due. As a result, actual payments may not conform to either the required maturities or the flexible maturity payments.

Bennett Kielson Storch DeSantis
The Government Services Division of
O'Connor Davies Munns & Dobbins, LLP
February 16, 2008

Bennett Kielson Storch DeSantis Division

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

STATEMENT OF NET ASSETS
December 31, 2007

ASSETS

Current Assets:

Cash and equivalents	\$ 206,780
Accounts receivable	1,204,710
Prepaid expenses	<u>3,840</u>

Total Current Assets 1,415,330

Noncurrent Assets:

Restricted cash and equivalents	401,294
Restricted investments	1,241,744
Costs of issuance, net of accumulated amortization of \$105,736	<u>323,634</u>

Total Noncurrent Assets 1,966,672

Total Assets \$ 3,382,002

LIABILITIES

Current Liabilities:

Accrued liabilities	71,782
Current portion of bonds payable	<u>\$ 380,000</u>

Total Current Liabilities 451,782

Noncurrent Liabilities -

Bonds payable, net of current maturities	<u>14,781,225</u>
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Total Liabilities 15,233,007

NET ASSETS

Deficit \$ (11,851,005)

See notes to financial statements.

SULLIVAN COUNTY TOBACCO ASSET SECURITIZATION CORPORATION
(A BLENDED COMPONENT UNIT OF THE
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STATEMENT OF REVENUES, EXPENSES AND CHANGES
IN NET ASSETS
YEAR ENDED DECEMBER 31, 2007

Operating Revenues - Tobacco settlement revenues	\$ 1,199,758
Operating Expenses:	
Professional fees	24,458
Insurance expense	4,726
Amortization	16,513
Total Operating Expenses	<u>45,697</u>
Income from Operations	<u>1,154,061</u>
Non-Operating Revenues (Expenses):	
Interest income	109,172
Interest expense	<u>(875,817)</u>
Total Non-Operating Expenses	<u>(766,645)</u>
Change in Net Assets	387,416
Deficit - Beginning of Year	<u>(12,238,421)</u>
Deficit - End of Year	<u><u>\$ (11,851,005)</u></u>

See notes to financial statements.

SULLIVAN COUNTY TOBACCO ASSET SECURITIZATION CORPORATION
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STATEMENT OF CASH FLOWS
YEAR ENDED DECEMBER 31, 2007

Cash Flows from Operating Activities:	
Cash received from tobacco settlement revenues	\$ 1,200,748
Cash paid to vendors	(29,054)
Net Cash Provided by Operating Activities	<u>1,171,694</u>
Cash Flows from Investing Activities:	
Increase in restricted cash and equivalents	(77,057)
Purchase of restricted investments	(1,241,744)
Sale of restricted investments	1,242,547
Interest income	109,172
Net Cash Provided by Investing Activities	<u>32,918</u>
Cash Flows from Non-Capital Financing Activities:	
Repayment of bonds payable	(315,000)
Interest paid	(869,594)
Net Cash Used in Non-Capital Financing Activities	<u>(1,184,594)</u>
Net Increase in Cash and Equivalents	20,018
Cash and Equivalents - Beginning of Year	<u>186,762</u>
Cash and Equivalents - End of Year	<u>\$ 206,780</u>
Reconciliation of income from operations to net cash provided by operating activities:	
Income from operations	\$ 1,154,061
Adjustments to reconcile income from operations to net cash provided by operating activities -	
Amortization	16,513
Changes in Assets and Liabilities:	
Accounts receivable	990
Prepaid expenses	130
Net Cash Provided by Operating Activities	<u>\$ 1,171,694</u>
Noncash Investing Activities -	
Increase in bonds payable from amortization of original issue and underwriters discounts	\$ 7,592

See notes to financial statements.

**SULLIVAN TOBACCO ASSET
SECURITIZATION CORPORATION
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NOTES TO FINANCIAL STATEMENTS

Note 1 - Nature of Business and Summary of Significant Accounting Principles

Nature of Business

Sullivan Tobacco Asset Securitization Corporation ("STASC") is a special purpose corporation. STASC was organized under the New York State Not-For-Profit Corporation Law and pursuant to the Public Authorities Law of the State of New York. The Board of Directors of STASC consists of five members; the County Manager, the County's Commissioner of Financial Management, the Chairman of the County's Board of Legislators, the Majority Leader of the County's Board of Legislators and the Minority Leader of the County's Board of Legislators.

An agreement among the attorneys general of 46 states and various territories ("Settling States") and the four largest United States tobacco manufacturers was entered into on November 23, 1998. The agreement known as the Master Settlement Agreement ("MSA") resolved cigarette smoking-related litigation between the Settling States and U.S. Tobacco manufacturers. Pursuant to the MSA, the Settling States and the participating manufacturers agreed to settle all past, present and future smoking related claims in exchange for an agreement by the participating manufacturers to make certain payments. Under the MSA, the State of New York is entitled to receive approximately 12.76% of the initial and annual payments. The New York Consent Decree, which was entered into in the Supreme Court of the State of New York for the County of New York in December 1998, allocated 0.155% of this State-wide share of the initial and annual payments to the County of Sullivan, New York ("County") and the remainder among the State, the City of New York and all other counties within the State.

During 2001, the County sold all of its future rights, title and interest to receive payments under the MSA and the Consent Decree to STASC for \$15,047,000. The debt issued by STASC to securitize these revenues is not considered debt of the County and is secured only by future tobacco settlement payments.

Entity Definition

Based on the guidance provided by Governmental Accounting Standards Board Technical Bulletin No. 2004-1, *Tobacco Settlement Recognition and Financial Reporting Entity Issues*, the STASC is reported as a blended component unit of the County in its financial statements.

Basis of Presentation

A fund is an independent fiscal and accounting entity with a self-balancing set of accounts which comprise its assets, liabilities, net assets, revenues and expenses. The accounts of the STASC are maintained on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The STASC applies all applicable Financial Accounting Standards Board pronouncements in accounting for and reporting on its operations.

The accompanying financial statements present only the activities of the STASC and do not purport to, and do not, present fairly the financial position of the County of Sullivan, New York as of December 31, 2007 and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

SULLIVAN TOBACCO ASSET
SECURITIZATION CORPORATION
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NOTES TO FINANCIAL STATEMENTS (Continued)

Note 1 - Nature of Business and Summary of Significant Accounting Principles (Continued)

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

Cash and Equivalents

Cash and equivalents consist of demand deposit accounts, time deposit accounts, money market accounts and certificates of deposit with original maturities of three months or less.

Restricted Cash and Equivalents and Investments

The terms of the bond indenture provide for the establishment of a liquidity reserve. The reserve has been established at the maximum annual debt service requirements in the current and any future fiscal year, assuming principal is paid in accordance with the requirements of the indenture.

The terms of the bond indenture also provide for the establishment of a trapping account. Following the occurrence of a trapping event (see Note 5), amounts that otherwise would have been paid on the residual certificate to the County will be deposited in the trapping account and will be restricted to pay interest, required amortization payments and flexible amortization payments, in such order, to the extent collections or other available amounts are insufficient for such purposes.

Costs of Issuance

The costs of issuance of the bonds are being amortized over the flexible maturities of the bonds, which is twenty six years.

Note 2 - Restricted Investments

Restricted investments at December 31, 2007 consisted of the following:

Commercial paper, at cost, which approximates fair value, due in June 2008, interest at 4.91%	<u>\$ 1,241,744</u>
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**SULLIVAN TOBACCO ASSET
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NOTES TO FINANCIAL STATEMENTS (Continued)

Note 3 - Bonds Payable

STASC issued bonds on August 8, 2001 to finance the purchase of the tobacco rights from the County and the related costs of issuance. The bonds were issued for \$16,767,617, net of original issue discount of \$197,383, and bear interest at rates ranging from 5.00% to 6.00%, depending on maturity. A payment schedule, based upon flexible maturities, is as follows:

<u>Year Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	\$ 380,000	\$ 851,506	\$ 1,231,506
2009	405,000	831,119	1,236,119
2010	435,000	809,056	1,244,056
2011	480,000	784,756	1,264,756
2012	505,000	758,425	1,263,425
2013 and thereafter	<u>13,105,000</u>	<u>6,394,985</u>	<u>19,499,985</u>
	15,310,000	<u>\$ 10,429,847</u>	<u>\$ 25,739,847</u>
Unamortized Original Issue Discount	<u>(148,775)</u>		
	<u>\$ 15,161,225</u>		

The required principal payments are as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
2008	\$ 80,000
2009	95,000
2010	105,000
2011	120,000
2012	130,000
2013 and thereafter	<u>14,780,000</u>
	<u>\$ 15,310,000</u>

Note 4- Trapping Event

In accordance with the terms of the bond indenture, a "Downgrade Trapping Event" occurs when any of the four largest United States tobacco manufacturers with a market share of 7% or more has a credit rating that falls below "Baa3" by Moody's or "BBB" by Standard & Poors. During 2003, the credit rating for one of these manufacturers had fallen below this allowable threshold and accordingly, a downgrade trapping event occurred. The indenture further requires that, upon the occurrence of this event, 25% of the principal amount outstanding on the bonds be accumulated in a special account until one year after the end of the downgrade trapping event. Accordingly, the amounts received after June 2003 of \$400,380, including accrued interest of \$35,607, are being held by STASC.

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NOTES TO FINANCIAL STATEMENTS (Concluded)

Note 5 - Significant Contingencies

The enforceability of the rights and remedies of the State (and thus the bondholders) and of the obligations of a participating manufacturer under the MSA are subject to the Bankruptcy Code and the other applicable insolvency, moratorium or similar laws relating to or affecting the enforcement of creditors' rights. Some of the risks include risks of delay in or reduction of amounts of payment or of non-payment under the MSA and the risk that the State (and thus the County and/or STASC) may be stayed for an extended time from enforcing any rights under the MSA and the Consent Decree or with respect to the payments owed by the bankrupt participating manufacturer or from commencing legal proceedings against the bankrupt participating manufacturer. As a result, if a participating manufacturer becomes a debtor in a bankruptcy case and defaults in making payment, funds available to STASC to pay bondholders may be reduced or eliminated.

The bonds are payable only from the assets of STASC. The bonds are neither legal nor moral obligations of the County or the State of New York, and no recourse may be had thereto for payment of amounts owing on the bonds. STASC's only source of funds for payments on the bonds is the collections and amounts on deposit in pledged accounts pursuant to the indenture. STASC has no taxing power and no significant assets other than the rights to receive tobacco settlement revenues.